

Chapter 22

GROUP ACCOUNTS THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION (1)

1. Introduction

Consolidated accounts are required when one company controls other companies. This can happen in many ways, but you will only be expected to deal with the simplest situation, which is where one company controls one other company.

Each company will prepare its own set of accounts. However, another set of accounts will be prepared for the group as a whole. These are known as the consolidated accounts.

In this and the next chapter we will look at the Consolidated Statement of Financial Position. In the third chapter we will consider the Consolidated Statement of Profit or Loss.

2. Definitions

Consolidated accounts are required if ever one company controls another. The precise definition of control contains several provisions, but the most common situation is where one company owns more than 50% of the ordinary share capital of the other company.

Parent company

The parent company is the company that controls the other company.

Subsidiary company

The subsidiary company is the company that is controlled by the parent company.

Group of companies

This is the parent company plus its subsidiaries.

Consolidated accounts

These are the accounts for the whole group, where we treat the group as though it is one big company.

Non-controlling interest

If the parent company does not own 100% of the subsidiary then the part owned by others is known as the non-controlling interest.



3. The Consolidated Statement of Financial Position

The purpose of the Consolidated Statement of Financial Position is to show all the assets and liabilities that are controlled by the parent company – effectively as though it is one big company.

We will work through a simple example and then gradually bring in the various complications that can occur.

Example 1

On 1 January 2008, P acquired 100% of the ordinary shares of S, which was incorporated on that date.

On 31 December 2010, the Statements of Financial Position of each the two companies were as follows:

	<i>P</i>	<i>S</i>
Non-current assets	25,000	12,000
Investment in S, at cost	10,000	
Current assets	8,000	9,000
	43,000	21,000
Share capital - \$1 shares	25,000	10,000
Retained earnings	15,000	8,000
Current liabilities	3,000	3,000
	43,000	21,000

Prepare a Consolidated Statement of Financial Position at 31 December 2010 for the P group.



4. Pre-acquisition profits

In the previous example, P had acquired S on incorporation (i.e. on the date that the company was formed).

Very often a company acquires another company some years after incorporation in which case the company will have earned profits by the time that they are acquired.

As a result the purchase price paid by the parent company will be for the share capital plus any profits already earned. These profits earned before the date of acquisition are known as pre-acquisition profits.

Example 2

P acquired 100% of the share capital of S on 1 January 2006 for \$28,000, at which date the retained earnings of S amounted to \$8,000.

At 31 December 2009 the companies' Statements of Financial Position were as follows:

	<i>P</i>	<i>S</i>
Non-current assets	55,000	25,000
Investment in S, at cost	28,000	
Current assets	18,000	14,000
	101,000	39,000
Share capital - \$1 shares	60,000	20,000
Retained earnings	38,000	15,000
Current liabilities	3,000	4,000
	101,000	39,000

Prepare the Consolidated Statement of Financial Position at 31 December 2009 for the P group.



5. Goodwill arising on consolidation

In both of the previous examples the amount that the parent company paid for the subsidiary was equal to the value of the subsidiary as shown in its Statement of Financial Position.

However, there are two reasons why the parent company may have paid more than this amount.

One reason is that the non-current assets may have been worth more than the carrying value (this is particularly likely to apply to any land and buildings). We would therefore expect the parent company to have paid a 'fair value' for the assets.

A second reason is that the parent company may have paid more than the fair value of the assets and liabilities because they were acquiring the goodwill of the subsidiary. If they did pay for goodwill, then although it will not appear in the accounts of the individual companies it will mean that there is an extra asset to appear in the consolidated Statement of Financial Position.

Example 3

P acquired 100% of the share capital of S on 1 January 2005 for \$60,000. On 1 January 2005, the retained earnings of S were \$15,000 and the fair value of the non-current assets was \$9,000 more than the carrying value.

At 31 December 2009 the companies' Statements of Financial Position were as follows:

	<i>P</i>	<i>S</i>
Non-current assets	82,000	27,000
Investment in S, at cost	60,000	
Current assets	20,000	12,000
	162,000	39,000
Share capital - \$1 shares	50,000	10,000
Retained earnings	110,000	28,000
Current liabilities	2,000	1,000
	162,000	39,000

Prepare a Consolidated Statement of Financial Position as at 31 December 2009 for the P group.



Example 4

P acquired 100% of the share capital of S on 1 July 2004 for \$25,000. On 1 July 2004, the retained earnings of S were \$6,000 and the fair value of the non-current assets was \$6,000 more than their carrying value.

At 30 June 2010 the companies' Statements of Financial Position were as follows:

	<i>P</i>	<i>S</i>
Non-current assets	76,000	18,000
Investment in S, at cost	25,000	
Current assets	12,000	9,000
	<u>113,000</u>	<u>27,000</u>
Share capital - \$1 shares	40,000	5,000
Retained earnings	70,000	20,000
Current liabilities	3,000	2,000
	<u>113,000</u>	<u>27,000</u>

Prepare a Consolidated Statement of Financial Position as at 30 June 2010 for the P group.

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Chapter 23

GROUP ACCOUNTS THE CONSOLIDATED STATEMENT OF FINANCIAL POSITION (2)

1. Introduction

In the previous chapter we looked at the Consolidated Statement of Financial Position. However in every example the parent company owned 100% of the subsidiary.

In this chapter we will look at what happens when the parent company owns less than 100% but still has control of the subsidiary.

We will also look at the effect of any trading between the parent company and the subsidiary company.

2. Non-controlling interest

The fundamental point when the parent company owns less than 100% of the subsidiary is that in the Consolidated Statement of Financial Position we still show all the assets and liabilities of the group (because the parent company controls them), but we need to take account of the fact that part of these are in fact owned by the non-controlling interest.

Example 1

On 1 January 2008, P acquired 80% of the ordinary shares of S, which was incorporated on that date.

On 31 December 2010, the Statements of Financial Position of each of the two companies were as follows:

	<i>P</i>	<i>S</i>
Non-current assets	30,000	15,000
Investment in S, at cost	8,000	
Current assets	7,000	6,000
	<u>45,000</u>	<u>21,000</u>
Share capital - \$1 shares	25,000	10,000
Retained earnings	15,000	8,000
Current liabilities	5,000	3,000
	<u>45,000</u>	<u>21,000</u>

Prepare a Consolidated Statement of Financial Position at 31 December 2010 for the P group.



3. Goodwill arising on consolidation

The previous example was very simple because P acquired its holding in S on the date of incorporation and simply paid the value of its share of the assets less liabilities on that date.

However you will remember from the previous chapter that it is more likely that P would have acquired the holding on a later date and therefore may have paid more due to paying for goodwill.

As with all the other assets and liabilities, we wish to show the full value of the goodwill in the Consolidated Statement of Financial Position, but this will no longer simply be the difference between the amount paid and the value of the assets – it will be the difference between the **total** value of the business at the date of acquisition and the fair value of **all** the assets less liabilities at the date of acquisition.

The calculation of the goodwill arising on consolidation therefore becomes as follows:

Fair value of consideration transferred	X
Plus: fair value of non-controlling interest at date of acquisition	X
	X
Less: fair value of net assets at date of acquisition	
Share capital	X
Retained earnings at date of acquisition	X
	(X)
Goodwill arising on consolidation	X

Example 2

P acquired 60% of the shares in S on 1 January 2007 when the retained earnings of S stood at \$6,000.

The fair value of the non-controlling interest at the date of acquisition was \$30,000.

On 31 December 2010, the Statements of Financial Position of each of the two companies were as follows:

	<i>P</i>	<i>S</i>
Non-current assets	50,000	30,000
Investment in S, at cost	40,000	
Current assets	14,000	12,000
	104,000	42,000
Share capital - \$1 shares	50,000	20,000
Retained earnings	44,000	16,000
Current liabilities	10,000	6,000
	104,000	42,000

Calculate the amount of the goodwill arising on consolidation.



We will show the full amount of the goodwill in the Consolidated Statement of Financial Position (in addition to showing the full amount of all the other assets and liabilities as usual). However, as before we will have an extra figure in the Statement of Financial Position showing the amount owing to the non-controlling interest.

The entitlement of the NCI will be made up of the following:

Fair value of the NCI at the date of acquisition	X
Plus: NCI's share of post-acquisition profits	X
	X

Example 3

Using the same information as in example 2, calculate the non-controlling interest at 31 December 2010.

(Note: you may be wondering why we have not calculated the non-controlling interest in the same way as in example 1 – i.e. by just taking 40% of the share capital and reserves of S.

The reason is that they are also entitled to a share of the goodwill arising on consolidation, which does not appear in S's own accounts.

We can calculate this and thus check the NCI as follows:

Fair value of NCI at date of acquisition	30,000
NCI in net assets at date of acquisition	
(40% x (20,000 + 6,000))	10,400
Goodwill attributable to NCI	19,600
NCI at 31 December 2010:	
Share capital (40% x 20,000)	8,000
Retained earnings (40% x 16,000)	6,400
Goodwill attributable to NCI	19,600
Total NCI	34,000

This is the same figure that we have already calculated.)



Now we need to calculate the retained earnings belonging to P. This will be calculated in the normal way:

Retained earnings of P		X
Retained earnings of S	X	
Less: pre-aquisition profits	X	
Post-acquisition profits of S	<u>X</u>	
P's share of post-acquisition profits of S		X
		<u>X</u>

Example 4

Using the information in example 2, calculate the retained earnings for inclusion in the Consolidated Statement of Financial Position as 31 December 2010.

We are now in a position to produce the Consolidated Statement of Financial Position as at 31 December 2010.

Example 5

Using the information in example 2 (and the workings from the later examples) prepare the Consolidated Statement of Financial Position at 31 December 2010 for the P group.



4. Inter-entity transactions

Although our work focuses on preparing a set of consolidated accounts, do remember that the parent company and the subsidiary company are two separate companies and that both of them prepare their own accounts in the normal way.

It is quite possible that the two companies trade with each other – i.e. that the parent company sells goods to the subsidiary company (or vice versa).

If this has happened, then there are two things that we need to be aware of when we come to prepare the consolidated accounts:

- (a) we only want to show receivables and payables from outside the group – we do not want to include receivables and payables between the parent and subsidiary
- (b) we only wish to record profits made as a result of sales outside the group

We will illustrate these two problems and how we deal with them by way of examples.

(a) Inter-entity balances

Example 6

Company P has a controlling interest in company S.

Extracts from the statements of financial position of each company individually as at 31 December 2010 are as follows:

	<i>P</i>	<i>S</i>
Receivables	50,000	30,000
Payables	35,000	40,000

Included in P's receivables is \$8,000 owing from S. S's payables include the \$8,000 owing to P.

Calculate the total receivables and payables to be shown on the Consolidated Statement of Financial Position as at 31 December 2010.

(b) Inventory sold at a profit within the group

The problem here relates to the situation where one of the companies has sold goods to the other company at a profit, and the receiving company still has some of the goods in inventory.

If the goods have been sold by the receiving company then all the profit has been realised and there is no problem.

If, however, some of the goods are still in inventory then there are two problems when we come to prepare consolidated accounts:

- (i) the inventory in the accounts of the receiving company will include the profit made by the selling company, whereas in the consolidated accounts we should be showing it at cost to the group.
- (ii) included in the profits of the selling company will be all the profit on goods sold to the other company. However the profit on any goods still in inventory should not be included in the profit of the group because the goods have not left the group (and the profit has therefore not been realised)



To deal with both problems we do the following:

- (i) calculate the unrealised profit in inventory,
- (ii) reduce the inventory and reduce the retained earnings of the company that has sold the goods by the amount of the unrealised profit.

Example 7

P acquired 75% of the share capital of S on its incorporation. The Statements of Financial Position of the two entities as at 31 December 2010 are as follows:

	<i>P</i>	<i>S</i>
Non-current assets	50,000	25,000
Investment in S, at cost	15,000	
Inventory	13,000	7,000
Other current assets	10,000	6,000
	<u>88,000</u>	<u>38,000</u>
Share capital - \$1 shares	45,000	20,000
Retained earnings	30,000	15,000
Current liabilities	13,000	3,000
	<u>88,000</u>	<u>38,000</u>

During December 2010 S had sold goods to P for \$6,000. S sells to P at cost plus 25%.

P had not sold any of these goods and all were therefore included in inventory.

Additionally, P had not paid S for these goods and therefore the sum of \$6,000 is included in P's payables and in S's receivables.

Prepare a Consolidated Statement of Financial Position at 31 December 2010.

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