HA2032
Corporate Accounting

HOLMES INSTITUTE

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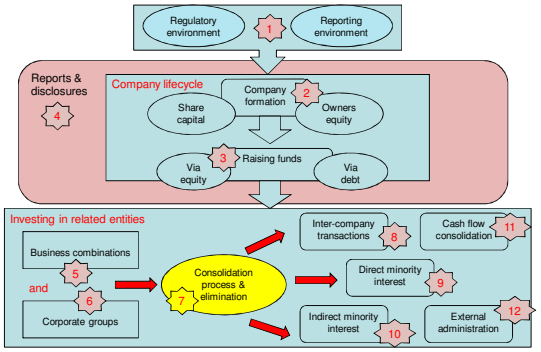
Topic 7
Consolidation process

Studying Corporate Accounting



Consolidated financial statements

- The parent company is responsible for, and has control over, the statements.
- *Acquisition method* is the only method permitted in Australia.
- Consolidated financial statements include:
  - the consolidated balance sheet
  - the consolidated comprehensive profit statement
  - the consolidated cash flow statement
  - the consolidated changes in equity statement
  - the notes.

Consolidated processes

- Substitution: elimination of parent investment in subsidiary.
  - Accounts of a newly acquired wholly owned subsidiary (S), show net assets, owner's equity (share capital, reserves and retained profits)
  - Parent co. (P) accounts would show 'investment in subsidiary'
  - In consolidated statements, investment a/c of P is *eliminated* against S owners' equity to avoid double-counting…. the investment amount is not included in the consolidated balance sheet

Consolidated processes (contd)

- Elimination of intra-group transactions
  - Transactions between member entities within the group - do not generate profit for the group or change its net assets, mere movements of resources
  - Two records from opposite-side of the same transaction, representing provider and receiver in the exchange, appear. In effect, they cancel each other, so there will be no change to financial position
  - Types of intra-group transactions are discussed in Chapter 20.

Consolidated processes (contd)

- Isolation of non-controlling interest (NCI):
  - Final step of consolidation process
  - Necessary for apportionment of group amounts to different owner categories: parent shareholders and NCI
  - NCI discussed in Chapter 21

Organising consolidated data

- The consolidation worksheet
  - provides columns for company's financial data adjustments, elimination, apportionments and the consolidated results
  - is a tool to help preparing the consolidated statements
  - is not the formal report
  - Refer to table 18.1.

Organising consolidated data

Table 18.1 Worksheet designs

Consolidation worksheet at . . . Profit or loss statement

	1	2	3		4	5	6		7	8	9	10
	Parent	Sub	Data adjustments			Sum	Eliminations			Group	Allocation to shareholders	
			Dr		Cr		Dr		Cr		NCI	Parent
Sales	900	350				1 250				1 250		
Total expenses	857	328				1 185				1 185		
Profit or loss	43	22				65				65	7	58
Retained profits analysis												
SOP[1] retained profits	27	(10)		a	9	26	6	1.4		20	(1)	21
EOP retained profits	70	12				91				85	6	79

Organising consolidated data (contd)

- Data requirements:
  - Primary data: from the latest financial statements of each member in the group
  - Additional necessary data:
    - subsidiary's owner's equity **at control date**
    - fair value of subsidiary's identifiable assets and identifiable liabilities (fair value of net assets) **at control date**
    - intra-group transactions (current and prior periods)
    - outstanding intra-group balances
    - needed to adjust subsidiaries' data so that all primary data are **consistent** and **correctly measured**

Organising consolidated data

- Data consistency:
  - Uniformity of consolidation data
    - Reporting date
    - Accounting policies
    - Classification
    - Currency.
- Data interpretation:
  - Group perspective.

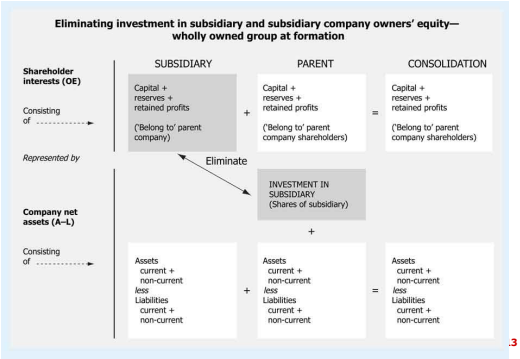
Organising consolidated data (contd)

- Data adjustments are required due to:
  1. Inconsistent data, e.g.
     - Depreciation methods
     - Inventory cost determination method
     - Provision for employee benefits
     - Refer to example 18.1.
  2. Incomplete data, e.g.
     - Unrecorded intercompany transactions
     - Subsidiary's assets not recorded at fair value
     - Refer to example 18.2.

The substitution elimination

- Elimination of the parent's investment against owner's equity of the subsidiary.
- From the figure overleaf, note that:
  - Consolidated net assets = Sum of all assets and liabilities of parent and subsidiary, apart from parent's investment in subsidiary.

The substitution elimination



The substitution elimination (contd)

- Standard substitution elimination entry:

Dr	Paid-up capital	X	
Dr	Fair value reserve (if needed)	X	
Dr	Other reserves	X	
Dr	Retained profits	X	
Cr	Investment in subsidiary		X

The substitution elimination (contd)

- Pre-control and post-control events
  - Control date:
    - The date when control is created between parent and subsidiary.
  - Pre-control equities:
    - Owners' equities of subsidiary companies existing at the control date (need to be eliminated)
    - Refer to example 18.4.
  - Post-control equities:
    - Those generated subsequently

The substitution elimination (contd)

- Consolidation difference
  - The price paid for investment should reflect all equities acquired; however, discrepancy may occur between *investment cost* and *equities acquired*
  - Consolidation difference is the difference between the *control date fair value of the consideration paid for the share investment* and the fair value of the identifiable net assets of the subsidiary
  - It is recognised immediately, either as **consolidation goodwill** (AASB 3.32) or **consolidation bargain purchase gain** (AASB 3.34)

The substitution elimination (contd)

- Consolidation difference
  - Ideally, the subsidiary's net assets are recorded at control date fair value
  - Otherwise, its net assets must be remeasured at control date fair value in the consolidation
  - Reasons why carrying amount and fair value differ:
    - → most inventory at lower cost and NRV
    - → limited ability to use FV to measure asset carrying amounts
  - See example 18.5 and compare with example 18.4

The substitution elimination (contd)

Disposal of consolidation difference

- 1. Consolidation goodwill
  - Amortisation is no longer permitted under AASB 3. Instead, an impairment test is to be performed annually, or as soon as signs of impairment appear
  - Goodwill is revised downwards through recognition of accumulating impairment expenses
  - Thus, goodwill will be written-off over time
  - Consolidation goodwill impairment expense is only recognised in consolidated financial report.

The substitution elimination (contd)

- Journal entry

  Dr Goodwill impairment expense X

  Cr Accumulated goodwill impairment X

The substitution elimination (contd)

Example:

On 1 January 20X7 Bee Ltd gained control of Flower Ltd by purchasing all of its shares. At that date the owners' equity of Flower Ltd comprised:

- Paid-up share capital 500 000
- Asset revaluation reserve 250 000
- Retained profits 250 000

The cost of the business combination (carrying amount of the investment in Flower Ltd) was $1 000 000

The substitution elimination (contd)

Since the cost of the businesses combination and the FV of the net assets acquired are the same, there is no acquisition difference, and the substitution elimination entry on the control date is:

Dr	Paid-up share capital	500 000	
Dr	Asset revaluation reserve	250 000	
Dr	Retained profits	250 000	
Cr	Investment in Flower Ltd		1 000 000

Elimination of pre-control owners' equity of Flower Ltd

The substitution elimination (contd)

Consolidation Worksheet as at 1/1/20X7

	Bee Ltd	Flower Ltd	Sum	Eliminations Debit		Eliminations Credit	Group
Owners' equity							
Paid-up share capital	1 200 000	500 000	1 700 000	500 000	1		1 200 000
Retained profits	600 000	250 000	850 000	250 000	1		600 000
Asset revaluation reserve	400 000	250 000	650 000	250 000	1		400 000
Total owners' equity	2 200 000	1 000 000	3 200 000				2 200 000
Liabilities							
Current liabilities	120 000	75 000	195 000				195 000
Non-current liabilities	675 000	450 000	1 125 000				1 125 000
Total liabilities	795 000	525 000	1 320 000				1 320 000
Total equities	2 995 000	1 525 000	4 520 000				3 520 000
Assets							
Cash	50 000	175 000	225 000				225 000
Other current assets	325 000	225 000	550 000				550 000
Investment in Flower Ltd	1 000 000		1 000 000		1	1 000 000	
Other non-current assets	1 620 000	1 125 000	2 745 000				2 745 000
Total assets	2 995 000	1 525 000	4 520 000	1 000 000		1 000 000	3 520 000

The substitution elimination (contd)

- The facts are those in lecture illustration 18.2 except that the cost of the business combination is $1 250 000
- Therefore, cost exceeds fair value of net assets acquired by $250 000
- The consolidation journal substitution entry is:

Dr	Paid-up share capital	500 000	
Dr	Asset revaluation reserve	250 000	
Dr	Retained profits	250 000	
Dr	Consolidation goodwill	250 000	
Cr	Investment in Flower Ltd		1 250 000

Elimination of pre-control owners' equity of Flower Ltd and recognition of consolidation goodwill

The substitution elimination (contd)

- 2. Consolidation bargain gain
  - **Only** recognised in a consolidated financial report
  - Recorded immediately as a gain and closed off to profit or loss account at year end (included in period profit or loss)
  - Illustrated in lecture illustration 18.3

The substitution elimination (contd)

- Journal entry

Dr	Consolidation excess	X	
Cr	Gain – excess over cost		X
Dr	Gain – excess over cost	X	
Cr	Profit or loss	X	

The substitution elimination (contd)

- The facts are those in lecture illustration 18.2 except that the cost of the business combination is $950 000
- Therefore, fair value of net assets acquired cost exceeds cost by $50 000
- The consolidation journal substitution entry is:

Dr Paid-up share capital	500 000	
Dr Asset revaluation reserve	250 000	
Dr Retained profits	250 000	
Cr Bargain purchase gain		50 000
Cr Investment in Flower Ltd		950 000

Elimination of pre-control owners' equity of Flower Ltd and recognition of bargain purchase gain

Substitution after control date

- Retained profits balance will include pre-control and post-control amounts
- Same may apply to share capital and reserve accounts
- Eliminate **pre-control portion only**
  - See Figure 19.1
- Eventually pre-control amounts (other than capital) will disappear as they are distributed

Substitution after control date

- Dividend distributions by subsidiary
  - Subsidiary's perspective a distribution of profit
  - Parent's perspective a revenue
  - Group perspective (wholly-owned subsidiary) the intra-group transition must be eliminated
- Dividends from subsidiary's pre-control profits treated by parent:
  - Reduction in investment carrying amount (pre-2009 amendment to AASB 127)
  - Revenue (post-2009 amendment to AASB 127)
  - Implications demonstrated in Example 19.7(1)

Substitution after control date

Parent's journal

Dr	Cash or dividend receivable	X	
Cr	Dividend revenue		X

Recognises dividend received from subsidiary

Consolidation journal

Dr	Dividend revenue	X	
Cr	Dividend appropriation		X

Eliminates intra-group dividend

Substitution after control date

Example 19.7(1) Dividend from pre-control profits

Barn Ltd acquired all the equity of Stable Ltd on 20 November 2008 for $80 000. Owners' equity of Stable Ltd at that date comprised share capital $50 000 and retained profits $18 000. Shortly thereafter Stable paid a dividend of $10 000 out of the control date retained profits. The next reporting date is 30 June 20X9.

Required:

Show how the dividend would be accounted for by the parent and dealt with in the consolidation if:

(a) it was approved and paid before AASB 127.38A came into effect

(b) it was approved and paid after AASB 127.38A came into effect.

Solution:

The journal entry for Barn Ltd to record the dividend is:

			Part (a)		Part (b)	
Date of payment or declaration	Dr	Cash	10 000		10 000	
	Cr	Investment in subsidiary		10 000		
	Cr	Dividend revenue				10 000

(a) Recognises dividend from subsidiary's pre-control equity as a deduction to the investment account

(b) Recognises dividend from subsidiary's pre-control equity as revenue

Substitution after control date

The journal entry for Stable Ltd is the same for (a) and (b):

Date of payment or declaration				
	Dr	Retained profits—dividend appropriation	10 000	
	Cr	Cash		10 000
		Payment of dividend		

The important point to note is that (a) reduced the investment and (b) does not, but that both reduce pre-control equity. Under (b), the amount of the dividend revenue must be eliminated, and in both cases the dividend appropriation has to be eliminated. The journal entry for the substitution elimination for part (a) or part (b) will be:

20X9 30 June			Part (a)		Part (b)	
	Dr	Paid up capital	50 000		50 000	
	Dr	Retained profits (SOP balance)	8 000		18 000	
	Dr	Consolidation goodwill	12 000		12 000	
	Cr	Investment in subsidiary		70 000		80 000
		Substitution				

And the elimination of the dividend will be:

	Dr	Dividend revenue			10 000	
	Dr	Retained profits (SOP balance)	10 000			
	Cr	Retained profits–dividend appropriation		10 000		10 000
		(a) Eliminates intra-group dividend from pre-control profits				
		(b) Eliminates intra-group dividend revenue and appropriation				

Substitution after control date

Comparison of the two treatments of pre-control dividends

	Previous treatment (a)	Current treatment
Treatment of divided from pre-control profits **by parent**	Reduces investment carrying amount	Recognised as revenue
Reporting date investment amount eliminated by substitution	Initial investment *less* dividends from pre-control profits	Initial investment
Elimination of dividend appropriation in period when paid	Produces reduction in retained profits SOP balance (resulting in SOP retained profit eliminated in substitution being same as pre-control retained profits at reporting date)	Produces reduction in dividend revenue (like all intra-group dividends it is not a revenue from the group perspective)
Treatment of pre-control equity	Eliminates amount remaining after appropriation	Eliminates amount at control date