CHAPTER 8-PART 2

Consolidated Statement of Financial Position

Learning Objective:

1. **Fair Value Adjustment**
2. **Intra-Group Trading**
3. **Unrealised Profit**
4. **Mid-Year Acquisitions**

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1. Fair Value Adjustment

Fair value of consideration and net assets

To ensure that an accurate figure is calculated for goodwill:

- the consideration paid for a subsidiary must be accounted for at fair value
- the subsidiary's identifiable assets and liabilities acquired must be accounted for at their fair values.

Adjusting both columns of working 2 (W2) as follows:

	At date of acquisition $	At the reporting date $
Share capital	x	x
Share premium	x	x
Revaluation surplus	x	x
Retained earnings	x	x
Fair value adjustment	x	x
Total	**x**	**x**

Example– Fair value adjustments

Hazelnut acquired 80% of the share capital of Peppermint on 1 January 20X3 for cash consideration of $1 million. At the date of acquisition, Peppermint had retained earnings of $125,000 and a revaluation surplus of $100,000

Below are the statements of financial position of Hazelnut and peppermint as at 31 December 20X4:

	Hazelnut $000	Peppermint $000
Investment in Peppermint at cost	1,000	
Property, plant & equipment	5,500	1,500
Current assets:		
Inventory	550	100
Receivables	400	200
Cash	200	50
	7,650	1,850
Share capital	1,800	400
Revaluation surplus	200	100
Retained earnings	1,400	300
	3,400	800
Non-current liabilities	3,000	400
Current liabilities	1,250	650
	7,650	1,850

At acquisition the fair value of Peppermint's plant exceeded its carrying amount by $200,000. At the date of acquisition, the fair value of the 20% non-controlling interest in Peppermint was $380,000.
Prepare the consolidated statement of financial position of Hazelnut Group as at 31 December 20X4. Include all relevant workings.

Hazelnut consolidated statement of financial position at 31 December 20X4

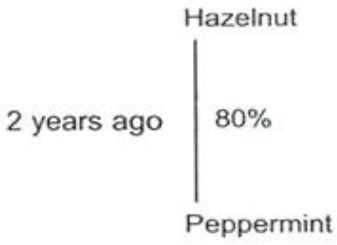
	$000
Goodwill (W3)	555
Property, plant & equipment (5,500 + 1,500 + 200)	7,200
Current assets:	
Inventory (550 + 100)	650
Receivables (400 + 200)	600
Cash (200 + 50)	250
	9,255

	$000
Share capital	1,800
Revaluation surplus	200
Retained earnings (W5)	1,540
	3,540
Non-controlling interest (W4)	415
	3,955
Non-current liabilities (3,000 + 400)	3,400
Current liabilities (1,250 + 650)	1,900
	9,255

Note that the revaluation surplus of the subsidiary is a pre-acquisition balance and is therefore not part of group revaluation surplus at the reporting date.

Workings

(W1) **Group structure**



(W2) **Net assets of Peppermint**

	At date of acquisition	**At reporting date**
	$000	$000
Share capital	400	400
Revaluation surplus	100	100
Retained earnings	125	300
Fair value adjustment: plant	200	200
	825	1,000

Note that, as there is no movement in revaluation surplus balance, all of the movement in net assets relates to retained earnings.

(W3) **Goodwill**

	$000
Fair value of consideration	
Cash paid	1,000
FV of NCI at acquisition	380
	1,380
Less:	
Fair value of net assets at acquisition (W2)	(825)
Goodwill on acquisition	555

(W4) **Non-controlling interest**

	$000
FV of NCI at acquisition (as in W3)	380
NCI share of post-acquisition reserves (20% × (1,000 – 825) (W2))	35
	415

(W5) **Group retained earnings**

	$000
Hazelnut retained earnings	1,400
Peppermint (80% × (1,000 – 825))	140
	1,540

2. Intra-Group Trading

P (parent) and S (subsidiary) may well trade with each leading to the following potential issues to be deal with:

- receivables and payables (current account) in P and S that effectively cancel each other out
- Dividends paid by the subsidiary recognized as income by the parent. The net effect of this to the group is zero.
- Unrealized profits on sales of inventory between the parent and the subsidiary.

3. Unrealised Profit In Inventory

When one group entity sells goods to another, the following transactions may happen:

- Profit recognized in the accounts of the individual entities concerned.
- Current accounts must be cancelled
- Where goods are still held by one entity at the reporting date, any unrealized profit must be cancelled.
- Inventory must be included at original cost to the group.

Goods have been sold subject to either the profit mark-up or sale margin.

Consolidated Entry:

If seller is the parent, the profit element relates entirely to the controlling group and will be adjusted:

Dr. Group retained Earnings (deduct the profit in W5)
Cr. Group inventory

If the seller is the subsidiary, the profit element is included in the subsidiary's accounts and relates partly to the group, partly to non-controlling interests (if any).

Dr. Subsidiary retained earnings (deduct the profit in W2-at reporting date)
Cr. Group inventory

However, if you do not prepare W2, alternative method is as follows:

Dr. Group retained earnings (group %)- W5
Dr. Non-controlling interest (NCI %)-W4
Cr. Group inventory (100%)

Example:

H acquired 90% of the ordinary share capital of S on 1 January 20X2 when the retained earnings of S were $5,000. Statements of financial position at 31 December 20X3 were as follows:

	H		S	
	$000	$000	$000	$000
Non-current assets:				
Property, plant & equipment		100		30
Investment in S at cost		34		
		134		30
Current assets:				
Inventory	90		20	
Receivables	110		25	
Bank	10		5	
		210		50
		344		80

	$000	$000
Equity:		
Share capital of $1 each	15	5
Retained earnings	159	31
	174	36
Non-current liabilities	120	28
Current liabilities	50	16
	344	80

S sold goods to H at a transfer price of $18,000, including a mark-up of 50%. Two-thirds of those goods remained in inventory at the year-end. The current accounts in H and S stood at $22,000 on that day.

The H group uses the fair value method to value the non-controlling interest. The fair value of the non-controlling interest at acquisition was $4,000.

Prepare the consolidated statement of financial position for the H Group, based on the preceding illustration, as at 31 December 20X3.

		$000
Non-current assets		
Goodwill (W3)		28.0
Property, plant & equipment (100 + 30)		130.0
		158.0
Current Assets		
Inventory (90 + 20 – 4 (W6))	106.0	
Receivables (110 + 25 – 22 intra-co receivable)	113.0	
Bank (10 + 5)	15.0	
		234.0
		392.0

	$000
Equity	
Share capital of $1	15.0
Group retained earnings (W5)	178.8
NCI (W4)	6.2
	200.0
Non-current liabilities (120 + 28)	148.0
Current liabilities (50 + 16 – 22 intra-co payable)	44.0
	392.0

Workings

(W1) **Group structure**

H
| 90% 01/01/X2
S

(W2) **Net assets**

	Acquisition date	Reporting date
	$000	$000
Share capital	5.0	5.0
Retained earnings	5.0	31.0
PURP (W6)		(4.0)
	10.0	32.0

(W3) **Goodwill**

	$000
Fair value of consideration	34.0
FV of NCI at acquisition	4.0
	38.0
Less:	
Fair value of net assets at acquisition (W2)	(10.0)
Goodwill on acquisition	28.0

(W4) **Non-controlling interest**

	$000
FV of NCI at acquisition (as in W3)	4.0
NCI share of post-acquisition reserves (W2) (10% × (32 – 10))	2.2
	6.2

(W5) **Group reserves**

	$000
100% H	159.0
90% S post-acq (90% × ($32 – $10 (W2))	19.8
	178.8

(W6) **PURP**

	$000	Percentage
Sales	18	150
COS		100
Gross profit	6	50
	× 2 / 3	
	PURP = $4,000	

4. **Mid-Year Acquisitions**

If a parent entity acquires a subsidiary mid-year, the net assets must be calculated at the date of acquisition.

The net assets at acquisition can be calculated as the net assets at the start of the subsidiary's financial year plus the retained for part of the year up to the date of acquisition, together with any fair value adjustments at the date of acquisition.

To calculate this, it is normally assumed that S's profit after tax has accrued evenly throughout the year.