HA2032
Corporate Accounting

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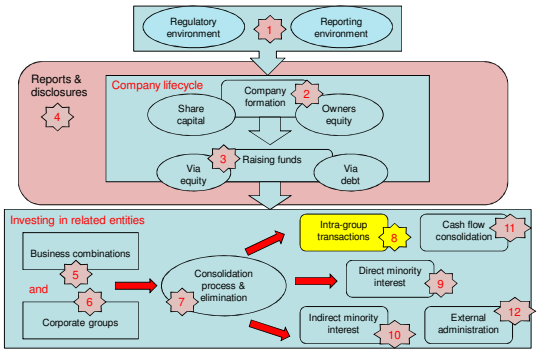
Topic 8
Intra-Group transactions

Studying Corporate Accounting



Introduction

- Intra-group transactions are not arms-length transactions
- They are internal movements of resources within the group
- They are always eliminated from aggregated group data
- The can have both short term impacts (one reporting period only) and long-term impacts (more than one reporting period)

The exchange

- Exchanges include revenue and expense, which has impact on period profit or loss of the transacting group companies (therefore in P&L account and profit or loss statement)
  - possible impact on other comprehensive profit
- Elimination of these exchanges has **NO effect** on consolidated profit
- Offset:
  - revenue of supplier
  - expense of purchaser

The exchange (contd)

- An intra-group exchange, at a price either higher or lower than cost, results in profit or loss to the selling company
  - on consolidation such a profit or loss may need to be cancelled (eliminated) against the buyer's 'extra' cost paid
  - called '**mark-up**' or '**mark-down**'
    - term 'unrealised profit' inappropriate – it is misleading in context of intra-group transactions

The exchange (contd)

- Services

Dr Management fee (Revenue)	x	
Cr Management fee (Expense)		x

- Sale of goods

Dr Sales	x	
Cr Stationery supplies (expense)		x

OR

Dr Sales	x	
Cr Purchases (or cost of sales)		x

The exchange (contd)

- Perpetual inventory
  - *if* inventory **is not** sold outside the group at reporting date

Dr	Sales revenue (profit or loss statement)	X	
Cr	COGS (profit or loss statement)		X
Dr	COGS (profit or loss statement)	X-Y	
Cr	Inventory (balance sheet)		X-Y

X-Y is the mark-up on the intra-group transfer

The exchange (contd)

Example:

- On 15 June 20X6 Kim Ltd sold to its parent, Ian Ltd, inventory with a cost of $600 000 for $700 000. At reporting date (30 June 20X6) Ian Ltd still held all of the inventory. The inventory was sold by Ian Ltd on 17 July 20X6 for $750 000
- What is the effect of these transactions on the consolidated financial statements for 20X6 and 20X7?

The exchange (contd)

- For 20X6: eliminate the intra-group transfer and the mark-up on the transfer

Dr	Sales revenue (P + L)	700 000	
Cr	COGS (P + L)		600 000
Cr	Inventory (BS)		100 000

Eliminates effect of sale by Kim Ltd to Ian Ltd for $700 000 of inventory with a cost of $600 000

The exchange (contd)

- For 20X7: adjust SOP retained profit to eliminate the prior period mark-up on the intra-group transfer

Dr	Retained profits (SOP balance) (retained profits analysis)	100 000	
Cr	COGS (P + L)		100 000

Eliminates mark-up of $100 000 on prior period of sale by Kim Ltd to Ian Ltd for $700 000 of inventory with a cost of $600 000

The exchange (contd)

- Dividend is appropriated by the subsidiary and treated as revenue by the parent; thus, elimination is required.
  - consolidated retained profit **is not** affected
- Dividend from the parent is paid to an external party
  - it **reduces** consolidated retained profit

The exchange (contd)

- Dividends from post-control profits

Dr	Dividend revenue (profit or loss statement)	X+Y	
Cr	Retained profits (interim dividend paid) (retained profits analysis)		X
Cr	Retained profits (declared and unpaid final dividend) (retained profits analysis)		Y
Dr	Dividend payable (balance sheet)	Y	
Cr	Dividend receivable (balance sheet)		Y

Receivables and payables

- Loan

Dr Accounts Payable		x
Cr Accounts Receivable		x

- Interest accrued

Dr Interest revenue	x	
Cr Borrowing expense		x
And, if interest is unpaid		
Dr Borrowing expense accrued (liabilities)	x	
Cr Interest accrued (assets)		x

Profits derived from Intra-group

- Intra-group sale of asset and subsequent sale to external party
  - Consolidated profit is the difference between the ultimate selling price (to an external party) and original cost of goods
  - Intra-group transfer price does not change consolidated profit
  - After sale to an external party, the intra-group profit is part of the consolidated profit and is no longer eliminated

Long lived intra-group transactions

- Transactions that influence financial results over more than one period

1 Opening inventory
- Must represent cost to the group
- Must be modified to remove any profit generated from intra-group transactions
- Amount previously eliminated from closing inventory (in cost of sales) must be eliminated from opening inventory in the next period.

Long lived intra-group transactions

2 Non-current assets
- (Non-depreciable asset)
- See example 19.8: land with changing fair value sold within the group for profit
- Profit on sale is eliminated in the year of sale, in subsequent years, until the land is sold to external party.

Long lived intra-group transactions

2 Non-current assets
- (Depreciable asset)
- Carrying amount changes each period when depreciation or impairment is recognised.
- When there is sale of depreciable assets within the group, with transfer price different from original cost (i.e. either with profit or loss), the buyer starts to depreciate from this base (the transfer price) and over a lifetime starting from transfer date.

Long lived intra-group transactions

- (Depreciable asset)
  - Since the sale includes a profit, eliminations must delete the mark-up from the asset carrying amount
  - Also, the impact of the mark-up on depreciation expense also needs to be eliminated.
  - Example 19.10

Long term debt

- Non-current intra-group debts are treated as per other receivables and payables
- Debentures or unsecured notes are more complex due to:
  - the fact that the financial asset and financial liability may be measured differently.
  - E.g. when the debt instruments are marketable the issuer's carrying amount of debt can differ from buyer's purchase price.
  - The intra-group debenture transaction is eliminated, but the difference (gain or loss) will be recognised in consolidation profit.

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