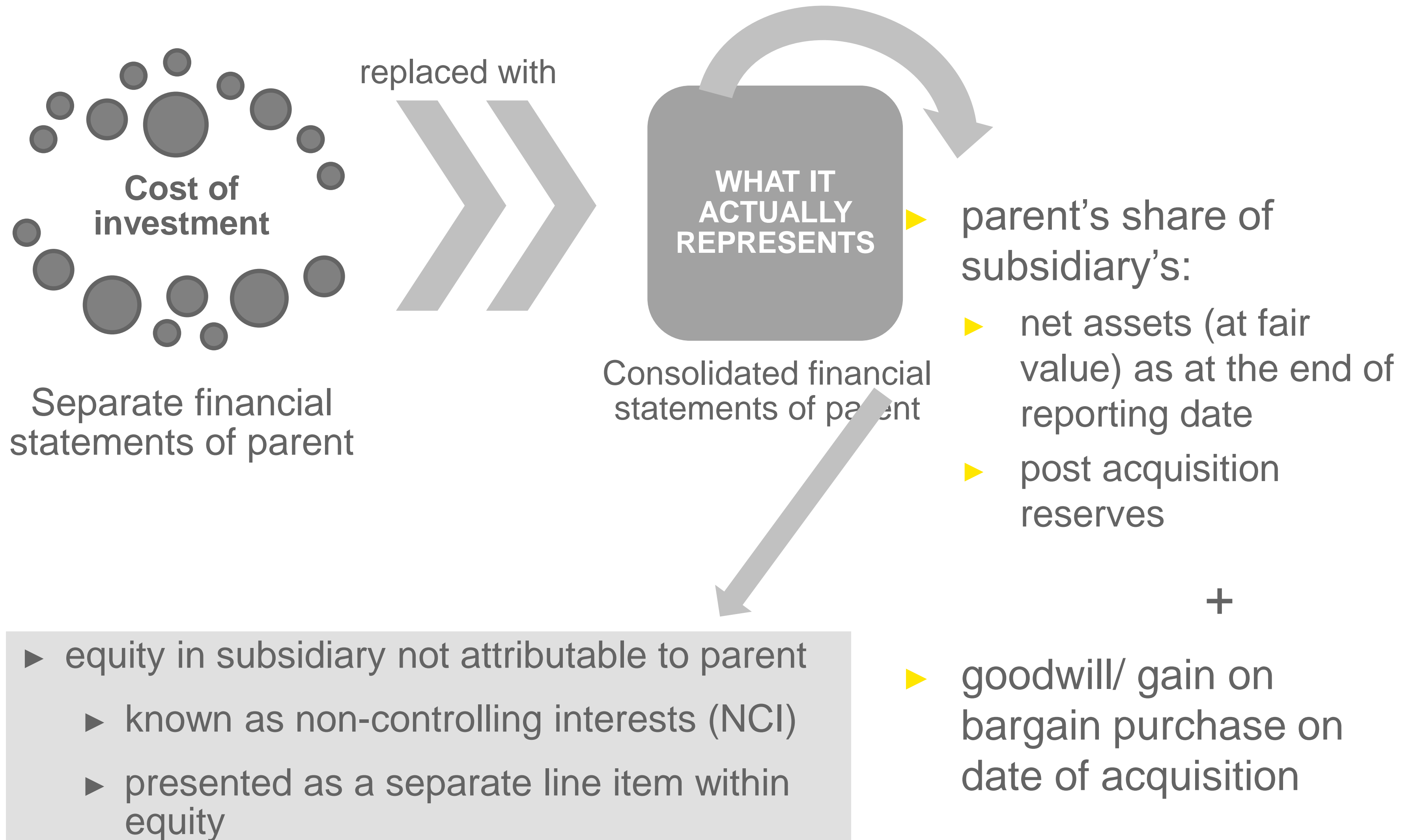
Substance of consolidation



Overview of the technique

	Separate statement of financial position				Consolidated statement of financial position
	Parent		Subsidiary		
Net assets	xxx	+	xxx	+ consolidation adjustments	xxx
Issued capital	xxx		xxx		parent's Issued Capital
Reserves	xxx		xxx		to be calculated

Overview of the technique

Consolidated statement of profit or loss

Revenue [Parent + Subsidiary (100%) – intra-group items]	xxx
↓	↓
Profit for the period (CONTROL)	xxx
OWNERSHIP	
Owners (equity holders) of the parent	xxx
NCI (….% of subsidiary's profit after tax)	
Profit for the period	xxx

Example

As at 31 December 2015

	Parent	**Subsidiary**
Non-current assets:		
Tangible assets	2,000	500
Investment in Subsidiary	1,000	
Net current assets	2,000	500
	5,000	1,000
Issued capital	500	1,000
Retained earnings	4,500	
	5,000	1,000

Further information:
Parent bought 100% of Subsidiary on 31 December 2015.

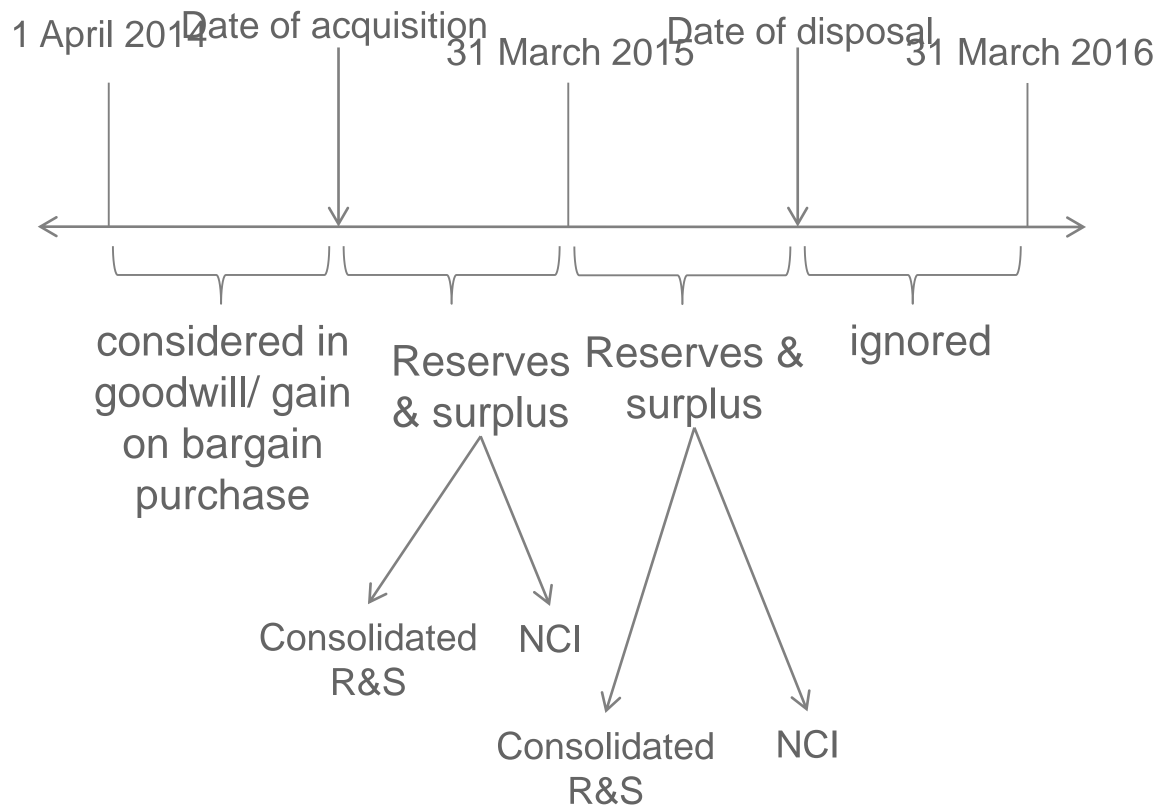
Solution

Consolidated statement of financial position

	$
Non-current assets:	
Tangible assets (2,000 + 500)	2,500
	←Cost of investment has disappeared
Net current assets (2,000 + 500)	2,500
	5,000
Issued capital	500
←*Issued capital of Parent*	
Retained earnings	4,500
	5,000

Period of consolidation

Results of operations of subsidiary



Goodwill/ gain on bargain purchase

In layman's term, goodwill is difference between:

a. value of business taken as a whole
b. fair value of separate net assets

Goodwill/ gain on bargain purchase is determined under Ind AS 103 as follows:

Particulars	Amount (INR)
Fair value of consideration	xxx
Amount of NCI	xxx
Less: Fair value of net assets at acquisition	xxx
Goodwill (if positive) Gain or bargain purchase (if negative)	xxx

Gain on bargain purchase arises in extremely rare circumstances

Example

	At 31 December 2015	
	Parent	**Subsidiary**
	$	**$**
Non-current assets		
Tangible assets	1000	800
Investment in Subsidiary	1200	
Net current assets	400	200
	--------	--------
	2600	1000
	--------	------
Issued capital	100	900
Retained earnings	2500	100
	---------	-------
	2600	1000
	-----------	-------

Example

Further information:

- Parent bought 100% of Subsidiary on the 31 December 2015.
- Subsidiary's reserves are $100 at the date of acquisition.

Solution

Consolidated balance sheet	$
Non-current assets:	
Goodwill (W2)	200
Tangible assets	1,800
Net current assets	600
	2,600
Issued capital	100
Retained earnings (W3)	2,500
	2,600

Solution

WORKINGS

(1) Subsidiary's net assets	*End of reporting period*	*Acquisition*
	$	$
Issued capital	900	900
Retained earnings	100	100
	1,000	1,000

(2) Goodwill	$
Cost	1,200
Non-controlling interest	–
Less: Net assets on acquisition (W1)	(1,000)
	200

(3) Retained earnings	$
Parent (as given)	2,500
Share of Subsidiary (W1)	–
100% × (100 – 100)	-----

Example

	At 31 December 2015	
	Parent	*Subsidiary*
	$	$
Non-current assets		
Tangible assets	1400	1000
Investment in Subsidiary	1200	
Net current assets	700	600
	--------	--------
	3300	1600
	--------	--------
Issued capital	100	900
Retained earnings	3200	700
	--------	--------
	3300	1600
	---------	--------

Example

Further information:

- Parent bought 100% of Subsidiary two years ago.
- Subsidiary’s reserves were $100 at the date of acquisition.
- Goodwill has been impaired by $80 since the date of acquisition.

Solution

Consolidated statement of financial position

	$
Non-current assets:	
Goodwill (W2)	120
Tangible assets	2,400
Net current assets	1,300
	3,820

Issued capital

Solution

WORKING

1. **Subsidiary's net assets**

	End of reporting period	*Acquisition*
	$	$
Issued capital	900	900
Retained earnings	700	100
	1,600	1,000

2. **Goodwill**

	$
Cost	1,200
Non-controlling interest	–
Less: Net assets on acquisition (100% × 1,000)	(1,000)

	200
Impaired	80

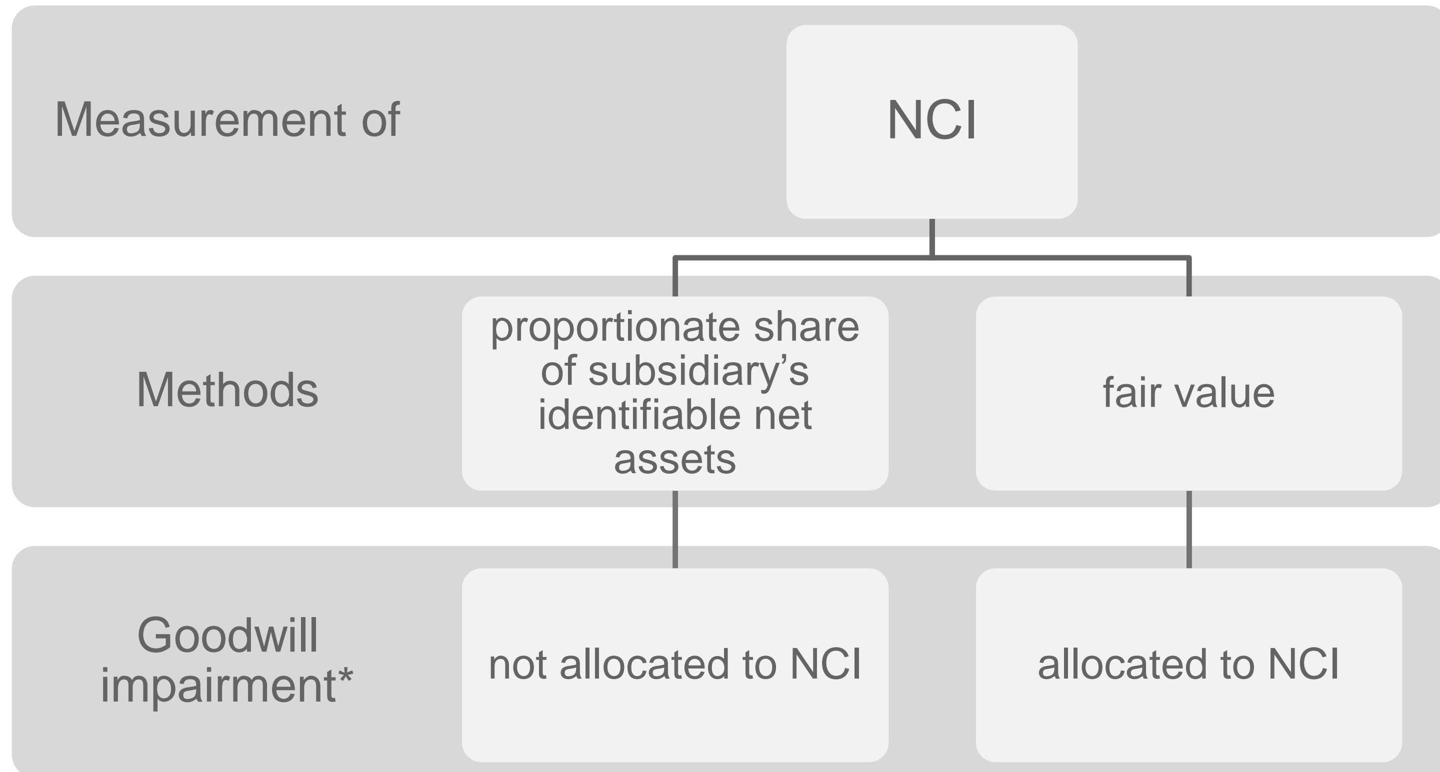
As an asset	120

Solution

3. Retained earnings

	$
Parent (as given)	3,200
Share of Subsidiary (W1) 100% (700 – 100)	600
Goodwill written off (W2)	(80)
	3,720

Non-controlling interest (NCI)



Election of method on transaction-by-transaction basis

** goodwill amortisation not allowed*

Example

- A Ltd. acquired 60% equity shares of B Ltd. for INR 60 lacs
- At the date of acquisition:
    - Fair value of net assets of B Ltd. is INR 80 lacs
    - Fair value of NCI is INR 45 lacs

Calculate goodwill if NCI measured using:

a. proportionate interest method
b. fair value method

Goodwill (when NCI measured at proportionate interest) = INR 12 lacs

Goodwill (when NCI measured at fair value) = INR 25 lacs

Example

	Parent	Subsidiary
	$	$
Non-current assets		
Tangible assets	1,000	600
Investment in Subsidiary	1,200	–
Net current assets	500	600
	2,700	1200
Issued capital	100	50
Retained earnings	2600	1150
	2,700	1,200

Example

Further information:

- Parent bought 80% of Subsidiary two years ago.
- Subsidiary’s reserves were $150 at the date of acquisition.
- Goodwill has been impaired by $200 since the date of acquisition.
- Non-controlling interest is valued at the proportionate share of the subsidiary’s identifiable net assets

Solution

Consolidated statement

of

financial position

$

Non-current assets:

Goodwill (W2)

840

Tangible assets

1,600

Net current assets

1,100

______

3,540

______

Equity attributable to owners of their parent

Solution

WORKINGS

1. Subsidiary's net assets

	End of reporting period	*Acquisition*
	$	$
Issued capital	50	50
Retained earnings	1,150	150
	1,200	200

2. Goodwill

	$
Cost	1,200
Non-controlling interest (200 × 20%)	40
Less: Net assets on acquisition (100%)	(200)
	1,040

Solution

To retained earnings

(via statement of profit or loss and other comprehensive income) 200

Asset in the statement of financial position

840

- **Non-controlling interest**

  $

Share of net assets (20% × 1,200 (W1))

240

———

- **Retained earnings**

  $

Parent (as given)

2,600

Share of subsidiary 80% × (1,150 – 150) (W1)

800

Goodwill impairment

(200)

Example

	Parent $	Subsidiary $
Non-current assets		
Tangible assets	1,000	600
Investment in Subsidiary	1,200	-
Net current assets	500	600
	2,700	1,200
Issued capital ($10 shares)	100	50
Retained earnings	2,600	1,150
	2,700	1,200

Further information:

1. Parent bought 80% of Subsidiary two years ago.
2. Subsidiary's reserves were $150 at the date of acquisition.
3. Goodwill has been impaired by $200 since date of acquisition.
4. Non-controlling interest is valued at fair value on acquisition. The market price of a share in the subsidiary at the date of acquisition was $29.60

Solution

	Consolidated statement of financial position
	$
Non-current assets:	
Goodwill (W2)	1,096
Tangible assets	1,600
Net current assets	1,100
	3,796
Issued capital	100
Retained earnings (W4)	3,240
Non-controlling interest (W3)	456
	3,796

Solution

WORKINGS

1. Subsidiary's net assets

	Reporting date	*Acquisition*
	$	$
Issued capital	50	50
Retained earnings	1,150	150
	1,200	200

2. Goodwill

	$
Cost	1,200
Add: Fair value of non-controlling interest (10 shares × $29.60)	296
Less: Net assets on acquisition (100%)	(200)
	1,296
Impaired	200
Goodwill recognized	1,096

Solution

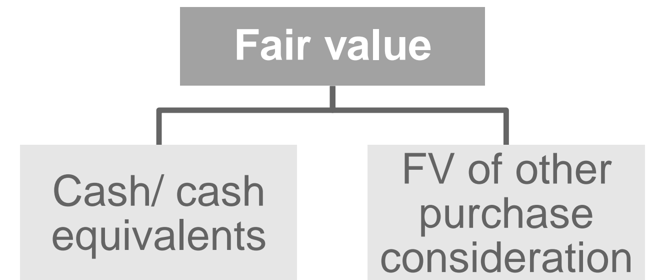
Of the goodwill impaired, 80% is debited to consolidated retained earnings and 20% is debited to non-controlling interest.

3. Non-controlling interest	$
Fair value on acquisition (W2)	296
Add: Share of post-acquisition profits (1,000 × 20%)	200
Less: Share of goodwill impaired (200 × 20%)	(40)
	456

4. Retained earnings	$
Parent (as given)	2,600
Share of Subsidiary (80% × (1,150 – 150) (W1))	800
Goodwill impairment (200 × 80%)	(160)
	3,240

Fair value of consideration - cost of acquisition

- Acquisition accounted at FV
- Acquisition costs - expensed



Deferred consideration

- Cost of acquisition is **present value** of consideration
- No impact of deferred consideration in goodwill computation
  - Finance costs (post-acquisition expense)

Contingent consideration

- Cost of acquisition includes FV of contingent consideration
  - If settlement in cash- recognise liability
  - If settlement in equity- recognise equity
- Contingent consideration recognised as liability measured at FV at each reporting date (changes recognised in P&L)

Example

Parent acquired 60% of Subsidiary on 1 January 2015 for $100,000 cash payable immediately and $121,000 after two years. The fair value of Subsidiary's net assets at acquisition amounted to $300,000. Parent's cost of capital is 10%. The deferred consideration was completely ignored when preparing group accounts as at 31 December 2015.

Non-controlling interest is measured at the proportionate share of identifiable net assets.

Required:
Calculate the goodwill arising on acquisition and show how the deferred consideration should be accounted for in Parent's consolidated financial statements.

Solution

Cost of investment in Subsidiary at acquisition: $100,000 + $121,000/1.21 = $200,000

Goodwill

	$000
Cost	200
Non-controlling interest (40% * 300,000)	120
Less: Net assets acquired	(300)
	20

Deferred consideration

Double entry at 1 January:

Dr Cost of Investment in Subsidiary	$100,000
Cr Deferred consideration	$100,000

On 31 December, due to unwinding of discount, the deferred consideration will equal $121,000/1.1 = 110,000

Dr Group retained earnings	$10,000
Cr Deferred consideration	$10,000

In the consolidated balance sheet, the cost of investment in Subsidiary will be replaced by the goodwill of $20,000. The deferred consideration will equal $110,000.

Net assets of subsidiary

- Identifiable assets and liabilities acquired are recognised separately
  - Recognise contingent liability of acquiree arisen due to present obligation
  - Future costs of restructuring subsidiary - post-acquisition costs
- Assets and liabilities of subsidiary measured at acquisition date FV

FV as per Ind AS 113 – 'market participants' approach

Exceptions

Exceptions to recognition and measurement principles	Contingent liabilities *(refer above)*
	Deferred taxes – Ind AS 12
	Employee benefits – Ind AS 19
	Indemnification assets - same basis as indemnified item
Exceptions to measurement principles	Share-based payments – Ind AS 102
	Non-current assets held for sale – Ind AS 105
	Reacquired rights

Provisional accounting

- If accurate amounts not available at date of acquisition
  - Account for using the provisional amounts
  - Adjust acquisition date assets and liabilities retrospectively when new information becomes available within the **‘measurement period’**

Measurement period cannot exceed one year

- Subsequent adjustments - as per Ind AS 108
  - Error - retrospectively
  - Change in estimate - prospectively

Intra-group balances

Eliminated on consolidation

Example

	Parent	Subsidiary	Adjustments on consolidation		Consolidated balance sheet
			Dr.	Cr.	
Receivables					
Amounts receivable from subsidiary	100			100	-
Payables					
Amounts payable to parent		100	100		-

For elimination, direction of transaction is irrelevant

Example

Parent acquired 75% of subsidiary on 1 April 2015. Extracts from the companies' statements of profit or loss for the year ended 31 December 2015 are:

	Parent	*Subsidiary*
	$	$
Revenue	100,000	75,000
Cost of sales	(70,000)	(60,000)
Gross profit	30,000	15,000

Since acquisition, parent has made sales to subsidiary of $15,000. None of these goods remain in inventory at the year end.

Required:

Calculate revenue, cost of sales and gross profit for the group for the year ended 31 December 2015.

Solution

Consolidated statement of profit or loss

	Parent	9/12 Subsidiary	Adjustment	Consolidated
	$	$	$	$
Revenue	100,000	56,250	(15,000)	141,250
Cost of sales	(70,000)	(45,000)	15,000	(100,000)
Gross profit	30,000	11,250	–	41,250

Unrealised profit

Eliminated on consolidation

- Sale of goods by parent to subsidiary
  - Reduce consolidated retained earnings
  - Reduce inventory
- Sale of goods by subsidiary to parent
  - Reduce net assets of subsidiary
  - Reduce inventory

Example

Parent owns 80% of Subsidiary. During the current accounting period, Parent transferred goods to Subsidiary for $4,000, which earned Parent a profit of $1,000. These goods were lying in Subsidiary's inventory at the end of the reporting period.

Required:

Show the adjustment in the consolidated balance sheet.

Solution

Dr	Retained earnings	$1,000	
Cr	Inventory		$1,000

Example

Parent owns 80% of Subsidiary. During the current accounting period, Subsidiary sold goods to Parent for $18,000 which earned Subsidiary a profit of $6,000. At the end of the reporting period, half of these goods are included in Parent's inventory.

At the end of the reporting period, Parent's accounts showed retained profits of $100,000 and Subsidiary's accounts showed net assets of $75,000, including retained profits of $65,000. Subsidiary had retained profits of $20,000 at acquisition.

Required:

Show the adjustment to eliminate unrealized profits in the consolidated financial statements.

Solution

Dr	Retained earnings (1/2 × 6,000)	$3,000
Cr	Inventory	$3,000

WORKING

1. **Subsidiary's net assets**		*Reporting date*	*Acquisition date*
		$	$
Issued capital		10,000	10,000
Retained earnings			
Per the question	65,000		20,000
Unrealized profit	(3,000)	62,000	
		72,000	30,000

Solution

2. Non-controlling interest

Share of net assets (including the unrealized profit)

3. Retained earnings

	$
Parent (as given)	100,000
Share of Subsidiary (including unrealized profit)	
80% × (62,000 – 20,000)	33,600
	133,600

Example

Whale owns 75% of Porpoise. The profit or loss for each company for the year ended 31 March 2016 is as follows:

Whale Porpoise

$

$

Revenue 120,000

70,000

Cost of sales (80,000)

(50,000)

Gross profit 40,000

20,000

During the year Porpoise made sales to Whale amounting to $30,000. $15,000 of these sales were in inventory at the year end. Profit made on the year-end inventory items amounted to $2,000.

Required:

Solution

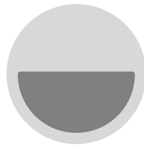
Seller adjustment

	Whale	Porpoise	Adjustment	Consolidated
	$	$	$	$
Revenue	120,000	70,000	(30,000)	160,000
Cost of sales – per question	(80,000)	(50,000)	30,000	
– unrealised profit		(2,000)		(102,000)
Gross profit	40,000	18,000		58,000

Non-current asset transfers

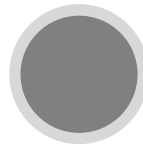
Eliminated on consolidation

Adjustments needed



Selling company

eliminate profit



Buying company

adjust depreciation

Example

Parent owns 80% of Subsidiary. Parent transferred an asset to Subsidiary at a value of $15,000 on 1 January 2015. The original cost to Parent was $20,000 and the accumulated depreciation at the date of transfer was $8,000. The asset had a useful life of 5 years when originally acquired, with a residual value of zero. The useful life at the date of transfer remains at 3 years. Full allowance is made for depreciation in the year of purchase and none in the year of sale.

Required:
Calculate the adjustment for the consolidated balance sheet at 31 December 2015.

Solution

With transfer | Without transfer | Adjustment

$ | $ | $

Cost | 20,000

15,000

Accumulated depreciation

(15,000/3 years) | *(12,000)

(5,000)

–

–

–

–

–

–

8,000 | 2,000

1

0

,

0

0

0

Solution

	Dr	Cr
Dr Parent profit or loss – profit on disposal	3,000	
Cr Non-current assets		3,000

and

	Dr	Cr
Dr Non-current assets	1,000	
Cr Subsidiary profit or loss – depreciation		1,000

* Accumulated depreciation of $12,000 is calculated as 3 years @ 20% per annum based on the original cost of $20,000.

Example

Parent owns 80% of subsidiary. Parent transferred a non-current asset to subsidiary on 1 January 2015 at a value of $15,000. The asset originally cost Parent $20,000 and depreciation to the date of transfer was $8,000. The asset had a useful life of 5 years when originally acquired, with a residual value of zero. The useful life at the date of transfer remains at 3 years. A full year's depreciation charge is made in the year of acquisition and none in the year of disposal. Total depreciation for 2014 was $700,000 for parent and $500,000 for subsidiary.

Required:

Show the adjustments required for the above transaction in the consolidated statement of profit or loss for the year ended 31 December 2015.

Solution

	Parent	Subsidiary	Adjustment	Consolidated
	$	$	$	
Per question	700,000	500,000		1,200,000
Asset unrealized profit				
[15,000 – (20,000 – 8,000)]	3,000			3,000
Depreciation adjustment				
(15,000/3 years) – 4,000		(1,000)		(1,000)

.