

CHAPTER 8 CONSOLIDATED STATEMENT OF FINANCIAL POSITION

PART 1

LEARNING OBJECTIVE

1. What is group?
 2. Requirement to prepare consolidated financial statement
 3. The basic method of preparing a consolidated statement of financial position
 4. The mechanics of consolidation
 5. Goodwill
 6. How to include fair value in consolidation workings
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1. What is a group?

A group exists where one entity, the **parent**, has **control** over another entity, the **subsidiary**.

In accordance with IFRS 10 consolidated Financial Statements control consists of three components:

- (1) Power over the investee, which is normally exercised through the majority of voting rights (i.e. owning more than 50% of the equity shares).
- (2) Exposure or rights to variable returns from involvement (e.g. a dividend).
- (3) The ability to use power over the investee to affect the amount of investor returns. This is regarded as a crucial determinant in deciding whether or not control is exercised.

An **investor** is an entity which owns a shareholding in another entity.

An **investee** is an entity in which another entity has a shareholding.

2. Requirement to prepare consolidated financial statements

If one company controls another then IFRS 10 requires that a single set of consolidated financial statements be prepared to reflect the financial performance and position of the group as one combined entity. This reflects the fact that the investment of the parents' shareholders is now tied up in more than one entity. Their returns and the stability of their investment now reflect the performance and position of both entities.

In order to make informed decisions about their investment, shareholders would need to read and interpret the financial statements of both companies. If there were more than one subsidiary company this could become quite complex for shareholders. To this end one set of financial statements is prepared where the revenues, expenses, assets and liabilities of the parent and subsidiary are combined for ease of understanding and analysis.

3. The basic method of preparing a consolidated statement of financial position

- (1) The assets and liabilities of the parent and the subsidiary are added together on a line-by-line basis.
- (2) The investment in the subsidiary included in the parent's SoFP is replaced by a goodwill asset in the consolidated SoFP.
- (3) The share capital and share premium balances of the parent and subsidiary are not added together, only the parent entity balances for share capital and share premium are included in the consolidated SoFP. This reflects the fact that the consolidated SoFP includes all of the assets and liabilities under the control of the parent entity.
- (4) The amount attributable to non-controlling interests is calculated and shown separately on the face of the consolidated SoFP.
- (5) The group share of the subsidiary's post-acquisition retained earnings is calculated and included as part of group retained earnings.

Non-controlling interests

Often when a parent entity controls a subsidiary it is due to the fact that it control voting rights (i.e. it owns more than 50% of the voting share capital). It is possible that it does not own all the shares, which means there are other, minority, shareholders. These are known as non-controlling interests.

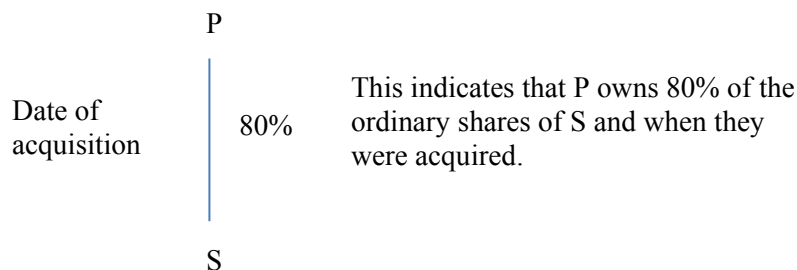
For Example: if the parent owns 80% of the ordinary share capital it is likely to have control due to the majority of voting rights they control (unless proven otherwise). The other 20% of shareholders are the non-controlling interests.

4. The mechanics of consolidation

You must be familiar with the following standard working

(W1) Establish the group structure

This is where you establish whether there is a parent-subsidiary relationship (i.e. does the parent have control?). You will need to identify the percentage shareholding of the parent and the non-controlling interest and the date the shares were acquired.



(W2) Net assets of subsidiary

	At date of acquisition	At the reporting date
	\$	\$
Share capital	x	x
Share premium	x	x
Revaluation surplus	x	x
Retained earnings	x	x
	<u>x</u>	<u>x</u>

The total of share capital and share premium from the subsidiary SoFP should be unchanged at both the date of acquisition and the reporting date.

(W3) Goodwill

	\$
Fair value (FV) of consideration paid	x
FV of non-controlling interest (NC) at acquisition	<u>x</u>
	x
Less:	
(FV) of net assets at acquisition (W2)	<u>(x)</u>
Goodwill on acquisition	x

(W4) Non-controlling interest

FV of NCI at acquisition (as in W3)	x
NCI share of post-acquisition reserves (W2)	<u>x</u>
	<u>x</u>

(W5) Group retained earnings

P's retained earnings (100%)	x
P's % of sub's post-acquisition retained earning	<u>x</u>
	<u>x</u>

5. Goodwill

The value of an entity will normally exceed the value of its net assets. The difference is goodwill. This represents assets not included in the statement of financial position of the acquired entity such as the reputation of the business, brand and the experience of employees.

Goodwill arises because the investor would rather buy a ready-made and established business than buy the individual components and set up the business themselves from nothing.

Example:

In order to illustrate the various workings involved in a consolidated statement of financial position we will use the example of D group, performing each calculation in turn and finally compiling the consolidated statement of financial position.

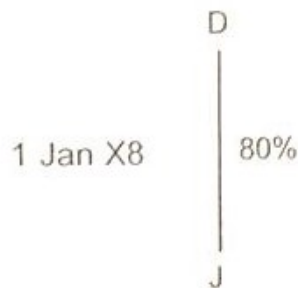
The statements of financial position of D and J as at 31 December 20X8.

	D \$	J \$
Non-Current assets:		
Property, plant & equipment	85,000	18,000
Investments:		
Shares in J	<u>60,000</u>	
	145,000	
Current assets	<u>160,000</u>	<u>84,000</u>
	<u>305,000</u>	<u>102,000</u>
Equity:		
Ordinary \$1 shares	65,000	20,000
Share premium	35,000	10,000
Retained earnings	<u>70,000</u>	<u>25,000</u>
	170,000	55,000
Current liabilities	<u>135,000</u>	<u>47,000</u>
	<u>305,000</u>	<u>102,000</u>

D acquired an 80% holding in J on 1 January 20X8. At this date J's retained earnings stood at \$200,000. On this date, the fair value of the 20% non-controlling shareholding in J was \$12,500.

Prepare consolidated statement of financial position

(W1) **Group structure**



(W2) **Net assets of J**

	At date of acquisition	At reporting date
	\$	\$
Share capital	20,000	20,000
Share premium	10,000	10,000
Retained earnings	20,000	25,000
	<hr/>	<hr/>
Net assets	50,000	55,000
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(W3) **Goodwill**

	\$
FV of consideration paid	60,000
FV of NCI at acquisition	12,500
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	72,500
Less:	
FV of net assets at acquisition (W2)	(50,000)
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Goodwill on acquisition (to SoFP)	22,500
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(W4) **Non-controlling interests**

FV of NCI at acquisition (as in W3)	12,500
NCI share of post-acquisition reserves (W2)	1,000
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(20% × (55,000 – 50,000))	13,500
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(W5) **Group retained earnings**

100% D's retained earnings	70,000
80% J post-acquisition retained earnings (80% × \$(55,000 – 50,000 (W2)))	4,000
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	74,000
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D consolidated statement of financial position as at 31 December 20X8

Non-current assets	\$
Goodwill (W3)	22,500
PPE	
(85,000 + 18,000)	103,000
Current assets	
(160,000 + 84,000)	244,000
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	369,500
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Equity	
Share capital	65,000
Share premium	35,000
Group retained earnings (W5)	74,000
Non-controlling interest (W4)	13,500
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	187,500
Current liabilities	
(135,000 + 47,000)	182,000
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	369,500
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