

# Selling a majority stake mid-year: consolidation through a loss of control

When a subsidiary becomes an associate, the reported gain includes a revaluation of the stake the group keeps. Getting to the right number means taking five steps in a set order.

August 12, 2026 · 12 min read

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## AT A GLANCE

- When a parent sells enough of a subsidiary to lose control, IFRS 10 (Ind AS 110 in India) does not treat it as a sale of shares. It treats it as the disposal of the whole subsidiary and the acquisition of a new investment, the stake that remains, at fair value.
- The reported gain therefore includes an unrealised element: the remeasurement of the shares the group keeps. That is correct accounting, and boards, lenders, and analysts regularly misread it.
- Five steps have to happen in a fixed order. Establish the date control is lost, consolidate to that date, derecognise the net assets, goodwill, and non-controlling interest, recognise the consideration and the retained interest at fair value, and deal with reserves in other comprehensive income.
- The errors we see most often involve the control date, the treatment of reserves, the equity accounting for the retained stake afterwards, and a cash flow statement that shows gross consideration rather than the net cash effect.

Stake sales have become an ordinary part of corporate life in India. Renewable energy platforms sell majority interests in operating portfolios to recycle capital. Family groups bring in a strategic partner for one line of business. Founders sell control of a subsidiary to an acquirer and keep a meaningful minority. In each case the commercial event is clear enough: a share purchase agreement is signed, the conditions are met, and money changes hands.

The accounting event is less intuitive. If the shares sold are enough to cost the parent control, the consolidated financial statements do not record the sale of a slice of a subsidiary. They record the subsidiary disappearing altogether, and a new investment, measured at fair value, taking its place. We recently worked through this sequence for a thirteen-entity group in which a mid-year stake sale turned a subsidiary into an associate. None of the mechanics is obscure, but they do not forgive shortcuts.

## The accounting sees two different transactions

IFRS 10 draws a sharp line between changes in ownership that leave control intact and changes that end it.

If a parent sells part of its holding and **keeps control**, the sale is a transaction between owners. No gain or loss goes to profit or loss. The carrying amount of the non-controlling interest is adjusted, and any difference between that adjustment and the consideration received goes directly to equity attributable to the parent.<sup>1</sup>

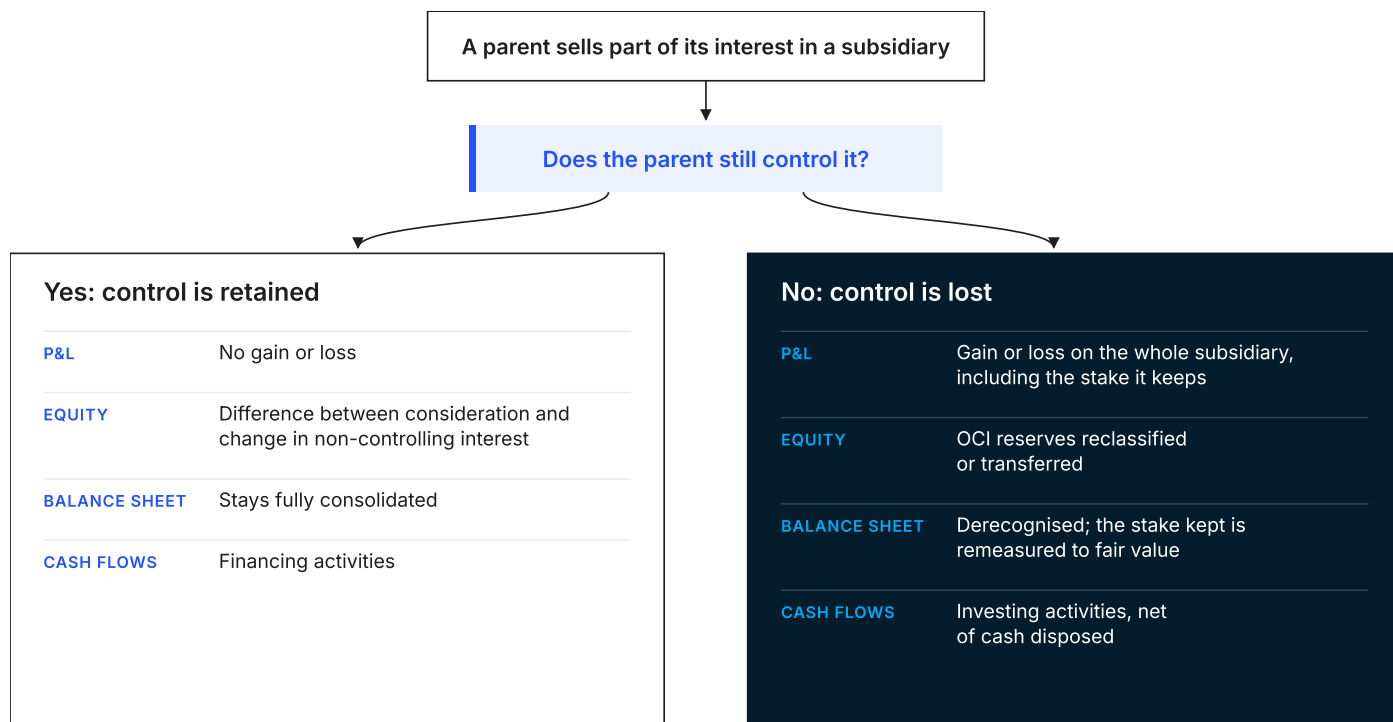
If the sale **ends control**, the parent derecognises the subsidiary in full, recognises the investment it keeps at fair value, and recognises a gain or loss in profit or loss.<sup>2</sup>

The asymmetry has real consequences. A group that sells 30 percent of a wholly owned subsidiary and keeps control reports no gain in its income statement, however much value the sale crystallises. A group that sells 51 percent reports a gain calculated on the whole subsidiary, including the 49 percent it still owns. The same commercial logic produces two very different income statements, depending on which side of the control line the transaction lands.

## EXHIBIT 1

## The same kind of sale can produce no gain at all, or a gain on the entire subsidiary

Accounting for a reduction in a parent's interest in a subsidiary under IFRS 10



Simplified. Assessing whether control has been lost requires judgement about power, exposure to returns, and their link.

Source: IFRS 10 Consolidated Financial Statements, paragraphs 23, 25, and B96 to B99; IAS 7, paragraphs 39 to 42A (mirrored in Ind AS 110 and Ind AS 7); SA&A analysis

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## Five steps, in order

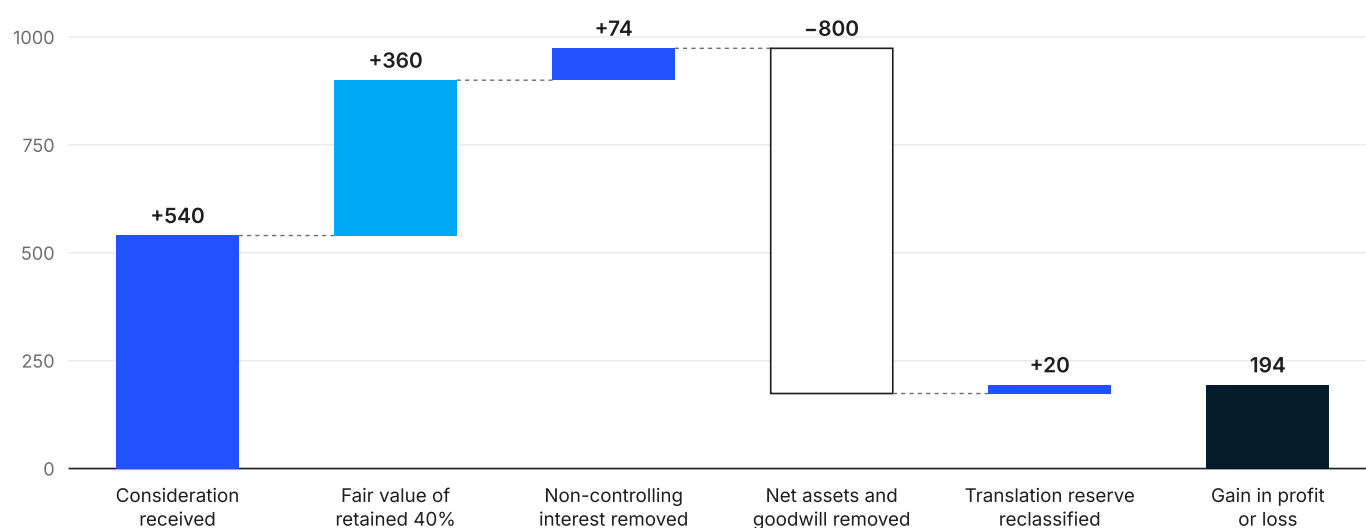
- 1. Establish the date control is lost.** This is not necessarily the signing date, or the day the cash arrives. Conditions precedent, regulatory approvals, and the transfer of board seats and veto rights all affect when the parent stops having power over the investee. The conclusion on the control date shapes everything that follows, and it deserves its own memorandum.
- 2. Consolidate up to that date.** The subsidiary's income and expenses are included in consolidated profit or loss until control is lost. That needs a closing balance sheet for the subsidiary at that date, not at the nearest quarter end.
- 3. Derecognise.** Remove the subsidiary's assets, including goodwill, and its liabilities at their carrying amounts, together with the carrying amount of any non-controlling interest and the components of other comprehensive income attributable to it.
- 4. Recognise.** Record the fair value of the consideration received, and the investment retained in the former subsidiary at its fair value on the date control is lost.

5. **Deal with reserves, then measure the result.** Amounts previously recognised in other comprehensive income for the subsidiary are accounted for as if the parent had disposed of the related assets and liabilities directly. A foreign currency translation reserve is reclassified to profit or loss; a revaluation surplus is transferred within equity. What remains is the gain or loss attributable to the parent.

## EXHIBIT 2

## The gain on losing control includes a remeasurement of the stake the group keeps

Illustrative: a parent holding 90 percent of a subsidiary sells 50 percent for ₹540 crore and keeps 40 percent, ₹ crore



Illustrative figures. Amounts in other comprehensive income are reclassified to profit or loss, or transferred within equity, as the underlying standards require. The fair value of the retained interest becomes its starting carrying amount as an associate.

Source: IFRS 10 Consolidated Financial Statements, paragraphs 25 and B97 to B99; IAS 28 (mirrored in Ind AS 110 and Ind AS 28); SA&A analysis

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## Reading the gain correctly

In the illustration, the parent reports a gain of ₹194 crore. Part of that gain matches cash received for the shares sold. The rest arises only because the 40 percent stake the group keeps has been remeasured from its share of carrying amounts to fair value. No cash comes with that part, and it will not recur.

The standards anticipate the confusion. IFRS 12 requires disclosure of the gain or loss on losing control and of **the portion of it attributable to measuring the retained investment at fair value.**<sup>3</sup> That disclosure is often buried, and sometimes left out. It should be neither. Boards approving results, lenders testing covenants, and analysts reading the income statement all need to see which part of the gain was realised.

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A stake sale that ends control reports a gain on shares the group still owns. The accounting is correct, and it needs explaining.

## What happens to the retained stake

On the date control is lost, the retained interest is recognised at fair value, and that fair value becomes its starting point under whichever standard now applies. If the group keeps significant influence, the stake becomes an associate accounted for using the equity method under IAS 28. If it keeps joint control, it becomes a joint venture. If it keeps neither, the stake is a financial asset under IFRS 9.

Three consequences are easy to overlook:

- **The fair value itself.** A minority stake is not automatically worth the price per share paid for a controlling one. A buyer taking control may pay a premium that does not attach to the shares left behind, so the value of the retained interest needs its own support.
- **The basis difference.** Under the equity method, the gap between the fair value of the retained stake and the investor's share of the investee's net assets is notionally allocated to the investee's identifiable assets and liabilities, and to goodwill. That allocation drives future amortisation within the share of profit. Groups that skip it misstate their share of the associate's results for years.
- **Deferred tax.** The new carrying amount of the investment will usually differ from its tax base, so the deferred tax position needs a fresh look.

## Cash flows and presentation

The consolidated cash flow statement is where many otherwise correct accounts go wrong. The cash flows arising from losing control are shown separately within investing activities. The group also discloses the total consideration, the part paid in cash, the cash held by the subsidiary when control was lost, and the main categories of other assets and liabilities derecognised.<sup>4</sup> The net investing inflow is the cash consideration less the cash that left the group with the subsidiary, not the gross consideration.

Cash flows from changes in ownership that do not cost the parent control are classified as financing activities instead. A group that completes one of each in the same year shows them in different sections of the statement.

Two presentation questions come up before the transaction closes. Where a sale that will lead to loss of control is highly probable at a reporting date, all of the subsidiary's assets and liabilities are classified as held for sale, even if the group will keep an interest.<sup>5</sup> And if the subsidiary is a separate major line of business or geographical area, its results may have to be presented as a discontinued operation.

**CHECKLIST****The quarter before a sale that ends control**

- A memorandum on the control date, agreed with the auditor before the transaction closes
- An assessment of held-for-sale and discontinued operation presentation at the preceding reporting date
- A plan for the subsidiary's closing balance sheet at the control date
- An independent valuation of the retained interest that considers control premiums
- An inventory of reserves in other comprehensive income and how each must be treated
- A roll-forward of non-controlling interest to the control date
- A list of intercompany balances that will become related party balances
- A draft cash flow schedule and the IFRS 12 disclosure

## The value of doing it in advance

Almost every error in this area is an error of sequence: a control date assumed rather than analysed, a valuation commissioned after the numbers were drafted, an equity method basis difference left for next year. None of these is hard to get right in the quarter before the transaction. All of them are hard to correct once results have been announced and the board has discussed the gain as though it were cash.

**NOTES**

1. IFRS 10 Consolidated Financial Statements, paragraphs 23 and B96; Ind AS 110 carries the same requirements.
2. IFRS 10, paragraphs 25 and B97 to B99.
3. IFRS 12 Disclosure of Interests in Other Entities, paragraph 19; Ind AS 112.
4. IAS 7 Statement of Cash Flows, paragraphs 39 to 42A; Ind AS 7.
5. IFRS 5 Non-current Assets Held for Sale and Discontinued Operations, paragraph 8A; Ind AS 105.

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This article reflects the author's understanding of the relevant laws and standards at the date of publication. It is general in nature and is not a substitute for advice on specific facts.

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