

Chapter 23

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

1. Subsidiary

A subsidiary is an entity that is controlled by another entity (parent).

An entity has control over an entity when it has the power to direct the activities, which is assumed to be when the entity has > 50% of the voting rights.

The parent company must prepare consolidated financial statement if it has control over one or more subsidiaries.

The underlying principles of consolidation are:

- Substance over legal form
- Control and ownership

2. Basic consolidation

2.1. Basic steps

100% P + 100% S assets and liabilities, ignoring the investments in subsidiary

100% P share capital and share premium only (reporting to parent's shareholders)

Retained earnings (balancing figure)

Example 1 – Basic consolidation

Peter acquired 100% of the equity share capital of Steven on 31 December 20X4 for \$1,000,000.

The financial statements of the two companies at that date were as follows:

	<i>Peter</i> \$000	<i>Steven</i> \$000
Investment in Steven Co	1,000	-
Other assets	1,500	1,200
Total assets	2,500	1,200
Equity share capital	1,000	250
Retained earnings	1,100	750
	2,100	1,000
Liabilities	400	200
Total equity and liabilities	2,500	1,200

Prepare the consolidated statement of financial position for the Peter Group at 31 December 20X4.



Example 2 – Basic consolidation (continued)

Following Peter's acquisition of the 100% of Steven's equity share capital of Steven on 31 December 20X4, both companies continued to trade. The financial statements of the two companies at the end of the following year 31 December 20X5 were as follows:

	<i>Peter</i> \$000	<i>Steven</i> \$000
Investment in Steven Co	1,000	-
Other assets	1,900	1,450
Total assets	<u>2,900</u>	<u>1,450</u>
Equity share capital	1,000	250
Retained earnings	1,400	900
	<u>2,400</u>	<u>1,150</u>
Liabilities	500	300
Total equity and liabilities	<u>2,900</u>	<u>1,450</u>

Prepare the consolidated statement of financial position for the Peter Group at 31 December 20X5.

3. Non-controlling interest

Control is exerted through a shareholding of greater than 50%, so therefore it is not always necessary to fully own a subsidiary.

Shareholdings of 75% will still give the parent the power to direct the activities of the subsidiary and therefore it must prepare consolidated financial statements.

As the parent's 75% holding still maintains control, the assets and liabilities of the subsidiary are consolidated **100% on a line-by-line basis**.

It is necessary to account for 25% ownership interest in the subsidiary which is referred to as the non-controlling interest. It is shown in the equity section of the consolidated statement of financial position.

The non-controlling interest is measured using either of the following methods:

- Proportionate share of net assets
- Fair value



Example 3 – Non-controlling interest

Pierre acquired 80% of Stefan's equity share capital on 31 December 20X4 when Stefan's retained earnings were \$750,000.

The financial statements of the two companies at the end 31 December 20X5 were as follows:

	<i>Pierre</i> \$000	<i>Stefan</i> \$000
Investment in Stefan Co	800	-
Other assets	1,900	1,450
Total assets	<u>2,700</u>	<u>1,450</u>
Equity share capital	1,000	250
Retained earnings	1,200	900
	<u>2,200</u>	<u>1,150</u>
Liabilities	500	300
Total equity and liabilities	<u>2,700</u>	<u>1,450</u>

Prepare the consolidated statement of financial position for the Pierre Group at 31 December 20X5 assuming the non-controlling interest is measured using the proportionate share of net assets method

4. Goodwill

On acquisition of a subsidiary, the parent will usually pay more for the subsidiary than the value of the net assets (assets less liabilities). Why?

- Customer loyalty
- Good reputation

The difference between what the parent pays and what the net assets are truly worth is referred to as goodwill.

Example 4 – Goodwill

A parent company buys 75% of the equity shares in a subsidiary company for \$156,000.

The remaining shares were valued at \$52,000 and the net assets at acquisition were \$170,000.

Calculate the goodwill arising on acquisition assuming that:

- **Non-controlling interest is measured using the proportionate share of net assets method**
- **Non-controlling interest is measured using the fair value method.**



Example 5 – Basic consolidation (revision)

On 1 January 20X3 Gasta Co acquired 75% of the share capital of Erica Co for \$1,380,000. The retained earnings of Erica Co at that date were \$480,000. Erica Co's share capital has remained unchanged since the acquisition.

The following draft statements of financial position for the two companies have been prepared at 31 December 20X9.

	<i>Gasta Co</i> \$000	<i>Erica Co</i> \$000
Investment in Erica Co	1,380	0
Other assets	4,500	2,400
Total assets	<u>5,880</u>	<u>2,400</u>
Equity share capital	2,000	1,000
Retained earnings	2,040	660
	<u>4,040</u>	<u>1,660</u>
Liabilities	1,840	740
Total equity and liabilities	<u>5,880</u>	<u>2,400</u>

The non-controlling interest (NCI) was valued at \$450,000 as at 1 January 20X3.

Required:

- (a) Calculate the goodwill arising on acquisition of Erica
- (b) Calculate the non-controlling interest at 31 December 20X9
- (c) Calculate the following figures which will be reported in Gasta's consolidated statement of financial position as at 31 December 20X9.
 - (i) Investment
 - (ii) Other assets
 - (iii) Share capital
 - (iv) Retained earnings
 - (v) Liabilities

4. Other reserves (e.g. revaluation reserve)

Each reserve has a separate calculation still based on ownership so the calculation is the same as for group retained earnings

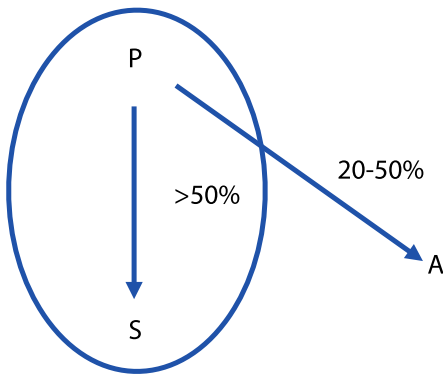
Group revaluation reserve

100% P	X
Add: P's % of S's post acq ⁿ revaluation reserve	X
	<u>X</u>



5. Workings

W1) Group Structure



W2) Net assets of subsidiary

	<i>At reporting date</i>	<i>At acquisition</i>	<i>Post acquisition</i>
Equity shares	X	X	
SP	X	X	
Ret. earnings	X	X	
	X	X	X

W3) Goodwill

FV of consideration (shares/cash)	X
NCI at acquisition	X
	X
FV of net assets at acquisition (W2)	(X)
Goodwill at acquisition	X

W4) Non-controlling interests

NCI @ acquisition (W3)	X
Add: NCI% x S's post-acq ⁿ profits (W2)	X
	X

W5) Group retained earnings

100% P	X
Add: P's % of S's post acq ⁿ retained earnings (P's% x (W2))	X
	X



Example 6 – Workings

Matthews purchased 80% of Jones for \$600,000 two years ago when Jones's retained earnings showed a balance of \$100,000.

	<i>Matthews</i>	<i>Jones</i>
	<i>\$000</i>	<i>\$000</i>
Non-current assets	1,000	500
Investment in Jones	600	-
Current assets	800	600
Total assets	<u>2,400</u>	<u>1,100</u>
Equity share capital (\$1)	500	200
Retained earnings	800	400
	<u>1,300</u>	<u>600</u>
Liabilities	1,100	500
Total equity and liabilities	<u>2,400</u>	<u>1,100</u>

Additional information:

Matthews measures the non-controlling interest using the fair value method.

The fair value of Jones's equity shares acquired was \$200,000 at acquisition

Prepare the consolidated statement of financial position for the Matthews group for the year-ended 31 December 20X5.



6. Adjustments – group and subsidiary

6.1. Intra-company balances

- Remove the payable
- Remove the receivable

6.2. Cash in transit

Step 1 Deal with cash in transit first (adjust receiver's books to assume they have recorded the cash)

Step 2 Remove the intra-company trade receivable and payable

Illustration – Cash in transit

P has an intra-company trade receivable of \$1,500 at the year-end due from S. This does not agree with the corresponding \$1,000 trade payable in S due to a cheque of \$500 sent by S immediately prior to the year-end, which P did not receive until after the start of the new accounting year.

To account for the cash in transit and intra-company balances we need to:

- 1) Record the cash in transit in the group accounts

DR Bank	\$500
CR Receivables	\$500

- 2) Eliminate the equal intra-company balances

DR Payables	\$1,000
CR Receivables	\$1,000

6.3. Inventory in transit

Dr Inventory (SFP)	X
Cr Payables (SFP)	X

6.4. Unrealised profits

Inventory PUP - Need to remove the intra-group profit included in inventory held @ year-end (cost structures)

Cr Inventory (SFP)	X
Dr Retained earnings (of seller)	X

If S is seller → Adjust (W2)

If P is seller → Adjust (W5)



Illustration – Unrealised profits

P sells \$100 goods to S at \$125 and S has not sold the goods on by the end of the year.

OpenTuition



Example 7 – Unrealised profits

Statements of financial position as at 31 December 20X5

	<i>James</i> \$'000	<i>Molly</i> \$'000
Non-current assets		
PPE	900	500
Investment in Molly	800	-
Current Assets	700	600
	<u>2,400</u>	<u>1,100</u>
Share Capital	500	200
Retained earnings	800	400
Current liabilities	<u>1,100</u>	<u>500</u>
	<u>2,400</u>	<u>1,100</u>

Additional information:

James bought 80% of the equity shares in Molly for \$800,000 when the retained earnings were \$150,000.

Non-controlling interest is measured using the fair value method.

The fair value of the non-controlling interest was \$200,000 at the acquisition date.

During the year Molly sold goods to James at \$120,000 based on a mark-up of 20%. Half of the goods remain in inventory at the year-end.

Prepare the James Group consolidated statement of financial position as at 31 December 20X5.

Non-current asset PUP - Need to remove the intra group profit on intra -company transfers of non-current assets

Cr PPE (CSFP) X

Dr Retained earnings (of seller) X

If S is seller → Adjust (W2)

If P is seller → Adjust (W5)

Illustration – Non-current assets PUPs

A parent company sold an item of PPE for \$250,000 to its subsidiary on the last day of the reporting period, when its carrying value was \$200,000.

The intra-group profit of \$50,000 needs to be removed so that the PPE is held at the carrying value to the group of £200,000. An adjustment would be required as follows:

DR Retained earnings (parent – (W5)) \$50,000

CR PPE (CSFP) \$50,000

Fair value adjustments (IFRS 3)

Bring in FV of identifiable assets and liabilities on a line by line basis into the group SFP (PPE, inventory, contingent liabilities)

Adjust S's net assets (W2) @ SFP date and @ acquisition column.

Adjust S's net assets (W2) @ acqⁿ column (extra depⁿ, sale of inventory)

Illustration – Fair value adjustment (PPE)

A parent company acquires a subsidiary at the start of the reporting period, where the fair value of the PPE is \$50,000 higher than its book value and the remaining life of the PPE is 10 years.

The fair value adjustment is recorded within the workings at the end of the first year as follows:

(W2) Net assets of the subsidiary

	<i>At reporting date</i>	<i>At acquisition</i>	<i>Post acquisition</i>
Equity shares	X	X	
Ret. earnings	X	X	
FV (PPE)	50	50	
Extra dep ⁿ .	(5)		
	<u>X</u>	<u>X</u>	<u>X</u>

And the fair value is also reflected on the face of the statement of financial position as follows:

Non-current assets

	\$000s
Property, plant and equipment (100% P + 100% S + 50 – 5)	X



Illustration – Fair value adjustment (contingent liability)

A parent company acquires a subsidiary at the start of the reporting period, and there is a contingent liability of \$100,000 disclosed in the notes to the subsidiary's accounts.

The contingent liability is recorded at fair value within the workings at the end of the first year as follows:

(W2) Net assets of the subsidiary

	<i>At reporting date</i>	<i>At acquisition</i>	<i>Post acquisition</i>
Equity shares	X	X	
Ret. earnings	X	X	
Contingent liability	(100)	(100)	
	<u>X</u>	<u>X</u>	<u>X</u>

And the fair value is also reflected on the face of the statement of financial position as follows:

Current liabilities

\$000s

Contingent liability 100

7. Other issues

7.1. Consideration

A parent may acquire a controlling interest in a subsidiary in other fashions as opposed to just a cash payment. Other considerations are as follows:

- Share for share exchange
- Deferred cash consideration
- Contingent consideration

7.2. Share for share exchange

- Calculate the number of subsidiary shares acquired
- Calculate the number of P shares issued
- Value the P shares issued
- Record the journal entry



Example 8 – Share exchange

Harry acquired 80% of the 10 million ordinary \$1 shares of Sally by offering a share exchange of one for every four shares acquired. The fair value of Harry's shares is \$3 per share.

Calculate the cost of investment for the acquisition and prepare the journal entry to record the share issue.

7.3. Deferred consideration

A parent may agree to pay cash in the future following the acquisition of the subsidiary. This deferred consideration is recorded on acquisition at present value.

Example 9 – Deferred consideration

Pony acquired 80% of the 30 million \$1 equity shares of Star on 1 January 20X5. The consideration was through the offer of a share exchange of two shares issued for every three shares acquired and a cash payment of \$1 per share payable on 31 December 20X5. The fair value of the Pany's equity shares was \$2 at 1 January 20X5.

The present value of \$1 received in one year's time is \$0.91 at a rate of 10%.

Calculate the cost of the investment in Star at 1 January 20X5

The deferred consideration needs to be unwound to its final value and is done so using the interest rate originally applied to discount back the original entry and is recorded as follows:

Dr Finance cost
Cr Deferred consideration liability

NOTE: The adjustment does not impact the fair value of consideration.



7.4. Mid-year acquisitions

Calculate the subsidiary's retained earnings at acquisition, assuming subsidiary profits in the year accrue evenly.

Illustration – Mid-year acquisition

Richard acquired 80% of Andy's equity share capital on 1 August 20X5. Both have a year end of 31 December 20X5.

Andy's retained earnings at the end of the year were \$600,000 and its profit for the year was \$120,000.

Assuming the profit accrued evenly during the year then the Andy's retained earnings figure at 1 August 20X5 is calculated as follows:

$$\$600,000 - (5/12 \times \$120,000) = \underline{\$540,000}$$

7.5. Uniform accounting policies

Subsidiary must adopt the parents accounting policies in the group accounts. Accounted for by adjusting the value of assets/liabilities and (W2).

7.6. Coterminous year-ends

Financial statements within three months of the parents year-end can be used and adjusted for any significant events.

7.7. Non-consolidation

Subsidiaries are not consolidated if it is:

- Held for sale in accordance with IFRS 5 and
- Operating under long-term restrictions such that the parent company cannot exercise control

