

Only study guide for

**2011**

# FAC3704

## Group financial reporting

Department Financial Accounting

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# INTRODUCTION AND OVERVIEW OF MODULE

## A. PURPOSE OF YOUR STUDY

Welcome to the FAC3704 module — Group Financial Reporting. The purpose of this module is to provide you with knowledge and skills to enable you to prepare a set of financial statements for an entity or group of entities with specific reference to the requirements of the Companies Act (as relates to widely held companies) and Standards of Generally Accepted Accounting Practice (GAAP) as contained in the statements set out by the South African Institute of Chartered Accountants.

## B. MEANING OF WORDS

In this module we require you to understand the meaning of certain words to enable you to interpret assessment criteria, to understand what various questions in the textbooks require you to do, and to interpret assignment and examination questions.

To indicate the length, scope and format of answers to study activities and questions, we have deliberately built limits or restrictions into the questions by using action verbs. These action verbs give you an indication of how to tackle the given problem and what style of writing is called for.

An analysis of the action verbs contained in a question will enable you to:

- Plan the answer systematically and organise your thoughts systematically, and
- Ensure that you comply with the lecturer's requirements.

You will also save yourself time and trouble by eliminating irrelevant material that falls outside the scope of the answer.

For the purpose of this module the following meanings will be attached to the following action words:

Account for	Record
Advice	Give advice to, express an expert opinion
Allocate	Assign, apportion
Apply	Use in a practical manner; use as relevant or suitable
Calculate	Figure out; determine by a mathematical procedure
Compare	Place side by side in order to observe similarities, relationships and differences
Complete	Finish; supply whatever is missing
Criticise	Evaluate
Define	Describe accurately; establish the exact meaning; explain the inherent meaning; make clear

Describe	Give an account of the respective particulars or essential characteristics; give an accurate account
Determine	Establish, reach a conclusion or decision
Disclose	Reveal; show
Discuss	Examine; explain, examine by means of argument
Distinguish	Determine; differentiate; tell the difference
Draft	Prepare a provisional outline
Examine	Inspect; investigate
Explain	Make clear or comprehensible; explain the meaning in detail
Identify/recognise	Establish through consideration; recognise; pick out
Illustrate	Use an example to explain something
List	Note/specify matters or objects that are related to one another
Motivate	Supply a reason or facts for substantiation of a point
Name/mention/state	Specify by name; give names, characteristics, items, elements or facts
Prepare	Make ready; finish, get something ready on the basis of previous study
Present	Make known; demonstrate (in writing)
Produce	Construct
Record	To put into writing; set down for reference and preservation
Summarise	Condense; state the crux of the matter

### C. MASTERY OF THE STUDY MATERIAL

This is a comprehensive module which requires careful and dedicated study. The student must become totally proficient in the field of accounting which cannot be achieved in a short period of time. A student must be diligent and thorough to be able to master this module.

This study guide has been devised to guide you through your studies for this module. You should bear in mind that you prescribed textbooks are the primary sources of information that you must study. These are supplemented in the study guide where necessary with further information, explanations, examples and questions, which are aimed at making the study content of the module more easily understandable. The study guide also indicates the level of mastery at which you are required to master the various study units included in the study content. Utilise the study guide to work through the prescribed textbooks for a maximum advantage in your study approach.

You will be required to complete a series of assignments for this module. Details pertaining to the completion and submission of assignments are contained in *Tutorial letter 101*.

### D. PRESCRIBED BOOKS AND CALCULATORS

The study guide is based on the following prescribed book:

1. **Group Statements** (Volumes 1 and 2) (Latest edition) by Binnekade, C.S., and Koppeschaar, Z.R. Lexisnexis, Durban. This work is referred to in this study guide as **Group Statements**.

**Students are required to use a non-programmable financial calculator for this module.**

### E. REVISION OF STUDY MATERIAL OF THE PREVIOUS YEAR

The following topics which have been fully dealt with in Accounting II, (FAC2602) must be revised. We may examine you on these topics without specifically dealing with them again:

- Those sections of the Companies Act (as relates to widely held companies) which refer to consolidated financial statements.
- Those sections of the Accounting II (FAC2602) study material which dealt with consolidated financial statements

## **F. ABBREVIATIONS USED IN THE STUDY MATERIAL**

Students are allowed to use these abbreviations for examination purposes.

<b>SCI</b>	Statement of comprehensive income
<b>SFP</b>	Statement of financial position
<b>SOCIE</b>	Statement of changes in equity
<b>SCF</b>	Statement of cash flows
<b>NCI</b>	Non-controlling interest
<b>SC</b>	Share capital
<b>RE</b>	Retained earnings
<b>FV</b>	Fair value
<b>CA</b>	Carrying amount
<b>CGT</b>	Capital Gains Tax
<b>PREFS</b>	Preference shares
<b>DEP</b>	Depreciation
<b>REV</b>	Revaluation
<b>P/L</b>	Profit or loss section of the statement of comprehensive income
<b>OCI</b>	Other comprehensive income section of the statement of comprehensive income

## **G. TAXATION**

Since 1 March 2008 the SA Normal tax rate for companies is 28%. However, for practical reasons a tax rate of 30% is regularly used in the study material for FAC3704.

**Please note:** The questions will state the tax rate in the additional information thus the student must use the tax rate given in the question to prepare their solutions.

## **H. NON-CONTROLLING INTEREST**

- Non-controlling interest in an acquiree can be measured at its proportionate share of the acquiree's identifiable net assets at acquisition date (also known as the partial goodwill method);
- or
- Non-controlling interest in an acquiree can be measured at its fair value as at date of acquisition (also known as the full goodwill method).

## STUDY UNIT

# 1

## Business combinations

### Learning outcome 1

After studying this study unit, you should be able to:

Prepare group financial statements as at the date of acquisition according to the requirements of Generally Accepted Accounting Practice.

### OVERVIEW OF THE STUDY UNIT

The study unit consists of the following sections:		Page
1.1	Introduction	1
1.2	At acquisition — IFRS 3 (AC 140) <i>Business Combinations</i>	5
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1.4	Assessment criteria	29

#### Study

**STUDY:** *Group Statements (Volume 1): Chapter 1, 2 and 3*

### 1.1 Introduction

#### Study

*Group Statements (Volume 1): Chapter 2 — section 2.15*

#### 1.1.1 Standards covered in this module

Three of the standards that specifically apply to this module are **IAS 1 (AC 101) *Presentation of Financial Statements***, **IFRS 3 (AC 140) — *Business Combinations*** and **IAS 27 (AC 132) *Consolidated and Separate Financial Statements***. It is important to understand the difference between the last two standards as well as the objective of each standard which will in turn assist you in the preparation of consolidated financial statements.

**IFRS 3 (AC 140) — *Business Combinations*** was issued on 10 January 2008 by the International Accounting Standards Board (IASB), which replaces IFRS 3 (AC 140) as issued in 2004. **IAS 27 (AC 132) — *Consolidated and Separate Financial Statements*** was also revised to bring into account all the relevant changes. The amendments are applicable to annual reporting periods beginning on or after 1 July 2009. Earlier application will be permitted

but only as far back as an annual reporting period that begins on or after 30 June 2007. IFRS 3 (AC 140) is to be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the annual period in which the standard is adopted.

## Comments

*IFRS 3 (AC 140) deals with the accounting treatment and initial determination of the value attached to the subsidiary being acquired **on the date of acquisition**. This standard deals with the methods of accounting for business combinations and their effects on consolidation, including goodwill (or gain on bargain purchase) arising on a business combination.*

*IAS 27 (AC 132) deals with the consolidation procedures and accounting treatment **after the date of acquisition**. This standard deals with the preparation and presentation of consolidated financial statements for a group of entities under the control of a parent. This statement also deals with the accounting for investments in subsidiaries, jointly controlled entities and associates in the separate financial statements of the parent, venturer or investor.*

In addition a further three standards are applicable to this module and they are:

- IAS 28 (AC 110) — *Investments in Associates* (Please refer study unit 4);
- IAS 31 (AC 119) — *Interests in Joint Ventures* (Please refer study unit 5); and
- IAS 7 (AC 118) — *Statement of Cash Flows* (Please refer study unit 7).

### 1.1.2 Topics covered in 2nd year accounting (FAC2602)

In FAC3704 we will build on certain topics that were covered in FAC2602. The following topics have been covered and should be revised:

Chapter	Group Statements — Volume 1 Topic
1	A group of entities and its financial statements — theory and background
3	Consolidation at acquisition date
4	Consolidation after acquisition date
5	Intragroup transactions (Excluding effect of tax — The tax effect on intragroup transactions will be dealt with in this module)
8	Interim acquisition of an interest in a subsidiary

**THE CONTENT OF THE AFOREMENTIONED CHAPTERS IS “ASSUMED KNOWLEDGE” AND EVEN THOUGH THEY MAY NOT BE DEALT SPECIFICALLY WITH IN THIS MODULE THE TOPICS ARE STILL EXAMINABLE.**



### 1.1.3 Theory

#### Study

#### *Group Statements (Volume 1): Chapter 1*

The acquisition of a shareholding in another entity can result in one of the following:

- Where the investor (the entity which acquired the shareholding in another entity) exercises some form of **control** over the investee, the investor is the parent of the investee, which is called its **subsidiary**.
- The investee is an **associate** of the investor if the investor exercises **significant influence** over the investee.
- If two or more entities hold shares in an investee and have **joint control** of the investee in terms of a contractual arrangement, the investor is in a **joint venture** with the other investor.

The objective of consolidated financial statements or group statements is to provide information regarding the financial position, the performance and the changes in the financial position of a group of entities to the users of the financial statements of those entities.

#### 1.1.3.1 Definitions

*Consolidated financial statements* are the financial statements of a group presented as those of a single economic entity.

A *parent* is an entity that has one or more subsidiaries.

A *subsidiary* is an entity, including an unincorporated entity such as partnership, that is controlled by another entity (known as parent).

A *group of companies* comprises a parent and all of its subsidiaries.

*Control* is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

Control is presumed to exist when the parent acquires more than half of the voting rights of the enterprise. Even when more than one half of the voting rights is not acquired, control may be evidenced by (IAS 27 (AC 132).13):

- power over more than one half of the voting rights by virtue of an agreement with other investors; or
- the power to govern the financial and operating policies of the other enterprise under a statute or an agreement; or
- the power to appoint or remove the majority of the members of the board of directors and control of the entity is by the board of directors; or
- the power to cast the majority of votes at a meeting of the board of directors and control of the entity is by the board of directors.

#### 1.1.3.2 Presentation of consolidated financial statements as required in terms of Generally Accepted Accounting Practice

##### Consolidation of subsidiaries

A parent is required to present consolidated financial statements in which it consolidates its

investments in subsidiaries (IAS 27 (AC 132).9), except in the following situations listed below. A parent need not present consolidated financial statements only if all of the following four conditions are met (IAS 27 (AC 132).10):

- the parent is itself a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;
- the parent's debt or equity instruments are not traded in a public market;
- the parent did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and
- the ultimate or any intermediate parent of the parent produces consolidated financial statements available for public use that comply with IFRS.

The consolidated financial statements are the financial statements of a group and include all of the parent's subsidiaries (IAS 27 (AC 132).12), both domestic and foreign, presented as those of a single economic entity. There is no exception for a subsidiary whose business is of a different nature from the parents nor is there an exception for a subsidiary for which control is intended to be temporary.

Once an investment ceases to fall within the definition of a subsidiary, it should be accounted for as an associate under IAS 28 (AC 110), or as a joint venture under IAS 31 (AC 119), or as an investment under IAS 39 (AC 133), as appropriate (IAS 27 (AC 132).31).

### 1.1.3.3 Accounting for investments

Two main kinds of investments in the shares of another entity are distinguished namely:

- simple share investments
- significant share investments, which give the investor entity an influence over or control of the affairs of the investee entity.

When accounting for *significant share investments*, it is necessary to determine the degree of influence exercised by the investor over the investee's financial and operating policies, as this determines the appropriate accounting method. It is also essential to determine the ownership interest, as this determines the degree to which the investor shares in the equity of the investee.

The different bases of accounting for investments can be set out as follows:

Degree of influence:	Applicable to:	Accounting method:
Control	Subsidiary	Consolidation (IAS 27 (AC 132))
Joint control	Joint venture	Proportionate consolidations or equity method (IAS 31 (AC 119)) (under revision)
Significant influence	Associate	Equity method or cost method (IAS 28 (AC 110))
No influence	Investments	Cost or fair value (IAS 39 (AC 133))

In order to determine the degree of influence, it is necessary to understand the definitions of control, joint control and significant influence as contained in section 1.1.3.1.

Once you have determined the degree of influence you must ensure that you are familiar with the specific accounting method that must be used to account for the group structure. The following is a synopsis of the accounting methods available:

## Subsidiaries

Subsidiaries are accounted for by means of *consolidation*. The consolidation of subsidiaries and consolidated financial statements will be discussed later in this chapter.

## Associates

An investment in an associate should be accounted for as an investment in consolidated financial statements under the *equity method*, except when the investment is acquired and held with a view to its disposal in the near future, in which case it should be accounted for under the *cost method*. The accounting treatment of investments in associates is set out in IAS 28 (AC 110) and will be discussed in Study unit 3.

## Joint ventures

The benchmark accounting treatment that should be used to account for joint ventures in the consolidated financial statements is *proportionate consolidation (IAS 31 (AC 119))*. In terms of exposure draft ED 229 joint arrangements the accounting for joint ventures may in the future change from proportionate consolidation to the equity method. Joint ventures is discussed in Study unit 4.

## Simple share investments

*Simple (or portfolio) share investments* are accounted for by using the cost price or fair value method (IAS 39 (AC 133)). The cost price or fair value of the investment is accounted for and disclosed in the consolidated statement of financial position and the dividend received by the investor is accounted for and disclosed in the statement of comprehensive income.

### 1.1.3.4 Separate financial statements

Separate financial statements are those presented by a parent, an investor in an associate or a venturer in a jointly controlled entity, in which the investments are accounted for on the basis of the direct equity interest rather than on the basis of the reported results and net assets of the investees (IAS 27 (AC 132).4).

## 1.2 At acquisition

### IFRS 3 (AC 140) — *Business Combinations*

## Study

*Group Statements (volume 1): Chapter 2 (excluding sections 2.11–2.14)*

### 1.2.1 Definitions (IFRS 3 (AC 140) — Appendix A)

<b>Acquiree</b>	The business or businesses that the acquirer obtains control of in a business combination.
<b>Acquirer</b>	The entity that obtains control of the acquiree.
<b>Acquisition date</b>	The date on which the acquirer obtains control of the acquiree.
<b>Business</b>	An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.

<b>Business combination</b>	A transaction or other event in which an acquirer obtains control of one or more businesses.
<b>Control</b>	The power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.
<b>Fair value</b>	The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction
<b>Goodwill</b>	An asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised.
<b>Identifiable</b>	An asset is identifiable if it either: is separable, i.e. capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.
<b>Non-controlling interest</b>	The equity in a subsidiary not attributable, directly or indirectly, to a parent.
<b>Owners</b>	For the purpose of IFRS 3 (AC 140), "owners" is used broadly to include holders of equity interests of investor-owned entities and owners or members of, or participants in, mutual entities.

### 1.2.2 Objective (IFRS 3 (AC 140).1)

This standard deals with the principles and requirements on how the acquirer should:

- recognise and measure the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree;
- recognise and measure the goodwill acquired in the business combination or gain from a bargain purchase; and
- determine what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.

### 1.2.3 Scope (IFRS 3 (AC 140).2)

## Study

*Group Statements (Volume 1): Chapter 2 — sections 2.01–2.02*

IFRS 3 (AC 140) applies to transactions or events that meet the definition of a business combination. IFRS 3 (AC 140) does not apply to the following:

- formation of a joint venture,
- the acquisition of an asset (or a group of assets) that does not constitute a business,
- a combination of entities or businesses under common control.

## 1.2.4 Identifying a business combination

### Study

*Group Statements (Volume 1): Chapter 2 — section 2.03*

Take note of the process to be followed on acquiring a business combination. Refer to the schematic summary on p. 34 of *Group Statements (Volume 1)* for this process.

Apply the definition of a business combination to identify whether a transaction or other events result in a business combination. If the assets acquired are not a business, then the entity shall account for the transaction or other event as an asset acquisition (IFRS 3 (AC 140).3).

### Comments

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*A business is an integrated set of activities and assets capable of being conducted and managed for the purpose of providing a return.*

*A business combination is a transaction or other event in which the acquirer obtains **control** of one or more businesses*

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## 1.2.5 The acquisition method (IFRS 3(AC140).4)

### Study

*Group Statements (Volume 1): Chapter 2 — sections 2.04–2.10*

The following table summarises the steps that are taken in applying the acquisition method to the accounting for business combinations:

#### Step

- 1 Identify the acquirer
- 2 Determine the acquisition date
- 3 Identify the consideration transferred
- 4 Measure the consideration transferred
- 5 Identify and measure the identifiable assets acquired and liabilities assumed
- 6 Measure the non-controlling interest
- 7 Determine the amount of goodwill or the gain on a bargain purchase
- 8 Account for any measurement period adjustments

## Comments

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*It is important that you realise that the abovementioned process **only** happens **once**, i.e. on the date that control is acquired. This process is in terms of IFRS 3 (AC 140). The subsequent consolidation of subsidiaries after the acquisition date is prescribed by IAS 27 (AC 132).*

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### Step 1 Identifying the acquirer

#### Study

*Group Statements (Volume 1): Chapter 2 — section 2.04*

For each business combination, one of the combining entities shall be identified as the **acquirer**. The entity that obtains **control** of the acquiree is thus the acquirer.

## Comments

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*The relationship between the combining entities determines which entity obtains control. IAS 27 (AC 132).4 defines control as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.*

*If the acquirer cannot be clearly identified additional factors should be considered, such as:*

- examining the form of consideration transferred,*
  - the relative size of the combining entities,*
  - relative voting rights,*
  - composition of the board of directors or senior management.*
- 

### Step 2 Determining the acquisition date

#### Study

*Group Statements (Volume 1): Chapter 2 — section 2.05*

The acquisition date is the date on which the acquirer obtains control of the acquiree.

In general terms the acquisition date is the date on which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree (the “closing date” of the transaction).

Control can be obtained on a date that is earlier or later than the “closing date”. Examples of such situations are:

- A written agreement provides that the acquirer obtains control of the acquiree on a date before the closing date.
- Certain suspensive legal conditions must be met (e.g.: completion of a due diligence review).

## Comments

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*It is only from the acquisition date that the results of the subsidiary are included in the consolidated financial statements of the group (IAS 27 (AC 132).26).*

*The acquisition date is also the date **on which** the fair values of the assets acquired and liabilities assumed, non-controlling interest and goodwill are measured.*

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### Step 3 Identify the consideration transferred

If a parent obtains an equity interest in a subsidiary the parent can settle the purchase price in different ways. The most common way is to settle it by means of cash only. Even though this is the most common way, we must remember that it is definitely not the only way to settle the purchase price.

The agreement can state that the purchase price may be settled either by a transfer of cash, transfer of assets, taking over of liabilities, shares issued by the acquirer (this would result in a crossholding and crossholdings are not examinable in FAC3704) or already issued shares of the parent, obtained from the parent's non-controlling interest. Furthermore it is important to note that the purchase price can be settled in a combination of the aforementioned options.

### Step 4 Measure the consideration transferred

The consideration transferred is measured at fair value at the acquisition date. Cash payments do not present measurement difficulties however the measurement of other forms of consideration may require judgment and it may be necessary to obtain independent valuations.

For illustrative purposes the examples explaining this concept have been compiled to settle the purchase price with a combination of options.

Let's look at a few different scenarios on this concept:

#### (a) Considerations only consist of cash:

<b>Example</b>	<b>1.1</b>
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#### Information provided:

Assume the H Limited group uses the partial goodwill method to account for goodwill and non-controlling interest.

H Limited obtained an 80% equity interest in the share capital of S Limited on 1 January 20.9 and paid R140 000 cash to settle the purchase price.

At acquisition date the equity of S Limited consisted of the following:

	<b>R</b>
Share capital (100 000 shares)	100 000
Retained earnings	50 000

If the purchase price of the interest in a subsidiary is settled by only transferring cash from the parent to the subsidiary, the following journals are recorded:

Journals in the **separate accounting records** of H Limited:

	<b>Dr R</b>	<b>Cr R</b>
Investment in S Limited	140 000	
Bank (cash)		140 000

**Pro forma consolidation journals** for the H Limited group:

	<b>Dr R</b>	<b>Cr R</b>
Share capital	100 000	
Retained earnings	50 000	
Goodwill ((140 000 + 30 000) (100 000 + 50 000))	20 000	
Investment in S Limited		140 000
Non-controlling interest ((100 000 + 50 000) x 20%)		30 000

**(b) Consideration consists of a combination of cash and non-current assets:**

### Example 1.2

Assume the same information as provided in example 1.1, except that H Limited paid R100 000 in cash and transferred a vehicle with a carrying amount of R40 000 (equal to market value), and an original cost of R60 000, to S Limited to settle the payment for the purchase price of R140 000.

If the purchase price of the interest in a subsidiary is settled with both cash being transferred from the parent to the subsidiary as well as a vehicle, the following journals are recorded:

Journals in the **separate accounting records** of H Limited:

	<b>Dr R</b>	<b>Cr R</b>
Investment in S Limited	140 000	
Bank (cash)		100 000
Vehicle (at cost)*		60 000
Accumulated depreciation – vehicles (60 000 – 40 000)*	20 000	

*\*The carrying amount of the vehicle needs to be derecognised from H Limited's records.*

**Pro forma consolidation journals** for the H Limited group:

	<b>Dr R</b>	<b>Cr R</b>
Share capital	100 000	
Retained earnings	50 000	
Goodwill ((140 000 + 30 000) – (100 000 + 50 000))	20 000	
Investment in S Limited		140 000
Non-controlling interest ((100 000 + 50 000) x 20%)		30 000



## Comments

1. Remember that the asset is transferred to the subsidiary at the market value thereof.
2. Note that there is no difference between the at acquisition date pro-forma consolidation journals between examples 1.1 and 1.2. The only difference is in the separate records of H Limited and S Limited. H Limited has to derecognise the vehicle transferred to S Limited, since H Limited no longer owns the vehicle. S Limited will recognise (market value) and depreciate it over its remaining economic useful life.

(c) Consideration consists out of a combination between cash and an investment in equity shares:

### Example 1.3

Assume the same information provided as in example 1.1, except that H Limited paid R100 000 cash and transferred 10 000 ordinary equity shares in S Limited, with a market value of R4 per share, to S Limited to settle the purchase price of R140 000 for the acquisition of 20 000 newly issued ordinary shares of S Limited. The non-controlling interest took up 5 000 shares of the new issue.

The payment of the cash and the transfer of the shares (transfer of asset) in S Limited will be recorded as follows:

Journals in the **separate accounting records** of H Limited.

	Dr R	Cr R
Investment in S Limited	140 000	
Bank (cash)		100 000
Investment in S Limited (10 000 shares)		40 000

Journals in the **separate accounting records** of S Limited.

	Dr R	Cr R
Bank (100 000 + 35 000(5 000 x (140 000/20 000)))	135 000	
Investment in S Limited (10 000 x 4,00)	40 000	
Share capital (100 000 + 40 000) + (5 000 x (140 000/20 000))		175 000

**Pro forma consolidation journals** for the H Limited group.

	Dr R	Cr R
Share capital		100 000
Retained earnings		50 000
Goodwill ((140 000 + 30 000) (100 000 + 50 000))	20 000	
Investment in S Limited		140 000
Non-controlling interest ((100 000 + 50 000) x 20%)		30 000

**Example 1.4**

Assume the same information provided as in example 1.1, except that H Limited paid R100 000 cash and issued 10 000 of its own ordinary equity shares, with a market value of R4 per share, to the non-controlling shareholders of S Limited to settle the purchase price of R140 000.

The payment of the cash and the transfer of the shares (transfer of asset) in H Limited will be recorded as follows:

Journals in the **separate accounting records** of H Limited:

	Dr R	Cr R
Investment in S Limited	140 000	
Bank (cash)		100 000
Share capital (10 000 shares)		40 000

Journals in the **separate accounting records** of S Limited:

There is no separate journal entry in S Limited's own records, since H Limited acquired its interest directly from the non-controlling interest. Thus, the shares in H Limited are the investment of the different parties making up the non-controlling interest of S Limited and not S Limited itself.

**Pro forma consolidation journals** for the H Limited group:

	Dr R	Cr R
Share capital	100 000	
Retained earnings	50 000	
Goodwill ((140 000 + 30 000) – (100 000 + 50 000))	20 000	
Investment in S Limited		140 000
Non-controlling interest ((100 000 + 50 000) x 20%)		30 000

**Comments**


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*If H Limited had issued its own shares to S Limited as settlement of the purchase price of its investment in S Limited, S Limited would have had an investment in H Limited that would need to be eliminated on consolidation. For consolidation purposes the H Limited group is seen as one legal entity and thus cannot have an investment in itself. This type of investment of H Limited in S Limited and S Limited in H Limited is referred to as crossholdings and is not examinable for FAC3704.*

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## Step 5 Recognising and measuring the identifiable assets acquired and liabilities assumed

### Study

*Group Statements (Volume 1): Chapter 2 — section 2.06*

IFRS 3 (IAS 140).18 requires that the identifiable assets acquired and liabilities assumed be measured at their **acquisition date fair values**. This is applicable even if the business combination is achieved in stages or if less than 100% of the equity interest is held at the acquisition date.

As of the acquisition date, the acquirer shall recognise (separately from goodwill):

- the identifiable assets acquired,
- the liabilities assumed and
- any non-controlling interest in the acquiree.

The following conditions must be met before the identifiable assets acquired and liabilities assumed can be recognised in a business combination:

- The identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities as in the *Framework for Preparation and Presentation of Financial Statements*.
- The identifiable assets acquired and liabilities assumed must be part of what the acquirer and the acquiree exchanged in the business combination rather than a result of separate transactions.

### Comments

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*The following are **not** liabilities at the acquisition date as there is no present obligation to pay them:*

- *Costs that the acquirer expects but is not obliged to incur in the future.*
- *Cost to terminate the employment of or relocate an acquiree's employees.*
- *Costs incurred due to the acquisition such as restructuring the acquiree.*

*These costs are only recognised **after** the date of acquisition, when an obligation arises to pay them.*

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#### (i) Exceptions to the recognition and measurement principle:

Exception:	Item:
Recognition principle	— Contingent liabilities
Measurement principle	— Reacquired rights
	— Share-based payment awards
	— Assets held for sale
Recognition and measurement principle	— Income taxes
	— Employee benefits
	— Indemnification assets

(ii) **Adjustments at date of acquisition:**

**Study**

*Group Statements (Volume 1): Chapter 6 — sections 6.03–6.07*

**(a) Revaluation in the records of the subsidiary**

If a subsidiary revalues its net assets at the acquisition date to fair value and recognises the revalued amounts in its own records at acquisition date then **no** adjustments are required on consolidation since the assets of the subsidiary are already recognised at fair values in the records of the investee (subsidiary) and will thus be included as such in the consolidated financial statements.

**(b) Revaluation not recorded in the records of the subsidiary**

If a subsidiary revalues its net assets at the acquisition date to fair value and **does not** recognise the revalued amounts in its own records at acquisition date, then an adjustment is required for consolidation purposes to recognise the revalued assets of the subsidiary. A pro forma journal entry has to be passed on consolidation to bring the revaluation into account.

— **Non-depreciable asset**

If a non-depreciable asset has been revalued (e.g. land) to its fair value which is higher than its carrying amount then a **revaluation surplus** will be included in the calculation of the purchase price of the subsidiary. A part of the revaluation surplus will be allocated to the non-controlling interest.

If the asset that has been revalued is a **non-depreciable asset** there will be tax implications and deferred tax will need to be calculated. (Refer to sub-section (d) for a discussion of the tax implications of the revaluation.)

— **Depreciable asset**

If a depreciable asset has been revalued (e.g. plant and equipment) to its fair value which is higher than its carrying amount then a **revaluation surplus** will be included in the calculation of the purchase price of the subsidiary. The depreciation for the group must be calculated on the revalued amount. A part of the revaluation surplus as well as a part of the depreciation of the group will be allocated to the non-controlling interest.

If the asset that has been revalued is a **depreciable asset** then there will be tax implications and deferred tax will need to be calculated. (Refer to sub-section (d) for a discussion of the tax implications of the revaluation.)

**(c) Available-for-sale financial assets**

**Study**

*Group Statements (Volume 1): Chapter 1 — section 1.15*

When a parent acquires an investment in a subsidiary, the investment can be treated in three ways:

- (a) the investment can be classified as an available-for-sale financial asset;
- (b) the investment can be designated as a financial asset or financial liability at fair value through profit or loss; or
- (c) if the fair value of the investment cannot be reliably measured, the investment will be carried at cost (which is not common because in most cases it will be possible to determine the fair value of the investment).

UNISA will specify which one of the three treatment options apply in the information supplied in the additional information questions.

(Refer to **sub-section (d)** for a discussion of the tax implications of an available-for-sale financial asset.)

### Illustration

On 1 January 20.8 X Limited purchased an 80% interest in Y Limited for R15 000. At 31 December 20.8 the fair value of the investment was considered to be R25 000. The tax rate is 30%.

Fair value adjustments on available-for-sale financial assets (i.e. Investment in Y Limited) are recognised in equity through the statement of changes in equity.

The re-measurement (mark-to-market reserve) would have been recorded in the accounting records of X Limited as follows:

**31 December 20.8**

	Dr R	Cr R
Investment in Y Limited (25 000 – 15 000)	10 000	
Mark-to-market reserve (10 000 – 1 500)		8 500
Deferred tax (10 000 x 15%)		1 500

## Comments

**Available-for-sale financial asset:**

*On consolidation a pro forma journal entry to reverse the effect of the above journal entry would need to be processed. The pro forma journal entry would be:*

*Dr: Mark-to-market reserve — R8 500*

*Dr: Deferred tax — R1 500*

*Cr: Investment in Y Limited — R10 000*

*Reversal of mark-to-market reserve on consolidation.*

## (d) Tax implications on intragroup transactions

### — Implications of capital gains tax

Capital gains tax has an impact on the preparation of consolidated annual financial statements as there may have been assets which were revalued as part of the acquisition of a subsidiary. The effect of the revaluation must be accounted for in the consolidation process.

Capital gains tax on property, plant and equipment is payable on capital profit after 1 October 2001. It forms part of current tax.

The proceeds up until the asset's cost price is taxed at the current tax rate of 28%.

50% of the proceeds above the cost price (or base cost) of the asset (capital gain) is taxed at 28%. Therefore the effective tax payable on the capital gain is  $50\% \times 28\% = 14\%$ .

*(For FAC3704 purposes the base cost is considered to be equal to the original cost price of the asset.)*

### Example 1.5

Blue Limited sold a motor vehicle for R600 000.

The tax base of the motor vehicle at date of sale was R400 000.

The motor vehicle originally cost R500 000. Assume a tax rate of 30%.

	R	R
Profit on sale of motor vehicle	$600\ 000 - 400\ 000 = 200\ 000$	
Calculation of capital gains tax:		
Selling price — Cost price	$600\ 000 - 500\ 000 = 100\ 000 \times 50\% \times 30\%$	15 000
Cost price — tax base	$500\ 000 - 400\ 000 = 100\ 000 \times 30\%$	30 000
		<u>45 000</u>

### — Capital gains tax on property, plant and equipment

Should an asset be revalued then the carrying amount of the asset is increased and deferred tax should be provided for on the revalued amount.

### — Deferred tax on the revaluation of property, plant and equipment

If the asset that has been revalued is a **non-depreciable asset** then there will be tax implications and deferred tax will need to be raised on the revaluation surplus that will reflect the tax consequences of selling the asset (e.g. land), as the carrying amount of the asset can only be recovered by the sale of the asset.

Should a revaluation surplus arise on the revaluation of a **depreciable asset** (buildings, plant and equipment) then deferred tax is provided for on the revaluation surplus. The difference between the carrying amount of a revalued asset and its tax base is a temporary difference even if the entity has no intention of selling the asset (IAS 12 (AC 102).20). If the entity has no intention to sell the asset then the revalued carrying amount reflects the value of economic benefits that the entity expects to recover through the use of the asset. In this case the deferred tax must be provided for at the tax rate applicable to taxable income. Currently the tax rate amounts to 28% on taxable income.

The basis of raising deferred tax assets and deferred tax liabilities should be to reflect the tax consequences of the manner in which the entity expects to recoup or recover the carrying

amount of its assets or liabilities at the reporting date (IAS 12 (AC 102).51). Therefore, if it is the entity's intention to sell a depreciable asset in the near future, then the provision for deferred tax on the revaluation surplus up to base cost is provided for at 28% (recovered through the generation of income) and the deferred tax on the portion above base cost would be provided for at 14% (50% x 28%), as this portion of the taxable gain would only be realised through selling the asset.

**Summary:**

The provision for deferred tax on the revaluation of property, plant and equipment is as follows:

- (1) If **land** is revalued, deferred tax should be provided for on the total surplus above base cost at 14% (50% x 28%), irrespective of whether or not there is any intention to dispose of the land, as the carrying amount of the land (a non-depreciable asset) can only be recovered by means of a sale. This would be the case even if there is no present intention to sell the land.
- (2) Where no **decision** has been made to **sell a depreciable asset**, deferred tax should be provided for at 28% on the total revaluation surplus (including the amount in excess of historical cost). This is done because the carrying amount of the asset will be realised through the use of the asset.
- (3) If a **decision** has been made to sell a depreciable asset, deferred tax should be provided for as follows: on the revaluation surplus up to the original cost at 28% and on the excess above original cost at 14% (50% x 28%).
- (4) Deferred tax relating to the revaluation should be charged directly to equity.

— **Capital gains tax on available-for-sale financial assets**

The re-measurement of available-for-sale financial assets (mark-to-market reserve) also has a capital gains tax implication. The 50% of the potential capital gain above cost (assumed to be original cost price) will be taxable at the current tax rate. Therefore deferred tax should be provided for on the fair value adjustment above cost price at 14% (50% x 28%).

**Step 6 Measure the non-controlling interest**

**Study**

*Group Statements (Volume 1): Chapter 2 — section 2.06*

Each identifiable asset and liability is measured at its acquisition-date fair value. Any non-controlling interest in the acquiree is measured at:

- fair value ("**full goodwill method**") or
- as the non-controlling interest's proportionate share of the acquiree's net identifiable assets ("**partial goodwill method**").

Work through Example 2.11 of Group Statements thoroughly

*Please refer to the examples that follow for the calculation of goodwill which illustrate the above.*

## Comments

The acquirer can elect, on a transaction-by-transaction basis to measure any non-controlling interest at the acquisition date using either of the above mentioned methods. In other words the method chosen is not an accounting policy.

The parent controls the economic resources of the subsidiary. Therefore the full carrying amounts of the assets and liabilities of the subsidiary are included in the consolidated statement of financial position. The portion of the net assets of the subsidiary owned by the non-controlling shareholders is shown as a single line item between equity and liabilities in the consolidated statement of financial position and is described as **Non-controlling interest**.

Because of its control over the subsidiary, the parent plays a dominant role in the operations of the subsidiary. Therefore the subsidiary's revenue and expenses are included in full in the consolidated statement of comprehensive income.

The profit or loss for the year is split between the amount attributable to owners of the parent and the amount attributable to the non-controlling interest. It is shown as follows:

### **CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED ....**

	<b>R</b>
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>	<u>XX XXX</u>
Total comprehensive income attributable to:	
Owners of the parent	xxx
Non-controlling interest	xxx
	<u>XX XXX</u>

## **Step 7: Recognising and measuring goodwill or gain on bargain purchase (IFRS 3 (IAS 140).32 -.36)**

### **Study**

Group Statements (Volume 1): Chapter 2 — section 2.07

#### ● **Goodwill or gain on bargain purchase**

##### **Goodwill**

Goodwill is an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised.

##### **Gain on bargain purchase**

If an acquirer makes a gain on a bargain purchase, before such a gain is recognised IFRS 3 (AC 140).36 requires the following:



The acquirer shall reassess whether it has correctly identified all of the assets acquired and all of the liabilities assumed and shall recognise any additional assets or liabilities that are identified in that review.

The acquirer shall review the procedures used to measure the amounts that IFRS 3 (AC 140) requires to be recognised at the acquisition date for all the following:

- the identifiable assets acquired and liabilities assumed;
- the non-controlling interest in the acquiree, if any;
- for a business combination achieved in stages, the acquirer's previously held equity interest in the acquiree; and
- the consideration transferred.

The objective of the review is to ensure that the measurements appropriately reflect consideration of all available information as of the acquisition date.

**Goodwill or gain on bargain purchase** is measured as the difference between (A) and (B)

**(A) The sum of:**

- the fair value of the consideration transferred;
- the recognised amount of any non-controlling interest in the acquiree; and
- if the business combination is achieved in stages, the fair value of any previously held equity interest in the acquiree.

**AND**

**(B) The recognised amount (usually fair value) of the identifiable assets acquired and liabilities assumed.**

If the difference is a positive amount (debit), goodwill is recognised. If the difference is a negative (credit), then a gain from a bargain purchase is recognised.

## Comments

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***Goodwill is recognised as a non-current asset in the Statement of Financial Position.***

***Gain on bargain purchase is recognised as a gain (income) in the profit or loss section of the Statement of Comprehensive Income in the year in which the acquisition took place after the reassessment of fair value.***

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### Example 1.6

A Limited acquired an 80% interest in B Limited on 1 January 20.8 for R1 100 000. On this date the share capital of B Limited was R200 000 consisting of 200 000 ordinary shares and the retained earnings amounted to R800 000. The fair value of the net assets of B Limited amounted to R1 000 000 on 1 January 20.8.

The market value of the shares of B Limited on 1 January 20.8 amounted to R7 per share.

## Partial goodwill method

Non-controlling interest in the acquiree measured as the non-controlling interest's proportionate share of the acquiree's net identifiable assets.

### Analysis of owners' equity of B Limited

	100%	80%		20%
	Total R	At R	Since R	NCI R
<b>At acquisition</b>				
Share capital	200 000	160 000		40 000
Retained earnings	800 000	640 000		160 000
	1 000 000	800 000		200 000
Equity represented by goodwill	300 000	300 000		—
Consideration and NCI	1 300 000	1 100 000		200 000

## Comments

The fair value of the net assets of B Limited amounts to R1 000 000. The non-controlling interest is measured using the partial goodwill method thus the non-controlling interest amounts to R200 000 ( $R1\ 000\ 000 \times 20\% = R200\ 000$ ).

## Full goodwill method

Non-controlling interest in the acquiree measured at fair value

### Analysis of owners' equity of B Limited

	100%	80%		20%
	Total R	At R	Since R	NCI R
<b>At acquisition</b>				
Share capital	200 000	160 000		40 000
Retained earnings	800 000	640 000		160 000
	1 000 000	800 000		200 000 <sup>a</sup>
Equity represented by goodwill				
— Parent and NCI	380 000	300 000		80 000 <sup>2</sup>
Consideration and NCI at fair value <sup>3</sup>	1 380 000	1 100 000		280 000 <sup>1</sup>

<sup>1</sup>  $200\ 000\ (\text{SC}) \times 20\% \times R7 = 280\ 000$

<sup>2</sup>  $280\ 000^1 - 200\ 000^a = 80\ 000$

<sup>3</sup>  $1\ 100\ 000 + 280\ 000 = 1\ 380\ 000$

## Comments

The non-controlling interest is measured at fair value, thus the non-controlling interest should be R280 000 ( $R7 \times 200\,000 \times 20\%$ ).

The goodwill will thus be R380 000.

$R1\,100\,000$  (investment) +  $R280\,000$  (NCI) –  $R1\,000\,000$  (net asset value) =  $R380\,000$

### Example 1.7

A Limited acquired a 60% interest in B Limited on 1 January 20.8 for R1 000 000. On this date the share capital of B Limited was R500 000 consisting of 500 000 ordinary shares and the retained earnings amounted to R700 000.

The fair value of the net assets of B Limited amounted to R1 500 000 on 1 January 20.8.

The fair value of the non-controlling interest is R650 000 based on the market price of the shares not obtained.

### Partial goodwill method

#### Analysis of owners' equity of B Limited

	100%	60%		40%
	Total R	At R	Since R	NCI R
<b>At acquisition</b>				
Share capital	500 000	300 000		200 000
Retained earnings	700 000	420 000		280 000
Revaluation surplus	300 000 <sup>1</sup>	180 000		120 000
	1 500 000	900 000		600 000
Equity represented by goodwill	100 000	100 000		—
Consideration and NCI	1 600 000 <sup>2</sup>	1 000 000		600 000

<sup>1</sup>  $1\,500\,000(\text{FV}) - 500\,000(\text{SC}) - 700\,000(\text{RE}) = 300\,000$

<sup>2</sup>  $1\,000\,000 + 600\,000 = 1\,600\,000$

#### Pro forma consolidation journal

		Dr R	Cr R
J1	Share capital	500 000	
	Retained earnings	700 000	
	Revaluation surplus	300 000 <sup>1</sup>	
	Non-controlling interest (SFP)		600 000
	Investment in B Limited		1 000 000
	Goodwill	100 000	
	<i>Elimination of owners' equity in B Limited at acquisition</i>		

<sup>1</sup>  $1\,500\,000(\text{FV}) - 500\,000(\text{SC}) - 700\,000(\text{RE}) = 300\,000$

## Comments

The fair value of the net assets of B Limited amounts to R1 500 000. The non-controlling interest is measured using the partial goodwill method thus the non-controlling interest amounts to R600 000 ( $R1\ 500\ 000 \times 40\% = R600\ 000$ ). This represents the non-controlling interest's proportionate share of the acquiree's net identifiable assets.

### Full goodwill method

#### Analysis of owners' equity of B Limited

	100%	60%		40%
	Total R	At R	Since R	NCI R
<b>At acquisition</b>				
Share capital	500 000	300 000		200 000
Retained earnings	700 000	420 000		280 000
Revaluation surplus	300 000 <sup>1</sup>	180 000		120 000
	1 500 000	900 000		600 000 <sup>4</sup>
Equity represented by goodwill — Parent and NCI	150 000	100 000		50 000 <sup>3</sup>
Consideration and NCI at fair value	1 650 000 <sup>5</sup>	1 000 000		650 000 <sup>2</sup>

<sup>1</sup>  $1\ 500\ 000(\text{FV}) - 500\ 000(\text{SC}) - 700\ 000(\text{RE}) = 300\ 000$

<sup>2</sup> 650 000 (given)

<sup>3</sup>  $650\ 000^2 - 600\ 000^4 = 50\ 000$

<sup>5</sup>  $1\ 000\ 000 + 650\ 000 = 1\ 650\ 000$

#### Pro forma consolidation journal

		Dr R	Cr R
J1	Share capital	500 000	
	Retained earnings	700 000	
	Revaluation surplus	300 000 <sup>1</sup>	
	Non-controlling interest (SFP) (given)		650 000
	Investment in B Limited		1 000 000
	Goodwill	150 000 <sup>2</sup>	
	<i>Elimination of owners' equity in B Limited at acquisition</i>		

<sup>1</sup>  $1\ 500\ 000(\text{FV}) - 500\ 000(\text{SC}) - 700\ 000(\text{RE}) = 300\ 000$

<sup>2</sup>  $100\ 000 + 50\ 000 = 150\ 000$

## Comments

The non-controlling interest is measured at fair value, thus the non-controlling interest should be R650 000 (given).

The goodwill will thus be R150 000.

$R1\,000\,000$  (investment) +  $R650\,000$  (NCI) –  $R1\,500\,000$  (net asset value) =  $R150\,000$

### Step 8: Account for any measurement period adjustments

#### Study

Group Statements (Volume 1): Chapter 2 — section 2.09

#### Example 1.8

Aden Limited paid R2 300 000 to acquire a 75% interest in Baden Limited on 1 April 20.1.

The information relating to Baden Limited's assets on 1 April 20.1 is as follows:

##### Plant

Carrying amount	R1 500 000
Fair value	R2 000 000
Remaining useful life	10 years
Depreciation policy	Straight-line method

The remaining net assets of Baden Limited had a fair value of R1 000 000 on that date.

Aden Limited decided to obtain an independent appraisal of the fair value of the plant. The appraisal was only finalised on 31 August 20.1. The results of the independent appraisal determined the fair value of the plant to be R1 800 000. The difference in the fair values was related to circumstances that existed on the date of acquisition of Baden Limited.

The non-controlling interest is measured at its proportionate share of Baden Limited's identifiable net assets.

The company's financial year end is 30 June 20.1.

The consolidation journal entries to account for the plant of Baden Limited in the consolidated financial statements for the year ended 30 June 20.1 will be as follows:

##### Pro forma consolidation journals (30 June 20.1).

	Dr R	Cr R
J1 Plant (2 000 000 – 1 500 000)	500 000	
Revaluation surplus – Plant		500 000
J2 Equity – Baden Limited (1 000 000 + 2 000 000)	3 000 000	
Non-controlling interest (3 000 000 x 25%)		750 000
Investment in Baden Limited		2 300 000
Goodwill	50 000	

	Dr R	Cr R
J3 Depreciation ( $500\,000 \times 10\% \times \frac{3}{12}$ )	12 500	
Accumulated depreciation		12 500

Since the independent appraisal was finalised within 12 months of the acquisition date the amount that was used for the plant will be retrospectively corrected in 20.2 financial statements.

#### Pro forma consolidation journals (30 June 20.2)

	Dr R	Cr R
J1 Plant (1 800 000 – 1 500 000)	300 000	
Revaluation surplus – Plant		300 000
J2 Equity – Baden Limited (1 000 000 + 1 800 000)	2 800 000	
Non-controlling interest ( $2\,800\,000 \times 25\%$ )		700 000
Investment in Baden Limited		2 300 000
Goodwill	200 000	
J3 Retained earnings ( $300\,000 \times 10\% \times \frac{3}{12}$ )	7 500	
Accumulated depreciation		7 500
J4 Depreciation for 20.2 ( $300\,000 \times 10\%$ )	30 000	
Accumulated depreciation		30 000

## Comments

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*A complete set of pro forma consolidation journals is prepared each financial year end. When the journals are prepared for the 20.2 financial year end the final amount for the fair value of the plant (R1 800 000) is used instead of the provisional amount that was available at date of acquisition (R2 000 000).*

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## 1.3 Disclosure

### IFRS 3 (AC 140) — Business Combinations

The acquirer shall disclose information that enables users of financial statements to evaluate the nature and financial effect of a business combination that occurs either:

- during the current reporting period; or
- after the end of the reporting period but before the financial statements are authorised for issue (IFRS 3 (AC 140).59).

To meet the above objective the acquirer shall disclose the following information for each business combination that occurs during the reporting period:

- (a) the name and a description of the acquiree.
- (b) the acquisition date.
- (c) the percentage of voting equity interests acquired.
- (d) the primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree.
- (e) a qualitative description of the factors that make up the **goodwill recognised**, such as:

- expected synergies from combining operations of the acquiree and the acquirer;
  - intangible assets that do not qualify for separate recognition or
  - other factors.
- (f) the acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration, such as:
- cash;
  - other tangible or intangible assets, including a business or subsidiary of the acquirer;
  - liabilities incurred, for example, a liability for contingent consideration; and
  - equity interests of the acquirer, including the number of instruments or interests issued or issuable and the method of determining the fair value of those instruments or interests.
- (g) for contingent consideration arrangements and indemnification assets:
- the amount recognised as of the acquisition date;
  - a description of the arrangement and the basis for determining the amount of the payment; and
  - an estimate of the range of outcomes (undiscounted) or, if a range cannot be estimated, that fact and the reasons why a range cannot be estimated. If the maximum amount of the payment is unlimited, the acquirer shall disclose that fact.
- (h) for acquired receivables:
- the fair value of the receivables
  - the gross contractual amounts receivable; and
  - the best estimate at the acquisition date of the contractual cash flows not expected to be collected.
- The disclosures shall be provided by major class of receivable, such as loans, direct finance leases and any other class of receivables.
- (i) the amounts recognised as of the acquisition date for each major class of assets acquired and liabilities assumed.
- (j) for each contingent liability information required in IAS 37 (AC 130) *Provisions, Contingent Liabilities and Contingent Assets*. If a contingent liability is not recognised because its fair value cannot be measured reliably, the acquirer shall disclose the information required by IAS 37 (AC 130).<sup>86</sup> and the reasons why the liability cannot be measured reliably.
- (k) the total amount of **goodwill** that is expected to be deductible for tax purposes.
- (l) for transactions that are recognised separately from the acquisition of assets and assumption of liabilities in the business combination, the following disclosure is required:
- a description of each transaction;
  - how the acquirer accounted for each transaction;
  - the amounts recognised for each transaction and the line item in the financial statements in which each amount is recognised; and
  - if the transaction is the effective settlement of a pre-existing relationship, the method used to determine the settlement amount.
- (m) the disclosure of separately recognised transactions required by (l) shall include the amount of acquisition-related costs and, separately, the amount of those costs recognised as an expense and the line item or items in the statement of comprehensive income in which those expenses are recognised. The amount of any issue costs not recognised as an expense and how they were recognised shall also be disclosed.
- (n) in a **bargain purchase**:
- the amount of any gain recognised; and

- line item in the statement of comprehensive income in which the gain is recognised; and
  - a description of the reasons why the transaction resulted in a gain.
- (o) for each business combination in which the acquirer holds less than 100 per cent of the equity interests in the acquiree at the acquisition date:
- the amount of the non-controlling interest in the acquiree recognised at the acquisition date and the measurement basis for that amount; and
  - for each non-controlling interest in an acquiree measured at fair value, the valuation techniques and key model inputs used for determining that value.
- (p) in a business combination achieved in stages:
- the acquisition-date fair value of the equity interest in the acquiree held by the acquirer immediately before the acquisition date; and
  - the amount of any gain or loss recognised as a result of remeasuring to fair value the equity interest in the acquiree held by the acquirer before the business combination; and
  - the line item in the statement of comprehensive income in which that gain or loss is recognised.
- (q) the following information:
- the amounts of revenue and profit or loss of the acquiree since the acquisition date included in the consolidated statement of comprehensive income for the reporting period; and
  - the revenue and profit or loss of the combined entity for the current reporting period as though the acquisition date for all business combinations that occurred during the year had been as of the beginning of the annual reporting period.

If disclosure of any of the information required is impracticable, the acquirer shall disclose that fact and explain why the disclosure is impracticable. IFRS 3 (AC 140) uses the term ‘impracticable’ with the same meaning as in IAS 8 (AC 103) *Accounting Policies, Changes in Accounting Estimates and Errors*.

For individually **immaterial business combinations** occurring during the reporting period that are material collectively, the acquirer shall disclose in aggregate the information required by paragraphs (e)–(q).

If the acquisition date of a business combination is after the end of the reporting period but before the financial statements are authorised for issue, the acquirer shall disclose the information required by paragraph (a)–(q) unless the initial accounting for the business combination is incomplete at the time the financial statements are authorised for issue. In that situation, the acquirer shall describe which disclosures could not be made and the reasons why they cannot be made.

The acquirer shall disclose information that enables users of its financial statements to evaluate the **financial effects** of adjustments recognised in the current reporting period that relate to business combinations that occurred in the period or previous reporting periods (IFRS 3 (AC 140).61).

To meet the above objective the acquirer shall disclose the following information for each material business combination or in the aggregate for individually immaterial business combinations that are material collectively:

- (a) if the initial accounting for a business combination is incomplete for particular assets,



liabilities, non-controlling interests or items of consideration and the amounts recognised in the financial statements for the business combination thus have been determined only provisionally:

- the reasons why the initial accounting for the business combination is incomplete;
  - the assets, liabilities, equity interests or items of consideration for which the initial accounting is incomplete; and
  - the nature and amount of any measurement period adjustments recognised during the reporting period in accordance with IFRS 3 (IAS 40).49.
- (b) for each reporting period after the acquisition date until the entity collects, sells or otherwise loses the right to a contingent consideration asset, or until the entity settles a contingent consideration liability or the liability is cancelled or expires:
- any changes in the recognised amounts, including any differences arising upon settlement;
  - any changes in the range of outcomes (undiscounted) and the reasons for those changes; and
  - the valuation techniques and key model inputs used to measure contingent consideration.
- (c) for contingent liabilities recognised in a business combination, the acquirer shall disclose the information required in terms of IAS 37 (AC130).85–.85 for each class of provision.
- (d) a **reconciliation of the carrying amount of goodwill** at the beginning and end of the reporting period showing separately:
- the gross amount and accumulated impairment losses at the beginning of the reporting period.
  - additional goodwill recognised during the reporting period, except goodwill included in a disposal group that, on acquisition, meets the criteria to be classified as held for sale in accordance with IFRS 5 (AC 142) *Non-current Assets Held for Sale and Discontinued Operations*.
  - adjustments resulting from the subsequent recognition of deferred tax assets during the reporting period.
  - goodwill included in a disposal group classified as held for sale in accordance with IFRS 5 (AC 142) and goodwill derecognised during the reporting period without having previously been included in a disposal group classified as held for sale.
  - impairment losses recognised during the reporting period in accordance with IAS 36 (AC 128). (IAS 36 (AC128) requires disclosure of information about the recoverable amount and impairment of goodwill in addition to this requirement.)
  - net exchange rate differences arising during the reporting period in accordance with IAS 21 (AC 112) *The Effects of Changes in Foreign Exchange Rates*.
  - any other changes in the carrying amount during the reporting period.
  - the gross amount and accumulated impairment losses at the end of the reporting period.
- (e) the amount and an explanation of any gain or loss recognised in the current reporting period that both:
- relates to the identifiable assets acquired or liabilities assumed in a business combination that was effected in the current or previous reporting period; and
  - is of such a size, nature or incidence that disclosure is relevant to understanding the combined entity's financial statements.

If the specific disclosures required by IFRS 3 (AC 140) and other IFRS's do not meet the objectives set out above, the acquirer shall disclose whatever additional information is necessary to meet those objectives.

## **IAS 27 (AC 132) — Consolidated and Separate Financial Statements**

The following disclosures shall be made in consolidated financial statements:

- (a) the nature of the relationship between the parent and a subsidiary when the parent does not own, directly or indirectly through subsidiaries, more than half of the voting power;
- (b) the reasons why the ownership, directly or indirectly through subsidiaries, of more than half of the voting or potential voting power of an investee does not constitute control;
- (c) the end of the reporting period of the financial statements of a subsidiary when such financial statements are used to prepare consolidated financial statements and are as of a date or for a period that is different from that of the parent's financial statements, as well as the reason for using a different date or period;
- (d) the nature and extent of any significant restrictions (e.g. resulting from borrowing arrangements or regulatory requirements) on the ability of subsidiaries to transfer funds to the parent in the form of cash dividends or to repay loans or advances;
- (e) a schedule that shows the effects of any changes in a parent's ownership interest in a subsidiary that do not result in a loss of control on the equity attributable to owners of the parent; and
- (f) if control of a subsidiary is lost, the parent shall disclose the gain or loss, if any, recognised and:
  - the portion of that gain or loss attributable to recognising any investment retained in the former subsidiary at its fair value at the date when control is lost; and
  - the line item(s) in the statement of comprehensive income in which the gain or loss is recognised (if not presented separately in the statement of comprehensive income).

When separate financial statements are prepared for a parent that elects not to prepare consolidated financial statements, those separate financial statements shall disclose:

- (a) the fact that the financial statements are separate financial statements; that the exemption from consolidation has been used; the name and country of incorporation or residence of the entity whose consolidated financial statements that comply with International Financial Reporting Standards have been produced for public use; and the address where those consolidated financial statements are obtainable;
- (b) a list of significant investments in subsidiaries, jointly controlled entities and associates, including the name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held; and
- (c) a description of the method used to account for the investments listed under (b).

When a parent (other than a parent that elects not to prepare consolidated financial statements), venturer with an interest in a jointly controlled entity or an investor in an associate prepares separate financial statements, those separate financial statements shall disclose:

- (a) the fact that the statements are separate financial statements and the reasons why those statements are prepared if not required by law;
- (b) a list of significant investments in subsidiaries, jointly controlled entities and associates, including the name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held; and
- (c) a description of the method used to account for the investments listed under (b);

Further more it shall identify that the financial statements are prepared in accordance with this Standard or IAS 28 (AC 110) and IAS 31 (AC 119) to which they relate.

## 1.4 Assessment criteria

After having studied this study unit you should be able to:

- Describe a group of companies.
- Distinguish between a subsidiary, an associate and a joint venture.
- Define and interpret control, significant influence and joint control.
- Distinguish between the accounting treatment of a subsidiary, an associate, a joint venture and an investment.
- Apply and account for the measurement criteria of identifiable assets acquired and liabilities assumed (including contingent liabilities) at their acquisition dates fair values, in terms of IFRS 3 (AC 140).
- Account for the non-controlling interests according to IFRS 3 (AC 140).
- Account for the consideration at acquisition as well as any acquisition costs in terms of IFRS 3 (AC 140).
- Account for goodwill/gain on bargain purchase according to IFRS 27 (AC 140).

## Consolidations after the date of acquisition

### Learning outcome 2

After studying this study unit, you should be able to:

Prepare group financial statements after the date of acquisition according to the requirements of Generally Accepted Accounting Practice.

### OVERVIEW OF THE STUDY UNIT

The study unit consists of the following sections:	Page
2.1 Introduction	30
2.2 Since acquisition — Application of IAS 27 (AC 140) <i>Consolidated and Separate Financial Statements</i>	31
2.3 Impairment of goodwill	45
2.4 Losses incurred by a subsidiary	52
2.5 Revision example	61
2.6 Assessment criteria	69

### Study

*Group Statements (Volume 1): Chapter 6 — sections 6.01 and 6.02*

### 2.1 Introduction

In principle the consolidated statements of a group are nothing more than the combined statements of all the companies in the group. Certain adjustments have to be made, however, before we can speak of consolidated statements. The principles, procedures, and the adjustments that are needed in order to prepare and present the consolidated financial statements for a group of companies will be discussed in this study unit.

## 2.2 Since acquisition — Application of IAS 27 (AC 132) *Consolidated and Separate Financial Statements*

### 2.2.1 Objective

IAS 27 (AC 132) deals with:

- the circumstances in which an entity must **consolidate** the financial statements of another entity (being a subsidiary);
- the accounting for **changes in ownership** interests in a subsidiary;
- the accounting for the **loss of control** of a subsidiary; and
- the information that an entity must **disclose** to enable users of the financial statements to evaluate the nature of the relationship between the entity and its subsidiaries.

### 2.2.2 Consolidation procedures

The consolidation procedures that should be applied in preparing the consolidated financial statements are set out in IAS 27 (AC 132).18 to .31. The consolidation procedures are as follows:

- (i) The financial statements of the parent entity and its subsidiaries are **combined on a line-by-line** basis by adding together like items of assets, liabilities, equity income and expenses.
- (ii) The following steps must be taken to ensure that the consolidated financial statements present financial information about the group as that of a **single entity**:
  - The carrying amount of the parent's **investment in each subsidiary** and the parent's portion of **equity of each subsidiary** must be eliminated;
  - The resultant **goodwill** must be treated according to IFRS 3 (AC 140);
  - **Non-controlling interests** in the profit or loss of consolidated subsidiaries for the reporting period must be identified; and
  - **Non-controlling interests** in the net assets of consolidated subsidiaries must be identified separately from the parent's ownership interests in them.
- (iii) Non-controlling interests in the net assets consist of:
  - the amount of those non-controlling interests at the date of acquisition calculated in accordance with IFRS 3 (AC 140); and
  - the non-controlling interest's share of changes in equity since the date of the combination.
- (iv) **Intragroup balances and transactions**, including income, expenses and dividends should be eliminated in full. Profits and losses resulting from intragroup transactions that are recognised in assets, such as inventory and property, plant and equipment, should be eliminated in full. Temporary differences (tax implications) that arise from the elimination of unrealised profits and losses resulting from intragroup transactions must be dealt with in accordance with IAS 12 (AC 102).
- (v) **Taxes** payable by the parent entity or its subsidiaries on distribution to the parent entity of the profits retained in subsidiaries must be accounted for in accordance with IAS 12 (AC 102).
- (vi) Consolidated financial statements should be prepared using **uniform accounting policies** for like transactions and other events in similar circumstances (IAS 27 (AC 132).24).
- (vii) The results of operations of a subsidiary are included in the consolidated financial

statements from the **acquisition date** as defined by IFRS 3 (AC 140). This is the date on which control of the acquired subsidiary is effectively transferred to the buyer (IAS 27 (AC 132).26).

- (viii) The results of operations of a subsidiary disposed of are included in the consolidated statement of comprehensive income until the **date of disposal**, which is the date on which the parent entity ceases to have control of the subsidiary.
- (ix) The financial statements for of the parent and its subsidiaries used in preparing the consolidated financial statements should all be prepared as of the same reporting date, unless it is impracticable to do so (IAS 27 (AC 132).22).
- (x) If it is impracticable for a particular subsidiary to prepare its financial statements as of the same date as its parent, adjustments must be made for the effects of significant transactions or events that occur between the dates of the subsidiary's and the parent's financial statements. In no case may the difference be more than three months (IAS 27 (AC 132).23).
- (xi) Non-controlling interests should be presented in the consolidated statement of financial position within equity, but separate from the parent's owners' equity (IAS 27 (AC 132).27).
- (xii) Non-controlling interests in the profit or loss of the group should also be separately presented (IAS 27 (AC 132).28) Total comprehensive income is attributed to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.
- (xiii) Consolidated financial statements report to the owners of the parent and therefore will only reflect the parent's **share capital** in the consolidated statement of financial position. Only the parent's **dividends** will be presented in the consolidated statement of changes in equity. The dividends that have been paid to/are payable to the non-controlling interest is shown in the non-controlling interest's column of the consolidated statement of changes in equity as a reduction of the amount attributable to the non-controlling interest.

## Comments

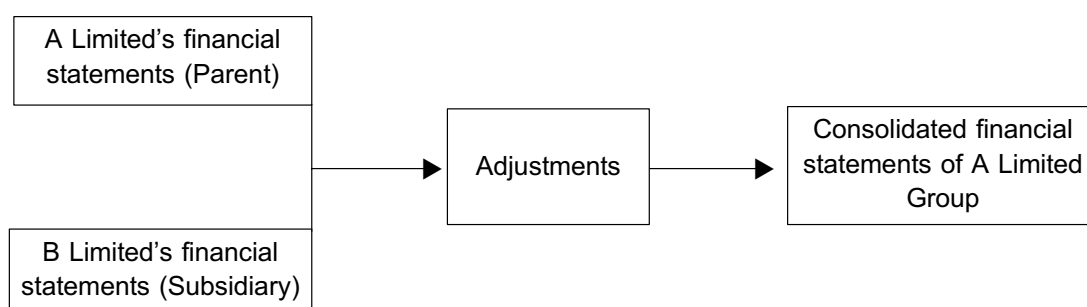
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*IAS 27 (AC 132) does not deal with the methods of accounting for business combinations and their effects of consolidation, including goodwill arising on a business combination. This is dealt with in IFRS 3 (AC 140) — Business Combinations.*

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### 2.2.3 Simple group

Consolidations can be schematically represented as follows:



A Limited drafts its financial statements from its financial records, as does B Limited. Once the individual statements have been completed the information from these separate financial statements is used to make the necessary consolidation adjustments. Only then can consolidated statements be compiled. Note that the original financial statements of A Limited and B Limited are never amended during the consolidation process. Use is made of pro forma consolidation journal entries to effect the consolidation adjustments.

This process repeats itself year after year and the adjustments have to be made afresh every year.

The basic consolidation procedures can be summarised as follows:

- Elimination of common items;
- Elimination of intragroup items; and
- Consolidation of the remaining items.

### 2.2.3.1 The elimination of common items

One of the first adjustments which should be made in consolidated statements is the elimination of the investment in the parent's books and the owners' equity section in the subsidiary's books as at the date of acquisition.

The following example illustrates the elimination of the investment in the parent's books at date of acquisition:

#### Example 2.1

#### STATEMENTS OF FINANCIAL POSITION AS AT 30 JUNE 20.8

	A Limited R	B Limited R
<b>ASSETS</b>		
Investment in B Limited: 10 000 ordinary shares — at fair value	10 000	—
Cash and cash equivalents	10 000	10 000
	20 000	10 000
<b>EQUITY AND LIABILITIES</b>		
Share capital — 20 000 ordinary shares	20 000	—
— 10 000 ordinary shares	—	10 000
	20 000	10 000

#### REQUIRED:

Draft the consolidated statement of financial position for the A Limited Group at 30 June 20.8. Assume that A Limited acquired its interest on that date. B Limited was incorporated on 30 June 20.8.

**Pro forma consolidation journal**

		Dr R	Cr R
J1	Share capital of B Limited Investment in B Limited <i>Elimination of owners' equity of B Limited at acquisition</i>	10 000	10 000

The consolidated statement of financial position would now be drafted as follows:

**A LIMITED GROUP**
**CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 20.8**

	R
<b>ASSETS</b>	
Cash and cash equivalents (10 000 + 10 000)	<u>20 000</u>
<b>EQUITY AND LIABILITIES</b>	
Share capital — 20 000 ordinary shares	<u>20 000</u>

The following example illustrates the elimination of the investment in the parent's records a few years after acquisition:

**STATEMENTS OF FINANCIAL POSITION AS AT 30 JUNE 20.8**

	A Limited R	B Limited R
<b>ASSETS</b>		
Investment in B Limited: 10 000 ordinary shares at fair value	10 000	—
Trade and other receivables	12 000	8 000
Cash and cash equivalents	14 000	10 000
<b>Total assets</b>	<u>36 000</u>	<u>18 000</u>
<b>EQUITY AND LIABILITIES</b>		
Share capital — 20 000 ordinary shares	20 000	—
— 10 000 ordinary shares	—	10 000
Retained earnings	16 000	8 000
<b>Total equity and liabilities</b>	<u>36 000</u>	<u>18 000</u>



### Additional information

The fair value of the available-for-sale financial assets is equal to the cost price thereof.

A Limited acquired its interest on 30 June 20.6 when B Limited was incorporated.

#### REQUIRED:

Draft the consolidated statement of financial position of the A Limited Group as at 30 June 20.8.

### Solution 2.2

#### Pro forma consolidation journal

		Dr R	Cr R
J1	Share capital of B Limited Investment in B Limited <i>Elimination of owners' equity of B Limited at acquisition</i>	10 000	10 000

The consolidated statement of financial position would now be drafted as follows:

#### A LIMITED GROUP

#### CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 20.8

	R
<b>ASSETS</b>	
<b>Current assets</b>	
Trade and other receivables (12 000 + 8 000)	20 000
Cash and cash equivalents (14 000 + 10 000)	24 000
<b>Total assets</b>	<u>44 000</u>
<b>EQUITY AND LIABILITIES</b>	
<b>Total equity</b>	
Share capital — 20 000 ordinary shares	20 000
Retained earnings (16 000 + 8 000)	24 000
<b>Total equity and liabilities</b>	<u>44 000</u>

On the basis of the above two examples the following conclusions can be made:

- The journal entry for the elimination of the investment and the owners' equity at the date of acquisition will remain unchanged from one year to the next.
- The share capital in the consolidated statement of financial position is always only that of the parent.
- Profits made by the subsidiary after the date of acquisition become part of the retained earnings of the group and are shown as such in the consolidated financial statements.
- Profits made by the subsidiary before the date of acquisition cannot form part of the retained earnings of the group. The parent pays for such profits.

- Since the parent obtained its interest in the subsidiary at the date of incorporation (date on which the entity was established), there could not have been any retained earnings in the books of B Limited.

The above two examples have been kept simple in order to highlight the at acquisition procedures for consolidating a subsidiary. IFRS 3 (AC 140) *Business Combinations* establishes principles and requirements for how the acquirer (parent) –

- (a) recognises and measures in its financial statements the *identifiable* assets acquired, the liabilities assumed and any *non-controlling interest* in the *acquiree*;
- (b) recognises and measures the *goodwill* acquired in the business combination or a gain from a bargain purchase; and
- (c) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.

### 2.2.3.2 The elimination of intragroup items

## Study

*Group Statements (Volume 1): Chapter 5 — sections 5.01–5.04*

(Please refer to section 1.2.5.3 (ii) (d) **Tax implications on intragroup transactions** for an explanation of the deferred tax implications.)

According to IAS 27 (AC 132).20, profits and losses resulting from intragroup transactions that are recognised in assets, such as inventory and property, plant and equipment, should be eliminated in full.

If an entity in a group records an unrealised profit resulting from a transaction with another entity in the group, this unrealised profit must be excluded in the preparation of the consolidated financial statements of the group, and the tax expense must be adjusted accordingly.

In South Africa intragroup profit and any other profit is taxed in the same manner. If unrealised profit generated between two companies in a group is eliminated upon consolidation, but no corresponding tax adjustment is made, the consolidated tax expense will be disproportionately high in relation to the consolidated pre-tax net profit of the group. A tax adjustment must be made to allocate the tax on the intragroup profit to the same accounting period in which the unrealised profit is going to realise.

The tax adjustment is done by crediting the income tax expense (decreasing the expense) in the profit or loss section of the consolidated statements of comprehensive income and debiting the deferred tax account in the statement of financial position (tax is prepaid, thus create a “debtor”).

Differing types of intragroup transactions are as follows:

**(a) Bills of exchange**

**Study**

*Group Statements (Volume 1): Chapter 5 — section 5.03*

**(b) Bank overdrafts and guarantees**

**Study**

*Group Statements (Volume 1): Chapter 5 — section 5.04*

A bank overdraft of one entity in a group should only be set off against the favourable bank balance of another entity in the group if:

bank accounts are at the **same** bank, and

- the entity with the favourable bank balance guarantees the bank overdraft of the other entity; OR
- the bank itself sets off the two amounts in terms of an agreement between the two entities and the bank.

**(c) Movement of assets between entities in the group**

If an entity in a group records an unrealised profit resulting from a transaction with another entity in the group, this unrealised profit must be excluded in the preparation of the consolidated financial statements of the group, and the tax expense must be adjusted accordingly.

The following categories of assets resulting of movements of assets between the entities in the group may result in unrealised profits that need to be adjusted for.

● **Inventories**

**Study**

*Group Statements (Volume 1): Chapter 5 — sections 5.05–5.12*

— **Unrealised profit in closing inventory**

If a subsidiary sells inventory to its parent and at year end the parent still has some of this inventory on hand, the cost of this inventory is too high because it includes profit which has not been realised with a third party outside the group.

The cost of inventory affects two items in the financial statements, i.e. closing inventory in the profit or loss section of the statement of comprehensive income (included in cost of sales) and inventory in the statement of financial position.

Closing inventory in the calculation of cost of sales in the statement of comprehensive income has a credit balance and must be debited to remove the unrealised profit. Inventory in the statement of financial position must be credited for the same reason. (Because the

consolidated statements of comprehensive income often shows just one line item for cost of sales (and not separate line items for opening inventory, purchases and closing inventory), cost of sales must be debited with the amount of the unrealised profit.)

Cost of sales increases, which implies that net profit before tax decreases, and consequently the entity will have to pay less tax. The tax expense must be decreased (credited) with the amount of the unrealised profit multiplied by the tax rate. The entity paid too much tax and this has the effect of a prepaid expense. Deferred tax in the statement of financial position must be debited to reflect this “prepaid expense”.

#### — Unrealised profit in opening inventory

Assume the same information as discussed above, except that it is now the companies next financial period. When the consolidation is performed at the end of the year, the consolidation journals which were recorded during the previous year's consolidation, will not be reflected in the financial statements. (Remember that consolidation journals are pro forma journals and are only done in the consolidation working papers, and are not actually processed through the accounting system.) The current year's opening inventory will not agree with the previous year's closing inventory because the unrealised profit was eliminated from the closing inventory of the previous year, but not from the opening inventory of the current year. The unrealised profit must be eliminated from the opening inventory so that it will agree with the closing inventory of the previous year. Opening inventory in the statement of comprehensive income (profit or loss section) shows a debit balance and must be credited with the amount of the unrealised profit to reduce it. If opening inventory does not appear as a separate line item in the statement of comprehensive income (profit or loss section), cost of sales will be credited.

The retained earnings at the beginning of the year will be higher than the balance actually used for consolidation purposes at the end of the previous year. The retained earnings at the beginning of the year must be debited to decrease it with the amount of the unrealised profit.

The effect of crediting cost of sales is a decrease in an expense, thus profit increases, which means more tax must be paid. The tax expense in the statement of comprehensive income (profit or loss section) must thus be debited. The other part of this journal is a credit to retained earnings at the beginning of the year because the unrealised profit and the tax effect thereon must be taken into account.

### Example 2.3

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B Limited is a subsidiary of A Limited.

A Limited sold inventory to B Limited at a profit of 25% on the cost of the inventory, during 20.8 and 20.9.

On 31 December 20.8 B Limited had inventory on hand of R300 000, which was bought from A Limited.

On 31 December 20.9 B Limited had inventory on hand of R200 000, which was bought from A Limited.

Assume a tax rate of 30%.

**REQUIRED:**

Prepare the consolidation pro forma journal entries for the years ended 31 December 20.8 and 20.9.

**Solution 2.3**

The pro forma consolidation journals for the year ended 31 December 20.8 will be as follows:

	<b>Dr R</b>	<b>Cr R</b>
<b>31/12/20.8</b>		
Cost of sales (SCI) (A) (300 000 × 25/125) Inventory (SFP) (B)	60 000	60 000
Deferred tax (SFP) (60 000 × 30%) Income tax expense (SCI) (A)	18 000	18 000
<i>Elimination of unrealised profit in closing inventory of B Limited</i>		

The pro forma consolidation journals for the year ended 31 December 20.9 will be as follows:

	<b>Dr R</b>	<b>Cr R</b>
<b>31/12/20.9</b>		
Retained earnings — beginning of year (A) Cost of sales (SCI) (A)	60 000	60 000
Income tax expense (SCI) (A) Retained earnings — beginning of year (A)	18 000	18 000
<i>Elimination of unrealised profit in opening inventory of B Limited</i>		

	<b>Dr R</b>	<b>Cr R</b>
<b>31/12/20.9</b>		
Cost of sales (SCI) (A) (200 000 × 25/125) Inventory (SFP) (B)	40 000	40 000
Deferred tax (SFP) (40 000 × 30%) Income tax expense (SCI) (A)	12 000	12 000
<i>Elimination of unrealised profit in closing inventory of B Limited</i>		

**Comments**

*Note that the profit for the year and retained earnings of B Limited are **not** adjusted because it is not B Limited that is making the unrealised profit, but A Limited.*

*Therefore the unrealised profit in the inventory will **not** be shown in the analysis of owners' equity of B Limited. The adjustments will **only** be taken into account in the consolidated statement of comprehensive income (profit or loss section).*

**Example 2.4**

B Limited is a subsidiary of A Limited.

B Limited sold inventory to A Limited at a profit of 25% on the cost of the inventory, during 20.8 and 20.9.

On 31 December 20.8 A Limited had inventory on hand of R300 000, which was bought from B Limited.

On 31 December 20.9 A Limited had inventory on hand of R200 000, which was bought from B Limited.

Assume a tax rate of 30%.

**REQUIRED:**

Prepare the pro forma consolidation journal entries for the years ended 31 December 20.8 and 20.9.

**Solution 2.4**

The pro forma consolidation journals for the year ended 31 December 20.8 will be as follows:

	<b>Dr R</b>	<b>Cr R</b>
<b>31/12/20.8</b>		
Cost of sales (SCI)(B) (300 000 × 25/125)	60 000	
Inventory (SFP)(A)		60 000
Deferred tax (SFP) (60 000 × 30%)	18 000	
Income tax expense (SCI)(B)		18 000
<i>Elimination of unrealised profit in closing inventory of B Limited</i>		

The pro forma consolidation journals for the year ended 31 December 20.9 will be as follows:

	<b>Dr R</b>	<b>Cr R</b>
<b>31/12/20.9</b>		
Retained earnings — beginning of year (B)	60 000	
Cost of sales (SCI)(B)		60 000
Income tax expense (SCI)(B)	18 000	
Retained earnings — beginning of year (B)		18 000
<i>Elimination of unrealised profit in opening inventory of A Limited</i>		
<b>31/12/20.9</b>		
Cost of sales (SCI)(B) (200 000 × 25/125)	40 000	
Inventory (SFP)(A)		40 000
Deferred tax (SFP) (40 000 × 30%)	12 000	
Income tax expense (SCI)(B)		12 000
<i>Elimination of unrealised profit in closing inventory of A Limited</i>		

## Comments

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Note that the profit for the year and retained earnings of B Limited **are** adjusted because it is B Limited that is making the unrealised profit and not A Limited.

Therefore the unrealised profit in the inventory **will** be shown in the analysis of owners' equity of B Limited. The adjustments will **also** be taken into account in the consolidated statement of comprehensive income (profit or loss section).

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- Property, plant and equipment

### Study

Group Statements (Volume 1): Chapter 5 — sections 5.13–5.17

#### — Unrealised profit included in property, plant and equipment

When one entity in a group sells an item of property, plant and equipment to another entity in the group, the profit made by the selling entity is seen as unrealised from the viewpoint of the group, for as long as the asset is held within the group. The profit of the group must be decreased with the amount of the unrealised profit, and the tax expense must be adjusted accordingly.

The above-mentioned consolidation adjustments will be made every year until the asset is sold to a party outside the group and the profit is realised from a group viewpoint. The effect of these adjustments is that the unrealised profit is moved to the accounting period in which the profit is realised by way of the sale of the asset or the sale of the products or services produced by the asset (i.e. via the use of the asset), to parties outside the group.

#### — Unrealised profit included in non-depreciable property, plant and equipment

### Example 2.5

A Limited has held a 100% interest in B Limited since 20.5.

On 2 January 20.6 A Limited sold an office building to B Limited for R20 000.

The cost price of the building for A Limited was R15 000.

B Limited sold the office building on 30 September 20.8 for R23 000 to a party outside the group.

Both entity's year ends fall on 31 December.

Assume a tax rate of 30%.

**REQUIRED:**

Prepare the pro forma consolidation journal entries for the years ended 31 December 20.6 and 20.7.

**Solution 2.5**

The pro forma consolidation journals for the year ended 31 December 20.6 will be as follows:

	<b>Dr R</b>	<b>Cr R</b>
<b>31/12/20.6</b>		
Profit on sale of property (A) Property, plant and equipment (B) <i>Elimination of unrealised intragroup profit included in the property, plant and equipment of B Limited (20 000 – 15 000)</i>	5 000	5 000
Deferred tax (SFP)(A) Income tax expense (SCI)(A) <i>Tax implication of elimination of unrealised intragroup profit included in property, plant and equipment of B Limited (5 000 × 30%)</i>	1 500	1 500

The pro forma consolidation journals for the year ended 31 December 20.7 will be as follows:

	<b>Dr R</b>	<b>Cr R</b>
<b>31/12/20.7</b>		
Retained earnings — beginning of year (A) (5 000 – 1 500) Deferred tax (SFP)(A) Property, plant and equipment (B) <i>Correction to agree opening balances for balances for 20.7 with closing balances for 20.6</i>	3 500 1 500	5 000

**— Unrealised profit included in depreciable property, plant and equipment**

As explained above, any unrealised profit made on the sale of property, plant and equipment by one entity in the group to another entity in the group, must be eliminated. The buying entity will calculate depreciation on the cost price of the asset (which includes unrealised profit). This excess depreciation must be written back.

Unrealised profit on depreciable property, plant and equipment is realised through the process of depreciation when the products or services produced by use of the asset is sold to parties outside the group. This unrealised profit which realises each year, must be included in the consolidated profit.

**Example 2.6**

A Limited has held an 80% interest in B Limited since 20.5.

On 31 December 20.6 B Limited sold manufacturing machinery to A Limited for R20 000.



The carrying amount of the machinery in the books of B Limited was R15 000.

Depreciation is provided for at 20% per annum on the straight-line method.

Both entity's year ends fall on 31 December.

Assume a tax rate of 30%.

**REQUIRED:**

Prepare the pro forma consolidation journal entries for the years ended 31 December 20.6 and 20.7.

**Solution 2.6**

The pro forma consolidation journals for the year ended 31 December 20.6 will be as follows:

	<b>Dr R</b>	<b>Cr R</b>
<b>31/12/20.6</b>		
Profit on sale of property (B) Property, plant and equipment (A) <i>Elimination of unrealised intragroup profit included in property, plant and equipment of A Limited (20 000 – 15 000)</i>	5 000	5 000
Deferred tax (SCI)(B) Income tax expense (SCI)(B) <i>Tax implication of elimination of unrealised intragroup profit included in property, plant and equipment of A Limited (5 000 × 30%)</i>	1 500	1 500

The pro forma consolidation journals for the year ended 31 December 20.7 will be as follows:

	<b>Dr R</b>	<b>Cr R</b>
<b>31/12/20.7</b>		
Retained earnings — beginning of year (B) Deferred tax (SFP)(B) Property, plant and equipment (A) <i>Correction to agree opening balances for 20.7 with closing balances for 20.6</i>	3 500 1 500	5 000
Accumulated depreciation (A) Depreciation (A) <i>Recording of unrealised intragroup profit realised during 20.7 (5 000 × 20%)</i>	1 000	1 000
Income tax expense (SCI)(A) Deferred tax (SFP)(A) <i>Tax implication of realising of intragroup profit during 20.7 (1 000 × 30%)</i>	300	300

The pro forma consolidation journals for the year ended 31 December 20.8 will be as follows:

	<b>Dr R</b>	<b>Cr R</b>
<b>31/12/20.8</b> Retained earnings — beginning of year (B) (3 500 – 1 000 + 300) Deferred tax (SFP)(B) (1 500 – 300) Accumulated depreciation (A) Property, plant and equipment (A) <i>Correction to agree opening balances for 20.8 with closing balances for 20.7</i>	2 800  1 200 1 000	   5 000
Accumulated depreciation (A) Depreciation (A) <i>Recording of unrealised intragroup profit realised during 20.8 (5 000 x 20%)</i>	1 000	1 000
Income tax expense (SCI)(A) Deferred tax (SFP)(A) <i>Tax implication of realising of intragroup profit during 20.8 (1 000 x 30%)</i>	300	300

The pro forma consolidation journals for the year ended 31 December 20.9 will be as follows:

	<b>Dr R</b>	<b>Cr R</b>
<b>31/12/20.9</b> Retained earnings — beginning of year (B) (2 800 – 1 000 + 300) Deferred tax (SFP) (B) (1 200 – 300) Accumulated depreciation (A) Property, plant and equipment (A) <i>Correction to agree opening balances for 20.9 with closing balances for 20.8</i>	2 100  900 2 000	   5 000
Accumulated depreciation (A) Depreciation (A) <i>Recording of unrealised intragroup profit realised during 20.9 (5 000 x 20%)</i>	1 000	1 000
Income tax expense (SCI)(A) Deferred tax (SFP)(A) <i>Tax implication of realising of intragroup profit during 20.9 (1 000 x 30%)</i>	300	300

**(d) Intragroup transactions not subject to tax**

If an intragroup transaction contains no unrealised profit element (or unrealised loss element), and it does not affect the taxable income (or assessed loss) of the companies concerned, the transaction will not have any tax implications.

If a parent grants an interest-bearing loan to its subsidiary the interest expense of the

subsidiary will contra against the interest income of the parent in the consolidated statement of comprehensive income. Thus the net effect of the interest transaction is zero, and it will have no effect on the taxable income or assessed loss of the group.

#### (e) Dividends of the subsidiary

### Study

*Group Statements (Volume 1): Chapter 6 — sections 6.08–6.10*

#### (f) Debentures within a group

### Study

*Group Statements (Volume 1): Chapter 6 —section 6.14*

#### 2.2.3.3 Consolidation of the remaining items

Once all common items and intragroup items have been eliminated, a consolidated statement of financial position, a consolidated statement of comprehensive income, a consolidated statement of changes in equity and a consolidated statement of cash flow can be drawn up.

## 2.3 Impairment of goodwill

Goodwill arising from a business combination is an intangible asset as defined by IAS 38 (AC 129) (*Intangible asset*). Goodwill arising from a business combination should be tested **annually** for possible impairment according to IAS 36 (AC 128) (*Impairment of asset*) and not only when there is an indication of impairment. (IFRS 3.54 – .55) *Business Combinations*. This annual testing usually takes place at the reporting date when the recoverable amount of the goodwill is determined and compared to the carrying amount. In cases where the recoverable amount of the goodwill is below the carrying amount, the goodwill is impaired (debit) by the difference between the recoverable amount, the goodwill is impaired (debit) by the difference between the recoverable amount and the carrying amount. This impairment loss is recorded in profit and loss as part of “Other expenses” and goodwill (asset) is credited with the same amount.

If no information is given on the impairment of the goodwill, the goodwill will be disclosed under “Non-current assets” in the consolidated statement of financial position at the amount that arose on date of acquisition (debit).

If the goodwill is impaired, the goodwill will be reflected at cost less accumulated impairment losses in the consolidated statement of financial position.

At third year level you will not be required to determine the impairment loss. This amount will be given in the question.

The question will specify whether the goodwill has been impaired **by** an amount or whether it has been impaired **down to** an amount.

The student will be required to account for and disclose the impairment loss in the consolidated annual financial statements.

**(a) Impairment of goodwill when the non-controlling interest is measured using the partial goodwill method**

When applying the partial goodwill method, the goodwill arising from the business combination is assumed to be goodwill acquired by the parent and attributable to the parent's interest in the subsidiary's net identifiable assets only. There is no goodwill recognised for the non-controlling interest in the subsidiary's net identifiable assets at acquisition.

Thus, when the goodwill is impaired at reporting date, the impairment loss is recognised in the consolidated financial statements as follows:

	Dr R	Cr R
Impairment loss (P/L)	xxx	
Goodwill (SFP)		xxx

In the analysis of the owners' equity of the subsidiary the impairment loss will be deducted from the goodwill figure in the "at"-column at the bottom of the column.

Work through the following simplified examples:

**Example 2.7**

**Impairment by an amount in the current year**

**Information provided:**

Assume the H Limited Group uses the **partial goodwill method** to account for goodwill and non-controlling interest.

H Limited obtained an 80% equity interest in the share capital of S Limited on 1 January 20.9 and paid R140 000 cash to settle the purchase price.

At acquisition date the equity of S Limited consisted of the following:

	R
Share capital (100 000 shares)	100 000
Retained earnings	50 000

S Limited made a profit for the year ended 31 December 20.9 of R10 000. The goodwill that arose from the business combination was assumed to be impaired at 31 December 20.9 with R2 000.

**Solution 2.7**

(Only the analysis of owner's equity of S Limited is illustrated.)

**Analysis of owners' equity of S Limited**

	100%	80%		20%
	Total R	At R	Since R	NCI R
<b>1 January 20.9</b>				
Share capital	100 000	80 000		20 000
Retained earnings	50 000	40 000		10 000
	150 000	120 000		30 000
Equity represented by goodwill	20 000	20 000		—
Consideration and NCI	170 000	140 000		30 000
<b>Current year</b>				
Profit for the year	10 000		8 000	2 000
	180 000	20 000	8 000	32 000
Impairment of goodwill	(2 000)	(2 000)		
	178 000	18 000		

The total goodwill in the consolidated statement of financial position for the H Limited Group as at 31 December 20.9 will consist of the following:

**Non-current assets:**

Goodwill (20 000 – 2 000) R18 000

**Example 2.8****Impairment to an amount in the current financial year****Information**

- H Limited acquired 80 000 ordinary shares in S Limited on 1 January 20.8 for R140 000. The owners' equity of S Limited at that date was as follows:

	R
Share capital — 100 000 ordinary shares	100 000
Retained earnings	50 000

On this date the assets and liabilities were considered to be fairly valued and there were no unaccounted for contingent liabilities.

- The retained earnings of S Limited amounted to R150 000 at 1 January 20.9.
- At 31 December 20.9 the goodwill of S Limited had been impaired to R5 000.
- The profit for the year of S Limited was R30 000.
- The group applies the **partial goodwill method** to account for goodwill.

**REQUIRED:**

Prepare the following:

- (i) The analysis of owners' equity at acquisition.
- (ii) The pro forma consolidation journal entries for the year ended 31 December 20.9.

**Solution 2.8****(i) Analysis of owners' equity of S Limited**

	Total R	At R	Since R	NCI R
<b>At acquisition</b>				
Share capital	100 000	80 000		20 000
Retained earnings	50 000	40 000		10 000
	150 000	120 000		30 000
Equity represented by goodwill	20 000	20 000		—
Consideration and NCI	170 000	140 000		30 000

**(ii) Pro forma consolidation journal**

		Dr R	Cr R
J1	Share capital Retained earnings Goodwill Non-controlling interest (SFP) Investment in S Limited <i>Elimination of owners' equity at acquisition of S Limited</i>	100 000 50 000 20 000	30 000 140 000
J2	Retained earnings Non-controlling interest (SFP) <i>Recording of non-controlling shareholders' interest in since acquisition reserves of S Limited</i> <i>((150 000 – 50 000) × 20%)</i>	20 000	20 000
J3	Retained earnings — beginning of year Goodwill <i>Recording of impairment of goodwill at 31 December 20.9</i> <i>(20 000 – 5 000)</i>	15 000	15 000
J4	Non-controlling interest (SCI) Non-controlling interest (SFP) <i>Recording of non-controlling interest in profit after tax of S Limited (30 000 × 20%)</i>	6 000	6 000

There is nothing new about the recognition of an impairment loss of goodwill when using the partial goodwill method. The changes to IFRS 3 (AC 140) *Business Combinations* brought in the full goodwill method where the non-controlling interest is measured at its fair value at acquisition date and therefore share in the goodwill arising from the business combination at acquisition.

Please make an in depth study of the following section. You must understand the differences that arise from recognising an impairment loss of goodwill when either the partial goodwill method is used or the full goodwill method.

**(b) Impairment of goodwill when the non-controlling interest is measured using the full goodwill method**

When applying the full goodwill method, the goodwill arising from the business combination represents goodwill relating to both the parent’s interest in the subsidiary’s net identifiable assets as well as that of the non-controlling interest. Remember that the ratio of the goodwill at acquisition attributable to both the parent and to the non-controlling interest is not necessarily equal to the profit sharing ratio. The parent’s goodwill is the excess between the consideration paid for the interest in the subsidiary’s net identifiable assets and the proportion of the equity reserves of the subsidiary as at acquisition date. The goodwill attributable to the non-controlling interest at acquisition is the excess between the fair value of the non-controlling interest’s shares of the subsidiary and the proportion of the equity reserves of the subsidiary as at date of acquisition.

The goodwill figure in the consolidated statement of financial position consists of the sum of the goodwill attributable to the parent and that of the non-controlling interest as at acquisition, as calculated in the analysis of owner’s equity of the subsidiary.

If the group’s goodwill appears to be impaired at the reporting date, the impairment loss on goodwill will be treated as a loss of the subsidiary and will therefore decrease the profit for the year in which that impairment loss arose. Since the non-controlling interest shares in the subsidiary’s profit for the year according to the profit sharing ratio, the non-controlling interest will automatically share in the impairment loss in that same profit sharing ratio. This will be the case regardless of whether that ratio is equal to the ratio in which the goodwill at acquisition is attributable to them or not.

The analysis of owner’s equity of the subsidiary will therefore be affected, but not at the bottom of the “at”-column, but within the current year’s profit calculation.

The same journal is required when the impairment loss is recognised. The only difference is that the non-controlling interest in the subsidiary’s profit is decreased with the percentage interest of the non-controlling interest in the recognised impairment loss on goodwill:

	<b>Dr</b>	<b>Cr</b>
	<b>R</b>	<b>R</b>
Impairment loss (P/L)	xxx	
Goodwill (SFP)		xxx
Non-controlling interest (SFP)	xxx	
Non-controlling interest (P/L)		xxx
<i>(impairment loss recognised above x NCI% in subsidiary’s profit)</i>		

**Example 2.9****Impairment by an amount in the current year****Information provided:**

Assume the H Limited Group uses the **full goodwill method** to account for goodwill and non-controlling interest.

H Limited obtained an 80% equity interest in the share capital of S Limited on 1 January 20.9 and paid R140 000 cash to settle the purchase price. The fair value of the non-controlling interest was estimated to be R35 000 at acquisition date.

At acquisition date the equity of S Limited consisted of the following:

	<b>R</b>
Share capital (100 000 shares)	100 000
Retained earnings	50 000

S Limited made a profit for the year ended 31 December 20.9 of R10 000. The goodwill that arose from the business combination was assumed to be impaired at 31 December 20.9 with R2 000.

**Solution 2.9**

(Only the analysis of owner's equity of S Limited is illustrated.)

**Analysis of owners' equity of S Limited**

	<b>100%</b>	<b>80%</b>		<b>20%</b>
	<b>Total R</b>	<b>At R</b>	<b>Since R</b>	<b>NCI R</b>
<b>1 January 20.9</b>				
Share capital	100 000	80 000		20 000
Retained earnings	50 000	40 000		10 000
	150 000	120 000		30 000
Equity represented by goodwill	25 000	20 000		5 000
Consideration and NCI	175 000	140 000		35 000
<b>Current year</b>				
Profit for the year	8 000		6 400	1 600
Given	10 000		8 000	2 000
Impairment of goodwill	(2 000)		(1 600)	(400)
	183 000		6 400	36 600

The goodwill in the consolidated statement of financial position for the H Limited Group as at 31 December 20.9 will still consist of the following:

**Non-current assets:**

Goodwill (25 000 – 2 000)	R23 000
---------------------------	---------

It is the non-controlling interest's share in S Limited's profit for the year which is affected by applying the full goodwill method, since it decreases by R400\* or (R2 000(impairment) x 20%(NCI)).



**Example 2.10****Impairment to an amount in the current financial year****Information**

1. H Limited acquired 80 000 ordinary shares in S Limited on 1 January 20.8 for R140 000. The owners' equity of S Limited at that date was as follows:

	R
Share capital — 100 000 ordinary shares	100 000
Retained earnings	50 000

On this date the assets and liabilities were considered to be fairly valued and there were no unaccounted for contingent liabilities.

2. The retained earnings of S Limited amounted to R150 000 at 1 January 20.9.  
 3. At 31 December 20.9 the goodwill of S Limited had been impaired to R5 000.  
 4. The profit for the year of S Limited was R30 000.  
 5. The group applies the **full goodwill method** to account for goodwill.  
 6. The fair value of the non-controlling interest on 1 January 20.8 was R35 000.

**REQUIRED:**

Prepare the following:

- (i) The analysis of owners' equity at acquisition.  
 (ii) The pro forma consolidation journal entries for the year ended 31 December 20.9.

**Solution 2.10****(i) Analysis of owners' equity of S Limited**

	Total R	At R	Since R	NCI R
<b>At acquisition</b>				
Share capital	100 000	80 000		20 000
Retained earnings	50 000	40 000		10 000
	150 000	120 000		30 000
Equity represented by goodwill — Parent and NCI	25 000	20 000		5 000 <sup>1</sup>
Consideration and NCI at fair value	175 000	140 000		35 000

<sup>1</sup> balancing amount

## (ii) Pro forma consolidation journals

		Dr R	Cr R
J1	Share capital Retained earnings Goodwill (20 000 + 5 000) NCI (at fair value) (SFP) Investment in S Limited <i>Elimination of owners' equity at acquisition of S Limited</i>	100 000 50 000 25 000	35 000 140 000
J2	Retained earnings Non-controlling interest (SFP) <i>Recording of non-controlling interest in since acquisition reserves of S Limited</i>	20 000	20 000
J3	Profit for the year (as part of "other expenses") Goodwill <i>Recording of impairment of goodwill at 31 December 20.9 (25 000 – 5 000)</i>	20 000	20 000
J4	Non-controlling interest (SCI) Non-controlling interest (SFP) <i>Recording of non-controlling interest in the profit after tax of S Limited</i> <i>((30 000 – 20 000(J3)) × 20%)</i>	2 000	2 000

## 2.4 Losses incurred by a subsidiary

### 2.4.1 General

The non-controlling interest is the portion of equity (net assets) in a subsidiary not attributable, either directly or indirectly, to a parent.

Due to the equity nature (i.e proportionate participation in the risks and rewards of the subsidiary) of the non-controlling interest any losses of a subsidiary will be allocated to the owners of the parent and the non-controlling interest according to the percentage of interest held. This may result in the non-controlling interest having a deficit balance.

### 2.4.2 Accumulated losses (or insolvency) at date of acquisition

#### Study

*Group Statements (Volume 1): Chapter 6 — section 6.11*

**Example 2.11**

The following are the abridged trial balances of Vision Limited and Star Limited for the year ended 31 December 20.0:

	<b>Vision Limited Dr/(Cr) R</b>	<b>Star Limited Dr/(Cr) R</b>
Investment in Star Limited at fair value	1 000	—
Property, plant and equipment at carrying amount	150 000	100 000
Inventories	50 000	25 000
Trade receivables	49 000	30 000
Share capital – 20 000 ordinary shares	(20 000)	—
– 10 000 ordinary shares	—	(10 000)
(Retained earnings)/Accumulated loss – 31 December 19.9	(180 000)	40 000
Long-term loan from Vision Limited	—	(80 000)
Trade and other payables	(45 000)	(35 000)
Profit for the year	(5 000)	(70 000)
	<u>—</u>	<u>—</u>

**Additional information**

- Vision Limited purchased 80% of the share capital of Star Limited on 1 January 19.8 when Star Limited had an accumulated loss of R100 000 and no other components of equity. The fair value of the identifiable assets, liabilities and contingent liabilities at the acquisition date of Star Limited was considered to be equal to the carrying amounts of these items.
- On 31 December 19.8, due to the poor financial position of Star Limited, Vision Limited wrote the loan of R80 000 to Star Limited off against retained earnings in its own financial records.
- The share capital of both companies has remained unchanged since incorporation of the companies.
- Goodwill in Star Limited is considered to be impaired by R41 000 at year end. Adjustments to the carrying amount of goodwill have no tax effect. The group uses the partial (proportionate) goodwill method to recognise goodwill.
- The fair value of the available-for-sale financial assets is equal to the original cost price thereof.
- Each share carries one vote.

**REQUIRED:**

Prepare the following for Vision Limited Group for the year ended 31 December 20.0:

- the consolidation journals;
- the consolidated statement of changes in equity; and
- the consolidated statement of financial position.

Your answer must comply with the requirements of Generally Accepted Accounting Practice.

**Only** the note on Goodwill is required and comparative figures are **not** required.

All calculations are to be done to the nearest R1.

## Part (a)

## VISION LIMITED GROUP

## Pro forma consolidation journals

	Dr R	Cr R	NCI R
J1 Share capital	10 000		
Goodwill	73 000		
Non-controlling interest (SFP)	18 000		(18 000)
Retained earnings		100 000	
Investment in Star Limited		1 000	
<i>Elimination of owners equity of Star Limited at acquisition</i>			
J2 Loan account – Star Limited	80 000		
Retained earnings		80 000	
<i>Re-instatement of loan made to Star Limited</i>			
J3 Retained earnings	12 000		
Non-controlling interest (SFP)		12 000	12 000
<i>Recording of non-controlling interest since acquisition to beginning of current year</i>			
<i>((100 000(J1) – 40 000) x 20%)</i>			
J4 Non-controlling interest (SCI) (70 000 x 20%)	14 000		
Non-controlling interest (SFP)		14 000	14 000
<i>Recording of non-controlling interest in profit for the year</i>			
J5 Profit for the year	41 000		
Goodwill		41 000	
<i>Impairment of goodwill</i>			
J6 Loan account – Vision Limited	80 000		
Loan account – Star Limited		80 000	
<i>Elimination of intragroup loans</i>			
			8 000

**Part (b)**

**VISION LIMITED GROUP**

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED  
31 DECEMBER 20.0**

	Share capital R	Retained earnings R	Total R	Non- controlling interest R	Total equity R
<b>Balance at 1 January 20.0</b>	20 000	308 000 <sup>1</sup>	328 000	(6 000)	322 000
<b>Changes in equity for 20.0</b>					
Total comprehensive income for the year		20 000 <sup>2</sup>	20 000	14 000 <sup>3</sup>	34 000
<b>Balance at 31 December 20.0</b>	<b>20 000</b>	<b>328 000</b>	<b>348 000</b>	<b>8 000</b>	<b>356 000</b>

<sup>1</sup> 180 000 + 80 000(loan) + 48 000(60 000<sup>a</sup> x 80%) = 308 000

<sup>2</sup> 5 000 + 70 000 – 14 000<sup>e</sup> – 41 000<sup>K</sup> = 20 000 or 5 000 + 56 000 (70 000 x 0,8) - 41 000<sup>K</sup> = 20 000

<sup>3</sup> 70 000 x 20% = 14 000

**Part (c)**

**VISION LIMITED GROUP**

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.0**

<b>ASSETS</b>	<b>Notes</b>	<b>R</b>
<b>Non-current assets</b>		282 000
Property, plant and equipment (150 000 + 100 000)		250 000
Goodwill (73 000 – 41 000)	1	32 000
<b>Current assets</b>		154 000
Inventories (50 000 + 25 000)		75 000
Trade receivables (49 000 + 30 000)		79 000
<b>Total assets</b>		<b>436 000</b>
<b>EQUITY AND LIABILITIES</b>		
<b>Total equity</b>		356 000
<b>Equity attributable to owners' of the parent</b>		348 000
Share capital		20 000
Retained earnings		328 000
<b>Non-controlling interest</b>		8 000
<b>Total liabilities</b>		80 000
<b>Non-current liabilities</b>		80 000
Trade and other payables (45 000 + 35 000)		80 000
<b>Total equity and liabilities</b>		<b>436 000</b>

**VISION LIMITED GROUP**  
**NOTES FOR THE YEAR ENDED 31 DECEMBER 20.0**

**1. Goodwill**

	<b>R</b>
<b>Carrying amount beginning of year</b>	73 000
Gross carrying amount	73 000
Accumulated impairment losses	—
Goodwill impaired during the year	(41 000)
<b>Carrying amount end of year</b>	32 000
Gross carrying amount	73 000
Accumulated impairment losses	(41 000)

**Calculations**

**1. Analysis of owners' equity of Star Limited**

	<b>100%</b>	<b>80%</b>		<b>20%</b>
	<b>Total R</b>	<b>At R</b>	<b>Since R</b>	<b>NCI R</b>
<b>At acquisition</b>				
Share capital	10 000	8 000		2 000
Accumulated loss	(100 000)	(80 000)		(20 000)
	(90 000)	(72 000)		(18 000)
Equity represented by goodwill	73 000	73 000		—
Consideration and NCI	(17 000)	1 000		(18 000)
<b>Since acquisition</b>				
Retained earnings ((40 000) – (100 000))	60 000		48 000	12 000
	43 000		48 000	(6 000)
<b>Current year</b>				
Profit for the year	70 000		56 000	14 000
	113 000	73 000	104 000	8 000
<b>Impairment of goodwill</b>				
Current year		(41 000)		
<b>Carrying amount – 31 December 20.0</b>		32 000		

**2. Proof of goodwill of Star Limited (IFRS 3 (AC 140).32)**

	<b>R</b>
Consideration transferred at acquisition date	1 000
Fair value of non-controlling interest ((10 000 – 100 000) x 20%)	(18 000)
	<u>17 000</u>
Less: Net amount of identifiable assets acquired and liabilities assumed at acquisition date (10 000 – 100 000)	90 000
Goodwill	73 000
Impairment (given)	(41 000)
	<u><u>32 000</u></u>

## 2.4.3 Post-acquisition losses (or insolvency) of subsidiaries

### Study

*Group Statements (Volume 1): Chapter 6 — section 6.12 – 6.13*

### Example 2.12

The following are the trial balances of Pritt Limited and Stick Limited for the year ended 28 February 20.9:

	<b>Pritt Limited Dr/(Cr) R</b>	<b>Stick Limited Dr/(Cr) R</b>
Share capital – 525 000 ordinary shares	(525 000)	—
– 90 000 ordinary shares	—	(90 000)
Retained earnings – 1 March 20.8	(497 335)	—
Accumulated loss – 1 March 20.8	—	86 700
Gross profit	(183 525)	(195 000)
Other income	(54 500)	—
Other expenses	96 630	31 300
Income tax expense	30 631	45 836
Dividends paid – 28 February 20.9	80 000	20 000
Loan from Pritt Limited	—	(100 000)
Trade and other payables	(40 470)	(14 320)
Property, plant and equipment	621 609	162 000
Investment in Stick Limited: – Ordinary shares at fair value	65 000	—
– Loan	100 000	—
Available-for-sale financial assets	175 000	—
Trade receivables	23 960	24 184
Inventories	108 000	29 300
	<u>—</u>	<u>—</u>

### Additional information

- On 1 March 20.6, Pritt Limited acquired a 60% interest in Stick Limited. On the date of acquisition the equity of Stick Limited consisted of the following items:

	<b>R</b>
Share capital – 90 000 ordinary shares	90 000
Retained earnings	12 000

On the above acquisition date there were no unidentified assets, liabilities or contingent liabilities and the fair value of all assets, liabilities and contingent liabilities were confirmed to be equal to the carrying amounts thereof, unless stated otherwise.

- During the current year Pritt Limited made a loan to Stick Limited. No repayment dates have been set and the loans bear interest at 10% per annum. The interest paid and received has been included in the trial balances of the relevant companies for the year ended 28 February 20.9.

3. Pritt Limited charges Stick Limited a management fee of R7 000 per annum. Management fees paid have been included in "other expenses". The management of Pritt Limited considers it possible to turn Stick Limited into a profitable entity.
4. The fair value of available-for-sale financial assets is equal to the cost price thereof unless otherwise stated.
5. The SA normal tax rate since 1 March 20.6 is 28%.
6. The value of goodwill was tested for impairment at 28 February 20.9 and it was determined that the goodwill in Stick Limited had been impaired to R1 000 at the end of the current year. The group uses the proportionate (partial) method to account for goodwill.
7. In all companies, each share carries one vote.

**REQUIRED:**

Prepare the consolidated financial statements for the Pritt Limited Group for the year ended 28 February 20.9.

Your answer must comply with the requirements of Generally Accepted Accounting Practice.

Notes to the consolidated annual financial statements and comparative figures are **not** required.

Round off all amounts to the nearest Rand.

**Solution 2.12**

**PRITT LIMITED GROUP  
CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 28 FEBRUARY 20.9**

	<b>R</b>
<b>ASSETS</b>	
<b>Non-current assets</b>	959 609
Property, plant and equipment (621 609 + 162 000)	783 609
Available-for-sale financial assets	175 000
Goodwill (3 800 – 2 800)	1 000
<b>Current assets</b>	185 444
Inventories (108 000 + 29 300)	137 300
Trade receivables (23 960 + 24 184)	48 144
<b>Total assets</b>	1 145 053
<b>EQUITY AND LIABILITIES</b>	
<b>Total equity</b>	1 090 263
<b>Equity attributable to owners of the parent</b>	1 049 797
Share capital	525 000
Retained earnings	524 797
<b>Non-controlling interest</b>	40 466
<b>Total liabilities</b>	54 790
<b>Current liabilities</b>	54 790
Trade and other payables	54 790
<b>Total equity and liabilities</b>	1 145 053



**PRITT LIMITED GROUP**

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED  
28 FEBRUARY 20.9**

	<b>R</b>
Gross profit (183 525 + 195 000)	378 525
Other income (54 500 – 7 000 ( <i>management fee</i> ) – 12 000 ( <i>dividend rec</i> ) – 10 000 ( <i>interest rec</i> ))	25 500
Other expenses (96 630 + 31 300 – 7 000 ( <i>management fee</i> ) – 10 000 ( <i>interest paid</i> ) + 2 800 ( <i>impairment</i> ))	(113 730)
<b>Profit before tax</b>	<u>290 295</u>
Income tax expense (30 631 + 45 836)	<u>(76 467)</u>
<b>PROFIT FOR THE YEAR</b>	<u>213 828</u>
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>	<u>213 828</u>
Total comprehensive income attributable to:	
Owners of the parent <sup>5</sup>	166 682
Non-controlling interest <sup>6</sup>	<u>47 146</u>
	<u>213 828</u>

**PRITT LIMITED GROUP**

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED  
28 FEBRUARY 20.9**

	Share capital R	Retained earnings R	Total R	Non- controlling interest R	Total equity R
<b>Balance at 1 March 20.8</b>	525 000	438 115 <sup>1</sup>	963 115	1 320 <sup>2</sup>	964 435
<b>Changes in equity for 20.9</b>					
Dividends		(80 000)	(80 000)	(8 000)	(88 000)
Total comprehensive income for the year		166 682	166 682	47 146	213 828
<b>Balance at 28 February 20.9</b>	<u>525 000</u>	<u>524 797</u>	<u>1 049 797</u>	<u>40 466</u>	<u>1 090 263</u>

<sup>1</sup> 497 335 – 59 220 = 438 115

<sup>2</sup> C1<sup>a</sup>

## Calculations

### B1 Analysis of owners' equity of Stick Limited

	100%	80%		20%
	Total R	At R	Since R	NCI R
<b>At acquisition</b>				
Share capital	90 000	54 000		36 000
Return earnings	12 000	7 200		4 800
	102 000	61 200		40 800
Equity represented by goodwill	3 800	3 800		—
Consideration paid and NCI	105 800	65 000		40 800
<b>Since acquisition</b>				
Retained earnings (86 700 + 12 000)	(98 700)		(59 220)	(39 480)
	7 100			1 320 <sup>a</sup>
<b>Current year</b>				
Profit for the year (C2)	117 864		70 718	47 146
Dividends paid	(20 000)		(12 000)	(8 000)
	104 964	3 800	(502)	40 466
<b>Impairment of goodwill</b>				
Current year (3 800 – 1 000)		(2 800)		
<b>Carrying amount at 28 February 20.9</b>		1 000		

### B2 Profit for the year

	<b>R</b>
Gross profit	195 000
Other expenses	(31 300)
Income tax expence	(45 836)
	<u>117 864</u>

## 2.5 Revision example

### Revision Example 1

The following are the trial balances of Auto Limited and Mobile Limited for the year ended 31 December 20.6:

	Auto Limited Dr/(Cr) R	Mobile Limited Dr/(Cr) R
Property, plant and equipment	535 000	462 000
Investment in Mobile Limited at fair value		
— 120 000 ordinary shares	180 000	—
Preference dividends paid	—	8 000
Ordinary dividends paid	15 000	20 000
Income tax expense	129 485	100 746
Long-term loan to Mobile Limited	80 000	—
Trade receivables	76 755	63 554
Cash and cash equivalents	260 320	302 000
Share capital — 300 000 ordinary shares	(300 000)	—
— 150 000 ordinary shares	—	(150 000)
— 10% 80 000 preference shares	—	(80 000)
Retained earnings — 1 January 20.6	(245 560)	(164 500)
Profit before tax	(446 500)	(347 400)
Long-term borrowings	(200 000)	(80 000)
Trade and other payables	(84 500)	(134 400)
	<u>—</u>	<u>—</u>

Intragroup loan —  
eliminated on  
consolidation

### Additional information

1. Auto Limited acquired 120 000 ordinary shares in Mobile Limited on 1 January 20.4. The retained earnings of Mobile Limited at this date were R47 000 and there were no other reserves.
2. On the date of acquisition the land and buildings of Mobile Limited with a carrying amount of R120 000 were revalued to R140 000. No entries were made in the books of Mobile Limited relating to the revaluation. (All tax implications relating to the revaluation can be ignored.)
3. At the above acquisition date there were no unidentified assets, liabilities or contingent liabilities and the fair values of all assets, liabilities and contingent liabilities were confirmed to be equal to the carrying amounts thereof, with the exception of the assets mentioned in additional information 2.

4. Profit before tax is made up as follows:

	Auto Limited R	Mobile Limited R
Gross profit	419 800	328 000
Other income	67 200	53 200
Other expenses	(32 500)	(22 600)
Finance costs	(8 000)	(11 200)
	446 500	347 400

Includes dividends received from Mobile Limited of R16 000 ( $20\ 000 \times 80\%$ ) to be eliminated on consolidation

Includes intragroup profit of R40 000 ( $140\ 000 - 100\ 000$ ) to be eliminated on consolidation (point 6)

Intragroup interest of R11 200 ( $80\ 000 \times 14\%$ ) to be eliminated on consolidation

5. On 1 January 20.6 a long-term loan of R80 000 was made by Auto Limited to Mobile Limited and is repayable in full on 1 January 20.10. Interest is calculated at 14% per annum and has been paid to Auto Limited for the current year.
6. Mobile Limited purchased a machine from Auto Limited for R140 000 on 1 July 20.6. The carrying amount of the machine on 1 July 20.6 was R100 000. The machine was originally purchased by Auto Limited on 1 July 20.3 for R250 000. Both companies depreciate machinery at 20% per annum using the straight-line method which is in line with the wear and tear allowance used by the South African Revenue Service. The useful life of the machine has remained unchanged.
7. In all companies, each share carries one vote.
8. The fair value of available-for-sale financial assets is equal to the cost price thereof, unless otherwise stated.
9. At the end of the current year goodwill was assessed for impairment and it was found that goodwill was not impaired. The group uses the partial goodwill method to recognise goodwill.

**REQUIRED:**

Prepare the consolidated annual financial statements of the Auto Limited Group for the year ended 31 December 20.6.

Your answer must comply with the requirements of Generally Accepted Accounting Practice.

Tax implications can be ignored

**No** notes or comparative amounts are required.

Show **all** calculations.

Round off **all** calculations to the nearest Rand.

## AUTO LIMITED GROUP

## CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.6

	R
<b>ASSETS</b>	
<b>Non-current assets</b>	993 400
Property, plant and equipment (535 000 + 462 000 (B1) – 40 000 (unrealised profit) + 10 000 (B1) + 20 000)	987 000
Goodwill	6 400 <sup>a</sup>
<b>Current assets</b>	702 629
Trade receivables (76 755 + 63 554)	140 309
Cash and cash equivalents (260 320 + 302 000)	562 320
<b>Total assets</b>	<u>1 696 029</u>
<b>EQUITY AND LIABILITIES</b>	
<b>Total equity</b>	1 277 129
<b>Equity attributable to owners of the parent</b>	1 086 498
Share capital	300 000
Retained earnings	786 498
<b>Non-controlling interest</b> (110 631 <sup>f</sup> + 80 000(pref. shares))	190 631
<b>Total liabilities</b>	418 900
<b>Non-current liabilities</b>	200 000
Long-term borrowings (200 000 + 80 000 – 80 000)	200 000
<b>Current liabilities</b>	218 900
Trade and other payables (84 500 + 134 400)	218 900
<b>Total equity and liabilities</b>	<u>1 696 029</u>

The revaluation of R20 000 (140 000 – 120 000) must be added as the revaluation was not recorded in the books of Mobile Limited

**AUTO LIMITED GROUP**

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.6**

	R
Gross profit (419 800 + 328 000)	747 800
Other income (67 200 + 53 200 – 16 000(div) – 40 000(B1) – 11 200(interest))	53 200
Other expenses (32 500 + 22 600 – 10 000(1)(dep))	(45 100)
Finance costs (8 000 + 11 200 – 11 200)	(8 000)
<b>Profit before tax</b>	<b>747 900</b>
Income tax expense (129 485 + 100 746)	(230 231)
<b>PROFIT FOR THE YEAR</b>	<b>517 669</b>
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>	<b>517 669</b>
Total comprehensive income attributable to:	
Owners of the parent (balancing)	461 938
Non-controlling interest (47 731 <sup>c</sup> + 8 000(pref dividends))	55 731
	<u>517 669</u>

**AUTO LIMITED GROUP**

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.6**

	Share capital R	Retained earnings R	Total R	Non-controlling interest R	Total equity R
<b>Balance at 1 January 20.6</b>	300 000	339 560 <sup>1</sup>	639 560	146 900 <sup>2</sup>	786 460
<b>Changes in equity for 20.6</b>					
Profit for the year/Total comprehensive income for the year		461 938	461 938	55 731	517 669
Dividends paid		(15 000)	(15 000)	(12 000) <sup>3</sup>	(27 000)
<b>Balance at 31 December 20.6</b>	<u>300 000</u>	<u>786 498</u>	<u>1 086 498</u>	<u>190 631<sup>4</sup></u>	<u>1 277 129</u>

<sup>1</sup> 245 560 + 94 000<sup>b</sup> = 339 560

<sup>2</sup> 66 900<sup>g</sup> + 80 000(pref) = 146 900

<sup>3</sup> 4 000<sup>e</sup> + 8 000(pref div) = 12 000

<sup>4</sup> Check: 110 631<sup>f</sup> + 80 000(pref shares) = 190 631

**Calculations**

**B1. Gain on sale of machinery (Auto Limited to Mobile Limited)**

	R
Selling price	140 000
Carrying amount	(100 000)
	<u>40 000</u>
Excess depreciation (40 000/2 years x 6/12)	<u>10 000</u>

## Comments

---

Auto Limited (parent) sold a machine to Mobile Limited (subsidiary) thus the intragroup profit of R40 000 (calculation 1) will be eliminated in the statement of financial position (property, plant and equipment) and the statement of comprehensive income (other income). The parent made the profit thus there is no effect on the non-controlling interest.

The remaining useful life of the machine is calculated as follows:

		<b>R</b>
1 July 20.3	Cost price	250 000
31 December 20.3	Depreciation (250 000 x 20% x 6/12)	(25 000) 6 months
31 December 20.4	Depreciation (250 000 x 20%)	(50 000) 1 year
31 December 20.5	Depreciation (250 000 x 20%)	(50 000) 1 year
30 June 20.6	Depreciation (250 000 x 20% x 6/12)	<u>(25 000) 6 months</u>
	Carrying amount on date of sale	<u>100 000 3 years</u>

The useful life of the machine is 5 years ( $100/20 = 5$  years).

3 years have already been written off before the asset was sold, therefore the remaining useful life of the machine is 2 years. The intragroup profit is thus realised over 2 years through depreciation. The asset was sold on 1 July 20.6 thus the excess depreciation is calculated pro rata for half the year (refer to calculation 1).

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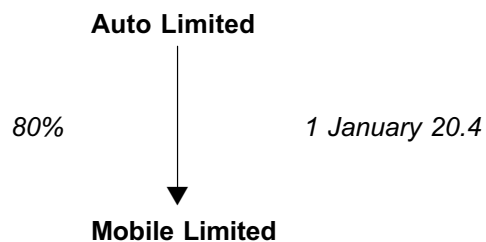
## Comments

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### **Percentage interest that Auto Limited has in:**

Mobile Limited:  $120\ 000/150\ 000 = 80\%$

### **Structure of group:**



The acquisition took place on 1 January 20.4 thus when the analysis of Mobile Limited is prepared there will be "since acquisition" reserves as the group is being consolidated on 31 December 20.6.

---

**2. Analysis of owners equity of Mobile Limited**

	Total 100%	Auto Limited 80%		NCI 20%
	R	At R	Since R	R
<b>At acquisition</b>				
Share capital	150 000	120 000		30 000
Retained earnings	47 000	37 600		9 400
Revaluation surplus (140 000 – 120 000)	20 000	16 000		4 000
	217 000	173 600		43 400
Equity represented by goodwill	6 400	6 400 <sup>a</sup>		—
Consideration and NCI	223 400	180 000		43 400
<b>Since acquisition</b>				
Retained earnings (164 500 – 47 000)	117 500		94 000 <sup>b</sup>	23 500
				66 900 <sup>g</sup>
<b>Current year</b>				
Profit for the year	238 654		190 923	47 731 <sup>c</sup>
Profit for the year (347 400 – 100 746)	246 654			
Income attributable to preference shareholders	(8 000)			
Dividends paid	(20 000)		(16 000)	(4 000) <sup>e</sup>
	559 554		268 923	110 631 <sup>f</sup>

Disclosed in **SOCIE** under the **RETAINED EARNINGS COLUMN** in opening retained earnings

Disclosed in **SFP** as **NON-CURRENT ASSET**

Disclosed in **SCI** after **TOTAL COMPREHENSIVE INCOME FOR THE YEAR**

Intragroup transaction – eliminated in **SCI** from “other income”

Disclosed in **SOCIE** as dividends paid under **NON-CONTROLLING INTEREST** column

Disclosed in **SFP** under **EQUITY AND LIABILITIES** (with regards to ordinary shares)



#### 4. Pro forma consolidation journals

	Dr R	Cr R	NCI R
<b>At acquisition</b>			
J1 Property, plant and equipment	20 000		
Revaluation surplus		20 000	
<i>Recording of land and buildings of Mobile Limited revalued to fair value at acquisition (140 000 – 120 000)</i>			
J2 Share capital	150 000		
Retained earnings	47 000		
Revaluation surplus	20 000		
Non-controlling interest (SFP)		43 400	43 400
Investment in Mobile Limited		180 000	
Goodwill	6 400		
<i>Elimination of owners' equity of Mobile Limited at acquisition</i>			
<b>Since acquisition</b>			
J3 Retained earnings – beginning of the year	23 500		
Non-controlling interest (SFP)		23 500	23 500
<i>Recording of non-controlling interest in retained earnings of Mobile Limited ((165 400 – 47 000) × 20%)</i>			
			66 900 <sup>g</sup>
<b>Current year</b>			
J4 Non-controlling interest (SCI)	47 731		
Non-controlling interest (SFP)		47 731	47 731 <sup>c</sup>
<i>Recording of non-controlling interest in profit after tax of Mobile Limited ((347 400 – 100 746 – 8 000(pref div)) × 20%)</i>			
J5 Other income	16 000		
Non-controlling interest (SFP)	4 000		(4 000) <sup>e</sup>
Dividends paid		20 000	
<i>Elimination of intragroup ordinary dividend and recording of non-controlling interest therein</i>			
			110 631 <sup>f</sup>
<b>Preference share capital</b>			
J6 Preference share capital	80 000		
Non-controlling interest (SFP)		80 000	80 000
<i>Elimination of preference owners' equity of Mobile Limited at acquisition</i>			
J7 Non-controlling interest (SCI)	8 000		(8 000) <sup>d</sup>
Preference dividend paid		8 000	
<i>Elimination of intragroup preference dividend and recording of non-controlling interest therein</i>			
<b>Non-controlling interest – Statement of Financial Position</b>			190 631

Students struggle to understand consolidation journals. The analysis can be used as guidance on how to prepare consolidation journals.

If the subsidiary revalues its net assets at the acquisition date to fair value and **does not** recognise the revalued amounts in its own records, then for consolidation purposes an adjustment is required to recognise the revalued assets of the subsidiary. A pro forma journal entry has to be passed on consolidation to bring the revaluation into account. (Refer to journal 1.)

**Analysis of owners' equity of Mobile Limited**

	100%	Auto Limited 80%		20%
	Total R	At R	Since R	NCI R
<b>At acquisition</b>				
Share capital	150 000	120 000		30 000
Retained earnings	47 000	37 600		9 400
Revaluation surplus (140 000 – 120 000)	20 000	16 000		4 000
	217 000	173 600		43 400
Equity represented by goodwill	6 400	6 400 <sup>a</sup>		—
Consideration and NCI	223 400	180 000		43 400
<b>Since acquisition</b>				
Retained earnings (164 500 – 47 000)	117 500		94 000 <sup>b</sup>	23 500
				66 900 <sup>g</sup>
<b>Current year</b>				
Profit for the year	238 654		190 923	47 731 <sup>c</sup>
Profit for the year (347 400 – 100 746)	246 654			
Income attributable to preference owners	(8 000)			
Dividends paid	(20 000)		(16 000)	(4 000) <sup>e</sup>
	559 554		268 923	110 631 <sup>f</sup>

Journal 2

Journal 3

Journal 4

Journal 5

## 2.6 Assessment criteria

After having studied this study unit you should be able to:

- Apply the consolidation procedures in IAS 27 (AC 132).
- Eliminate intragroup balances and intragroup transactions and resulting unrealised profits.
- Provide for deferred tax on unrealised intragroup profits.
- Prepare the pro forma consolidation journal entries for a group.
- Account for the accumulated losses of a subsidiary and insolvent subsidiaries.
- Account for any impairment of goodwill.
- Prepare the consolidated statement of comprehensive income, statement of changes in equity and statement of financial position of a group.

## Complex groups

### Learning outcome 3

After studying this study unit, you should be able to:

identify different group formats in order to apply the relevant consolidation procedures for the preparation of consolidated annual financial statements of a complex group.

### OVERVIEW OF THE STUDY UNIT

This study unit consists of the following sections:	Page
3.1 Composition of a group of entities	70
3.2 Horizontal groups	72
3.3 Vertical groups	77
3.4 Mixed groups	96
3.5 Assessment criteria	103

#### Study

*Group Statements (Volume 1): Chapter 8*

### 3.1 Composition of a group of entities

#### Study

*Group Statements (Volume 1): Chapter 8 (8.01–8.04)*

A parent together with its subsidiaries and sub-subsidiaries, if there are any, form a group of entities. The following describes the different possible compositions of a group of entities:

#### Simple group

A simple group is a group consisting of a parent and a single subsidiary.

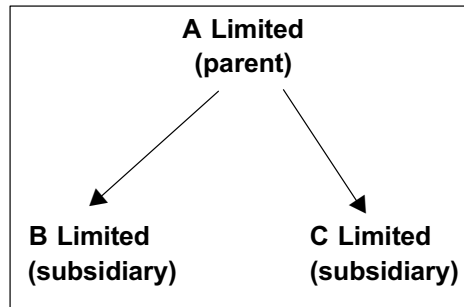
#### Complex group

A complex group is a group consisting of a parent and more than one subsidiary. There are three types of complex groups, namely horizontal, vertical and mixed groups.

**Horizontal group** (single level structures)

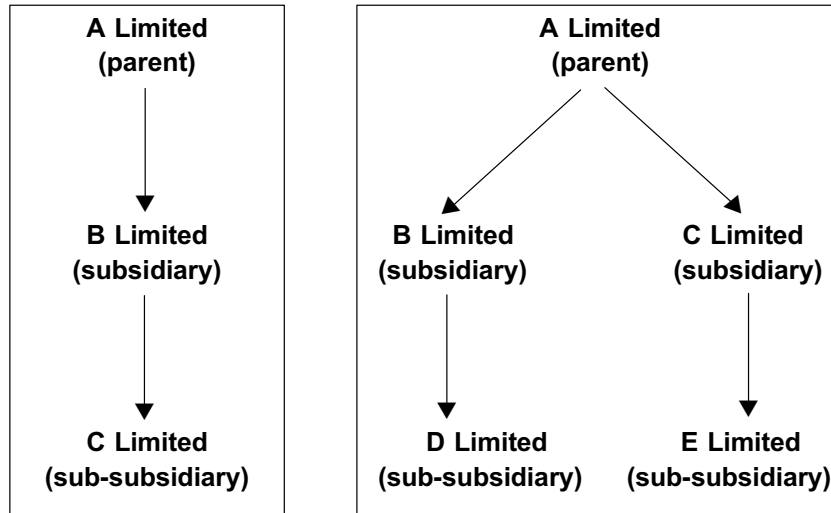
A horizontal group is a group consisting of a parent which holds a direct interest in several other entities (subsidiaries).

The group can be schematically illustrated as follows:



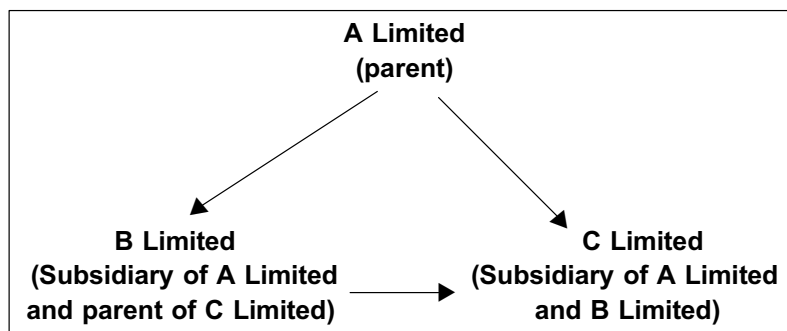
**Vertical group** (multiple level structures)

A vertical group is a group consisting of a parent which holds a direct interest in a subsidiary which in turn holds a direct interest in its own subsidiary. The parent thus holds an indirect interest in the bottom subsidiary. The group can be schematically illustrated as follows:



**Mixed group**

A mixed group is a group consisting of a horizontal and vertical group. The group can be schematically illustrated as follows:



## 3.2 Horizontal groups

### Example 3.1

The following are the abridged trial balances of A Limited, B Limited and C Limited at 31 December 20.3:

	A Limited R	B Limited R	C Limited R
<b>Credits</b>			
Share capital			
— 100 000 ordinary shares	100 000	—	—
— 80 000 ordinary shares	—	80 000	—
— 30 000 ordinary shares	—	—	60 000
Retained earnings – beginning of year	200 000	150 000	110 000
Profit before tax	345 000	220 000	95 000
	645 000	450 000	265 000
<b>Debits</b>			
Property, plant and equipment	266 500	284 000	136 500
Investment in B Limited at fair value	110 000	—	—
Investment in C Limited at fair value	100 000	—	—
Trade and other receivables	35 000	60 000	65 000
Income tax expense	103 500	66 000	28 500
Dividends paid	30 000	40 000	35 000
	645 000	450 000	265 000

### Additional information

1. A Limited purchased 60 000 shares in B Limited on 1 January 20.0 when B Limited's retained earnings amounted to R60 000. On 1 January 20.1 A Limited acquired 27 000 shares in C Limited, when the retained earnings of C Limited amounted to R40 000. On both acquisition dates the fair values of the identifiable assets, liabilities and contingent liabilities were considered to be equal to the carrying amounts of these items.
2. Each share carries one vote.
3. The group uses the partial goodwill method to recognise goodwill. (The non-controlling interest is measured at its proportionate interest in the net identifiable assets of the acquirer.) Goodwill was not considered to be impaired at year end.
4. The fair value of available-for-sale financial assets is equal to the cost price thereof. All fair value adjustments are recognised in equity.

#### REQUIRED:

Prepare the consolidated annual financial statement of the A Limited Group for year ended 31 December 20.3. Your answer must comply with the requirements of Generally Accepted Accounting Practice.

No notes are required.

Ignore comparative figures.

## A LIMITED GROUP

## CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.3

	R
<b>ASSETS</b>	
<b>Non-current assets</b>	702 000
Property, plant and equipment (266 500 + 284 000 + 136 500)	687 000
Goodwill (5 000 <sup>a</sup> + 10 000 <sup>g</sup> )	15 000
<b>Current assets</b>	160 000
Trade and other receivables (35 000 + 60 000 + 65 000)	160 000
<b>Total assets</b>	<u>862 000</u>
<b>EQUITY AND LIABILITIES</b>	
<b>Total equity</b>	862 000
<b>Equity attributable to owners of the parent</b>	755 850
Share capital	100 000
Retained earnings	655 850
<b>Non-controlling interest</b> (86 000 <sup>f</sup> + 20 150 <sup>m</sup> )	106 150
<b>Total equity and liabilities</b>	<u>862 000</u>

## A LIMITED GROUP

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.3

	R
<b>Profit before tax</b> (345 000 + 220 000 + 95 000 – 30 000(div) – 31 500(div))	598 500
Income tax expense (103 500 + 66 000 + 28 500)	(198 000)
<b>PROFIT FOR THE YEAR</b>	<u>400 500</u>
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>	<u>400 500</u>
Total comprehensive income attributable to:	
Owners of the parent	355 350
Non-controlling interest (38 500 <sup>d</sup> + 6 650 <sup>j</sup> )	45 150
	<u>400 500</u>

## A LIMITED GROUP

### CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.3

	Share capital R	Retained earnings R	Total R	Non- controlling interest R	Total equity R
<b>Balance at 1 January 20.3</b>	100 000	330 500 <sup>1</sup>	430 500	74 500 <sup>2</sup>	505 000
<b>Changes in equity for 20.3</b>					
Dividends paid		(30 000)	(30 000)	(13 500) <sup>3</sup>	(43 500)
Profit for the year/Total comprehensive income for the year		355 350	355 350	45 150	400 500
<b>Balance at 31 December 20.3</b>	<b>100 000</b>	<b>655 850</b>	<b>755 850</b>	<b>106 150<sup>4</sup></b>	<b>862 000</b>

<sup>1</sup>  $200\,000 + 67\,500^b + 63\,000^h = 330\,500$  or  $200\,000 + ((110\,000 - 40\,000) - 7\,000 (J6)) + ((150\,000 - 60\,000) - 22\,500 (J2)) = 330\,500$

<sup>2</sup>  $57\,500^c + 17\,000^i = 74\,500$

<sup>3</sup>  $10\,000^e + 3\,500^k = 13\,500$

<sup>4</sup> Check:  $86\,000^f + 20\,150^m = 106\,150$

## Calculations

### C1 Analysis of owners' equity of B Limited

	100%	75%		25%
	Total R	At R	Since R	NCI R
<b>At acquisition</b>				
Share capital	80 000	60 000		20 000
Retained earnings	60 000	45 000		15 000
	140 000	105 000		35 000
Equity represented by goodwill	5 000	5 000 <sup>a</sup>		—
Consideration and NCI	145 000	110 000		35 000
<b>Since acquisition</b>				
Retained earnings (150 000 – 60 000)	90 000		67 500 <sup>b</sup>	22 500
				57 500 <sup>c</sup>
<b>Current year</b>				
Profit for the year (220 000 – 66 000)	154 000		115 500	38 500 <sup>d</sup>
Dividends paid	(40 000)		(30 000)	(10 000) <sup>e</sup>
	349 000	5 000	153 000	86 000 <sup>f</sup>



## C2 Analysis of owners' equity of C Limited

	100%	90%		10%
	Total R	At R	Since R	NCI R
<b>At acquisition</b>				
Share capital	60 000	54 000		6 000
Retained earnings	40 000	36 000		4 000
	100 000	90 000		10 000
Equity represented by goodwill	10 000	10 000 <sup>g</sup>		—
Consideration and NCI	110 000	100 000		10 000
<b>Since acquisition</b>				
Retained earnings (110 000 – 40 000)	70 000		63 000 <sup>b</sup>	7 000
				17 000 <sup>i</sup>
<b>Current year</b>				
Profit for the year (95 000 – 28 500)	66 500		59 850	6 650 <sup>j</sup>
Dividends paid	(35 000)		(31 500)	(3 500) <sup>k</sup>
	211 500	(10 000)	91 350	20 150 <sup>m</sup>

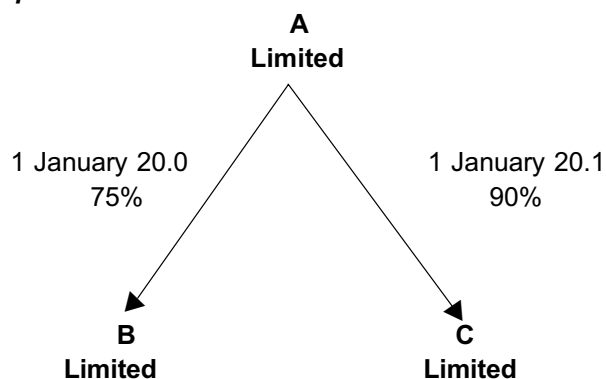
## Comments

### Percentage interest that A Limited has in:

B Limited:  $60\,000/80\,000 = 75\%$

C Limited:  $27\,000/(60\,000/R2) = 90\%$

### Structure of group:



From the above it is clear that A Limited has a direct interest in B Limited and a direct interest in C Limited thus the group is a **horizontal group**.

An analysis will be prepared for B Limited and C Limited. An analysis is prepared for each subsidiary individually as the group is a horizontal group and there is no direct relationship between B Limited and C Limited.

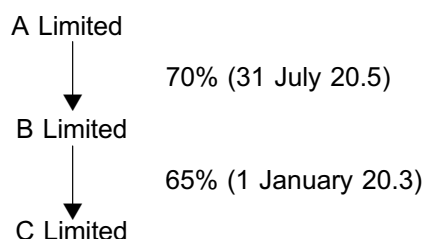
### C3 Pro forma consolidation journals

	Dr R	Cr R	NCI R
J1	Share capital	80 000	
	Retained earnings	60 000	
	Goodwill	5 000 <sup>a</sup>	
	Non-controlling interest (SFP)		35 000
	Investment in B Limited	110 000	
	<i>Elimination of owners' equity in B Limited at acquisition</i>		
J2	Retained earnings — beginning of year	22 500	
	Non-controlling interest (SFP)		22 500
	<i>Recording of the non-controlling interest in retained earnings of B Limited [(150 000 – 60 000) × 25%]</i>		
			<u>57 500<sup>c</sup></u>
J3	Non-controlling interest (SCI)	38 500	
	Non-controlling interest (SFP)		38 500
	<i>Recording of non-controlling interest in profit for the year of B Limited [(220 000 – 66 000) × 25%]</i>		
J4	Profit before tax (other income)	30 000	
	Non-controlling interest (SFP)	10 000	(10 000) <sup>e</sup>
	Dividends paid		40 000
	<i>Elimination of intragroup dividend and recording portion of non-controlling interest therein</i>		
			<u>86 000<sup>f</sup></u>
J5	Share capital	60 000	
	Retained earnings	40 000	
	Goodwill	10 000 <sup>g</sup>	
	Non-controlling interest (SFP)		10 000
	Investment in C Limited	100 000	
	<i>Elimination of owners' equity in C Limited at acquisition</i>		
J6	Retained earnings — beginning of year	7 000	
	Non-controlling interest (SFP)		7 000
	<i>Recording of non-controlling interest in retained earnings of C Limited [(110 000 – 40 000) × 10%]</i>		
			<u>17 000<sup>i</sup></u>
J7	Non-controlling interest (SCI)	6 650	
	Non-controlling interest (SFP)		6 650
	<i>Recording of non-controlling interest in profit for the period of C Limited [(95 000 – 28 500) × 10%]</i>		
J8	Profit before tax (other income)	31 500	
	Non-controlling interest (SFP)	3 500	(3 500) <sup>k</sup>
	Dividends paid		35 000
	<i>Elimination of intragroup dividend and portion of non-controlling interest therein.</i>		
			<u>20 150<sup>m</sup></u>

### 3.3 Vertical groups

**Important:**

Note that the effective holding method explained in **Group Statements** is not used in this module. You do not need to study the effective holding method for FAC3704.



#### Comments

A vertical group is always consolidated from bottom to the top.

The owners' equity of C Limited will always be analysed before the owners' equity of B Limited. **The date of acquisition** of an interest in a subsidiary is therefore **very important**. If B Limited purchased its interest in C Limited on 1 January 20.3 and A Limited purchased its interest in B Limited on 31 July 20.5, C Limited will only become a subsidiary of A Limited on 31 July 20.5, the date the group was formed. In simple terms we will only take into account profits of the sub-subsidiary "C Limited" from 31 July 20.5 (the date the group was formed.)

#### Example 3.2

The following are the abridged trial balances of A Limited, B Limited and C Limited at 31 December 20.3:

	A Limited R	B Limited R	C Limited R
<b>Credits</b>			
Share capital — 200 000 ordinary shares	200 000	—	—
— 140 000 ordinary shares	—	140 000	—
— 150 000 ordinary shares	—	—	150 000
Retained earnings — beginning of year	300 000	190 000	210 000
Profit before tax	250 000	200 000	210 000
Long-term liability	70 000	—	95 000
	820 000	530 000	665 000
<b>Debits</b>			
Property, plant and equipment	345 000	150 000	437 000
Investment in B Limited at fair value	165 000	—	—
Investment in C Limited at fair value	—	232 000	—
Trade and other receivables	205 000	48 000	130 000
Income tax expense	75 000	60 000	63 000
Dividends paid	30 000	40 000	35 000
	820 000	530 000	665 000

## Additional information

1. A Limited purchased 98 000 shares in B Limited on 1 January 20.0 when B Limited's retained earnings amounted to R90 000. The fair values of the identifiable assets, liabilities and contingent liabilities at the acquisition date of B Limited were considered to be equal to the carrying amounts of these items.
2. B Limited acquired 127 500 shares in C Limited on 1 January 20.1, when C Limited's retained earnings amounted to R120 000. The fair values of the identifiable assets, liabilities and contingent liabilities at the acquisition date of C Limited were considered to be equal to the carrying amounts of these items.
3. Each share carries one vote.
4. The group uses the partial goodwill method to recognise goodwill. (The non-controlling interest is recognised at its proportionate share of the acquirer's net identifiable assets.) Goodwill was not considered to be impaired at year end.
5. The fair value of available-for-sale financial assets is equal to the cost price thereof.

### REQUIRED:

Prepare the consolidated annual financial statement of the A Limited Group for year ended 31 December 20.3. Your answer must comply with the requirements of Generally Accepted Accounting Practice.

Ignore the implication of secondary tax on companies.

No notes are required.

Ignore comparative figures.

## Solution 3.2

### A LIMITED GROUP

#### CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.3

	R
<b>ASSETS</b>	
<b>Non-current assets</b>	937 750
Property, plant and equipment (345 000 + 150 000 + 437 000)	932 000
Goodwill (4 000 <sup>g</sup> + 1 750 <sup>o</sup> (2 500 <sup>a</sup> × 70%))	5 750
<b>Current assets</b>	383 000
Trade and other receivables (205 000 + 48 000 + 130 000)	383 000
<b>Total assets</b>	<u>1 320 750</u>

R

**EQUITY AND LIABILITIES**

<b>Total equity</b>	1 155 750
<b>Equity attributable to owners of the parent</b>	905 190
Share capital	200 000
Retained earnings	705 190
<b>Non-controlling interest</b> (70 800 <sup>f</sup> + 179 760 <sup>n</sup> )	250 560
<b>Total liabilities</b>	165 000
<b>Non-current liabilities</b>	165 000
Long-term borrowings (70 000 + 95 000)	165 000
<b>Total equity and liabilities</b>	1 320 750

**A LIMITED GROUP****CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.3**

R

<b>Profit before tax</b> (C3)	602 250
Income tax expense (75 000 + 60 000 + 63 000)	(198 000)
<b>PROFIT FOR THE YEAR</b>	404 250
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>	404 250
Total comprehensive income attributable to:	
Owners of the parent	311 640
Non-controlling interest (42 000 <sup>k</sup> + 28 560 <sup>l</sup> + 22 050 <sup>d</sup> )	92 610
	404 250

**A LIMITED GROUP****CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.3**

	Share capital R	Retained earnings R	Total R	Non-controlling interest R	Total equity R
<b>Balance at 1 January 20.3</b>	200 000	423 550 <sup>1</sup>	623 550	175 200 <sup>2</sup>	798 750
<b>Changes in equity for 20.3</b>					
Profit for the year/Total comprehensive income for the year		311 640	311 640	92 610	404 250
Dividends paid		(30 000)	(30 000)	(17 250) <sup>3</sup>	(47 250)
<b>Balance at 31 December 20.3</b>	200 000	705 190	905 190	250 560 <sup>4</sup>	1 155 750

<sup>1</sup> 300 000 + 70 000<sup>h</sup> + 53 550<sup>i</sup> = 423 550 or 300 000 + ((190 000 – 90 000) – 30 000 (J6)) + (210 000 – 120 000 – 13 500 (J2) – 22 950 (J7)) = 423 550

<sup>2</sup> 54 000<sup>c</sup> + 121 200<sup>j</sup> = 175 200

<sup>3</sup> 5 250<sup>e</sup> + 12 000<sup>m</sup> = 17 250

## Calculations

### C1 Analysis of owners' equity of C Limited

	100%	85%		15%
	Total R	At R	Since R	NCI R
<b>At acquisition</b>				
Share capital	150 000	127 500		22 500
Retained earnings — 01/01/20.1	120 000	102 000		18 000
	270 000	229 500		40 500
Equity represented by goodwill	2 500	2 500 <sup>a</sup>		—
Consideration and NCI	272 500	232 000		40 500
<b>Since acquisition</b>				
Retained earnings (210 000 – 120 000)	90 000		76 500 <sup>b</sup>	13 500
				54 000 <sup>c</sup>
<b>Current year</b>				
Profit for the year (210 000 – 63 000)	147 000		124 950	22 050 <sup>d</sup>
Dividends paid	(35 000)		(29 750)	(5 250) <sup>e</sup>
	474 500		171 700	70 800 <sup>f</sup>

### C2 Analysis of owners' equity of B Limited

	100%	70%		30%
	Total R	At R	Since R	NCI R
<b>At acquisition</b>				
Share capital	140 000	98 000		42 000
Retained earnings — 01/01/20.0	90 000	63 000		27 000
	230 000	161 000		69 000
Equity represented by goodwill	4 000	4 000 <sup>g</sup>		—
Consideration and NCI	234 000	165 000		69 000
<b>Since acquisition</b>				
Retained earnings (190 000 – 90 000)	100 000		70 000 <sup>h</sup>	30 000
C Limited: Retained earnings	76 500		53 550 <sup>i</sup>	22 950
Goodwill	(2 500) <sup>a</sup>	(1 750) <sup>o</sup>		(750)
	408 000			121 200 <sup>i</sup>
<b>Current year</b>				
Profit for the year — B Limited (200 000 – 60 000)	140 000		98 000	42 000 <sup>k</sup>
Profit for the year — C Limited (124 950 – 29 750)	95 200		66 640	28 560 <sup>l</sup>
Dividends paid	(40 000)		(28 000)	(12 000) <sup>m</sup>
	603 200		260 190	179 760 <sup>n</sup>

### C3 Profit before tax

	R
Profit before tax – A Limited	250 000
Intragroup dividends received from B Limited (40 000 × 70%)	(28 000)
Profit before tax – B Limited	200 000
Intragroup dividends received from C Limited (35 000 × 85%)	(29 750)
Profit before tax – C Limited	210 000
Profit before tax – Group	602 250

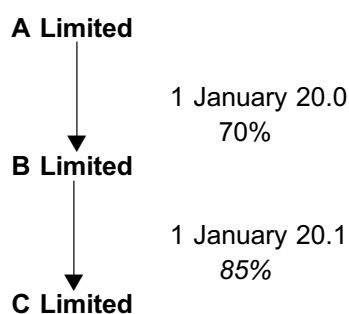
## Comments

### Percentage interest that A Limited has in:

B Limited:  $98\ 000/140\ 000 = 70\%$

C Limited:  $127\ 500/150\ 000 = 85\%$

### Structure of group:



A Limited acquired its interest in B Limited before B Limited acquired its interest in C Limited. The group therefore was formed on the date (1 January 20.0) that A Limited acquired its interest in B Limited.

From the above it is clear that A Limited has a direct interest in B Limited and an indirect interest in C Limited (due to B Limited having a direct interest in C Limited) thus the group is a **vertical group**.

An analysis will **first** be prepared for C Limited and then for B Limited due to the group being a vertical group.

### C4 Pro forma consolidation journals

	Dr R	Cr R	NCI R
J1 Share capital	150 000		
Retained earnings	120 000		
Goodwill	2 500 <sup>a</sup>		
Non-controlling interest (SFP)		40 500	40 500
Investment in C Limited		232 000	
<i>Elimination of owners' equity in C Limited at acquisition</i>			

	Dr R	Cr R	NCI R
J2 Retained earnings — beginning of year	13 500		
Non-controlling interest (SFP)		13 500	13 500
<i>Recording of non-controlling interest in retained earnings of C Limited</i>			
<i>[(210 000 – 120 000) × 15%]</i>			
			<u>54 000<sup>c</sup></u>
J3 Non-controlling interest (SCI)	22 050		
Non-controlling interest (SFP)		22 050	22 050 <sup>d</sup>
<i>Recording of non-controlling interest in retained earnings of C Limited</i>			
<i>[(210 000 – 120 000) × 15%]</i>			
J4 Profit before tax	29 750		
Non-controlling interest (SFP)	5 250		(5 250) <sup>e</sup>
Dividends paid		35 000	
<i>Elimination of intragroup dividend and recording of portion of non-controlling interest therein</i>			
			<u>70 800<sup>f</sup></u>
J5 Share capital	140 000		
Retained earnings	90 000		
Goodwill	4 000 <sup>g</sup>		
Non-controlling interest (SFP)		69 000	69 000
Investment in B Limited		165 000	
<i>Elimination of owners' equity in B Limited at acquisition</i>			
J6 Retained earnings — beginning of year	30 000		
Non-controlling interest (SFP)		30 000	30 000
<i>Recording of non-controlling interest in retained earnings of B Limited</i>			
<i>[(190 000 – 90 000) × 30%]</i>			
J7 Retained earnings — beginning of year	22 950		
Non-controlling interest (SFP)		22 950	22 950
<i>Recording of non-controlling interest of B Limited in retained earnings of C Limited</i>			
<i>[(210 000 – 120 000) × 85% × 30%]</i>			
J8 Non-controlling interest (SFP)	750		(750)
Goodwill		750	
<i>Recording of non-controlling interest of B Limited in goodwill of C Limited (2 500 × 30%)</i>			
			<u>121 200<sup>j</sup></u>
J9 Non-controlling interest (SCI)	42 000		
Non-controlling interest (SFP)		42 000	42 000 <sup>k</sup>
<i>Recording of non-controlling interest in profit for the year of B Limited [(200 000 – 60 000) × 30%]</i>			



	Dr R	Cr R	NCI R
J10 Non-controlling interest (SCI)	28 560		
Non-controlling interest (SFP)		28 560	28 560 <sup>l</sup>
<i>Recording of non-controlling interest of B Limited in profit for the year of C Limited. [(210 000 – 63 000 – 35 000) × 85% × 30%]</i>			
J11 Profit before tax (other income)	28 000		
Non-controlling interest (SFP)	12 000		(12 000) <sup>m</sup>
Dividends paid		35 000	
<i>Elimination of intragroup dividend and recording of portion of non-controlling interest therein.</i>			
			<u>179 760<sup>n</sup></u>

### Example 3.3

Use the same information as in example 2, but change the following:

#### Additional information

1. A Limited purchased 98 000 shares in B Limited on 1 January 20.3. B Limited acquired 127 500 shares in C Limited on 1 January 20.1, when C Limited's retained earnings were R120 000.
2. Assume that the fair values of the identifiable assets, liabilities and contingent liabilities at the time of both acquisitions have been reassessed and were considered to be reasonable.

#### REQUIRED:

Prepare the consolidated annual financial statements of the A Limited Group for the year ended 31 December 20.3. Your answer must comply with the requirements of Generally Accepted Accounting Practice.

No notes are required.

Ignore comparative figures.

### Solution 3.3

#### A LIMITED GROUP

#### CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.3

R

#### ASSETS

##### Non-current assets

932 000

Property, plant and equipment (345 000 + 150 000 + 437 000)

932 000

##### Current assets

383 000

Trade and other receivables (205 000 + 48 000 + 130 000)

383 000

##### Total assets

1 315 000

R

**EQUITY AND LIABILITIES**

<b>Total equity</b>	1 150 000
<b>Equity attributable to owners of the parent</b>	899 440
Share capital	200 000
Retained earnings	699 440
<b>Non-controlling interest</b> (70 800 <sup>e</sup> + 179 760 <sup>i</sup> )	250 560
<b>Total liabilities</b>	165 000
<b>Non-current liabilities</b>	165 000
Long-term borrowings (70 000 + 95 000)	165 000
<b>Total equity and liabilities</b>	1 315 000

**A LIMITED GROUP****CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.3**

R

<b>Profit before tax</b> (C3)	720 050
Income tax expense (75 000 + 60 000 + 63 000)	(198 000)
<b>PROFIT FOR THE YEAR</b>	522 050
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>	522 050
Total comprehensive income attributable to:	
Owners of the parent	429 440
Non-controlling interest (42 000 <sup>g</sup> + 28 560 <sup>h</sup> + 22 050 <sup>c</sup> )	92 610
	522 050

**A LIMITED GROUP****CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.3**

	Share capital R	Retained earnings R	Total R	Non-controlling interest R	Total equity R
<b>Balance at 1 January 20.3</b>	200 000	300 000	500 000		500 000
<b>Changes in equity for 20.3</b>					
Non-controlling interest in respect of investment acquired				175 200 <sup>1</sup>	175 200
Profit for the year/Total comprehensive income for the year		429 440	429 440	92 610	522 050
Dividends paid		(30 000)	(30 000)	(17 250) <sup>2</sup>	(47 250)
<b>Balance at 31 December 20.3</b>	200 000	699 440	899 440	250 560	1 150 000

<sup>1</sup> 54 000<sup>b</sup> + 121 200<sup>k</sup> = 175 200<sup>2</sup> 5 250<sup>d</sup> + 12 000<sup>l</sup> = 17 250

## Calculations

### C1 Analysis of owners' equity of C Limited

	100%	85%		15%
	Total R	At R	Since R	NCI R
<b>At acquisition</b>				
Share capital	150 000	127 500		22 500
Retained earnings — 01/01/20.3	210 000	178 500		31 500
	360 000	306 000		54 000 <sup>b</sup>
Equity represented by gain on bargain purchase	(74 000)	(74 000) <sup>a</sup>		—
Consideration and NCI	286 000	232 000		54 000
<b>Current year</b>				
Profit for the year (210 000 – 63 000)	147 000		124 950	22 050 <sup>c</sup>
Dividends paid	(35 000)		(29 750)	(5 250) <sup>d</sup>
	398 000		95 200	70 800 <sup>e</sup>

### C2 Analysis of owners' equity of B Limited

	100%	70%		30%
	Total R	At R	Since R	NCI R
<b>At acquisition</b>				
Share capital	140 000	98 000		42 000
Retained earnings	190 000	133 000		57 000
Gain on bargain purchase – C Limited (C1)	74 000 <sup>a</sup>	51 800		22 200
	404 000	282 800		121 200 <sup>k</sup>
Equity represented by gain on bargain purchase	(117 800)	(117 800) <sup>f</sup>		—
Consideration and NCI	286 200	165 000		121 200
<b>Current year</b>				
Profit for the year:				
— B Limited (200 000 – 60 000)	140 000		98 000	42 000 <sup>g</sup>
— C Limited (124 950 – 29 750)	95 200		66 640	28 560 <sup>h</sup>
Dividends paid	(40 000)		(28 000)	(12 000) <sup>i</sup>
	481 400		136 640	179 760 <sup>j</sup>

### C3 Profit before tax

	R
Profit before tax – A Limited	250 000
Intragroup dividends received from B Limited (40 000 × 70%)	(28 000)
Profit before tax – B Limited	200 000
Intragroup dividends received from C Limited (35 000 × 85%)	(29 750)
Profit before tax – C Limited	210 000
Recognition of gain on bargain purchase (C2) (refer to comments)	117 800 <sup>f</sup>
Profit before tax – Group	<u>602 250</u>

## Comments

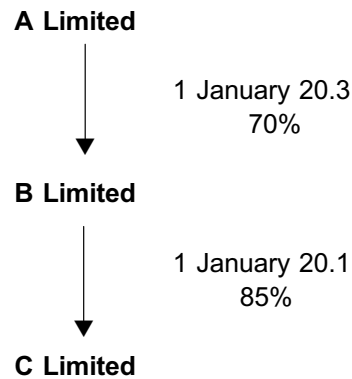
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**Percentage interest that A Limited has in:**

B Limited:  $98\,000/140\,000 = 70\%$

C Limited:  $127\,500/150\,000 = 85\%$

**Structure of group:**



A Limited acquired its interest in B Limited after B Limited acquired its interest in C Limited. The group therefore was formed on the date that A Limited acquired its interest in B Limited (1 January 20.3).

From the above it is clear that A Limited has a direct interest in B Limited and an indirect interest in C Limited (due to B Limited having a direct interest in C Limited) thus the group is a **vertical group**.

An analysis will **first** be prepared for C Limited and then for B Limited due to the group being a vertical group.

**Gain on bargain purchase**

A Limited acquired its interest in B Limited after B Limited acquired its interest in C Limited thus the gain on bargain purchase (R74 000) of C Limited will be included in the **at acquisition reserves** of B Limited. The gain on bargain purchase (R117 400) of B Limited will be included in the consolidated **profit for the year** (“other income”) in the **statement of comprehensive income** as the acquisition took place in the current year.

---

#### C4 Pro forma consolidation journals

	Dr R	Cr R	NCI R
J1	Share capital	150 000	
	Retained earnings	210 000	
	Non-controlling interest (SFP)		54 000
	Gain on bargain purchase		74 000 <sup>a</sup>
	Investment in C Limited	232 000	
	<i>Elimination of owners' equity in C Limited at acquisition</i>		
J2	Non-controlling interest (SCI)	22 050	
	Non-controlling interest (SFP)		22 050
	<i>Recording of non-controlling interest in profit for the year of C Limited</i> <i>[(210 000 – 63 000) × 15%]</i>		
J3	Profit before tax	29 750	
	Non-controlling interest (SFP)	5 250	(5 250) <sup>d</sup>
	Dividends paid		35 000
	<i>Elimination of intragroup dividend and recording portion of non-controlling interest therein.</i>		
			<u>70 800<sup>e</sup></u>
J4	Share capital	140 000	
	Retained earnings	190 000	
	Gain on bargain purchase – C Limited	74 000 <sup>a</sup>	
	Non-controlling interest (SFP)		121 200
	Gain on bargain purchase		117 800 <sup>f</sup>
	Investment in B Limited	165 000	
	<i>Elimination of owners' equity in B Limited at acquisition</i>		
J5	Non-controlling interest (SCI)	42 000	
	Non-controlling interest (SFP)		42 000
	<i>Recording of non-controlling interest in profit for the year of B Limited ((200 000 – 60 000) × 30%)</i>		
J6	Non-controlling interest (SCI)	28 560	
	Non-controlling interest (SFP)		28 560
	<i>Recording of non-controlling interest of B Limited in profit for the year of C Limited</i> <i>((210 000 – 63 000 – 35 000) × 85% × 30%)</i>		
J7	Profit before tax	28 000	
	Non-controlling interest (SFP)	12 000	(12 000) <sup>i</sup>
	Dividends paid		40 000
	<i>Elimination of intragroup dividend and recording portion of non-controlling interest therein</i>		
			<u>179 760<sup>j</sup></u>

**Example 3.4**

The following balances were taken from the accounting records of Left Limited, Right Limited and Centre Limited at 30 June 20.5:

	<b>Left Limited Dr/(Cr) R</b>	<b>Right Limited Dr/(Cr) R</b>	<b>Centre Limited Dr/(Cr) R</b>
Profit for the year	(450 000)	(900 000)	(720 000)
Inventories	900 000	460 000	700 000
Trade receivables	724 857	697 714	603 571
Cash and cash equivalents	1 033 000	—	412 000
Investment in Right Limited — 60 000 ordinary shares at fair value	1 800 000	—	—
Investment in Centre Limited — 40 000 ordinary shares at fair value	—	1 600 000	—
Land	1 419 000	2 400 000	1 000 000
Plant at cost	1 228 000	1 420 000	618 000
Provisional tax payments	412 000	196 000	158 000
Retained earnings — 1 July 20.4	(6 000 000)	(4 805 000)	(2 113 000)
Deferred tax	(48 000)	(62 000)	(24 000)
Provision for tax	(192 857)	(385 714)	(308 571)
Share capital — 100 000 ordinary shares	(100 000)	—	—
Share capital — 50 000 ordinary shares	—	—	(50 000)
Share capital — 75 000 ordinary shares	—	(150 000)	—
Accumulated depreciation — plant	(221 040)	(170 400)	(37 080)
Trade and other payables	(504 960)	(280 600)	(238 920)
Short-term borrowings (bank overdraft)	—	(20 000)	—
	—	—	—

**Additional information**

- On 1 July 20.2 Left Limited purchased 60 000 ordinary shares in Right Limited for R1 800 000. On the same day Right Limited purchased 40 000 ordinary shares in Centre Limited and paid R1 600 000 for the investment.
- On 1 July 20.2 the following information was applicable:

	<b>Right Limited R</b>	<b>Centre Limited R</b>
Retained earnings	1 500 000	1 200 000

- On 1 July 20.2 Right Limited valued Centre Limited's land at R1 600 000. The revaluation was not recorded in the books of Centre Limited. The fair values of the remaining assets, liabilities and contingent liabilities of Right Limited and Centre Limited on 1 July 20.2 were considered to be equal to the carrying amounts of these items.
- During the current year Left Limited sold inventories to Centre Limited at a profit of 50% on cost price. On 30 June 20.5 Centre Limited had inventories on hand that were purchased from Left Limited of R300 000.
- During the current year Centre Limited sold inventories to Right Limited at a profit of 33<sup>1</sup>/<sub>3</sub>% on cost price. On 30 June 20.5 Right Limited had inventories on hand that were purchased from Centre Limited of R100 000.
- Included in the trade receivables of Left Limited is a loan to Centre Limited of R15 000. The loan is included in the trade and other payables of Centre Limited.

7. The group uses the partial goodwill method to recognise goodwill. (The non-controlling interest is recognised at its proportionate share of the acquirer's net identifiable assets.)
8. The goodwill that arose on the acquisition of Right Limited was considered to be impaired by R200 000 at year end.
9. Assume a tax rate of 30%.
10. The fair value of available-for-sale financial assets is equal to the cost price thereof.
11. Each share carries one vote.

**REQUIRED:**

Prepare the consolidated annual financial statements of Left Limited Group for the year ended 30 June 20.5. Your answer must comply with the requirements of Generally Accepted Accounting Practice.

No notes are required.

Ignore comparative figures.

**Solution 3.4**

**LEFT LIMITED GROUP**

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 JUNE 20.5**

	<b>R</b>
<b>ASSETS</b>	
<b>Non-current assets</b>	8 690 080
Property, plant and equipment (C8)	8 256 480
Goodwill (633 600 <sup>g</sup> – 200 000 <sup>m</sup> )	433 600
<b>Current assets</b>	5 391 142
Inventories (900 000 + 460 000 + 700 000 – 100 000(C4) – 25 000(C4))	1 935 000
Trade receivables (724 857 + 697 714 + 603 571 – 15 000 (loan))	2 011 142
Cash and cash equivalents (1 033 000 + 412 000)	1 445 000
<b>Total assets</b>	14 081 222

R

**EQUITY AND LIABILITIES**

<b>Total equity</b>	12 744 100
<b>Equity attributable to owners of the parent</b>	10 677 920
Share capital	100 000
Retained earnings	10 577 920
<b>Non-controlling interest</b> (675 100 <sup>f</sup> + 1 391 080 <sup>l</sup> )	2 066 180
<b>Total liabilities</b>	1 337 122
<b>Non-current liabilities</b>	186 500
Deferred tax (C6)	186 500
<b>Current liabilities</b>	1 150 622
Short-term borrowings	20 000
Trade and other payables (504 960 + 280 600 + 238 920 – 15 000 (loan))	1 009 480
Current tax payable (C7)	121 142
<b>Total equity and liabilities</b>	14 081 222

**LEFT LIMITED GROUP****CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 20.5**

	R
<b>PROFIT BEFORE TAX</b> (C5)	1 782 500
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>	1 782 500
Total comprehensive income attributable to:	
Owners of the parent	1 349 600
Non-controlling interest (180 000 <sup>i</sup> + 112 400 <sup>k</sup> + 140 500 <sup>e</sup> )	432 900
	1 782 500

**LEFT LIMITED GROUP****CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 30 JUNE 20.5**

	Share capital R	Retained earnings R	Total R	Non- controlling interest R	Total equity R
<b>Balance at 1 July 20.4</b>	100 000	9 228 320 <sup>1</sup>	9 328 320	1 633 280 <sup>2</sup>	10 961 600
<b>Changes in equity for 20.5</b>					
Profit for the year/Total comprehensive income for the year		1 349 600	1 349 600	432 900	1 782 500
<b>Balance at 30 June 20.5</b>	100 000	10 577 920	10 677 920	2 066 180	12 744 100

<sup>1</sup> 6 000 000 + 3 228 320<sup>h</sup> = 9 228 320 or 6 000 000 + (2 133 000 – 1 200 000 – 182 000(J3)) + (4 805 000 – 1 500 000 – 661 000(J8)) – 146 080(J9) = 9 228 320

<sup>2</sup> 534 600<sup>d</sup> + 1 098 680<sup>l</sup> = 1 633 280



## Calculations

### C1 Analysis of owners' equity of Centre Limited

	100%	80%		20%
	Total R	At R	Since R	NCI R
<b>At acquisition</b>				
Share capital	50 000	40 000		10 000
Retained earnings	1 200 000	960 000		240 000
Revaluation surplus (600 000(C2) – 90 000(C2))	510 000	408 000		102 000
	1 760 000	1 408 000		352 000
Equity represented by goodwill	192 000	192 000 <sup>a</sup>		—
Consideration and NCI	1 952 000	1 600 000		352 000
<b>Since acquisition</b>				
Retained earnings (2 113 000 – 1 200 000)	913 000		730 400 <sup>b</sup>	182 600
	2 865 000			534 600 <sup>d</sup>
<b>Current year</b>				
Profit for the year	702 500		562 000 <sup>c</sup>	140 500 <sup>e</sup>
Profit for the year (given)	720 000			
Unrealised profit (100 000 × 33 <sup>1</sup> / <sub>3</sub> /133 <sup>1</sup> / <sub>3</sub> )	(25 000)			
Tax effect (25 000 × 30%)	7 500			
	3 567 500		1 292 400	675 100 <sup>f</sup>

### C2 Revaluation of land

	R
Fair value	1 600 000
Carrying amount	<u>(1 000 000)</u>
Revaluation surplus	<u>600 000</u>
Deferred tax (600 000 × 50% × 30%)	<u>90 000</u>

## Comments

### **Revaluation not recorded in the records of the subsidiary**

Land of Centre Limited was revalued at acquisition however the revaluation was not recorded in the books of Centre Limited. An adjustment is required for consolidation purposes to recognise the revalued assets of the subsidiary (i.e. the revaluation is included in the analysis). A pro forma journal entry has to be passed on consolidation to bring the revaluation into account (refer J3).

### **Deferred tax on revaluation**

If land is revalued, deferred tax should be provided for on the total surplus above original cost at 15% (50% × 30%), irrespective of whether or not there is any intention to dispose of the land, as the carrying amount of the land (a non-depreciable asset) can only be recovered by means of sale.

### C3 Analysis of owners' equity of Right Limited

	100%	80%		20%
	Total R	At R	Since R	NCI R
<b>At acquisition</b>				
Share capital	150 000	120 000		30 000
Retained earnings	1 500 000	1 200 000		300 000
Goodwill — Centre Limited (C1)	(192 000) <sup>a</sup>	(153 600)		(38 400)
	1 458 000	1 166 400		291 600
Goodwill	633 600	633 600 <sup>g</sup>		—
Consideration and NCI	2 091 600	1 800 000		291 600
<b>Since acquisition</b>				
Retained earnings	4 035 400		3 228 320 <sup>h</sup>	807 080
– Right Limited (4 805 000 – 1 500 000)	3 305 000			
– Centre Limited (C1)	730 400 <sup>b</sup>			
				1 098 680 <sup>j</sup>
<b>Current year</b>				
Profit for the year	1 462 000		1 169 600	292 400
– Right Limited (given)	900 000			180 000 <sup>i</sup>
– Centre Limited (C1)	562 000 <sup>c</sup>			112 400 <sup>k</sup>
	7 589 000	(633 600)	4 397 920	1 391 080 <sup>l</sup>
<b>Impairment of goodwill</b>				
Current year (given)		200 000 <sup>m</sup>		
<b>Carrying amount — 30/06/20.5</b>		(433 600)		

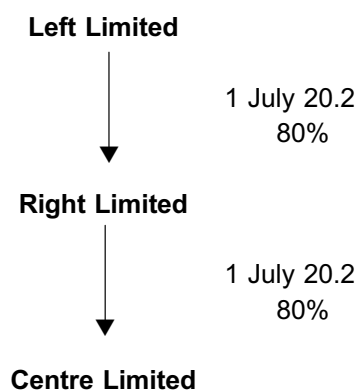
### Comments

#### Percentage interest that Left Limited has in:

Right Limited:  $60\,000 / (150\,000 / 2) = 80\%$

Centre Limited:  $40\,000 / 50\,000 = 80\%$

#### Structure of group:



Left Limited acquired its interest in Right Limited on the same date that Right Limited acquired its interest in Centre Limited. The group therefore was formed on the date that Left Limited acquired its interest in Right Limited (1 July 20.2).

From the above it is clear that Left Limited has a direct interest in Right Limited and an indirect interest in Centre Limited (due to Right Limited having a direct interest in Centre

Limited) thus the group is a **vertical group**.

An analysis will **first** be prepared for Centre Limited and then for Right Limited due to the group being a vertical group.

---

#### C4 Unrealised profit included in inventories

	R
Inventories purchased by Centre Limited from Left Limited:	
Unrealised profit in closing inventory (300 000 × 50/150)	100 000
Deferred tax (100 000 × 30%)	30 000
Inventories purchased by Right Limited from Centre Limited:	
Unrealised profit in closing inventory (100 000 × 33 <sup>1</sup> / <sub>3</sub> / 133 <sup>1</sup> / <sub>3</sub> )	25 000
Deferred tax (25 000 × 30%)	7 500

#### C5 Profit for the year

	R
Profit for the year:	
– Left Limited	450 000
– Right Limited	900 000
– Centre Limited	720 000
Unrealised profit in closing inventory (300 000 × 50/150)	(100 000)
Tax effect on unrealised profit (100 000 × 30%)	30 000
Unrealised profit in closing inventory (100 000 × 33 <sup>1</sup> / <sub>3</sub> / 133 <sup>1</sup> / <sub>3</sub> )	(25 000)
Tax effect on unrealised profit (25 000 × 30%)	7 500
Goodwill impaired	(200 000)
Consolidated profit	1 782 500

#### C6 Deferred tax

	R
Deferred tax (given):	
– Left Limited	48 000
– Right Limited	62 000
– Centre Limited	24 000
Revaluation of land (C2)	90 000
Deferred tax on unrealised intragroup profit:	
– Centre Limited (C4)	(30 000)
– Right Limited (C4)	(7 500)
	186 500

## C7 Tax payable

	R
Provision for income tax expense:	
– Left Limited	192 857
– Right Limited	385 714
– Centre Limited	308 571
Provisional tax payments:	
– Left Limited	(412 000)
– Right Limited	(196 000)
– Centre Limited	(158 000)
	121 142
	121 142

## C8 Property, plant and equipment

	Property R	Plant R	Total R
Carrying amount at end of year	5 419 000	2 837 480	8 256 480
Cost	5 419 000 <sup>1</sup>	3 266 000 <sup>2</sup>	8 685 000
Accumulated depreciation	—	(428 520) <sup>3</sup>	(428 520)

<sup>1</sup> 1 419 000 + 2 400 000 + 1 000 000 + 600 000(2) = 5 419 000

<sup>2</sup> 1 228 000 + 1 420 000 + 618 000 = 3 266 000

<sup>3</sup> 221 040 + 170 400 + 37 080 = 428 520

## Comments

### ***Unrealised profits included in inventories***

#### ***Sale of inventories from Left Limited to Centre Limited***

*Left Limited sold inventories to Centre Limited (parent to subsidiary). Left Limited made the intragroup profit thus cost of sales of Left Limited is debited which will decrease the group profit. Centre Limited purchased the inventories from Left Limited thus the unrealised profit is included in the closing inventories of Centre Limited at year end. Inventories are decreased with the unrealised profit to eliminate the unrealised intragroup profit.*

*Left Limited (parent) is making the profit thus the unrealised profit in the inventories will **not** be shown in the **analysis of owners' equity** of Centre Limited. In other words the non-controlling interest will **not** be affected. The adjustments will be taken into account in the consolidated statement of comprehensive income (profits) and consolidated statement of financial position (inventories).*

#### ***Sale of inventories from Centre Limited to Right Limited***

*Centre Limited sold inventories to Right Limited (subsidiary to parent). Centre Limited made the intragroup profit. Cost of sales of Centre Limited is thus debited which will decrease the group profit. Right Limited purchased the inventories from Centre Limited thus the unrealised profit is included in the closing inventories of Right Limited at year end. The inventories are decreased with the unrealised profit to eliminate the unrealised intragroup profit.*

*Centre Limited (subsidiary) is making the profit thus the unrealised profit in the inventories will be shown in the **analysis of owners' equity** of Centre Limited. In other words, the non-controlling interest will also be adjusted. The adjustments will also be taken into account in the consolidated statement of comprehensive income (profits or loss, part) and consolidated statement of financial position (inventories).*

## C9 Pro forma consolidation journals

	Dr R	Cr R	NCI R
J1	Share capital	50 000	
	Retained earnings	1 200 000	
	Revaluation surplus		
	(600 000 – (600 000 × 15%))	510 000	
	Goodwill	192 000 <sup>a</sup>	
	Non-controlling interest (SFP)		352 000
	Investment in Centre Limited	1 600 000	
	<i>Elimination of owners' equity in Centre Limited at acquisition</i>		
J2	Land (1 600 000 – 1 000 000)	600 000	
	Deferred tax (SFP) (600 000 × 15%)		90 000
	Revaluation surplus		510 000
	<i>Revaluation of land of Centre Limited at acquisition</i>		
J3	Retained earnings	182 600	
	Non-controlling interest (SFP)		182 600
	<i>Recording of non-controlling interest in retained earnings since acquisition of Centre Limited [(2 113 000 – 1 200 000) × 20%]</i>		
			<u>534 600<sup>d</sup></u>
J4	Profit for the year (Cost of sales) (C4)	25 000	
	Inventory (SFP)		25 000
	<i>Elimination of unrealised profit in closing inventory of Right Limited</i>		
J5	Deferred tax (SFP) (C4)	7 500	
	Profit for the year (Income tax expense)		7 500
	<i>Tax implication of elimination of intragroup profit in closing inventory</i>		
J6	Non-controlling interest (SCI)	140 500	
	Non-controlling interest (SFP)		140 500
	<i>Recording of non-controlling interest in profit for the year of Centre Limited [(720 000 – 25 000 + 7 500) × 20%]</i>		
			<u>675 100<sup>f</sup></u>
J7	Share capital	150 000	
	Retained earnings	1 500 000	
	Goodwill	633 600 <sup>g</sup>	
	Goodwill – Centre Limited		192 000
	Non-controlling interest (SFP)		291 600
	Investment in Right Limited	800 000	
	<i>Elimination of owners' equity in Right Limited at acquisition</i>		
J8	Retained earnings — beginning of year	661 000	
	Non-controlling interest (SFP)		661 000
	<i>Recording of non-controlling interest in retained earnings since acquisition of Right Limited [(4 805 000 – 1 500 000) × 20%]</i>		

	Dr R	Cr R	NCI R
J9 Retained earnings — beginning of year	146 080		
Non-controlling interest (SFP)		146 080	146 080
<i>Recording of non-controlling interest in retained earnings since acquisition of Centre Limited ((2 113 000 – 1 200 000) x 80% x 20%)</i>			
			<u>1 098 680<sup>j</sup></u>
J10 Non-controlling interest (SCI) (900 000 x 20%)	180 000		
Non-controlling interest (SFP)		180 000	180 000 <sup>i</sup>
<i>Recording of non-controlling interest in profit for the year of Right Limited</i>			
J11 Non-controlling interest (SCI) (562 000 x 20%)	112 400		
Non-controlling interest (SFP)		112 400	112 400 <sup>k</sup>
<i>Recording of non-controlling interest in profit for the year of Centre Limited for the current year</i>			
J12 Profit for the year	200 000		
Goodwill		200 000 <sup>m</sup>	
<i>Impairment of goodwill</i>			
J13 Profit for the year (Cost of sales)	100 000		
Inventory (SFP) (300 000 x 50/150)		100 000	
<i>Elimination of intragroup profit in closing inventory of Centre Limited</i>			
J14 Deferred tax (SFP) (100 000 x 30%)	30 000		
Profit for the year (Income tax expense)		30 000	
<i>Tax implication of elimination of intragroup profit in closing inventory</i>			
J15 Trade and other payables (Centre Limited)	15 000		
Trade receivables (Left Limited)		15 000	
<i>Elimination of intragroup loan</i>			
			<u><u>1 391 080<sup>l</sup></u></u>

### 3.4 Mixed groups

#### Study

*Group Statements (Volume 1): Section 8.10 and example 8.7 (pages 392–397)*

#### Example 3.5

The following represents the abridged annual financial statements of Utah Limited, Ohio Limited and the Maine Limited Group:

**STATEMENTS OF FINANCIAL POSITION AS AT 31 AUGUST 20.8**

	<b>Utah Limited R</b>	<b>Ohio Limited R</b>	<b>Maine Limited R</b>
<b>ASSETS</b>			
<b>Non-current assets</b>	981 000	337 500	778 400
Property, plant and equipment	541 000	337 500	778 400
Investments			
— 80 000 Ordinary shares in Maine Limited at fair value	270 000	—	—
— 30 000 Ordinary shares in Ohio Limited at fair value	170 000	—	—
<b>Current assets</b>	494 000	305 000	283 000
Inventories	100 000	85 000	180 000
Trade and other receivables	394 000	220 000	103 000
<b>Total assets</b>	<u>475 000</u>	<u>642 500</u>	<u>1 061 400</u>
<b>EQUITY AND LIABILITIES</b>			
<b>Total equity</b>	750 000	527 500	788 400
<b>Equity attributable to owners of the parent</b>	750 000	527 500	668 400
Share capital — 200 000 ordinary shares	200 000	—	—
— 50 000 ordinary shares	—	50 000	—
— 100 000 ordinary shares	—	—	100 000
Retained earnings	550 000	477 500	568 400
<b>Non-controlling interest</b>	—	—	120 000
<b>Total liabilities</b>	725 000	115 000	273 000
<b>Non-current liabilities</b>	600 000	50 000	250 000
Long-term borrowings	600 000	50 000	250 000
<b>Current liabilities</b>	125 000	65 000	23 000
Trade and other payables	125 000	65 000	23 000
<b>Total equity and liabilities</b>	<u>1 475 000</u>	<u>642 500</u>	<u>1 061 400</u>

**STATEMENTS OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 AUGUST 20.8**

	<b>Utah Limited R</b>	<b>Ohio Limited R</b>	<b>Maine Limited R</b>
<b>Profit before tax</b>	500 000	375 000	672 000
Income tax expense	(150 000)	(112 500)	(201 600)
<b>PROFIT FOR THE YEAR</b>	<u>350 000</u>	<u>262 500</u>	<u>470 400</u>
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>	<u>350 000</u>	<u>262 500</u>	<u>470 400</u>
Total comprehensive income attributable to:			
Owners of the parent	350 000	262 500	398 400
Non-controlling interest	—	—	72 000
	<u>350 000</u>	<u>262 500</u>	<u>470 400</u>

**STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 AUGUST 20.8**

	Retained earnings		
	Utah Limited R	Ohio Limited R	Maine Limited R
<b>Balance at 1 September 20.7</b>	240 000	240 000	200 000
<b>Changes in equity for 20.8</b>			
Dividends paid	(40 000)	(25 000)	(30 000)
Profit for the year/Total comprehensive income for the year	350 000	262 500	398 400
<b>Balance at 31 August 20.8</b>	<u>550 000</u>	<u>477 500</u>	<u>568 400</u>

**Additional information**

- Utah Limited acquired its interest in Maine Limited on 1 September 20.7. The fair value of the identifiable assets, liabilities and contingent liabilities at the acquisition date of Maine Limited were considered to be equal to the carrying amount of these items.
- Utah Limited acquired its interest in Ohio Limited on 1 September 20.7. The identifiable assets, liabilities and contingent liabilities at the acquisition date of Ohio Limited were considered to be fairly reflected except for the following items:

	Fair value R	Carrying amount R
Administration building	200 800	180 000
Inventories	57 600	70 000

Assume that the fair values of the above items have been reassessed and are considered to be reasonable.

- The group uses the partial goodwill method to recognise goodwill. (The non-controlling interest is recognised at its proportionate share of the acquirer's net identifiable assets.) The goodwill that arose on the acquisition of Maine Limited was considered to be impaired by R20 000 at the end of the current year.
- Each share carries one vote.
- The fair value of available-for-sale financial assets is equal to the cost price thereof.
- The normal company tax rate is 30%.

**REQUIRED:**

Prepare the consolidated annual financial statements of Utah Limited Group for the year ended 31 August 20.8. Your answer must comply with the requirements of Generally Accepted Accounting Practice.

No notes are required.

Ignore comparative figures.



## UTAH LIMITED GROUP

## CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 AUGUST 20.8

	R
<b>ASSETS</b>	
<b>Non-current assets</b>	1 687 700
Property, plant and equipment (541 000 + 337 500 + 778 400 + 20 800(C3))/(J5)	1 677 700
Goodwill (30 000 <sup>a</sup> – 20 000 <sup>f</sup> )	10 000
<b>Current assets</b>	1 082 000
Trade receivables (394 000 + 220 000 + 103 000)	717 000
Inventories (100 000 + 85 000 + 180 000)	365 000
<b>Total assets</b>	<u>2 769 700</u>
<b>EQUITY AND LIABILITIES</b>	
<b>Total equity</b>	1 653 580
<b>Equity attributable to owners of the parent</b>	1 181 828
Share capital – 200 000 ordinary shares	200 000
Retained earnings	981 828
<b>Non-controlling interest</b> (120 000(given) + 133 680 <sup>e</sup> + 218 072 <sup>k</sup> )	471 752
<b>Total liabilities</b>	1 116 120
<b>Non-current liabilities</b>	903 120
Long-term borrowings (600 000 + 50 000 + 250 000)	900 000
Deferred tax (3 720 – 600)	3 120
<b>Current liabilities</b>	213 000
Trade and other payables (125 000 + 65 000 + 23 000)	213 000
<b>Total equity and liabilities</b>	<u>2 769 700</u>

**UTAH LIMITED GROUP**

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 AUGUST 20.8**

	R
<b>Profit before tax<sup>1</sup></b>	1 509 800
Income tax expense <sup>2</sup>	(467 820)
<b>PROFIT FOR THE YEAR</b>	<u>1 041 980</u>
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>	<u><u>1 041 980</u></u>
Total comprehensive income attributable to:	
Owners of the parent	781 828
Non-controlling interest <sup>3</sup>	260 152
	<u><u>1 041 980</u></u>

- <sup>1</sup> 500 000 (60% x 25 000(div)) – (80% x 30 000(div)) + 375 000 + 12 400(3) + 672 000 – 20 000<sup>f</sup> + 9 400<sup>g</sup> = 1 509 800
- <sup>2</sup> 150 000 + 112 500 = 3 720(B3) + 201 600 = 467 820
- <sup>3</sup> 72 000(given) + 79 680<sup>c</sup> + 108 472<sup>i</sup> = 260 152

**Comments**

*The gain on bargain purchase (R9 400) that arose on the acquisition of Ohio Limited is included in “profit before tax” due to the acquisition of Ohio Limited by Utah Limited taking place in the current year (1 September 20.7).*

**UTAH LIMITED GROUP**

**STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 AUGUST 20.8**

	Share capital R	Retained earnings R	Total R	Non- controlling interest R	Total equity R
<b>Balance at 1 September 20.7</b>	200 000	240 000	440 000	—	440 000
<b>Changes in equity for 20.8</b>					
Acquisition of subsidiaries				227 600 <sup>1</sup>	227 600
Dividends paid		(40 000)	(40 000)	(16 000) <sup>2</sup>	(56 000)
Profit for the year/Total comprehensive income for the year		781 828	781 828	260 152	1 041 980
<b>Balance at 31 August 20.8</b>	<u>200 000</u>	<u>981 828</u>	<u>1 181 828</u>	<u>471 752</u>	<u>1 653 580</u>

- <sup>1</sup> 60 000<sup>b</sup> + 119 600<sup>h</sup> + (120 000(given (SFP)) – 72 000 (given (SCI))) = 227 600
- <sup>2</sup> 10 000<sup>j</sup> + 6 000<sup>d</sup> = 16 000

## Calculations

### C1 Analysis of owners' equity of Maine Limited

	100%	80%		20%
	Total R	At R	Since R	NCI R
<b>At acquisition</b>				
Share capital	100 000	80 000		20 000
Retained earnings	200 000	160 000		40 000
	300 000	240 000		60 000 <sup>b</sup>
Equity represented by goodwill	30 000	30 000 <sup>a</sup>		—
Consideration and NCI	330 000	270 000		60 000
<b>Current year</b>				
Profit for the year (given (SCI))	398 400		318 720	79 680 <sup>c</sup>
Dividends paid	(30 000)		(24 000)	(6 000) <sup>d</sup>
	698 400	(30 000)	294 720	133 680 <sup>e</sup>
<b>Impairment of goodwill</b>				
Current year (given)		20 000 <sup>f</sup>		
<b>Carrying amount — 31 August 20.8</b>		(10 000)		

### C2 Analysis of owners' equity of Ohio Limited

	100%	60%		40%
	Total R	At R	Since R	NCI R
<b>At acquisition</b>				
Share capital	50 000	30 000		20 000
Retained earnings (240 000 – 8 680(C3))	231 320	138 792		92 528
Revaluation surplus (C3)	17 680	10 608		7 072
	299 000	179 400		119 600 <sup>h</sup>
Equity represented by gain on bargain purchase	(9 400)	(9 400) <sup>g</sup>		—
Consideration and NCI	289 600	170 000		119 600
<b>Current year</b>				
Profit for the year (262 500 + (8 680(C3)))	271 180		162 708	108 472 <sup>i</sup>
Dividends paid	(25 000)		(15 000)	(10 000) <sup>j</sup>
	535 780		147 708	218 072 <sup>k</sup>

### C3 Calculation of effect of fair value adjustments at acquisition

	Carrying amount R	Fair value R	Re-valuation R	Tax effect R	After tax revaluation R
Administration building	180 000	200 800	20 800	(3 120) <sup>1</sup>	17 680
Inventories	70 000	57 600	(12 400)	3 720 <sup>2</sup>	(8 680)

<sup>1</sup> 20 800 × 50% × 30% = 3 120

<sup>2</sup> 12 400 × 30% = 3 720

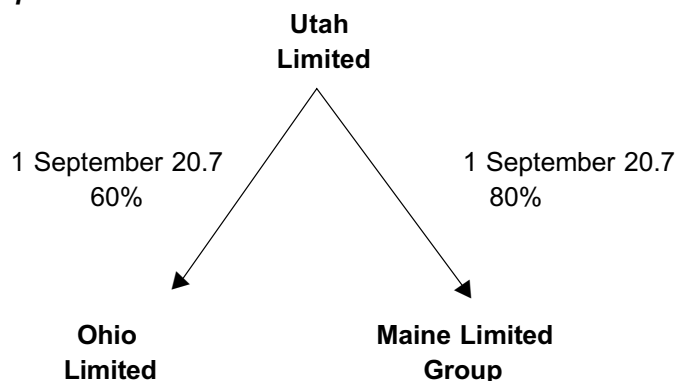
## Comments

### Percentage interest that Utah Limited has in:

Ohio Limited:  $30\,000/50\,000 = 60\%$

Maine Limited Group:  $80\,000/100\,000 = 80\%$

### Structure of group:



From the above it is clear that Utah Limited has a direct interest in Ohio Limited and a direct interest in the Maine Limited Group thus the group is a **horizontal group**.

An analysis will be prepared for Ohio Limited and the Maine Limited Group. An analysis is prepared for each subsidiary individually as the group is a horizontal group and there is no direct relationship between Ohio Limited and the Maine Limited Group.

## C4 Pro forma consolidation journals

	Dr R	Cr R	NCI R
J1 Share capital	100 000		
Retained earnings	200 000		
Goodwill	30 000 <sup>a</sup>		
Non-controlling interest (SFP)		60 000	60 000 <sup>b</sup>
Investment in Maine Limited		270 000	
<i>Elimination of owners' equity in Maine Limited at acquisition by H Limited</i>			
J2 Non-controlling interest (SCI)	79 680		
Non-controlling interest (SFP)		79 680	79 680 <sup>c</sup>
<i>Recording of non-controlling interest in profit for the year of Maine Limited (398 400 x 20% = 79 680)</i>			
J3 Profit before tax	24 000		
Non-controlling interest (SFP)	6 000		(6 000) <sup>d</sup>
Dividends paid		30 000	
<i>Elimination of intragroup dividend and recording of portion of non-controlling interest therein of Maine Limited</i>			
			<u>133 680<sup>e</sup></u>

	Dr R	Cr R	NCI R
J4 Profit before tax	20 000		
Goodwill		20 000 <sup>f</sup>	
<i>Impairment of goodwill of Maine Limited</i>			
J5 Property, plant and equipment	20 800		
Deferred tax	600		
Inventories		12 400	
Revaluation surplus		9 000	
<i>Recording of fair value adjustments at acquisition (3)</i>			
J6 Share capital	50 000		
Retained earnings (240 000 – 8 680)	231 320		
Revaluation surplus	17 680		
Non-controlling interest (SFP)		119 600	119 600 <sup>h</sup>
Investment in Ohio Limited		170 000	
Gain on bargain purchase (profit before tax)		9 400 <sup>g</sup>	
<i>Elimination of owners' equity in Ohio Limited at acquisition</i>			
J7 Non-controlling interest (SCI)	108 472		
Non-controlling interest (SFP)		108 472	108 472 <sup>i</sup>
<i>Recording of non-controlling interest in profit for the year of Ohio Limited</i>			
<i>((262 500 + 8 680(3)) × 40% = 108 472)</i>			
J8 Profit before tax	15 000		
Non-controlling interest (SFP)	10 000		(10 000) <sup>j</sup>
Dividends paid		25 000	
<i>Elimination of intragroup dividend and recording portion of non-controlling interest therein of Ohio Limited</i>			
			<u><u>218 072<sup>k</sup></u></u>

### 3.5 Assessment criteria

After having studied this study unit you should be able to:

- describe and identify the different types of complex groups.
- compile the consolidation working papers of the different types of complex groups.
- consolidate from the consolidation working papers the information contained in the financial statements of the different companies in the complex group.
- prepare and present the consolidated annual financial statements of a complex group.

## Accounting for investments in associates (IAS 28 (AC 110))

### Learning outcome 4

After having studied this study unit you should be able to:

- Explain associates in terms of IAS 28 (AC 110).
- Apply consolidation procedures in order to prepare consolidated annual financial statements when a parent holds a direct or indirect interest in an associate and the results of the associate are accounted for according to the equity method.

### OVERVIEW OF THE STUDY UNIT

The study unit consists of the following sections:	Page
4.1 Basic concepts	104
4.2 Accounting for investments in associates in the separate financial statements of the investor	105
4.3 Accounting for investments in associates in the consolidated financial statements of the investor	105
4.4 Application of the equity method	105
4.5 Summary	114
4.6 Assessment criteria	115

#### Study

*Group Statements (Volume 2): Chapter 9*

### 4.1 Basic concepts

#### Study

*Group Statements (Volume 2): Chapter 9 – sections 9.01–9.02*

## 4.2 Accounting for investments in associates in the separate financial statements of the investor

### Study

*Group Statements (Volume 2): Chapter 9 — page 4*

## 4.3 Accounting for investments in associates in the consolidated financial statements of the investor

### Study

*Group Statements (Volume 2): Chapter 9 — sections 9.03–9.04*

## 4.4 Application of the equity method

### Study

*Group Statements (Volume 2): Chapter 9 — sections 9.05–9.14*

### 4.4.1 Theory

The equity method is an accounting method whereby the investment is initially recognised at cost and thereafter adjusted for any post-acquisition changes in the investee's (associates) net assets (or as net assets are equal to equity, the equity of the investee).

The increase/decrease in equity consists of the following:

- Retained earnings/(Accumulated loss) since acquisition to the beginning of the current period;
- Profit or loss for the current period; and
- Gains or losses included in other comprehensive income for the current period.

The recognition of an investor's share of the losses of the associate (investee) will decrease the carrying amount of the investment in the associate.

When the investor's share of the losses equals (or exceeds) its interest in the associate, the investor will discontinue recognising any further share of losses. Should the investee once again make profits such profits will only be recognised after the share of profits equals the losses not recognised.

Any dividends received from the associate will be accounted for as a reduction in the carrying amount of the investment in the associate.

### 4.4.2 Intragroup transactions

The broad concepts underlying the consolidation procedures applied in the acquisition of a subsidiary are adopted in accounting for the acquisition of an investment in an associate. (IAS 28(AC 110).20)

When an associate is accounted for using the equity method, unrealised profits and losses resulting from transactions between an investor (or its consolidated subsidiaries) and associates should be eliminated **only** to the extent of the investor's interest in the associate, or recognised in the investor's financial statements **only** to the extent of unrelated investors' interest in the associate. (IAS 28(AC 110).22)

When an investor **contributes or sells** assets to an associate, recognition of any portion of a gain or loss from the transaction should reflect the substance of the transaction. While the assets are retained by the associate, and provided the investor has transferred the significant risks and rewards of ownership, the investor should recognise only that portion of the gain that is attributable to the interests of the **other** investors in the associate.

**Example 4.1**

**Investor sells to associate**

A Limited has a 25% interest in B Limited and has significant influence over B Limited. A Limited sold inventory to B Limited at a profit. At year end B Limited still had inventory on hand amounting to R100 000. A Ltd sells inventory to B Ltd at a profit mark-up of 20% on selling price. Assume a SA normal tax rate of 30%.

**REQUIRED:**

Prepare the pro forma consolidation journal entries for the above transaction.

**Solution 4.1**

	Dr R	Cr R
J1 Gross profit (A Limited) $(20\,000(100\,000 \times \frac{20}{100}) 25\%)$	5 000	
Investment in B Limited (SFP)		5 000
<i>Elimination of the unrealised profit in inventory of A Limited</i>		
<b>OR</b>		
Revenue $(100\,000 \times 25\%)$	25 000	
Cost of sales $(100\,000 \times \frac{80}{100}) \times 25\%$		20 000
Investment in B limited $(100\,000 \times \frac{20}{100} \times 25\%)$		5 000
J2 Deferred tax (SFP) $(5\,000 \times 30\%)$	1 500	
Deferred tax (SCI)		1 500
<i>Tax implication of elimination of investor's share of unrealised profit.</i>		

The net assets of B Limited include the unrealised profit in the carrying amount of inventory, therefore the carrying amount of the investment is adjusted.

**Example 4.2**

**Associate sells to investor**

A Limited has a 25% interest in B Limited and has significant influence over B Limited. B Limited sold inventory to A Limited at a profit of R20 000. At year end A Limited still had this inventory on hand. Assume a SA normal tax rate of 30%.

**REQUIRED:**

Prepare the pro forma consolidation journal entries for the above transaction.



<b>Option 1</b>	<b>Dr R</b>	<b>Cr R</b>
J1 Share of profit of associate (SCI) (20 000 × 25% × 70%) Investment in B Limited (SFP) <i>Elimination of the unrealised profit in inventory of A Limited</i>	3 500	3 500

<b>Option 2</b>	<b>Dr R</b>	<b>Cr R</b>
J1 Share of profit of associate (SCI) (20 000 × 25%) Inventories (SFP) <i>Elimination of the unrealised profit in inventory of A Limited</i>	5 000	5 000
J2 Deferred tax (SFP) (5 000 × 30%) Share of profit of associate (SCI) <i>Tax implication of elimination of investor's share of unrealised profit of A Limited.</i>	1 500	1 500

**Unisa follows option 2 and this is also the method applied in Group Statements.**

**Note:** A Limited recognises its 25% interest in B Limited's profit for the period and therefore only R3 500 (25% × R20 000 × 70%) is shown as a reduction of the attributable profit of the associate and included in A Limited's Statement of Comprehensive Income.

If B Limited's income statement had shown a profit for the period of R100 000, the portion attributable to A Limited would have been calculated as follows:

	<b>Total R</b>	<b>A Limited (25%) R</b>
Administration building	100 000	25 000
Inventories	<u>(57 600)</u>	<u>(3 000)</u>
	<u>86 000</u>	<u>21 500</u>

#### **4.4.3 Goodwill and excess of fair value above cost on acquisition**

If any **goodwill** arises as a result of acquiring an investment in an associate, the goodwill is included in the carrying amount of the investment. Amortisation of goodwill is not permitted and is therefore not included in determining the investor's share of profit in the associate (IAS 28 (AC 110). 23(a)).

Any **excess** of the fair values of the identifiable assets, liabilities and contingent liabilities acquired above the cost of the investment in the associate is excluded from the carrying amount of the investment and is instead included as income in the determination of the investor's share of profit in the associate in the period in which the investment is acquired (IAS 28 (AC 110). 23 (b)).

Goodwill included in the carrying amount of an investment in an associate is not separately recognised, thus it is not tested for **impairment** separately. Instead the entire carrying amount of the investment is tested for impairment in terms of IAS 36 Impairment of Assets (IAS 28 (AC 110). 33).

**Example 4.3**

On 1 July 20.3 Pretty Limited acquired a 30% interest in the 10 000 R1 equity shares of Lucky Limited for R24 000 when the retained earnings of Lucky Limited were R61 000.

On this date the land of Lucky Limited was revalued above the original carrying amount by R5 000. Pretty Limited had significant influence over Lucky Limited since 1 July 20.3.

The financial year end of Pretty Limited is 30 June.

**REQUIRED:**

Calculate the goodwill at acquisition of the investment in Lucky Limited.

**Solution 4.3**

	R
Share capital	10 000
Retained earnings	61 000
Revaluation of land	5 000
Net asset value on 1 July 20.3	<u>76 000</u>
30% interest (76 000 × 30%)	22 800
Cost price of investment	<u>(24 000)</u>
Goodwill	<u>1 200</u>

The journal entry for recording the investment in Lucky Limited on acquisition in the records of Pretty Limited in accordance with the equity method will be as follows:

<b>Option 1</b>	<b>Dr</b>	<b>Cr</b>
	<b>R</b>	<b>R</b>
Investment in Lucky Limited (net asset value)	22 800	
Investment in Lucky Limited (goodwill)	1 200	
Bank		24 000
Recording of the investment in Lucky Limited		

#### 4.4.4 Example of equity method

Work through the following example dealing with the application of the equity method:

<b>Example</b>	<b>4.4</b>
----------------	------------

The following represents the trial balances of Stereo Limited and Sound Limited for the year ended 30 June 20.9:

	<b>Stereo Limited Dr/(Cr) R</b>	<b>Sound Limited Dr/(Cr) R</b>
Share capital (130 000 ordinary shares)	(162 500)	—
Share capital (18 000 ordinary shares)	—	(36 000)
(Retained earnings)/Accumulated loss – 30 June 20.8	(122 500)	14 500
Gross profit	(72 200)	(32 000)
Gain on expropriation of land (tax effect – Rnil)	—	(5 500)
Dividends received	(11 500)	—
Trade and other payables	(25 300)	(7 200)
Property, plant and equipment at carrying amount	323 600	28 000
Inventories	21 900	18 100
Income tax expense	20 600	8 100
Dividends paid	12 500	12 000
Investment in Sound Limited at fair value	15 400	—
	<u>—</u>	<u>—</u>

#### Additional information

1. Stereo Limited acquired 8 100 ordinary shares for R15 400 in Sound Limited, an unlisted company in the motor industry, on 1 July 20.6 when the retained earnings of Sound Limited amounted to R8 000. Stereo Limited exercises significant influence over management and financial policies of Sound Limited.
2. During the current financial year Stereo Limited bought inventory from Sound Limited at cost plus 20%. At year end on 30 June 20.9, Stereo Limited had inventory amounting to R5 700 on hand that was bought from Sound Limited during the year.
3. At acquisition date no unidentified assets, liabilities or contingent liabilities existed and the fair values of all assets, liabilities and contingent liabilities were confirmed to be equal to the carrying amounts thereof.
4. The SA normal tax rate has been 29% since 20.6.
5. The directors' valuation of the investment in Sound Limited is R16 000.
6. The fair value of available-for-sale financial assets is equal to the original cost price thereof.
7. Each share carries one vote.

**REQUIRED:**

- (a) Discuss the appropriate accounting treatment of goodwill which arises as a result of the acquisition of an investment in an associate.
- (b) Discuss the appropriate accounting treatment if an excess of fair value above the cost price of the investment arises as a result of the acquisition of an investment in an associate.
- (c) Discuss the appropriate accounting treatment of unrealised profits or losses resulting from intercompany transactions between an investor and an associate.
- (d) Prepare the consolidated annual financial statements of Stereo Limited for the year ended 30 June 20.9.

Only the following note is required:

— Investment in associate

Your answer must comply with the requirements of Generally Accepted Accounting Practice.

Comparative figures are **not** required.

All calculations are to be done to the nearest R1.

**Solution 4.4**

**Part (a)**

If any **goodwill** arises as a result of acquiring an investment in an associate, the goodwill is included in the carrying amount of the investment. Amortisation of goodwill is not permitted and is therefore not included in determining the investor's share of profit in the associate.

Goodwill included in the carrying amount of an investment in an associate is not separately recognised, thus it is not tested for **impairment** separately. Instead the entire carrying amount of the investment is tested for impairment.

**Part (b)**

Any **excess** of the fair value of the identifiable assets, liabilities and contingent liabilities acquired above the cost of the investment in the associate is **excluded** from the carrying amount of the investment and is instead included as income in the determination of the investor's share of profit in the associate in the period in which the investment is acquired.

**Part (c)**

Unrealised profits or losses should be eliminated only to the extent of the investor's interest in the associate or recognised in the investor's financial statements only to the extent of unrelated investors' interest in the associate.

Part (d)

**STEREO LIMITED**

**STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 20.9**

<b>ASSETS</b>	<b>Notes</b>	<b>R</b>
<b>Non-current assets</b>		341 229
Property, plant and equipment		323 600
Investment in associate		17 505
Deferred tax ( $5\,700 \times 20/120 \times 45\% \times 29\%$ )	2	124
<b>Current assets</b>		21 472
Inventories ( $21\,900 - 428(5\,700 \times 20/120 \times 45\%)$ )		21 472
<b>Total assets</b>		<u>362 701</u>
<b>EQUITY AND LIABILITIES</b>		
<b>Total equity</b>		337 401
Share capital		162 500
Retained earnings		174 901
<b>Total liabilities</b>		25 300
<b>Current liabilities</b>		25 300
Trade and other payables		25 300
<b>Total equity and liabilities</b>		<u>362 701</u>

**STEREO LIMITED**

**STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 20.9**

	<b>R</b>
Gross profit	72 200
Other income ( $11\,500 - 5\,400(12\,000 \times 45\%)(div)$ )	6 100
Share of profit of associate	12 926
<b>Profit before tax</b>	<u>91 226</u>
Income tax expense	(20 600)
<b>PROFIT FOR THE YEAR</b>	<u>70 626</u>
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>	<u>70 626</u>

**STEREO LIMITED**

**STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 30 JUNE 20.9**

	<b>Share capital R</b>	<b>Retained earnings R</b>	<b>Total R</b>
<b>Balance at 1 July 20.8</b>	162 500	116 775 <sup>1</sup>	279 275
<b>Changes in equity for 20.9</b>			
Total comprehensive income for the year		70 626	70 626
Dividends paid		(12 500)	(12 500)
<b>Balance at 30 June 20.9</b>	<u>162 500</u>	<u>174 901</u>	<u>337 401</u>

<sup>1</sup>  $122\,500 - 5\,725a = 116\,775$

**STEREO LIMITED**

**NOTES FOR THE YEAR ENDED 30 JUNE 20.9**

**1. Investment in associate**

Stereo Limited has a 45% interest in an unlisted company, Sound Limited. Sound Limited is in the motor industry

**Carrying amount of investment in associate:**

Cost of investment	R 15 400
Cumulative post-acquisition reserve (-5 725 <sup>a</sup> + 13 230 <sup>c</sup> - 5 400(div))	2 105
	17 505

**Summarised financial information of Sound Limited:**

	R
Total assets (28 000 + 18 100)	46 100
Total liabilities	7 200
Revenue (not supplied in question)	XXX

The directors' valuation of the investment in Sound Limited is R16 000.

**Calculations**

**C1 Analysis of owners' equity of Sound Limited**

	100%	45%		Carrying amount R
	Total R	At R	Since R	
<b>At acquisition</b>				
Share capital	36 000	16 200		
Retained earnings	8 000	3 600		
	44 000	19 800		
Investment in Sound Limited		(15 400)		15 400
Excess of fair value over cost		4 400		
			(5 725) <sup>a</sup>	(5 725)
<b>Since acquisition</b>				
Accumulated loss (14 500 + 8 000)	(22 500)		(10 125)	
Excess of fair value over cost			4 400	
	28 725		12 926	
<b>Current year</b>				
Profit for the year				
(32 000 - 8 100 + 5 500)	29 400		13 230	13 230 <sup>c</sup>
Unrealised profit in inventory	(675)		(304)	
Dividends paid	(12 000)		(5 400)	(5 400)
	38 225		(1 801)	17 505

## 2. Pro forma consolidation journals

		Dr R	Cr R
J1	Retained earnings – beginning of year $((14\,500 + 8\,000) \times 45\%)$	10 125	
	Share of profit of associate $((32\,000 - 8\,100 + 5\,500 - 12\,000) \times 45\%)$		7 830
	Investment in associate		2 295
	<i>Recording of profit of Sound Limited</i>		
J2	Investment in associate	4 400	
	Retained earnings – beginning of year		4 400
	<i>Recognition of excess of fair value above cost at acquisition</i> $(19\,800 - ((36\,000 + 8\,000) \times 45\%) - 15\,400)$		
J3	Share of profit of associate	428	
	Inventories		428
	<i>Elimination of unrealised profit in closing inventories of Stereo Limited</i> $(5\,700 \times 20/120 \times 45\%)$		
J4	Deferred tax (SFP)	124	
	Share of profit of associate $(428 \times 29\%)$		124
	<i>Tax implication of unrealised profit in closing inventories of Stereo Limited</i>		

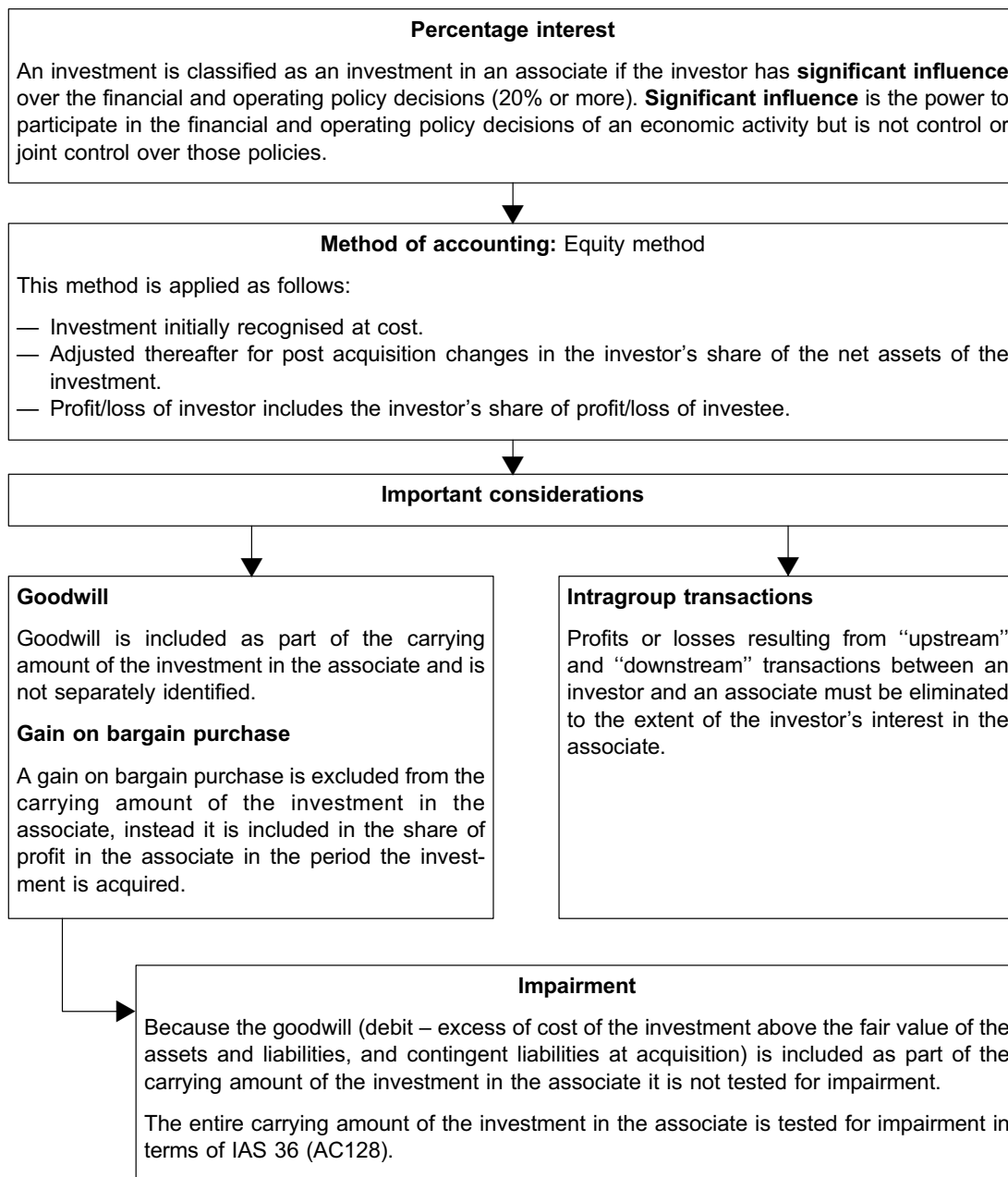
## Comments

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*The excess of fair value above cost at acquisition is excluded from the carrying amount of the investment and it is included as income in the determination of the investor's share of the associate's profit/loss in the period in which the investment is acquired*

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## 4.5 Summary





## 4.6 Assessment criteria

After having studied this study unit you should be able to:

- define an associate in terms of IAS 28 (AC 110).
- describe the two methods to account for an investment in associate in terms of IAS 28 (AC 110).
- differentiate between an associate, subsidiary and a joint venture.
- record and disclose an investment in an investee according to the equity method in the financial statements of the investor.
- prepare and present the consolidated annual financial statements of an investor when the investment in an associate is accounted for according to the equity method.
- in the case of intragroup transactions, calculate the percentage of unrealised profit/loss in inventories or property, plant and equipment sold.
- record the pro forma journals for the elimination of the intragroup profit/loss.
- record the pro forma journals in respect of the tax implications on the elimination of the intragroup profit/loss.
- prepare and present consolidated annual financial statements of an investor when the investment in an associate is accounted for according to the equity method and when the intragroup profit/loss between the investor and the associate is eliminated.

## **Accounting for interests in joint ventures (IAS 31 (AC 119))**

There is currently an exposure draft issued that may change the accounting treatment of interests in joint ventures, namely ED 229 *Joint arrangements*. In terms of ED 229, it is suggested that the proportionate consolidation method is scrapped and that all interests in joint ventures be accounted for only according to the equity method. ED 229 has not yet been approved and therefore the proportionate consolidation method is still being used.

Once the accounting statement is issued examples that deal with this section of the work will be forwarded to students.

## Changes in ownership

### Learning outcome 6

After studying this study unit, you should be able to:

Apply consolidation procedures in order to prepare the consolidated annual financial statements for a group where there has been a change in ownership.

### OVERVIEW OF THE STUDY UNIT

The study unit consists of the following sections:	Pages
6.1 Introduction	117
6.2 Piecemeal acquisition of interests in investees	119
6.3 Sale of interest in an investee	125
6.4 Changes resulting from the issue of additional shares by investees	132
6.5 Assessment criteria	144

#### Study

*Group Statements (Volume 2): Chapter 11*

### 6.1 Introduction

#### Study

*Group Statements (Volume 2): Chapter 11 — section 11.01*

A company investing in another company exercises a certain degree of ownership (control) over the acquired company's financial and operating policies. The principles of IFRS 3 (AC 140) should be applied at the acquisition date, i.e. the date that control is obtained.

A **change in status** implies that either there was control over a company which no longer exists after the change in ownership (i.e. decrease in degree of control) or that there was no control before the change in ownership and thereafter there is control (i.e. increase in the degree of control).

## 6.1.1 Occurrences of changes in ownership

Changes in ownership can occur in many different ways, including the following:

### (a) Increase of interest (thus increase in degree of control) by means of the following:

- Additional shares are bought in a step acquisition whereby an investment in the acquired company becomes an investment exercising significant influence or to gain control over the acquired company (in stages). (Resulting in a change in status)
- Additional equity shares in the acquired company are bought from the other investors or from a share issue of the acquired company. This will increase the already existing degree of control or significant influence. (Not resulting in a change in status)
- The investing company exercises its allocated rights of the rights issue of the acquired company and thereby increases their interest. This will occur if the ratio of their exercised rights is greater than the ratio of the exercised rights of the other investors. (This could result in a change in status, depending on the ratio in which shares are eventually taken up.)

## Comments

---

*Bear in mind that a right issue of the acquired company will not always result in an increase in the degree of control. If the non-controlling shareholders take up more rights than the acquiring company then the interest of the acquiring company will decrease.*

---

### (b) Decrease of interest by means of the following:

- Shares in a subsidiary are sold to either become an ordinary IAS 39 (AC 133) investment, or an associate (resulting in a change in status i.e. loss of control).
- Shares in a subsidiary are sold, but the acquired company still remains a subsidiary but the parent has a smaller interest in the subsidiary's net identifiable assets and liabilities (not resulting in a change in status i.e. parent is still the controlling party).
- The investing company partially exercises its allocated rights of the rights issue of the acquired company and thereby decreases its interest. This will occur if the ratio of their exercised rights is smaller than the ratio of the exercised rights of the other investors (i.e. the non-controlling interest exercise some or all of their rights) (may or may not result in a change in status, depending on the ratio in which the shares are eventually taken up).

### (c) No change in the degree of control:

This is the result when both the parent and the non-controlling interest take up either all of their rights in a subsidiary's rights issue in the original ratio that they accrued to the investors or when neither of the parties exercise the rights that accrued to them.

## 6.2 Piecemeal acquisition of interests in investees

### Study

*Group Statements (Volume 2): Chapter 11 — sections 11.02–11.05*

#### Different scenarios where there is an increase in the degree of control:

Firstly, we look at scenarios where there will be a **change in status** between the before and after degree of ownership.

#### (a) Examples of scenarios where there was a change in status (no control changed to having control):

- Associate becomes —————▶ a subsidiary
- Investment becomes —————▶ a subsidiary

In these cases:

- (i) Apply the steps of the acquisition process (Refer study unit 1.) and
- (ii) on the acquisition date (the date when **control** is obtained over the investee), recognise the **previously held interest** at its **fair value** through profit and loss. If there was any fair value adjustments recognised through equity relating to the investment before the acquisition date, they will be reclassified from equity to profit and loss.

### Comments

---

*Goodwill or gain on bargain purchase is recognised **only on the acquisition date** i.e. the date when **control is obtained** and not again on any date thereafter should additional interests in the subsidiary be acquired.*

---

#### b) In the following examples there is a change in the degree of control, but not a change in status:

- Investment becomes —————▶ associate
- Associate becomes —————▶ greater associate

In these cases we must apply the requirements of IAS 28 (AC 110). There are **no requirements** in terms of IAS 28 (AC 110) to fair value any previously held interest on the date on which **significant influence** is obtained over the associates operating and financing activities.

On every date an interest in an investee is obtained, goodwill or gain on bargain purchase will be calculated and appropriately recognised in the consolidated financial statements

### Comments

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*This differs from the case of a subsidiary when goodwill or gain on bargain purchase is only recognised at acquisition date i.e. the date on which control is obtained.*

---

**(c) A change in the degree of control, but not in status and control has already been obtained:**

- Subsidiary becomes —————▶ greater subsidiary

In this case it is important to firstly realise that there is no change in status, the subsidiary remains a subsidiary, only with a greater interest and that the following needs to be done:

- The **carrying amounts** of the controlling and non-controlling interest, including any goodwill attributable to the non-controlling interest (if applicable) needs to be **adjusted** with the difference in the interest held in the net assets of the subsidiary before and after the change in ownership.
- Furthermore, the **difference** between the non-controlling interest's adjustment amount (as discussed above) and the consideration transferred by the parent for the additional interest, must be recognised **directly in equity** against the **retained earnings**, instead of recognising any additional goodwill or gain on bargain purchase.

## Comments

---

*Goodwill or gain on bargain purchase is recognised **only on the acquisition date** i.e. when **control is obtained** and not again on any date thereafter should additional interests in the subsidiary be acquired.*

---

### Example 6.1

**(Increase in holding, no change in status, with revaluation of property, plant and equipment)**

The abridged trial balances of Bon Limited and its subsidiary, Aqua Limited, for the year ended 31 December 20.3, are as follows:

	<b>Bon Limited R</b>	<b>Aqua Limited R</b>
<b>Credits</b>		
Share capital (60 000 ordinary shares); (40 000 ordinary shares)	300 000	200 000
(Retained earnings) – 1 January 20.3	500 000	150 000
Profit before tax	190 000	240 000
Long-term borrowings	270 000	175 000
Trade and other payables	13 900	20 000
	<u>1 273 900</u>	<u>785 000</u>
<b>Debits</b>		
Property, plant and equipment	823 000	651 000
Investment in Aqua Limited at fair value	268 900	—
Trade receivables	76 900	34 400
Income tax expense	55 000	69 600
Dividends paid – 31 December 20.3	50 000	30 000
	<u>1 273 900</u>	<u>785 000</u>

## Additional information

1. On 1 January 20.1 Bon Limited acquired 60% of the equity of Aqua Limited and paid R190 000 for the investment. The share capital has remained unchanged since that date and there were no other reserves other than retained earnings of R75 000 on date of acquisition. At this acquisition date no unidentified assets, liabilities or contingent liabilities existed and the fair value of all assets, liabilities and contingent liabilities was confirmed to be equal to the carrying amounts thereof, except for a vacant piece of land that was revalued by R60 000 (cost R40 000) for purposes of this acquisition. Aqua Limited did not process any revaluation in their records.
2. On 30 June 20.2 Aqua Limited sold the piece of land for R110 000.
3. On 1 October 20.3 Bon Limited acquired an additional 6 000 ordinary shares in Aqua Limited. On this date there was no change in the fair value of assets, liabilities or contingent liabilities as was determined on 1 January 20.1. The profit of Aqua Limited other than the effect of the intercompany transaction (refer point 5.) has been earned evenly throughout the year.
4. The cost price of the investment in the subsidiary is considered to be equivalent to the fair value thereof.
5. On 2 October 20.3 Aqua Limited sold machinery with a carrying amount of R80 000 to Bon Limited for R120 000. The depreciation policy of the group is to depreciate machinery over the expected useful life of 5 years on the straight-line method. Machinery is depreciated at the same rate as is allowed for tax purposes.
6. Assume that each share carries one vote.
7. The SA normal tax rate is 29%. You may assume the tax rate has been 29% since 1 January 20.1.
8. The companies uses is the partial goodwill method to account for non-controlling interest. The value of goodwill was tested for impairment at the end of 20.3 and it was found to be unimpaired.

### REQUIRED:

- (a) Explain what is meant by the “several acquisition dates” method of accounting for the acquisition of an interest in a subsidiary.
- (b) Prepare the following for the Bon Limited Group for the year ended 31 December 20.3:
  - (i) Consolidated statement of financial position.
  - (ii) Consolidated statement of comprehensive income; and
  - (iii) Consolidated statement of changes in equity.

Your answer must comply with the requirements of Generally Accepted Accounting Practice.

The notes to the consolidated annual financial statements and comparative figures are **not** required.

All calculations are to be done to the nearest R1.

(a) The “several acquisition dates” method entails the determination of the difference between the purchase price and carrying amount of the investment for each separate block of shares purchased, including acquisitions before control was acquired.

**(b) (i) BON LIMITED GROUP**

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.3**

<b>ASSETS</b>	<b>R</b>
<b>Non-current assets</b>	1 447 020
Property, plant and equipment (823 000 + 651 000 – 40 000 (machinery) + 2 000(C2))	1 436 000
Deferred tax (11 600(40 000 x 29%) – 580(C2))	11 020
<b>Current assets</b>	111 300
Trade receivables (76 900 + 34 400)	111 300
<b>Total assets</b>	<u>1 558 320</u>
<b>EQUITY AND LIABILITIES</b>	
<b>Total equity</b>	1 079 420
<b>Equity attributable to owners of the parent</b>	963 565
Share capital	300 000
Retained earnings	673 990
Other components of equity	(10 425)
<b>Non-controlling interest</b>	115 855 <sup>h</sup>
<b>Total liabilities</b>	478 900
<b>Non-current liabilities</b>	445 000
Long-term borrowings (270 000 + 175 000)	445 000
<b>Current liabilities</b>	33 900
Trade and other payables (13 900 + 20 000)	33 900
<b>Total equity and liabilities</b>	<u>1 558 320</u>

**(b) (ii) BON LIMITED GROUP**

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.3**

	<b>R</b>
<b>Profit before tax</b>	369 500
(190 000 + 240 000 – 22 500 (interco div) – 40 000 (machinery) + 2 000(C2))	
Income tax expense (55 100 + 69 600 – 11 600 (40 000 x 29%) + 580 (C2))	(113 680)
<b>PROFIT FOR THE YEAR</b>	<u>255 820</u>
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>	<u>255 820</u>
 Total comprehensive income attributable to:	
Owners of the parent	203 990
Non-controlling interest (42 600 <sup>a</sup> + 9 230 <sup>b</sup> )	51 830
	<u>255 820</u>



**(b) (iii) BON LIMITED GROUP****CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.3**

	Share capital R	Retained earnings R	Change in Control (bleeding) R	Total R	Non-controlling interest R	Total equity R
<b>Balance at 1 January 20.3</b>	300 000	520 000 <sup>1</sup>		820 000	140 000 <sup>i</sup>	960 000
<b>Changes in equity for 20.3</b>						
Total comprehensive income for the year		203 990		203 990	51 830	255 820
Equity sold to parent					(68 475) <sup>e</sup>	(68 475)
Purchase additional interest			(10 425)	(10 425)		(10 425)
Dividend paid		(50 000)		(50 000)	(7 500) <sup>e</sup>	(57 500)
<b>Balance at 31 December 20.0</b>	300 000	673 990	(10 425)	963 565	115 855	1 079 420

<sup>1</sup> 500 000 + 14 220<sup>c</sup> + 5 780<sup>d</sup> = 520 000 or 500 000 + (150 000 – 75 000 – 51 300 – 9 480 (J4)) + 5 780<sup>d</sup> = 520 000

**Calculations****C1 Analysis of owners' equity of Aqua Limited**

	100%	60% – 75%		40% – 25%
	Total R	At R	Since R	NCI R
<b>At acquisition</b>				
Share capital	200 000	120 000		80 000
Retained earnings	75 000	45 000		30 000
Revaluation surplus (60 000 – 8 700 (60 000 x 50% x 29%))	51 300	30 780		20 520
	326 300	195 780		130 520
Equity represented by gain on bargain purchase	(5 780)	(5 780) <sup>d</sup>		—
Consideration and non-controlling interest	320 520	190 000		130 520
<b>Since acquisition</b>				
Gain on bargain purchase	5 780		5 780	—
Retained earnings (150 000 – 75 000 – 51 300)	23 700		14 220 <sup>c</sup>	9 480
	350 000		20 000	140 000 <sup>i</sup>
<b>Current year</b>				
Profit for the year (C2)	106 500		63 900	42 600 <sup>a</sup>
	456 500		83 900	182 600
Purchase of 6 000 shares (450 720 + 5 780) x 15%		68 475		(68 475) <sup>e</sup>
Investment in Aqua Limited (Purchase of additional interest) (268 900 – 190 000)		(78 900)		
Change in ownership		(10 425) <sup>g</sup>		
Profit for the year (C2)	36 920		27 690	9 230 <sup>b</sup>
Dividends paid	(30 000)		(22 500)	(7 500) <sup>f</sup>
	463 420		89 090	115 855 <sup>h</sup>

**C2 profit for the year**

	<b>Total R</b>	<b>9 months R</b>	<b>3 months R</b>
Profit before tax (240 000 – 40 000 (interco))	200 000	150 000	50 000
Income tax expense (69 600 – 11 600 (40 000 x 29%))	(58 000)	(43 500)	(14 500)
	142 000	106 500	35 500
Realisation of intercompany profit (40 000/5 x 3/12)			2 000
Tax effect of realisation of intercompany profit (2 000 x 29%)			(580)
			36 920

**C3 Pro forma consolidation journals**

	<b>Dr R</b>	<b>Cr R</b>	<b>NCI R</b>
J1 Property, plant and equipment	60 000		
Deferred tax (60 000 x 50% x 29%)		8 700	
Revaluation surplus		51 300	
<i>Revaluation of fixed property at date of acquisition</i>			
J2 Share capital	200 000		
Retained earnings	75 000		
Revaluation surplus	51 300		
Non-controlling interest (SFP)		130 520	130 520
Investment in Aqua Limited		190 000	
Retained earnings (Gain on bargain purchase)		5 780 <sup>d</sup>	
<i>Elimination of original investment in Aqua Limited</i>			
J3 Retained earnings	51 300		
Deferred tax	8 700		
Property, plant and equipment		60 000	
<i>Sale of fixed property revalued at acquisition (reversal of J1)</i>			
J4 Retained earnings	9 480		
Non-controlling interest (SFP)		9 480	9 480
<i>Recording of non-controlling interest in retained earnings since acquisition to beginning of current year ((150 000 – 75 000 – 51 300) x 40%)</i>			
			140 000 <sup>i</sup>
J5 Non-controlling interest (SCI)	42 600		
Non-controlling interest (SFP)		42 600	42 600 <sup>a</sup>
<i>Recording of non-controlling interest in profit for the year for 9 months to 30/09/20.3 (106 500(2) x 40%)</i>			
			182 600
J6 Non-controlling interest (SFP) (182 600 x 15%/40%)	68 475		(68 475) <sup>e</sup>
Retained earnings (change in control)	10 425		
Investment in Aqua Limited (268 900 – 190 000)		78 900	
<i>Elimination of additional investment in Aqua Limited</i>			

J7	Non-controlling interest (SCI)	9 230		
	Non-controlling interest (SFP)		9 230	9 230 <sup>b</sup>
	<i>Recording of non-controlling interest in profit for the 3 month period to 31/12/20.3 (36 920(C2) x 25%)</i>			
J8	Dividend received	22 500		
	Non-controlling interest (SFP) (30 000 × 25%)	7 500		(7 500) <sup>f</sup>
	Dividend paid		30 000	
	<i>Elimination of intercompany dividends and recording of non-controlling interest in dividends paid</i>			
				115 855 <sup>h</sup>

### 6.3 Sale of interests in an investee

#### Study

*Group Statements (Volume 2): Chapter 11 — sections 11.07–11.10*

Similarly, as for increases in the degree of control, there are different scenarios for decreases in the degree of control. A decrease in the degree of control mostly occurs when a company disposes of a part of or all of its investment in the investee.

**NB:** There can be a decrease in the degree of control without any change in status (control retained before and after the change in ownership) or with a change in status (control lost after the change in ownership). Further consequences on these scenarios are listed below.

#### 6.3.1 Example of loss in control (change in status)

**A parent can lose control of a subsidiary in a number of ways.**

Examples of events that may result in a loss of control include:

- parent sells all or part of its ownership interest in its subsidiary such that it loses control; or
- subsidiary issues shares to a third party, thereby reducing the parents' ownership interest in the subsidiary so that it no longer has control of the subsidiary. (Refer section 6.4.)

This results in:

- a subsidiary becoming —————> an investment
- a subsidiary becoming —————> an associate

A few steps need to be taken when a parent disposes of its interest or part of its interest in the subsidiary resulting in a loss of control, either by **becoming an associate** after the disposal or resulting in an **investment** in an investee in terms of IAS 39 (AC 133) after the disposal.

These steps include the following as starting points:

### Step 1

The **carrying amounts** of the **assets and liabilities of the subsidiary** need to be **derecognised**. Any goodwill that arose at acquisition date will also need to be adjusted for the decrease in interest.

**NB:** The new goodwill figure will be calculated by subtracting the cost of the remaining investment's shares from the capitalised equity (profits and reserves) associated with those remaining shares retained as an investment in the investee.

### Step 2

The **carrying amount** of the **non-controlling** needs to be **derecognised** as well, since the parent no longer has control as a result of the change in ownership. If the full goodwill method is used then this amount would include the goodwill allocated to the non-controlling interest. Refer to example 6.4.

### Step 3

The consideration received must be recognised at the fair value thereof. Refer to example 6.4.

### Step 4

Any investment retained in the former subsidiary (if applicable) must be measured at the **fair value** thereof on the date control was lost (disposal date) and the difference (fair value adjustment) must be accounted for in the parent's profit and loss as a resulting gain/loss. Refer to example 6.4.

### Step 5

The gain/loss (Refer to example 6.4) resulting from the loss in control consists of 2 parts:

- (1) A fair value adjustment for the remaining investment held in the investee after the change in ownership (refer comment below); and
- (2) a gain/loss on the investment disposed of.

The capital gain/loss on the disposal of the shares for the group's purposes **can also** be calculated as follows:

Subtract the portion of the equity reserves "at" acquisition and the portion of the "since" acquisition equity reserves lost with the disposal, from the proceeds received from the disposal of the interest.

Refer to **example 11.9(a)** in Group Statements (Volume 2) for the application of these principles. The example deals with the partial disposal of an interest in a subsidiary which results in a change in status and the subsidiary becoming an associate. The non-controlling interest is measured at the proportionate share of the acquiree's net assets.

## Comments

1. The journal entry that is normally processed at reporting date for fair value adjustments on available-for sale financial assets is as follows:

The investment in S Limited is shown in the financial records of the parent at R400 000. At the reporting date the fair value of the investment is considered to be R450 000. The fair value adjustment is as follows:

	Dr R	Cr R
Investment in S Limited (450 000 – 400 000)	50 000	
Mark-to-market-reserve (50 000 × 86%)		43 000
Deferred tax (50 000 × 14%) (tax at capital gains tax rate of 28% × 50% of taxable gain)		7 000

2. In terms of IAS 27(AC 132):34(d) any investment retained in a subsidiary must be measured at the **fair value** thereof on the date control was lost (disposal date) and the resulting fair value adjustment must be accounted for in the **consolidated profit and loss** for the year. This fair value adjustment therefore forms part of the total consolidated gain or loss on the disposal of the investment.

### Example 6.2

The following are the financial statements of Pan Limited and San Limited:

#### STATEMENTS OF FINANCIAL POSITION AS AT 31 DECEMBER 20.9

	Pan Limited R	San Limited R
<b>ASSETS</b>		
<b>Non-current assets</b>	1 221 250	780 000
Property, plant and equipment	931 250	780 000
Investment in San Limited at fair value	290 000	—
<b>Current assets</b>	247 000	280 000
Inventory, trade receivables and bank	247 000	280 000
<b>Total assets</b>	<u>1 468 250</u>	<u>1 060 000</u>
<b>Equity and liabilities</b>		
<b>Total equity</b>	1 401 000	1 034 000
Share capital (350 000 ordinary shares and 300 000 ordinary shares)	350 000	300 000
Retained earnings	946 725	734 000
Mark-to-market reserve	104 275	—
<b>Total liabilities</b>	67 250	26 000
Deferred tax	16 975	—
Trade payables	50 275	26 000
<b>Total equity and liabilities</b>	<u>1 468 250</u>	<u>1 060 000</u>

## INCOME INFORMATION FOR THE YEAR ENDED 31 DECEMBER 20.9

	R	R
<b>Profit before tax</b>	928 750	700 000
Income tax expense	<u>(242 025)</u>	<u>(196 000)</u>
<b>Profit for the year</b>	<u>686 725</u>	<u>504 000</u>
<b>Retained earnings:</b>		
Opening balance 1 January 20.9	260 000	230 000
Profit for the year	<u>686 725</u>	<u>504 000</u>
Closing balance 31 December 20.9	<u>946 725</u>	<u>734 000</u>

### Additional information

1. On 1 January 20.9 Pan Limited acquired an 80% interest in San Limited. Pan Limited paid R450 000 for the investment. All the assets and liabilities were fairly valued on the date of acquisition. The equity of San Limited on the date of acquisition was as follows:

	R
Share capital (300 000 ordinary shares)	300 000
Retained earnings	<u>230 000</u>
	<u>530 000</u>

2. Pan Limited measures available-for-sale financial assets (investments in subsidiaries) at cost in its separate financial statements. Pan Limited elected to measure the non-controlling interest at their proportionate share of the identifiable net assets at the acquisition date.
3. On 30 April 20.9 Pan Limited disposed of a 50% interest in San Limited for R410 000. From 30 April 20.9 onwards Pan Limited has exercised significant influence over the operating and financial policies of San Limited. The fair value of the remaining 30% interest on 30 April 20.9 was R260 000. The fair value at 31 December 20.9 was R290 000.
4. Included in the profit before tax of Pan Limited is the gain on disposal of the shares in San Limited of R128 750 (calculated as  $(410\ 000 - (450\ 000 \times 50/80))$ ). The tax effect of R18 025 of this transaction has been included in income tax expense (calculated as  $R128\ 750 \times 14\%$ ).

## Solution 6.2

### (a) Calculations

#### C1 Calculation of goodwill

	R
Consideration transferred	450 000
Non-controlling interest	<u>106 000</u>
	556 000
Fair value of net assets	<u>(530 000)</u>
Goodwill	<u>26 000</u>

**C2 Consolidation gain or loss on disposal**

Proceeds (as per information given)	410 000
Less: Consolidated net asset value ((724 000 – 26 000) × 50%)	(349 000)
Goodwill realised (26 000 × 50/80)	(16 250)
	<u>44 750</u>

**OR**

	<b>R</b>
Proceeds	410 000
Less: Cost	<u>(281 250)</u>
Gain in separate financial statements	128 750
Less: Since acquisition reserves	<u>(84 000)</u>
Consolidated gain on sale of investment	<u>44 750</u>

**C3 Restatement of carrying amount of investment to fair value at date of sale**

	<b>R</b>
Fair value (given)	260 000
Less: Consolidated carrying amount	
Net asset value at date of sale ((724 000 – 26 000) × 30%)	(209 400)
Goodwill (26 000 × 30/80)	<u>(9 750)</u>
Fair value adjustment	<u>40 850</u>

The total consolidated gain on the disposal of the 50% interest in San Limited is R87 550 (44 750 + 40 850).

**This amount can also be proved by applying IFRS 3 (AC 140).34****R**

If parent loses control of subsidiary the following steps are applied (Step 1 to Step 5)

Step 1	Derecognise assets and liabilities (including goodwill) on date control is lost	(724 000)
Step 2	Derecognise carrying amount of non-controlling interest	139 600
Step 3	Recognise fair value of consideration received	410 000
Step 4	Recognise any investment retained in former subsidiary at fair value	<u>260 000</u>
		85 600
Step 5	Gain or loss on disposal to profit or loss	<u>44 750</u>
	Reclassify mark-to-market reserve or revaluation surplus to profit or loss	<u>40 850</u>

#### 4. Analysis of the owners' equity San Limited

	100%	80%	30%	20%	30%
<b>Subsidiary</b>	<b>Total R</b>	<b>At R</b>	<b>Since R</b>	<b>NCI R</b>	<b>Carrying amount R</b>
Share capital	300 000	240 000		60 000	
Retained earnings	230 000	184 000		46 000	
	530 000	424 000		106 000	
Equity represented by goodwill	26 000	26 000		—	
Consideration paid and non-controlling interest	556 000	450 000		106 000	
<b>Current year</b>					
Profit for the year before sale (504 000 × 4/12)	168 000		134 400	33 600	
	724 000		134 400	139 600	
Sale of Investment in San Limited (450 000 × 50/80) (134 400 × 50/80)	(504 850)	(281 250)	(84 000)	(139 600)	
	219 150	168 750	50 400	—	219 150
<b>Associate</b>					
Profit for the year after sale (504 000 × 8/12)	336 000		100 800	—	100 800
			100 800	—	319 950

#### (b) Financial statements

##### PAN LIMITED GROUP

##### CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.9

<b>ASSETS</b>	<b>R</b>
<b>Non-current assets</b>	1 292 050
Property, plant and equipment	931 250
Investment in associate – at carrying amount (319 950 + 40 850)	360 800
<b>Current assets</b>	247 000
Trade and other receivables	247 000
<b>Total assets</b>	<u>1 539 050</u>
<b>EQUITY AND LIABILITIES</b>	
<b>Total equity</b>	1 488 775
<b>Equity attributable to owners of the parent</b>	1 488 775
Share capital	350 000
Retained earnings	1 138 775
<b>Total liabilities</b>	50 275
Trade and other payables	50 275
<b>Total equity and liabilities</b>	<u>1 539 050</u>



**PAN LIMITED GROUP**

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.9**

	R
Gross profit (800 000 + 233 333)	1 033 333
Other income (128 750 – 128 750)	—
Gain on disposal of subsidiary	44 750
Fair value adjustment	40 850
Share of profit of associate	100 800
<b>Profit before tax</b>	<b>1 219 733</b>
Income tax expense (224 000 + 18 025 + 65 333)	(307 358)
<b>PROFIT FOR THE YEAR</b>	<b>912 375</b>
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>	<b>912 375</b>
Total comprehensive income attributable to:	
Owners of the parent	878 775
Non-controlling interest	33 600
	<b>912 375</b>

**PAN LIMITED GROUP**

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.9**

	Share capital R	Retained earnings R	Total R	Non-controlling interest R	Total equity R
<b>Balance at 1 January 20.9</b>	350 000	260 000	610 000	106 000	716 000
<b>Changes in equity for 20.9</b>					
Total comprehensive income for the year	—	878 775	878 775	33 600	912 375
Loss of control in subsidiary	—	—	—	(139 600)	(139 600)
<b>Balance at 31 December 20.9</b>	<b>350 000</b>	<b>1 138 775</b>	<b>1 488 775</b>	<b>—</b>	<b>1 488 775</b>

**6.3.2 Example of a decrease in degree of control (no change in status):**

- Subsidiary becomes —————▶ smaller subsidiary
  - Similar principles are applicable when a part of the interest in a subsidiary is disposed of with no loss in control occurring, except for the goodwill.
  - The **goodwill figure will not be adjusted** to account for the part of the interest that was disposed of.
  - None of the other assets or liabilities of the subsidiary will be adjusted nor derecognised in such a case where control has not been lost.
  - Transactions which result in a change in the parent's degree of control in a subsidiary that do not result in a loss of control should be accounted for as **equity transactions** (IAS 27 (AC 132):30)).

The only adjustments to be taken into account would be the adjustments to the carrying amounts of the parent and the non-controlling interest in the net assets of the subsidiary.

The difference between the **fair value of the consideration received** and the **adjustment to the non-controlling interests** carrying amount, should be recognised **directly in equity** in the section attributable to the parent.

Refer to **example 11.8** in Group Statements (Volume 2).

## 6.4 Changes resulting from the issue of additional shares by investees

### Study

*Group Statements (Volume 2): Chapter 11 — sections 11.12–11.14*

### Example 6.3

#### (Increase in holding, change in status, an associate becomes a subsidiary)

The following are the trial balances of Syrup Limited and Lemon Limited for the year ended 31 December 20.7:

	Syrup Limited R	Lemon Limited R
<b>Credits</b>		
Share capital (240 000 ordinary shares and 250 000 ordinary shares)	240 000	256 000
Retained earnings – 1 January 20.7	140 000	190 000
Gross profit	110 000	36 000
Deferred tax	30 000	24 000
Long-term loan	60 000	80 000
Trade and other payables	40 000	21 000
	620 000	607 000
<b>Debits</b>		
Interest expense	5 600	9 000
Income tax expense	21 370	11 400
Dividends paid – 31 December 20.7	50 000	—
Property, plant and equipment	240 000	260 000
Investment in Lemon Limited at fair value	200 000	—
Trade receivables	44 000	91 000
Inventories	42 000	85 000
Bank	17 030	150 600
	620 000	607 000

#### Additional information

- On 1 January 20.5 Syrup Limited acquired 80 000 (40%) shares in Lemon Limited for R144 000. The acquisition of the shares resulted in Syrup Limited exercising significant influence over the financial and operating policies of Lemon Limited. Lemon Limited had share capital of R200 000 and retained earnings of R180 000 at that date. The net identifiable assets were deemed to be fairly valued on this date.

On 1 March 20.7 Lemon Limited had a rights issue of 50 000 shares at R1,12. The rights issue was taken up in full by Syrup Limited on 1 May 20.7.

2. During June 20.7, Lemon Limited sold inventories to Syrup Limited at a profit of 25% on selling price. At the end of the year, Syrup Limited had inventories of R20 000 on hand that were purchased from Lemon Limited.
3. In both companies, each share carries one vote.
4. Assume a SA Normal tax rate of 29% for the current year and all preceding years.
5. The income and expenses of Lemon Limited have accrued evenly during the year.
6. At every date of exchange, the identifiable assets and liabilities of Lemon Limited were regarded as fair in terms of IFRS 3 (AC 140).
7. The acquisition date fair value of Syrup Limited's previously-held equity interest is equal to its proportionate share of the net equity of Lemon Limited at the acquisition date.
8. The fair value of available-for-sale financial assets is equal to the cost price thereof, unless stated otherwise.
9. At the end of the current year goodwill was assessed for impairment and it was not considered to be impaired.

**REQUIRED: Part (a)**

Prepare the following for the Syrup Limited Group for the year ended 31 December 20.7:

- the consolidated statement of financial position
- the consolidated statement of comprehensive income
- the consolidated statement of changes in equity

Your answer must comply with the requirements of Generally Accepted Accounting Practice.

**Assume it is the accounting policy of Syrup Limited to measure the non-controlling interest using the partial goodwill method in terms of IFRS 3(AC 140).19.**

Notes to the consolidated annual financial statements and comparative figures are not required.

All calculations must be done to the nearest Rand.

**REQUIRED: Part (b)**

Prepare the following for the Syrup Limited Group for the year ended 31 December 20.7:

- the consolidated statement of financial position
- the consolidated statement of comprehensive income
- the consolidated statement of changes in equity

Your answer must comply with the requirements of Generally Accepted Accounting Practice.

**Assume it is the accounting policy of Syrup Limited to measure the non-controlling interest using the full goodwill method in terms of IFRS 3(AC 140).19.**

**The market value of Lemon Limited's shares was R1.95 on 1 May 20.7.**

The fair value of the previously held 40% interest was R158 080 on 1 May 20.7.

Notes to the consolidated annual financial statements and comparative figures are not required.

**SYRUP LIMITED GROUP**
**CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.7**

<b>ASSETS</b>	<b>R</b>
<b>Non-current assets</b>	500 000
Property, plant and equipment (240 000 + 260 000)	500 000
<b>Current assets</b>	424 630
Inventories (42 000 + 85 000 – (5 000(20 000 x 25/100))	122 000
Trade receivables (44 000 + 91 000)	135 000
Cash and cash equivalents (17 030 + 150 600)	167 630
<b>Total assets</b>	<u>924 630</u>
<b>EQUITY AND LIABILITIES</b>	
<b>Total equity</b>	671 080
<b>Equity attributable to owners of the parent</b>	451 216
Share capital	240 000
Retained earnings	211 216
<b>Non-controlling interest</b>	219 864 <sup>g</sup>
<b>Total liabilities</b>	253 550
<b>Non-current liabilities</b>	192 550
Deferred tax (30 000 + 24 000 – 1 450(5 000 x 29%))	52 550
Long-term borrowings (60 000 + 80 000)	140 000
<b>Current liabilities</b>	61 000
Trade and other payables (40 000 + 21 000)	61 000
<b>Total equity and liabilities</b>	<u>924 630</u>

**SYRUP LIMITED GROUP**
**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.7**

	<b>R</b>
Gross profit (110 000 + 24 000(36 000 x 8/12) – 5 000(20 000 x 25/100))	129 000
Other income (gain on bargain purchase)	20 544 <sup>e</sup>
Finance costs (5 600 + 6 000(9 000 x 8/12))	(11 600)
Share of profit from associate	2 080 <sup>c</sup>
<b>Profit before tax</b>	140 024
Income tax expense (21 370 + 7 600(11 400 x 8/12) – 1 450(5 000 x 29%))	(27 520)
<b>PROFIT FOR THE YEAR</b>	<u>112 504</u>
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>	<u>112 504</u>
Total comprehensive income attributable to:	
Owners of the parent	109 216
Non-controlling interest	3 288
	<u>112 504</u>

**SYRYP LIMITED GROUP**

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED  
31 DECEMBER 20.7**

	Share capital R	Retained earnings R	Total R	Non- controlling interest R	Total equity R
<b>Balance at 1 January 20.7</b>	240 000	152 000	(1) 392 000	—	392 000
<b>Changes in equity for 20.7</b>					
Non-controlling interest of subsidiary when still an associate				216 576 <sup>d</sup>	216 576
Dividends		(50 000)	(50 000)		(50 000)
Total comprehensive income for the year		109 216	109 216	3 288 <sup>f</sup>	112 504
<b>Balance at 31 December 20.7</b>	<b>240 000</b>	<b>211 216</b>	<b>451 216</b>	<b>219 864</b>	<b>671 080</b>

<sup>1</sup> 140 000 + 4 000<sup>b</sup> + 8 000<sup>a</sup> = 152 000

## Calculations

### C1 Analysis of owners' equity of Lemon Limited

	100%	Syrp Limited 40% – 52% <sup>1</sup>		60% – 48%
	Total R	At R	Since R	NCI R
<b>At first exchange: 1 January 20.5</b>				
Share capital	200 000	80 000		120 000
Retained earnings	180 000	72 000		108 000
	380 000	152 000		228 000
Equity represented by gain on bargain purchase	(8 000)	(8 000) <sup>a</sup>		—
Consideration paid and non-controlling interest	372 000	144 000		228 000
<b>Since first exchange</b>				
To beginning of current year:				
Retained earnings (190 000 – 180 000)	10 000		4 000 <sup>b</sup>	6 000
Gain on bargain purchase	8 000		8 000	—
<b>Current year</b>				
Profit for the period: 01/01/20.7 to 30/04/20.7 (15 600 <sup>2</sup> × 4/12)	5 200		2 080 <sup>c</sup>	3 120
	395 200		14 080	237 120
<b>Acquisition date: 1 May 20.7</b>				
Share capital (rights issue) <sup>3</sup>	56 000	29 120 <sup>3</sup>		26 880 <sup>3</sup>
Transfer from non-controlling interest <sup>4</sup> (395 200 × 12%)		47 424 <sup>4</sup>		(47 424) <sup>4</sup>
	451 200	76 544		216 576 <sup>d</sup>
Equity represented by gain on bargain purchase	(20 544)	(20 544) <sup>e</sup>		—
Consideration paid and non-controlling interest	430 656	56 000		216 576
Profit for the year: 01/05/20.7 to 31/12/20.7	6 850		3 562	3 288 <sup>f</sup>
Profit for the period (15 600(1) × 8/12)	10 400			
Unrealised profit in inventories (20 000 × 25/100)	(5 000)			
Tax effect (5 000 × 29%)	1 450			
Gain on bargain purchase	20 544		20 544	—
	458 050		38 186	<sup>5</sup> 219 864 <sup>g</sup>

<sup>1</sup>  $130\,000 \div (80\,000 \div ((250\,000 - 50\,000) \times 40\%) + 50\,000) \div 250\,000 = 52\%$

<sup>2</sup>  $36\,000 - 9\,000 - 11\,400 = 15\,600$

<sup>3</sup>  $(56\,000 \times 52\%) = 29\,120$ ;  $56\,000 \times 48\% = 26\,880$

<sup>4</sup>  $237\,120 \times 12/60 = 47\,424$

<sup>5</sup>  $458\,050 \times 48\% = 219\,864$

**Part (b)****SYRUP LIMITED GROUP****CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.7**

<b>ASSETS</b>	<b>R</b>
<b>Non-current assets</b>	517 424
Property, plant and equipment (240 000 + 260 000)	500 000
Goodwill	17 424
<b>Current assets</b>	424 630
Inventories (42 000 + 85 000 – 5 000 (20 000 x 25/100))	122 000
Trade receivables (44 000 + 91 000)	135 000
Cash and cash equivalents (17 030 + 150 600)	167 630
<b>Total assets</b>	<u>942 054</u>
<b>EQUITY AND LIABILITIES</b>	
<b>Total equity</b>	688 504
<b>Equity attributable to owners of the parent</b>	451 216
Share capital	240 000
Retained earnings	211 216
<b>Non-controlling interest</b>	237 288 <sup>h</sup>
<b>Total liabilities</b>	253 550
<b>Non-current liabilities</b>	192 550
Deferred tax (30 000 + 24 000 – 1 450(5 000 x 29%))	52 550
Long-term borrowings (60 000 + 80 000)	140 000
<b>Current liabilities</b>	61 000
Trade and other payables (40 000 + 21 000)	61 000
<b>Total equity and liabilities</b>	<u>942 054</u>

**SYRUP LIMITED GROUP****CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.7**

	<b>R</b>
Gross profit (110 000 + 24 000(36 000 x 8/12) – 5 000(20 000 x 25/100))	129 000
Other income (gain on bargain purchase)	20 544 <sup>e</sup>
Finance costs (5 600 + 6 000(9 000 x 8/12))	(11 600)
Share of profit from associate	2 080 <sup>c</sup>
<b>Profit before tax</b>	140 024
Income tax expense (21 370 + 7 600(11 400 x 8/12) – 1 450(5 000 x 29%))	(27 520)
<b>PROFIT FOR THE YEAR</b>	<u>112 504</u>
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>	<u>112 504</u>
Total comprehensive income attributable to:	
Owners of the parent	109 216
Non-controlling interest	3 288
	<u>112 504</u>

**SYRYP LIMITED GROUP**

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED  
31 DECEMBER 20.7**

	Share capital R	Retained earnings R	Total R	Non- controlling interest R	Total equity R
<b>Balance at 1 January 20.7</b>	240 000	152 000 <sup>1</sup>	392 000	—	392 000
<b>Changes in equity for 20.7</b>					
Subsidiary becomes associate	—	—	—	234 000 <sup>g</sup>	234 000
Dividends	—	(50 000)	(50 000)	—	(50 000)
Total comprehensive income for the year	—	109 216	109 216	3 288 <sup>f</sup>	112 504
<b>Balance at 31 December 20.7</b>	<b>240 000</b>	<b>211 216</b>	<b>451 216</b>	<b>237 288<sup>h</sup></b>	<b>688 504</b>

<sup>1</sup> 140 000 + 4 000<sup>b</sup> + 8 000<sup>a</sup> = 152 000



## Calculations

### C1 Analysis of owners' equity of Lemon Limited

	100%	Syrup Limited 40% – 52% <sup>1</sup>		60% – 48%
	Total	At	Since	NCI
<b>At first exchange: 1 January 20.5</b>				
Share capital	200 000	80 000		120 000
Retained earnings	180 000	72 000		108 000
	380 000	152 000		228 000
Equity represented by gain on bargain purchase	(8 000)	(8 000) <sup>a</sup>		
Consideration paid and non-controlling interest	372 000	144 000		
<b>Since first exchange</b>				
To beginning of current year:				
Retained earnings (190 000 – 180 000)	10 000		4 000 <sup>b</sup>	6 000
Gain on bargain purchase	8 000 <sup>a</sup>		8 000	—
<b>Current year</b>				
Profit for the period: 01/01/20.7 to 30/04/20.7 (15 600 <sup>2</sup> x 4/12)				
	5 200		2 080 <sup>c</sup>	3 120
	395 200		14 080	237 120
<b>Acquisition date: 1 May 20.7</b>				
Share capital (rights issue) <sup>3</sup>	56 000	29 120 <sup>3</sup>		26 880 <sup>3</sup>
Transfer from non-controlling interest <sup>4</sup>		47 424 <sup>4</sup>		(47 424) <sup>4</sup>
Net asset value	451 200	76 544		216 576 <sup>d</sup>
Equity represented by gain on bargain purchase (Parent) and goodwill (NCI)	(20 544) 17 424	(20 544) <sup>e</sup> —		— 17 424
Consideration paid and non-controlling interest <sup>5</sup>	448 080	56 000		<sup>5</sup> 234 000 <sup>g</sup>
Profit for the year: 01/05/20.7 to 31/12/20.7	6 850		3 562	3 288 <sup>f</sup>
Profit for the period (15 600(1) x 8/12)	10 400			
Unrealised profit in inventories (20 000 x 25/100)	(5 000)			
Tax effect (5 000 x 29%)	1 450			
Gain on bargain purchase	20 544		20 544	
	475 474		38 186	<sup>6</sup> 237 288 <sup>h</sup>

<sup>1</sup>  $130\,000 \div (80\,000 \div ((250\,000 - 50\,000) \times 40\%) + 50\,000) \div 250\,000 = 52\%$

<sup>2</sup>  $36\,000 - 9\,000 - 11\,400 = 15\,600$

<sup>3</sup>  $(56\,000 \times 52\%) = 29\,120$ ;  $56\,000 \times 48\% = 26\,880$

<sup>4</sup>  $237\,120 \times 12/60 = 47\,424$

<sup>5</sup>  $250\,000 - 130\,000 (80\,000 + 50\,000) = 120\,000$  shares;  $120\,000 \times 1.95 = 234\,000$

<sup>6</sup>  $458\,050 (475\,474 - 17\,424) \times 48\% = 219\,864 + 17\,424 = 237\,288$

## Comments

*Even though the non-controlling interest is measured using the full goodwill method, the “non-controlling interest” are the “controlling parties” at 1 January 20.5, thus the goodwill (gain on bargain purchase) attributable to them will not be recognised at 1 January 20.5, since goodwill (gain on bargain purchase) is only recognised once the parent obtains control on the acquisition date (1 May 20.7).*

### Example 6.4

#### (Increase in holding, no change in status, and an associate)

The following trial balances have been extracted from the financial records of the relevant companies for the year ended 31 December 20.8:

	Retained earnings		
	Gibbs Limited R	Pollock Limited R	Adams Limited R
Property, plant and equipment	593 000	302 500	223 600
Investment in Pollock Limited at fair value – 80 000 ordinary shares	209 250	—	—
Investment in Adams Limited at fair value – 30 000 ordinary shares	—	60 000	—
Dividends paid – 30 April 20.8	—	20 000	—
Dividends paid – 30 December 20.8	—	—	10 000
Income tax expense	83 491	27 840	40 600
Trade receivables	53 159	35 610	46 700
Cash and cash equivalents	12 500	22 890	76 200
Share capital – 300 000 ordinary shares	(300 000)	—	—
Share capital – 150 000 ordinary shares	—	(175 000)	—
Share capital – 100 000 ordinary shares	—	—	(100 000)
Retained earnings – 1 January 20.8	(293 900)	(151 500)	(22 000)
Profit before dividend income	(287 900)	(96 000)	(140 000)
Dividends received	(16 000)	(3 000)	—
Long-term liability	—	—	(91 000)
Trade and other payables	(53 600)	(43 340)	(44 100)
	—	—	—

#### Additional information

- Gibbs Limited acquired 80 000 ordinary shares in Pollock Limited on 1 January 20.3 On this date Pollock Limited’s share capital was R100 000 (100 000 shares) and the retained earnings was R55 000.
- Pollock Limited acquired 30 000 ordinary shares in Adams Limited on 1 October 20.8. Pollock Limited exercises significant influence over the financial and operating policies of Adams Limited. The profit for the current year was earned evenly throughout the year.
- At both the above acquisition dates there were no unidentified assets, liabilities or contingent liabilities and the fair values of all assets, liabilities and contingent liabilities were confirmed to be equal to the carrying amounts thereof.

4. On 1 May 20.8 Pollock Limited had a rights issue of 1 ordinary share for every 2 shares held at R1,50 per share. The parent took up 47 500 of the shares and the non-controlling shareholders took up the balance.
5. The fair value of available-for-sale financial assets is equal to the cost price thereof, unless otherwise stated.
6. The SA Normal tax rate is 29% and for all the entities, each share carries one vote.
7. It is the accounting policy of the group to measure non-controlling interest using the partial goodwill method.
8. At the end of the current year goodwill was assessed for impairment and it was not considered to be impaired.

**REQUIRED:**

- (a) Prepare the consolidated financial statements of the Gibbs Limited Group for the year ended 31 December 20.8.
- (b) Prepare the pro forma consolidation journals for the Gibbs Limited Group for the year ended 31 December 20.8.

Journal narrations are required.

Notes to the financial statements are **not** required.

Your answer must comply with the requirements of Generally Accepted Accounting Practice.

All calculations must be done to the nearest Rand.

**Solution 6.4**

(a)

**GIBBS LIMITED GROUP**

**STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.8**

**ASSETS**

**Non-current assets**

Property, plant and equipment (593 000 + 302 500)

Goodwill

Investment in associate – carrying amount

**Current assets**

Trade receivables (53 159 + 35 610)

Cash and cash equivalents (12 500 + 22 890)

**Total assets**

**EQUITY AND LIABILITIES**

**Total equity**

**Equity attributable to owners of the parent**

Share capital

Retained earnings

Other components of equity

**Non-controlling interest**

**Current liabilities**

Trade and other payables (53 600 + 43 340)

**Total equity and liabilities**

**R**

973 955

895 500

14 000

64 455

124 159

88 769

35 390

1 098 114

1 001 174

943 857

300 000

638 646

5 211

57 317

96 940

96 940

1 098 114

**GIBBS LIMITED GROUP**

**EXTRACT FROM THE CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 20.8**

	<b>R</b>
Gross profit (287 900 + 96 000)	383 900
Share of profit of associate	7 455
<b>Profit before tax</b>	<u>391 355</u>
Income tax expense (83 491 + 27 840)	<u>(111 331)</u>
<b>PROFIT FOR THE YEAR</b>	<u>280 024</u>
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>	<u><u>280 024</u></u>
Total comprehensive income attributable to:	
Owners of the parent	267 546
Non-controlling interest (6 816 + 1 118 + 4 544)	12 478
	<u><u>280 024</u></u>

**GIBBS LIMITED GROUP**

**EXTRACT FROM THE CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 20.8**

	Share capital R	Retained earnings R	Change in ownership R	Total R	Non- controlling interest R	Total equity R
<b>Balance at 1 January 20.8</b>	300 000	371 100 <sup>1</sup>	—	671 100	50 300	721 400
<b>Changes in equity for 20.8</b>						
Rights issue			5 211	5 211	(1 461)	3 750
Dividends paid					(4 000)	(4 000)
Total comprehensive income for the year		267 546		267 546	12 478	280 024
<b>Balance at 31 December 20.8</b>	<u>300 000</u>	<u>638 646</u>	<u>5 211</u>	<u>943 857</u>	<u>57 317</u>	<u>1 001 174</u>

<sup>1</sup> 293 900 + 77 200 = 371 100

**(b)**

**Pro forma consolidation journals**

	Dr R	Cr R	NCI R
J1 Share capital	100 000		
Retained earnings	55 000		
Goodwill	14 000		
Investment in Pollock Limited (2)		138 000	
Non-controlling interest (SFP) ((100 000 + 55 000) x 20%)		31 000	31 000
<i>Elimination of owners' equity at acquisition of Pollock Limited</i>			
J2 Retained earnings – beginning of the year	19 300		
((151 500 – 55 000) x 20%)			
Non-controlling interest (SFP)		19 300	19 300
<i>Recording of non-controlling interest since acquisition to beginning of current year</i>			
Balance c/f			<u>50 300</u>

J3	Non-controlling interest (SCI) $((96\,000 - 27\,840) \times 20\% \times 4/12)$	4 544		
	Non-controlling interest (SFP)		4 544	4 544
	<i>Recording of non-controlling interest in profit from 1 January to 30 April 20.8</i>			
J4	Dividend received (other income) $(20\,000 \times 80\%)$	16 000		
	Non-controlling interest (SFP) $(20\,000 \times 20\%)$	4 000		(4 000)
	Dividend paid		20 000	
	<i>Elimination of intercompany dividends and recording of non-controlling interest in dividends paid</i>			<u>50 844</u>
J5	Share capital $(175\,000 - 100\,000)$	75 000		
	Non-controlling interest (SFP)	1 461		(1 461)
	Change in ownership		5 211	
	Investment in Pollock Limited (2)		71 250	
	<i>Elimination of owners' equity at second acquisition of shares in Pollock Limited</i>			
J6	Non-controlling interest (SCI) $(6\,816 + 1\,118)$	*7 934		
	Non-controlling interest (SFP)		7 934	7 934
	<i>Recording of non-controlling interest in profit from 1 May to 31 December 20.8</i>			
J7	Investment in Adams Limited - associate	7 455		
	Share of profit of associate $((140\,000 - 40\,600) \times 3/12 \times 30\%)$		7 455	
	<i>Recording of interest in profit of associate for current year</i>			
	Non-controlling interest — statement of Financial position			<u><u>157 317</u></u>

\*  $((96\,000 - 27\,840) \times 8/12 \times 15\%) + ((140\,000 - 40\,600) \times 3/12 \times 30\% \times 15\%)$

### Calculations

#### C1 Gibbs Limited's interest in Pollock Limited

To 30 April 20.8	$(80\,000/100\,000)$	80%
Since 1 May 20.8	$(80\,000 + 47\,500/150\,000)$	85%

#### C2 Analysis of owners' equity of Adams Limited (not required – only provided for education purposes)

	100%	30%		30%
	Total R	At R	Since R	CA R
<b>At acquisition</b>				
Share capital	100 000	30 000		
Retained earnings	96 550	28 965		
	196 550	58 965		—
Investment in Adams Limited		(60 000)		60 000
Goodwill		(1 035)		
<b>Current year</b>				
Profit for the year (3 months)	24 850		7 455	7 455
Dividends paid – 30 December 2008	(10 000)		(3 000)	(3 000)
	211 400	(1 035)	4 455	64 455

### C3 Analysis of owners' equity of Pollock Limited

	100%	80% – 85%		20% – 15%
	Total R	At R	Since R	NCI R
<b>At acquisition</b>				
Share capital	100 000	80 000		20 000
Retained earnings	55 000	44 000		11 000
	155 000	124 000		31 000
Equity represented by goodwill	14 000	14 000		—
Consideration paid and NCI	169 000	138 000 <sup>1</sup>		31 000
<b>Since acquisition</b>				
Retained earnings (151 500 – 55 000)	96 500		77 200	19 300
	265 500		77 200	50 300
<b>Current year</b>				
Profit for the year ((96 000 – 27 840) x 4/12)	22 720		18 176 <sup>c</sup>	4 544
Dividends paid	(20 000)		(16 000)	(4 000)
	268 220		79 376	50 844
<b>Rights issue</b>				
Share capital (100 000/2 x 1)	75 000	63 750		11 250 <sup>2</sup>
Transfer from non-controlling interest		12 711		(12 711) <sup>3</sup>
	343 220	76 461 (71 250)		49 383
Investment in Pollock Limited (47 500 x 1.50)		5 211		
Change in ownership				
Profit for the year (68 160 x 8/12)	45 440		38 624	6 816
Profit for the year – associate	7 455		6 337	1 118
	396 115		124 337	57 317

<sup>1</sup> (209 250 – (47 500 x 1.50)) = 138 000

<sup>2</sup> 75 000 x 15% = 11 250

<sup>3</sup> 329 220(343 220 – 14 000) x 15% = 49 383; 62 094 – 49 383 = 12 711

## 6.5 Assessment criteria

After having studied this study unit you should be able to:

- describe the various methods by which a change in ownership can be effected.
- calculate the change in interest for every method.
- allocate and record the changed interest.
- prepare and present consolidated annual financial statements when there is changes in ownership.
- describe the various ways in which changes can result from the issue of additional shares by a subsidiary.
- calculate the changes of interest resulting from the issue of additional shares by a subsidiary.
- prepare and present consolidated annual financial statements after the issue of additional shares by a subsidiary has taken place.

## Consolidated statement of cash flows (IAS 7 (AC 118))

### Learning outcome 7

After studying this study unit, you should be able to:

Prepare a consolidated statement of cash flows in terms of the requirements of Generally Accepted Accounting Practice.

### OVERVIEW OF THE STUDY UNIT

The study unit consists of the following sections:	page
7.1 Introduction and basic aspects	145
7.2 Elements of the statement of cash flows	146
7.3 Change of interest in subsidiaries	151
7.4 Sundry aspects	169
7.5 Assessment criteria	174

#### Study

*Group Statements (Volume 2): — Chapter 13*

### 7.1 Introduction and basic aspects

#### Study

*Group Statements (Volume 2): Chapter 13 — section 13.01–13.05*

If a consolidated set of financial statements is prepared for a group of companies this would include a consolidated statement of cash flows. The cash flows would only be those that are external to the group. The basic approach that is followed is that the consolidated statement of cash flows is prepared from the consolidated statement of financial position, the consolidated statement of changes in equity and the consolidated statement of comprehensive income. By doing so the statement of cash flows is prepared for a group as a single entry as the intragroup transactions have already been eliminated.

## 7.2 Elements of the statement of cash flows

### Study

*Group Statements (Volume 2): Chapter 13 — sections 13.06–13.10*

The objective of the statement of cash flows is to provide useful information in respect of the changes that have taken place in the financial resources (cash flows) of the entity between the beginning and end of the financial year. The statement provides detail of any cash generated by the operations of the entity, the cash that has been used by the entity in its operations and what portion of the cash was used to finance the operations of the entity as well as the portion used to invest in the entity to ensure the continued operations of the entity.

Cash flow information is needed in order to inform the users of the financial statements about the liquidity and solvency of the entity.

Work through the following example which highlights the different sections of the statement of cash flows.

**PART A** Cash flows from operating activities

**PART B** Cash flows from investing activities

**PART C** Cash flows from financing activities

**PART D** Cash and cash equivalents

#### Illustrative example

#### Information for PARTS A to D

#### VENTURE LIMITED

#### CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.8

	<b>20.8</b>	<b>20.7</b>
	<b>R</b>	<b>R</b>
<b>ASSETS</b>		
<b>Non-current assets</b>	400 000	380 000
Property, plant and equipment	390 000	370 000
Available-for-sale-financial asset	10 000	10 000
<b>Current assets</b>	207 600	133 140
Inventories	56 300	36 500
Trade receivables	67 400	42 040
Cash and cash equivalents	83 900	54 600
<b>Total assets</b>	<u>607 600</u>	<u>513 140</u>
<b>EQUITY AND LIABILITIES</b>		
<b>Total equity</b>	369 256	264 400
<b>Equity attributable to owners of the parent</b>	314 256	224 400
Share capital	165 000	100 000
Retained earnings	149 256	124 400
<b>Non-controlling interest</b>	55 000	40 000
<b>Total liabilities</b>	238 344	248 740
<b>Non-current liabilities</b>	195 000	185 000
Long-term borrowings	195 000	185 000
<b>Current liabilities</b>	43 344	63 740
Trade and other payables	13 344	43 740
Short-term portion of long-term borrowings	30 000	20 000
<b>Total equity and liabilities</b>	<u>607 600</u>	<u>513 140</u>



**VENTURE LIMITED**

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED  
31 DECEMBER 20.8**

	Share capital R	Retained earnings R	Total R	Non- controlling interest R	Total equity R
<b>Balance at 1 January 20.8</b>	100 000	124 400	224 400	40 000	264 400
<b>Changes in equity for 20.8</b>					
Shares issued	45 000	—	45 000	—	45 000
Capitalisation issue	20 000	(20 000)	—	—	—
Dividends paid	—	(10 000)	(10 000)	(2 000)	(12 000)
Total comprehensive income for the year	—	54 856	54 856	17 000	71 856
<b>Balance at 31 December 20.8</b>	<b>165 000</b>	<b>149 256</b>	<b>314 256</b>	<b>55 000</b>	<b>369 256</b>

**VENTURE LIMITED**

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED  
31 DECEMBER 20.8**

	R
<b>Revenue</b>	297 600
Gross of sales	(153 400)
Gross profit	144 200
Other income	19 000
Other expenses	(45 300)
Finance costs	(18 100)
<b>Profit before tax</b>	99 800
Income tax expense	(27 944)
<b>PROFIT FOR THE YEAR</b>	<b>71 856</b>
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>	<b>71 856</b>
Total comprehensive income attributable to:	
Owners of the parent	54 856
Non-controlling interest	17 000
	<b>71 856</b>

**Additional information**

1. Property, plant and equipment consists of the following items:

	20.8 R	20.7 R
Machinery	390 000	370 000
Cost	620 000	590 000
Accumulated depreciation	(230 000)	(220 000)

2. During the current year, Venture Limited replaced an existing machine with a new machine to meet the current production demands. The machine which was replaced had a carrying amount of R75 000 and was sold for R93 000.
3. Included in "Other income" for the current year is a gain on sale of machinery and investment income of R1 000.

4. "Other expenses" includes depreciation of R40 000. The depreciation for the machinery that was replaced per additional information 2 is included in the amount.
5. Included in trade and other payables is R4 400 due to the South African Revenue Service for the year ended 31 December 20.8 (20.7: R5 200).
6. Except for the given information no other non-cash flow item existed which could influence the statement of cash flows.

#### **PART A Cash flows from operating activities**

The operating activities are the principal revenue producing activities of the entity. The cash generated from (or used for) operating activities is normally the cash flows derived from the activities of the entity (the cash that arises from the entities main purpose) and is the effect of transactions that determine profit or loss.

Cash generated from (or used for) operations is calculated in one of two ways, namely:

- The direct method, or
- The indirect method.

The disclosure for the two methods of calculating **cash generated by operations** differs in the statement of cash flows.

#### **An illustration of the "Cash flows from operating activities" section of the statement of cash flows according to the DIRECT METHOD:**

	<b>R</b>
<b>Cash flows from operating activities</b>	6 300
Cash receipts from customers (C1)	272 240
Cash paid to suppliers and employees (C2)	(208 096)
Cash generated from operations	64 144
Investment income (given)	1 000
Interest paid (given)	(18 100)
Taxes paid (5 200 + 27 944 – 4 400)	(28 744)
Dividends paid (10 000 + 2 000)	(12 000)

#### **Calculations**

##### **C1 Cash receipts from customers**

	<b>R</b>
Revenue per statement of comprehensive income	297 600
Increase in trade receivables	(25 360)
Opening balance	42 040
Closing balance	(67 400)
	272 240

## C2 Cash paid to suppliers and employees

	R
Cost of sales	(153 400)
Increase in inventories	(19 800)
Opening balance	36 500
Closing balance	(56 300)
Decrease in trade and other payables	(29 596)
Opening balance (43 740 – 5 200)	(38 540)
Closing balance (13 344 – 4 400)	8 944
Expenses paid in cash	(5 300)
Other expenses per statement of comprehensive income	(45 300)
Non-cash item - depreciation	40 000
	<u>(208 096)</u>

**An illustration of the “Cash flows from operating activities” section of the statement of cash flows according to the INDIRECT METHOD:**

	R
<b>Cash flows from operating activities</b>	6 300
Profit before tax	99 800
Adjustments:	
Depreciation	40 000
Gain on disposal of equipment (19 000 – 1 000)	(18 000)
Investment income	(1 000)
Finance costs	18 100
Net changes in working capital (C3)	(74 756)
Cash generated from operations	64 144
Investment income (given)	1 000
Interest paid (given)	(18 100)
Taxes paid (5 200 + 27 944 – 4 400)	(28 744)
Dividends paid (10 000 + 2 000)	(12 000)

### Calculations

#### C3 Net changes in working capital

	R
Increase in inventories (56 300(cb) – 36 500(ob))	(19 800)
Increase in trade receivables (67 400(cb) – 42 040(ob))	(25 360)
Decrease in trade and other payables (8 944(cb) – 38 540(ob))	(29 596)
	<u>(74 756)</u>

## Comments

*It is important to study the format of the cash flow statement so that you can calculate the outflows and inflows of cash for the financial period. Make sure you are able to calculate cash receipts from customers and cash paid to suppliers and employees. You will also be penalised if the outflow or inflow is incorrectly indicated.*

## PART B Cash flows from investing activities

Investing activities are activities that relate to the acquisition and disposal of long-term assets and other investments (those which are not part of cash equivalents). This section includes the entities expenditure on items which form the infrastructure of the entity which places the entity in a position to be able to generate income.

In order for the expenditure to be recognised under cash flows from investing activities the expenditure must have resulted in the recognition of an asset in the statement of financial position.

Examples of investing activities are:

Purchase of property, plant and equipment,  
Disposal of property, plant and equipment,  
Disposal of intangible assets,  
Acquisition of intangible assets, and  
Acquiring or disposing of equity or debt instruments of other entities.

It is important for the user of the financial statements to be able to determine whether the investment by the entities is in order to —

- Maintain the operating capacity of the entity, or
- Increase (expand) the operating activity of the entity.

For this reason investing cash flows are split in the statement of cash flows between expenditure which is to **REPLACE** property, plant and equipment in order to maintain operations and expenditure for the purchasing of new property, plant and equipment and thereby **EXPAND** operations.

**Illustration of the “Cash flows from investing activities” section of the statement of cash flows:**

	R
<b>Cash flows from investing activities</b>	(42 000)
Replacement of machinery (C4)	(135 000)
Sale of property, plant and equipment (given)	93 000

### C4 Machinery

	R
Opening balance	370 000
Closing balance	(390 000)
	(20 000)
Depreciation for the year	(40 000)
Disposal of asset – carrying amount	(75 000)
Cash purchases of machinery	(135 000)

## PART C Cash flows from financing activities

Financing activities are the activities that relate to the funding of the infrastructure of the entity. The transactions will result in a change in the size and composition of the debt and capital funding of the entity.

The cash flows from financing section of the statement of cash flows is divided into the major classes of gross cash receipts and gross cash payments arising from the financing activities.

Examples of financing activities are:

Proceeds from issuing shares,  
Proceeds from issuing debentures, loans, notes, bonds and mortgages,  
Repayment of long-term borrowings, and  
Payments by a lessee of the liability portion of finance lease.

**Illustration of the “Cash flows from financing activities section of the statement of cash flows:**

	R
<b>Cash flows from financing activities</b>	65 000
Long-term loans raised ((195 000 + 30 000) – (185 000 + 20 000))	20 000
Issue of shares	45 000

#### **PART D Cash and cash equivalents**

The results of the sections-cash flows from operations, cash flows from investing activities and cash flows from financing activities are aggregated into a single line —

“Net increase or decrease in cash and cash equivalents”.

This amount is used to reconcile the cash and cash equivalents at the beginning of the year (balance as per the statement of financial position previous year) with the cash and cash equivalents at the end of the year (balance as per the statement of financial position for the current year).

**Illustration of the “Cash flows from financing activities section of the statement of cash flows:**

	R
<b>Net increase in cash and cash equivalents</b>	29 300
<b>Cash and cash equivalents at beginning of period</b>	54 600
<b>Cash and cash equivalents at end of period</b>	<u>83 900</u>

### **7.3 Change of interests in subsidiaries**

#### **Study**

*Group Statements (Volume 2): Chapter 13 — sections 13.11 and 13.15*

When control in a subsidiary is obtained or lost, the resultant cash flows are reflected as a single line item in the consolidated statement of cash flows as part of investing activities. This implies that the consideration paid for a subsidiary or the proceeds received from the sale of the subsidiary are treated in the same manner as the purchase or sale of other investments.

In terms of IAS 7 (AC 118).40 the details of the assets and liabilities of the subsidiary acquired or disposed of must be disclosed in a note to the statement of cash flows.

Refer to Examples 7.1 and 7.3 for the information required in a note for the acquisition of a subsidiary and Examples 7.2 and 7.3 for the information required in a note for the disposal of a subsidiary.

Work through the following examples which deal with the stated changes in interests in subsidiaries:

- 7.1 Acquisition of a subsidiary,
- 7.2 Disposal of a subsidiary, and
- 7.3 Acquisition and disposal of a subsidiary.

**Example 7.1**

The following is an extract from the annual financial statements of the Mentco Group of companies for the year ended 31 December 20.7:

**MENTCO LIMITED GROUP**

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.7**

	20.7 R	20.6 R
<b>ASSETS</b>		
<b>Non-current assets</b>	1 220 400	499 400
Investment property	620 000	155 000
Property, plant and equipment	590 800	344 400
Goodwill	9 600	—
<b>Current assets</b>	156 860	249 850
Trade receivables	43 060	68 500
Cash and cash equivalents	58 000	83 550
Inventories	55 800	97 800
<b>Total assets</b>	<u>1 377 260</u>	<u>749 250</u>
<b>EQUITY AND LIABILITIES</b>		
<b>Total equity</b>	650 440	480 200
<b>Equity attributable to owners of the parent</b>	575 840	480 200
Share capital	165 000	100 000
Retained earnings	410 840	380 200
<b>Non-controlling interest</b>	74 600	—
<b>Total liabilities</b>	726 820	269 050
<b>Non-current liabilities</b>	568 150	128 350
Deferred tax	6 400	4 500
Long-term borrowings	561 750	123 850
<b>Current liabilities</b>	158 670	140 700
Short-term portion of long-term borrowings	95 000	51 000
Trade and other payables	63 670	89 700
<b>Total equity and liabilities</b>	<u>1 377 260</u>	<u>749 250</u>

**MENTCO LIMITED GROUP**

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED  
31 DECEMBER 20.7**

	Share capital R	Retained earnings R	Total R	Non- controlling interest R	Total equity R
<b>Balance at 1 January 20.7</b>	100 000	380 200	480 200	—	480 200
<b>Changes in equity for 20.7</b>					
Issue of share capital	45 000	—	45 000	—	45 000
Obtaining control of subsidiary	—	—	—	37 600	37 600
Capitalisation issue	20 000	(20 000)	—	—	—
Dividends	—	(20 000)	(20 000)	(8 000)	(28 000)
Total comprehensive income for the year	—	70 640	70 640	45 000	115 640
<b>Balance at 31 December 20.7</b>	165 000	410 840	575 840	74 600	650 440

**Additional information**

- On 1 December 20.7 Mentco Limited paid R400 000 to purchase a piece of land to be held as investment property. The transaction was financed by means of a mortgage bond.
- Included in property, plant and equipment are the following items:

	<b>20.7</b> R	<b>20.6</b> R
<b>Land and buildings</b>	340 000	285 000
The building is not depreciated. Any purchases made were to expand the business of the company.		
<b>Machinery</b>	250 800	59 400
Machinery with a carrying amount of R45 000 was sold during the current year. The accumulated depreciation of the machinery at the date of sale was R13 000. A machine was purchased to replace the abovementioned machine at a cost of R75 000 and the remaining purchases were made to expand the operations of the company.		
	590 800	344 400

- Mentco Limited acquired an 80% interest in Webco Limited on 1 January 20.7. The fair values of the identifiable assets and liabilities of Webco Limited on 1 January 20.7 were as follows:

	R
Machinery – carrying amount	154 000
Trade receivables	30 000
Cash and cash equivalents	4 000

4. The following items are extracted from the consolidated statement of comprehensive income of the Mentco Limited Group for the year ended 31 December 20.7:

	<b>Dr/(Cr)</b>
	<b>R</b>
Revenue	(340 000)
Cost of sales	146 800
Other expenses	60 000
Depreciation	14 000
Sundry expenses	46 000
Dividends received	(22 500)
Interest paid	18 000
Fair value adjustment – Investment property	(15 000)
Gain on sale of machinery	(12 500)
Income tax expense	49 560

5. Included in trade and other payables is an amount of R5 000 (20.6: R13 000) being dividends payable to ordinary shareholders. The Mentco Group owed the SA Revenue Service R22 000 on 31 December 20.7 (20.6: R8 000). These amounts are also included in trade and other payables.

### **REQUIRED:**

#### **Part (a)**

Calculate the following amounts that will be disclosed in the consolidated statement of cash flow of the Mentco Limited Group for the year ended 31 December 20.7:

- Cash generated from operations
- Income taxes paid

#### **Part (b)**

Prepare the consolidated statement of cash flow of the Mentco Limited Group for the year ended 31 December 20.7.

#### **Part (c)**

Prepare the note to the consolidated statement of cash flows for the acquisition of a subsidiary.

Your answer must comply with the requirements of Generally Accepted Accounting Practice.

Comparative figures are **not** required.

All calculations must be done to the nearest Rand



**Part (a)**
**• Cash generated from operations**

	<b>R</b>
Cash receipts from customers (C1)	395 440
Cash paid to suppliers and employees (C2)	<u>(182 830)</u>
Cash generated from operations	<u>212 610</u>

OR

	<b>R</b>
Profit for the year	115 640
Income tax expense	<u>49 560</u>
Profit before tax	165 200
Interest paid	18 000
Depreciation	14 000
Fair value adjustment	(15 000)
Gain on sale of machinery	(12 500)
Dividends received	<u>(22 500)</u>
	147 200
Trade and other payables (C3)	(32 030)
Inventories	42 000
Trade receivables	<u>55 440</u>
	<u>212 610</u>

OR

	<b>R</b>
Revenue	340 000
Cost of sales	(146 800)
Sundry expenses	<u>(46 000)</u>
	147 200
Trade and other payables	(32 030)
Inventories	42 000
Trade receivables	<u>55 440</u>
	<u>212 610</u>

**Calculations**
**C1 Cash receipts from customers**

	<b>R</b>
Sales	340 000
(Increase)/Decrease in trade receivables	55 440
Opening balance	68 500
Subsidiary acquired	30 000
Closing balance	<u>(43 060)</u>
	<u>395 440</u>

**C2 Cash paid to suppliers and employees**

	<b>R</b>
Cost of sales	(146 800)
Cash expenses	(46 000)
Increase/(Decrease) in trade and other payables	(32 030)
Opening balance	(68 700)
Closing balance	36 670
(Increase)/Decrease in inventory	42 000
Opening balance	97 800
Closing balance	(55 800)
	<u>(182 830)</u>

**C3 Trade and other payables**

	<b>R</b>
Balance per statement of financial position	89 700
Dividend paid to ordinary shareholders	(13 000)
SA Revenue Service	(8 000)
	<u>68 700</u>

**• Income taxes paid**

	<b>R</b>
Balance at beginning of year	8 000
Per statement of comprehensive income	49 560
Adjusted for deferred tax	(1 900)
Deferred tax – closing balance	(6 400)
Deferred tax – opening balance	4 500
Unpaid amounts at end of year	(22 000)
	<u>33 660</u>

**Part (b)****MENTCO LIMITED GROUP****CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED  
31 DECEMBER 20.7**

	<b>R</b>
<b>Cash flows from operating activities</b>	147 450
Cash receipts from customers (Part (a)C1)	395 440
Cash paid to suppliers and employees (Part (a)C2)	(182 830)
<b>Cash generated from operations</b>	212 610
Investment income (given)	22 500
Interest paid (given)	(18 000)
Taxes paid (Part (a)C4)	(33 660)
Dividends paid (13 000 + 20 000 + 8 000 – 5 000)	(36 000)
<b>Cash flows from investing activities</b>	(299 900)
Proceeds on sale of machinery (C2)	57 500
Acquisition of subsidiary (C4)	(156 000)
Purchases of property, plant and equipment	(201 400)
Additions to investment property (C3)	(50 000)
Additions to land and buildings (340 000 – 285 000)	(55 000)
Additions to machinery (C1)	(21 400)
Replacement of machinery	(75 000)
<b>Cash flows from financing activities</b>	126 900
Long-term loans raised (C5)	81 900
Issue of shares (165 000 – 100 000 – 20 000)	45 000
<b>Net increase in cash and cash equivalents</b>	(25 550)
<b>Cash and cash equivalents at beginning of period</b>	83 550
<b>Cash and cash equivalents at end of period</b>	<u>58 000</u>

**Calculations****C1 Purchase of machinery**

	<b>R</b>
Opening balance – carrying amount	59 400
Depreciation – machinery	(14 000)
Carrying amount of machinery sold	(45 000)
Carrying amount of machinery acquired from subsidiary	154 000
Closing balance – carrying amount	(250 800)
Purchase of machinery	<u>(96 400)</u>
Purchase of machinery	96 000
Machinery purchased to maintain operations – given	(75 000)
Machinery purchased to expand operations	<u>21 400</u>

**C2 Proceeds on sale of machinery**

	<b>R</b>
Carrying amount	45 000
Gain on sale – given	12 500
Proceeds on sale of machinery	<u>57 500</u>

**C3 Investment property**

	<b>R</b>
Closing balance – carrying amount	620 000
Fair value adjustment	(15 000)
Property financed by mortgage bond	(400 000)
Opening balance – carrying amount	<u>(155 000)</u>
Purchase of investment property for cash	<u>50 000</u>

**C4 Acquisition of subsidiary**

	<b>R</b>
Machinery – carrying amount	154 000
Trade receivables	30 000
Cash and cash receivables	<u>4 000</u>
	188 000
Non-controlling interest – given	(37 600)
Goodwill	<u>9 600</u>
	160 000
Cash and cash equivalents	<u>(4 000)</u>
Consideration	<u>156 000</u>

**C5 Long-term loans raised**

	<b>R</b>
Closing balance – carrying amount (561 750 + 95 000)	656 750
Property financed by mortgage bond	(400 000)
Opening balance – carrying amount (123 850 + 51 000)	<u>(174 850)</u>
Long-term loans raised	<u>81 900</u>

The following represents an extract from the consolidated financial statements of the Water Limited Group:

**WATER LIMITED GROUP  
CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20.5**

	<b>20.5</b>	<b>20.4</b>
	<b>R</b>	<b>R</b>
<b>ASSETS</b>		
<b>Non-current assets</b>	152 000	124 300
Property, plant and equipment at fair value	150 000	120 000
Goodwill	2 000	4 300
<b>Current assets</b>	195 090	179 800
Inventories	35 600	63 500
Trade receivables	66 000	82 000
Cash and cash equivalents	93 490	34 300
<b>Total assets</b>	<u>347 090</u>	<u>304 100</u>
<b>EQUITY AND LIABILITIES</b>		
<b>Total equity</b>	307 055	271 500
<b>Equity attributable to owners of the parent</b>	267 305	215 000
Share capital	50 000	50 000
Other components of equity ( <i>Revaluation surplus</i> )	12 825	—
Retained earnings	204 480	165 000
<b>Non-controlling interest</b>	39 750	56 500
<b>Total liabilities</b>	40 035	32 600
<b>Non-current liabilities</b>	12 175	15 000
Deferred tax	2 175	—
Long-term borrowings	10 000	15 000
<b>Current liabilities</b>	27 860	17 600
Trade and other payables	8 500	7 000
Current tax payable	16 860	5 600
Short-term portion of long-term borrowings	2 500	5 000
<b>Total equity and liabilities</b>	<u>347 090</u>	<u>304 100</u>

**WATER LIMITED GROUP**

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED  
31 DECEMBER 20.5**

	<b>R</b>
<b>Revenue</b>	96 000
Cost of sales	(54 300)
Gross profit	41 700
Other expenses	(4 400)
Other income (includes interest received of R2 900)	54 900
Finance costs	(5 890)
<b>Profit before tax</b>	86 310
Income tax expense	(26 030)
<b>PROFIT FOR THE YEAR</b>	<u>60 280</u>
<b>Other comprehensive income</b>	
Revaluation surplus	12 825
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>	<u><u>73 105</u></u>
Total profit for the year attributable to:	
Owners of the parent	47 480
Non-controlling interest	12 800
	<u><u>60 280</u></u>
Total comprehensive income attributable to:	
Owners of the parent	60 305
Non-controlling interest	12 800
	<u><u>73 105</u></u>

**WATER LIMITED GROUP**

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED  
31 DECEMBER 20.5**

	<b>Share capital R</b>	<b>Revalua- tion surplus R</b>	<b>Retained earnings R</b>	<b>Total R</b>	<b>Non- controlling interest R</b>	<b>Total equity R</b>
<b>Balance at 1 January 20.5</b>	50 000	—	165 000	215 000	56 500	271 500
<b>Changes in equity for 20.5</b>						
Total comprehensive income for the year	—	12 825	47 480	60 305	12 800	73 105
Disposal of subsidiary	—	—	—	—	(29 550)	(29 550)
Dividends paid	—	—	(8 000)	(8 000)	—	(8 000)
<b>Balance at 31 December 20.5</b>	<u>50 000</u>	<u>12 825</u>	<u>204 480</u>	<u>267 305</u>	<u>39 750</u>	<u><u>307 055</u></u>

### Additional information

1. On 30 June 20.5 Water Limited sold its shareholding of 70% in Filter Limited and made a profit of R52 000. The gain of R52 000 is included in other income. The net assets and liabilities of Filter Limited on 30 June 20.5 consisted of the following:

	<b>R</b>
Property, plant and equipment at fair value	80 000
Inventories	15 000
Cash and cash equivalents	2 000
Trade receivables	6 000
Trade and other payables	(4 500)
	<hr/>
	98 500
	<hr/> <hr/>

2. The value of the goodwill of the investment in Filter Limited was R1 900 on 30 June 20.5. The company applies the partial(proportionate) goodwill method to account for goodwill.
3. No other subsidiaries were sold or purchased during the year.
4. Property, plant and equipment only consists of property. Property is not depreciated and any purchases of property were made to maintain current operations.
5. The revaluation surplus arose as a result of a property of the parent being revalued during the current year.
6. Except for the given information no other non-cash flow items existed which could influence the consolidated cash flow statement.
7. The SA Normal tax rate is 29%.

#### **REQUIRED:**

- (a) Prepare the consolidated statement of cash flows according to the **DIRECT** method for the Water Limited Group for the year ended 31 December 20.5.
- (b) Prepare the following note to the consolidated statement of cash flows of the Water Limited Group for the year ended 31 December 20.5:
  - Disposal of subsidiary.
- (c) Prepare the “Cash flows from operating activities” section of the consolidated statement of cash flows according to the **INDIRECT** method for the Water Limited Group for the year ended 31 December 20.5.

Your answer must comply with the requirements of Generally Accepted Accounting Practice.

Comparative figures are not required.

All calculations must be done to the nearest Rand

(a) Statement of cash flows according to the direct method

**WATER LIMITED GROUP**

**CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED  
31 DECEMBER 20.5**

	Notes	R
<b>Cash flows from operating activities</b>		40 840
Cash receipts from customers (C1)		106 000
Cash paid to suppliers and employees (C3)		(39 400)
<b>Cash generated from operations</b>		66 600
Interest received		2 900
Interest paid		(5 890)
Dividends paid		(8 000)
Taxes paid ((C6) or (5 600 – 16 860 + 26 030))		(14 770)
<b>Cash flows from investing activities</b>		25 850
Additions to property (C7)		(95 000)
Disposal of subsidiary	1	120 850
<b>Cash flows from financing activities</b>		(7 500)
Repayment of long-term borrowings (C8)		(7 500)
<b>Net increase in cash and cash equivalents</b>		59 190
(40 840 + 25 850 – 7 500)		59 190
<b>Cash and cash equivalents at beginning of period</b>		34 300
<b>Cash and cash equivalents at end of period</b>		93 490

(b) Notes to the consolidated statement of cash flows

**WATER LIMITED GROUP**

**NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT FOR THE YEAR ENDED  
31 DECEMBER 20.5**

**1. Disposal of subsidiary**

During the year the group disposed of its 70% interest in Filter Limited. The fair value of assets and liabilities on that date were as follows:

	R
Property, plant and equipment	80 000
Cash and cash equivalents	2 000
Inventories	15 000
Trade receivables	6 000
Trade and other payables	(4 500)
Net assets disposed of	98 500
Non-controlling interest (98 500 x 30%)	(29 550)
Goodwill	1 900
Gain on sale of subsidiary	52 000
Total disposal received in cash	122 850
Less: Cash and cash equivalents of subsidiary	(2 000)
Net cash inflow	120 850



## Calculations

### C1 Cash receipts from customers

		<b>R</b>
Revenue (given)		96 000
Decrease in trade receivables (C2)		10 000
		<u>106 000</u>

### C2

<b>Trade receivables</b>			
	<b>R</b>		<b>R</b>
Opening balance	82 000	Disposal of subsidiary	6 000
		Net decrease	10 000
		Closing balance	66 000
	<u>82 000</u>		<u>82 000</u>

### C3 Cash paid to suppliers and employees:

		<b>R</b>
Cost of sales (given)		(54 300)
Other expenses (given)		(4 400)
Impairment of goodwill ((C9) or (4 300 – 1 900 – 2 000))		400
Decrease in inventories (C4)		12 900
Decrease in trade and other payables (C5)		6 000
		<u>(39 400)</u>

### C4

<b>Inventories</b>			
	<b>R</b>		<b>R</b>
Opening balance	63 500	Disposal of subsidiary	15 000
		Net decrease	12 900
		Closing balance	35 600
	<u>63 500</u>		<u>63 500</u>

### C5

<b>Trade and other payables</b>			
	<b>R</b>		<b>R</b>
Disposal of subsidiary	4 500	Opening balance	7 000
Closing balance	8 500	Net increase	6 000
	<u>13 000</u>		<u>13 000</u>

### C6

<b>Taxes paid</b>			
	<b>R</b>		<b>R</b>
Taxes paid	14 770	Opening balance	5 600
Closing balance	16 860	SCI	26 000
	<u>31 630</u>		<u>31 630</u>

**C7****Property, plant and equipment**

	<b>R</b>		<b>R</b>
Opening balance	120 500	Disposal of subsidiary	80 000
Revaluation (12 825 + 2 175)	15 000		
Additions	95 000	Closing balance	150 600
	<u>230 000</u>		<u>230 000</u>

**C8****Long-term borrowings**

	<b>R</b>		<b>R</b>
Bank (net decrease)	7 500	Opening balance	20 000
Closing balance (10 000 + 2 500)	12 500	(15 000 + 5 000)	
	<u>20 000</u>		<u>20 000</u>

**C9****Goodwill**

	<b>R</b>		<b>R</b>
Opening balance	4 300	Impairment of goodwill	400
		Goodwill realised	1 900
		Closing balance	2 000
	<u>4 300</u>		<u>4 300</u>

**(c) Indirect method****WATER LIMITED GROUP****CONSOLIDATED STATEMENT OF CASH FLOW FOR THE YEAR ENDED  
31 DECEMBER 20.5**

	<b>R</b>
<b>Cash flows from operating activities</b>	40 840
Profit before tax	86 310
Adjusted for:	
Gain on disposal of subsidiary	(52 000)
Investment income	(2 900)
Impairment of goodwill ((Part b) C9)	400
Finance costs	5 890
Net changes in working capital (C1)	28 900
<b>Cash generated from operations</b>	66 600
Interest received	2 900
Interest paid	(5 890)
Dividends paid	(8 000)
Taxes paid ((Part b) C6) or (5 600 – 16 860 + 26 030))	(14 770)
<b>C1 Net changes in working capital</b>	<b>R</b>
Decrease in inventories ((Part b) C4)	12 900
Decrease in trade receivables ((Part b) C2)	10 000
Increase in trade and other payables ((Part b) C5)	6 900
Net cash inflow	<u>28 900</u>

The following is an extract from the abridged consolidated annual financial statements of the Diet Limited Group:

**DIET LIMITED GROUP  
CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 20.7**

	<b>20.7</b>	<b>20.6</b>
	<b>R</b>	<b>R</b>
<b>ASSETS</b>		
<b>Non-current assets</b>	113 494	93 940
Property, plant and equipment at fair value	109 694	93 940
Goodwill	3 800	—
<b>Current assets</b>	14 350	16 810
Inventories	6 150	9 010
Trade receivables	4 500	3 800
Cash and cash equivalents	3 700	4 000
<b>Total assets</b>	<u>127 844</u>	<u>110 750</u>
<b>EQUITY AND LIABILITIES</b>		
<b>Total equity</b>	98 164	86 500
<b>Equity attributable to owners of the parent</b>	87 567	76 000
Share capital	40 000	40 000
Retained earnings	47 567	36 000
<b>Non-controlling interest</b>	10 597	10 500
<b>Total liabilities</b>	29 680	24 250
<b>Non-current liabilities</b>	6 330	3 550
Deferred tax	6 330	3 550
<b>Current liabilities</b>	23 350	20 700
Trade and other payables	19 800	9 700
South African Revenue Service	3 550	11 000
<b>Total equity and liabilities</b>	<u>127 844</u>	<u>110 750</u>

**DIET LIMITED GROUP  
CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED  
30 JUNE 20.7**

	<b>R</b>
<b>Revenue</b>	87 000
Cost of sales	(35 000)
Gross profit	52 000
Other income	2 263
Other expenses	(26 000)
<b>Profit before tax</b>	28 263
Income tax expense	(8 196)
<b>PROFIT FOR THE YEAR</b>	<u>20 067</u>
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>	<u>20 067</u>

Total comprehensive income attributable to:	<b>R</b>
Owners of the parent	17 567
Non-controlling interest	2 500
	<u>20 067</u>

## DIET LIMITED GROUP

### CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 30 JUNE 20.7

	Share capital R	Retained earnings R	Total R	Non- controlling interest R	Total equity R
<b>Balance at 1 July 20.6</b>	40 000	36 000	76 000	10 500	86 500
<b>Changes in equity for 20.7</b>					
Total comprehensive income for the year		17 567	17 567	2 500	20 067
Dividends paid		(6 000)	(6 000)	(1 700)	(7 700)
Acquisition of subsidiary				1 800	1 800
Disposal of subsidiary				(2 503)	(2 503)
<b>Balance at 30 June 20.7</b>	<u>40 000</u>	<u>47 567</u>	<u>87 567</u>	<u>10 597</u>	<u>98 164</u>

#### Additional information

1. The following items were included in the calculation of profit before tax:

	<b>R</b>
Gain on disposal of interest in subsidiary (Weight Limited)	1 493
Interest received	770
Depreciation	12 000

2. On 1 July 20.5 Diet Limited acquired a 75% interest in the issued share capital of Weight Limited. On that date the owners' interest of Weight Limited was as follows:

	<b>R</b>
Share capital – 10 000 Ordinary shares	10 000
Retained earnings	6 000

3. On 28 February 20.7 Diet Limited sold its entire interest in Weight Limited for R9 000. The fair value of assets and liabilities of Weight Limited on 28 February 20.7 were as follows:

	<b>R</b>
Inventories	10 200
Trade and other payables	990
Cash and cash equivalents	800

4. On 1 September 20.6 Diet Limited acquired 14 000 ordinary shares in Atkins Limited for R8 000. On that date the owners' interest of Atkins Limited was as follows:

	<b>R</b>
Share capital – 20 000 Ordinary shares	20 000
Retained earnings	9 100

The fair values of the identifiable assets, liabilities and contingent liabilities of Atkins Limited on 1 September 20.6 were as follows:

	<b>R</b>
Property, plant and equipment	3 100
Trade receivables	2 900

5. Trade receivables include prepaid expenses of R600 for the current year (20.6: R350).
6. Property, plant and equipment was purchased to expand operations.
7. The goodwill of Atkins Limited was not considered to be impaired at year end.
8. The SA Normal tax rate is 29%.

**REQUIRED:**

- (a) Prepare the consolidated statement of cash flows for the Diet Limited Group for the year ended 30 June 20.7 using the **DIRECT METHOD**
- (b) Prepare the following notes to the consolidated cash flow statement of the Diet Limited Group for the year ended 30 June 20.7:
  - Acquisition of subsidiary
  - Disposal of subsidiary

Your answer must comply with the requirements of Generally Accepted Accounting Practice.

Ignore comparative figures.

All calculations must be done to the nearest Rand.

**Solution 7.3**

**DIET LIMITED GROUP**

**CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED 30 JUNE 20.7**

	Notes	R
<b>Cash flows from operating activities</b>		24 154
Cash receipts from customers (C1)		89 450
Cash paid to suppliers and employees (C2)		(45 500)
<b>Net cash from operating activities</b>		43 950
Interest received		770
Taxes paid (C3)		(12 866)
Dividends paid to owners of the parent (given)		(6 000)
Dividends paid to non-controlling interest (given)		(1 700)
<b>Cash flows from investing activities</b>		(24 454)
Additions to property, plant and equipment (C4)		(24 654)
Acquisition of subsidiary	2	(8 000)
Proceeds on sale of subsidiary	3	8 200
<b>Net decrease in cash and cash equivalents</b>		(300)
<b>Cash and cash equivalents at beginning of year</b>		4 000
<b>Cash and cash equivalents at end of year</b>		3 700

## DIET LIMITED GROUP

### NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT FOR THE YEAR ENDED 30 JUNE 20.7

#### 1. Obtaining control of subsidiary

During the period, Diet Limited acquired a 70% interest in Atkins Limited. The fair value of assets acquired and liabilities assumed were as follows:

	R
Property, plant and equipment	(3 100)
Trade receivables	(2 900)
	<u>(6 000)</u>
Non-controlling interest (6 000 x 30%)	1 800
Goodwill	(3 800)
	<u>(8 000)</u>
Cash paid to obtain control net of cash acquired	<u>(8 000)</u>

#### 2. Disposal of subsidiary

During the period, Diet Limited disposed of its entire interest in Weight Limited. The fair value of the assets and liabilities at the date of sale were as follows:

	R
Inventories	10 200
Trade and other payables	(990)
Cash and cash equivalents	800
	<u>10 010</u>
Total net asset value	10 010
Non-controlling interest (10 010 x 25%)	(2 503)
Gain (Profit) on disposal of shares	1 493
	<u>9 000</u>
Total consideration received (Proceeds from sale of shares)	9 000
Cash and cash equivalents disposed of	(800)
	<u>(800)</u>
Net increase in cash and cash equivalents	<u>8 200</u>

#### Calculations

##### C1 Cash receipts from customers

	R
Revenue	87 000
Trade receivables:	2 450
— opening balance (3 800 – 350)	3 450
— closing balance (4 500 – 600)	(3 900)
— subsidiary acquired	2 900
	<u>89 450</u>

## C2 Cash paid to suppliers and employees

	R
Cost of sales	35 000
Increase in prepaid expenses (600 – 350)	250
Inventories	7 340
— Opening balance	(9 010)
— Closing balance	6 150
— Subsidiary sold	10 200
Trade and other payables	(11 090)
— Opening balance	9 700
— Closing balance	(19 800)
— Subsidiary sold	(990)
Other expenses paid in cash	26 000
Non-cash item – Depreciation	(12 000)
	<u>45 500</u>

## C3 Taxes paid

	R
South African Revenue Service – Opening balance	(11 000)
South African Revenue Service – Closing balance	3 550
Tax per statement of comprehensive income	(8 196)
Deferred tax – Opening balance	(3 550)
Deferred tax – Closing balance	6 330
	<u>12 866</u>

## C4 Property, plant and equipment

	R
Opening balance	93 940
Closing balance	(109 694)
Depreciation – current year	(12 000)
Subsidiary acquired	3 100
	<u>24 654</u>

## 7.4 Sundry aspects

### Study

*Group Statements (Volume 2): Chapter 15.16 — section 15.18*

### 7.4.1 Investment in associates

Where an associate is equity accounted in the consolidated financial statements of the group, any profits received in cash by the investor will be reflected as dividends received in the statement of cash flows. Because the accumulated equity profits of the associate in the consolidated statement of comprehensive income does not represent a flow of cash, it is excluded from the consolidated statement of cash flows. Loans made to or by the associate during the financial year will be reflected in the statement of cash flows classified as either investing or financing activities.

An investment made during the year in an associate should be disclosed as cash flow from an investing activity. An additional investment in an existing associate (so long as there is no change in status i.e. the associate does not become a subsidiary) will also be disclosed as an investing activity.

Work through Example 7.4 whereby the investor has an investment in an associate.

**Example 7.4**

The following are the consolidated financial statements of the North Limited Group of companies:

**NORTH LIMITED GROUP**

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 28 FEBRUARY 20.6**

	20.6 R	20.5 R
<b>ASSETS</b>		
<b>Non-current assets</b>	458 850	288 300
Property, plant and equipment	376 500	209 000
Investment in associate – at carrying amount	38 850	18 000
Loan to associate	18 000	—
Deferred tax	5 500	1 300
Available-for-sale financial assets	20 000	60 000
<b>Current assets</b>	90 100	53 400
Cash and cash equivalents	48 000	11 000
Inventories	24 000	19 000
Trade receivables	18 100	23 400
<b>Total assets</b>	548 950	341 700
<b>EQUITY AND LIABILITIES</b>		
<b>Total equity</b>	268 300	135 000
<b>Equity attributable to owners of the parent</b>	268 300	135 000
Share capital	120 000	55 000
Retained earnings	148 300	80 000
<b>Total liabilities</b>	280 650	206 700
<b>Non-current liabilities</b>	160 000	90 000
Long-term loan	160 000	90 000
<b>Current liabilities</b>	120 650	116 700
Short-term portion of long-term loan	42 400	10 300
Trade and other payables	78 250	106 400
<b>Total equity and liabilities</b>	548 950	341 700



**NORTH LIMITED GROUP**

**CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED  
28 FEBRUARY 20.6**

	<b>R</b>
<b>Revenue</b>	185 500
Cost of sales	(88 000)
<b>Gross profit</b>	<u>97 500</u>
Other income	12 180
Other expenses	(42 000)
Finance costs	(990)
Share of profit of associate	<u>22 650</u>
<b>Profit before tax</b>	89 340
Income tax expense	<u>(16 040)</u>
<b>PROFIT FOR THE YEAR</b>	<u>73 300</u>
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>	<u><u>73 300</u></u>

**NORTH LIMITED GROUP**

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED  
28 FEBRUARY 20.6**

	<b>Share capital R</b>	<b>Retained earnings R</b>	<b>Total R</b>
<b>Balance at 1 March 20.5</b>	55 000	80 000	135 000
<b>Changes in equity for 20.6</b>			
Issue of shares	65 000	—	65 000
Total comprehensive income for the year	—	73 300	73 300
Dividends paid	—	(5 000)	(5 000)
<b>Balance at 28 February 20.6</b>	<u>120 000</u>	<u>148 300</u>	<u>268 300</u>

**Additional information**

- North Limited acquired an investment in an associate, West Limited on 1 January 20.5. North Limited granted a loan to West Limited on 1 July 20.5. West Limited has made repayments of R17 000 on the loan. Interest of R990 was charged on the loan.
- Property, plant and equipment consists of land and machinery and the details are as follows:

	<b>Cost R</b>	<b>Accumulated depreciation R</b>	<b>Carrying amount R</b>
<b>Balance at 28 February 20.6</b>			
Land	160 000	—	160 000
Machinery	391 500	175 000	<u>216 500</u>
<b>Balance at 28 February 20.5</b>			<u>376 500</u>
Land	54 000	—	54 000
Machinery	365 500	210 500	<u>155 000</u>
			<u>209 000</u>

- Land at a cost of R54 000 was sold during the year. Land is not depreciated. A larger stand was purchased to expand operations.

4. Machinery with a cost of R114 000 was purchased and available for use on 1 July 20.5. This machine replaced on the same date a machine that had a carrying amount of R22 000. The machine that was replaced was 5 years old.
5. Machinery is depreciated at 15% per annum on the straight-line basis. The depreciation other than the depreciation on the machines acquired and sold amounted to R14 700.
6. Other income includes a gain on the sale of land of R5 000. A gain was also made on the sale of the machine. The group did not receive other investment income other than the dividend from its associate West Limited.

**REQUIRED:**

Prepare the consolidated statement of cash flows for the North Limited Group for the year ended 28 February 20.6 using the **DIRECT METHOD**.

Your answer must comply with the requirements of Generally Accepted Accounting Practice.

Ignore comparative figures.

All calculations must be done to the nearest Rand.

**Solution 7.4**

**NORTH LIMITED GROUP**

**CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR ENDED  
28 FEBRUARY 20.6**

	<b>R</b>
<b>Cash flows from operating activities</b>	<b>33 720</b>
Cash receipts from customers (C1)	190 800
Cash paid to suppliers and employees (C2)	(132 650)
<b>Cash generated from operations</b>	<b>58 150</b>
Investment Income (C4)	1 800
Interest paid	(990)
Dividends paid	(5 000)
Taxes paid (C3)	(20 240)
<b>Cash flows from investing activities</b>	<b>(145 820)</b>
Disposal of available-for-sale financial assets (20 000(cb) – 60 000(ob))	40 000
Acquisition of machine to maintain operations (given)	(114 000)
Proceeds from sale of machine (22 000 + 7 180(12 180 – 5 000))	29 180
Additions to property to expand operations (160 000(cb) – 54 000(ob) + 54 000)	(160 000)
Proceeds from sale of land (54 000 + 5 000)	59 000
<b>Cash flows from financing activities</b>	<b>149 100</b>
Advances received on long-term borrowings (C6)	102 100
Issue of shares (120 000(cb) – 55 000(ob))	65 000
Repayment of loan by associate (C7)(given)	17 000
Advances to associate (C7)	(35 000)
<b>Net increase in cash and cash equivalents</b>	<b>37 000</b>
<b>Cash and cash equivalents at beginning of period</b>	<b>11 000</b>
<b>Cash and cash equivalents at end of period</b>	<b>48 000</b>

## Calculations

### C1 Cash receipts from customers

	<b>R</b>
Revenue (given)	185 500
Decrease in trade receivables (18 100(cb) – 23 400(ob))	5 300
	<u>190 800</u>

### C2 Cash paid to suppliers and employees

	<b>R</b>
Cost of sales (given)	(88 000)
Other expenses (given)	(42 000)
Increase in inventories (24 000(cb) – 19 000(ob))	(5 000)
Decrease in trade and other payables (78 250(cb) – 106 400(ob))	(28 150)
Depreciation (C5)	30 500
	<u>(132 650)</u>

### C3

<b>Taxes paid</b>			
	<b>R</b>		<b>R</b>
Deferred tax opening balance	1 300	SCI	16 040
Taxes paid	20 240	Deferred tax – closing balance	5 500
	<u>21 540</u>		<u>21 540</u>

### C4

<b>Dividend received from associate</b>			
	<b>R</b>		<b>R</b>
Opening balance	18 000	Dividend (balancing amount)	1 800
SCI	22 650	Closing balance	38 850
	<u>40 650</u>		<u>40 650</u>

### C5 Depreciation

	<b>R</b>
Depreciation for machine bought (114 000 x 15% x 8/12)	11 400
Depreciation for machine sold (88 000 x 15% x 4/12)	4 400
<i>(carrying amount = (100 – amount written off of 15% x 5yrs)</i>	
<i>= 100 – 75</i>	
<i>= 25</i>	
<i>= 22 000/.25</i>	
<i>Cost = 88 000</i>	
Depreciation for other machinery – given	14 700
	<u>30 500</u>

### C6

<b>Long-term borrowings</b>			
	<b>R</b>		<b>R</b>
Closing balance (160 000 + 42 400)	202 400	Opening balance (90 000 + 10 300)	100 300
	<u>202 400</u>	Loan advanced	102 100
			<u>202 400</u>

**C7**

<b>Loan to associate</b>			
	<b>R</b>		<b>R</b>
Opening balance	—	Repayments (given)	17 000
Loan advanced	35 000	Closing balance	18 000
	<u>35 000</u>		<u>35 000</u>

**7.4.2 Investment in jointly controlled entities**

There is currently an exposure draft issued that may change the accounting treatment of interests in joint ventures, namely ED 229 *Joint arrangements*. In terms of ED 229, it is suggested that the proportionate consolidation method is scrapped and that all interests in joint ventures be accounted for according to the equity method. ED 229 has not yet been approved and therefore the proportionate consolidation method is still being used.

Once the accounting statement is issued examples that deal with this section of the work will be forwarded to students.

**7.5 Assessment criteria**

**After having studied this study unit you should be able to:**

- prepare a consolidated statement of cash flows when a parent purchases a subsidiary in the current year.
- prepare a consolidated statement of cash flows when a parent sells a subsidiary in the current year.
- prepare a consolidated statement of cash flows when a parent holds shares in an associate.
- prepare a consolidated statement of cash flows when a parent invests in a jointly controlled entity.