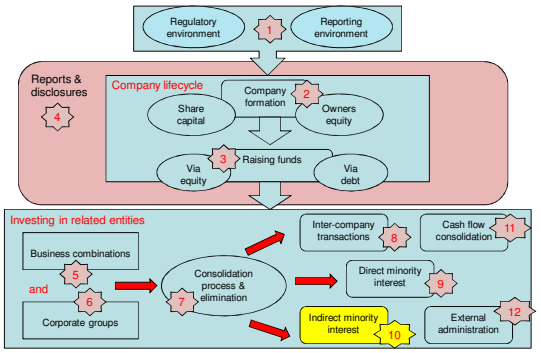
HA2032
Corporate Accounting

HOLMES INSTITUTE

Cum Propris Suis Alis Volat

Topic 10
Indirect Interest

Studying Corporate Accounting



Overview: Multi-tier groups

- Attributes that impact on consolidation:
  - Contains a principal and at least one nested group (as in figure 23.1)
  - Parent entity and non-controlling interest (NCI) can both have indirect interests (see figure 23.1(2) next slide: parent has 42% indirect interest in Company C; NCI has 28% indirect interest in Company D)
  - A parent can have direct and indirect interests simultaneously in a subsidiary

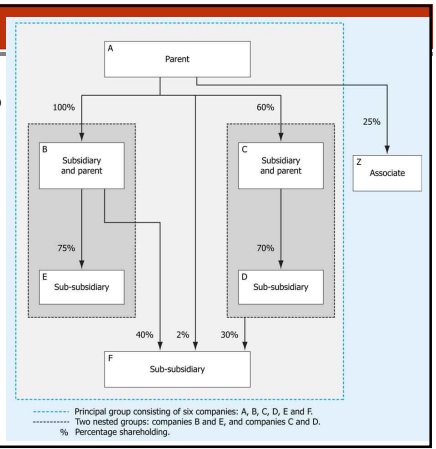
Overview: Multi-tier groups (contd)

- Each indirect interest in a subsidiary company occurs through holding shares in an intermediate subsidiary
- The size of any indirect interests is a function of ownership at each tier in the structure
- All indirect interests in a particular subsidiary sum to the direct interest of that subsidiary's immediate parent or, where there is no immediate parent, to the direct interest of one or more intermediate group entities.

Overview: Multi-tier groups (contd)

- Definitions: direct vs indirect interest
  - Direct interest:
    - An entity's ownership interest in another entity, which is based on owning equity in that other entity
  - Indirect interest:
    - An entity's ownership interest in another entity, which derives from owning equity in that other entity's parent.

- Figure 17.1 Specimen group of companies: A Co. Ltd and its subsidiaries



- Table 17.2
  Distribution of equity interests in the A company group between the ultimate parent and minority interest

	Parent interest		Minority interest	
	Direct %	Indirect %	Direct %	Indirect %
Company A	100.0			
Company B	100.0			
Company C	60.0		40.0	
Company D		42.0	30.0	28.0
Company E		75.0	25.0	
Company F	2.0	52.6	28.0	17.4

Wholly owned 3-tier group

- The order of investments is important, this is demonstrated by the 2 cases of example 22.1
  - Case 1 : Bridge Ltd (Father) acquires all shares of Pears Ltd (Son) in 20X4; Pears Ltd acquires all shares of Britten Ltd (Grandson) in 20X7
  - Bridge Ltd interest in Pears Ltd and indirect interest in Britten Ltd; Pears has direct interest in Britten
  - Pears' $1,000 post control profit is included in consolidation
  - Britten's $2,000 retained profits are eliminated, against Pears' investment

Wholly owned 3-tier group (contd)

- Case 2 : Bridge Ltd (Father) acquires all shares of Pears Ltd (Son) in 20X7 and Pears Ltd acquires all shares of Britten Ltd (Grandson) in 20X4
- Pears' profit is eliminated
- Britten's $2,000 retained profits are eliminated, against Pears' investment ($500) and Bridge's investment ($1500)

Partly owned 3-tier group

Example 22.2

- J Ltd (ultimate parent), R Ltd (the subsidiary) and O Ltd (sub-subsidiary)
  - R Ltd acquired all shares in O Ltd in 1/1/20X8 and J Ltd acquired 70% of R Ltd shares on 31/12/20X9
  - R Ltd have direct interest in O Ltd; J Ltd has 70% direct interest in R Ltd and 70% indirect interest in O Ltd
  - MI has 30% direct interest in R Ltd and 30% indirect interest in O Ltd

Partly owned 3-tier group (contd)

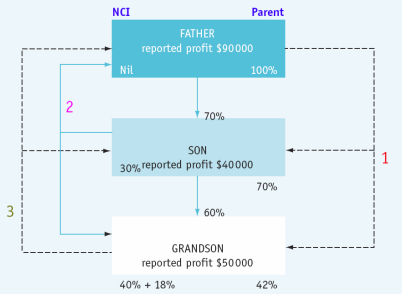
- Substitution elimination

R Ltd profit at 31/12/20X9	70% of $30 000	21 000
less Consolidation goodwill impairment	70% of $1000	(700)
Plus O Ltd profits at 1/1/20X8	100% of $7000	7 000
Plus O Ltd profits from 1/1/20X8 to 31/12/20x9	70% of $4000	2 800
Total retained profits elimination		**$30 100**

Intra-group transactions (contd)

- Indirect interests and unrealised profit elimination

FIGURE 23.3 INDIRECT INTERESTS AND UNREALISED PROFIT ELIMINATION
Unrealised profit of $4000 on intercompany transactions is eliminated. The elimination is deducted from profit of the selling company which is 1 Father, 2 Son and 3 Grandson.



Intra-group transactions (contd)

FIGURE 23.3 INDIRECT INTERESTS AND UNREALISED PROFIT ELIMINATION

Unrealised profit of $4000 on intercompany transactions is eliminated. The elimination is deducted from profit of the selling company which is 1 Father, 2 Son and 3 Grandson.

		Profit			
		Father	Son	Grandson	Total
Allocated to shareholders:					
	Parent direct and indirect	86 000	28 000	21 000	135 000
1	NCI direct	—	12 000	20 000	
	NCI indirect	—	—	9 000	41 000
		86 000	40 000	50 000	176 000
	Parent direct and indirect	90 000	25 200	21 000	136 200
2	NCI direct	—	10 800	20 000	
	NCI indirect	—	—	9 000	39 800
		90 000	36 000	50 000	176 000
	Parent direct and indirect	90 000	28 000	19 320	137 320
3	NCI direct	—	12 000	18 400	
	NCI indirect	—	—	8 280	38 680
		90 000	40 000	46 000	176 000

Second colour Blue identifies, for each case, the calculation for the party making the sale.

Intra-group transactions (contd)

- Dividends
  - Dividend paid to group companies needs to be eliminated.
  - Dividends paid to other shareholders must be included in consolidated statement.
    - Refer to example 23.3

Intra-group transactions (contd)

- The comprehensive example, example 23.4, contains a demonstration of the allocation process