

Only Study Guide for
FAC3704
Semesters 1 and 2

**GROUP
FINANCIAL
REPORTING
2018**

Department of Financial Accounting
University of South Africa, Pretoria



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1 INTRODUCTION

Dear Student

Attached please find your FAC3704 learning units. It is in your own interest to work through the learning units in conjunction with the **Group statements** prescribed textbook.

You will notice that calculations are shown in brackets after some of our suggested solutions that deal with company financial statements. Such calculations are given for tuition purposes only and consequently do NOT form part of the statutory disclosure requirements.

2 CONTACT DETAILS

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3 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 2008 (sections 28 to 30 that relate to the financial statements and the Companies Act regulations that are synchronised with the Companies Act) and the International Financial Reporting Standards (IFRS) as contained in the standards set out by the South African Institute of Chartered Accountants (SAICA).

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 required.

An analysis of the action verbs contained in a question enables you to

- plan the answer systematically and organise your thoughts systematically
- ensure that you comply with the lecturers' requirements

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

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

Account for	Record
Advise	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 using 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 or specify matters or objects that are related to one another
Motivate	Supply a reason or facts to prove 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. You must become totally proficient in the field of accounting, which cannot be achieved in a short period of time. You must be diligent and thorough to be able to master this module.

The learning units have been devised to guide you through your studies for this module. You should bear in mind that your prescribed textbooks are the primary sources of information that you must study. Where necessary, these are supplemented in the learning units with further information, explanations, examples and questions, which are aimed at making the study content of the module more easily understandable. The learning units also indicate the level at which you are required to master the various learning units included in the study content. Use the learning units to work through the prescribed textbook for maximum advantage.

You are 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 BOOK AND CALCULATORS

The learning units are based on the following prescribed book:

Binnekade, CS & Koppeschaar, ZR. **Group statements** (volumes 1 & 2). Latest edition. Durban: LexisNexis.

In the learning units this work is referred to as **Group statements**.

You 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):

- sections of the Companies Act 2008 that relate to the consolidated financial statements
- sections of the Accounting II (FAC2602) study material that deal with consolidated financial statements

F. ABBREVIATIONS USED IN THE STUDY MATERIAL

Students are allowed to use the following abbreviations for examination purposes:

SP/LOCI	Statement of profit or loss and other comprehensive income
SFP	Statement of financial position
SOCIE	Statement of changes in equity
NCI	Non-controlling interests
SC	Share capital
RE	Retained earnings
FV	Fair value
CA	Carrying amount
CGT	Capital gains tax
PREFS	Preference shares
DEP	Depreciation
REV	Revaluation
P/L	Profit or loss section of the statement of profit or loss and other comprehensive income
OCI	Other comprehensive income section of the statement of profit or loss and other comprehensive income

G. TAXATION

Since 1 March 2008, the South African normal tax rate for companies has been 28%. However, another tax rate could be used in the study material for FAC3704.

From 1 March 2016 the capital gains tax (CGT) inclusion rate has changed from 66,6% to 80%. The effective CGT rate increased from 18,648%(66,6% x 28%) to 22,4%(80% x 28%). The questions will state the tax rate in the additional information. You must use the tax rate given in the questions to prepare their solutions.

FAC3704

LEARNING UNIT 1

BUSINESS COMBINATIONS



Group Financial Reporting

4 LEARNING UNIT 1

Business combinations

Learning outcome 1

After studying this learning unit, you should be able to prepare group financial statements as at the date of acquisition according to the requirements of the International Financial Reporting Standards (IFRS).

OVERVIEW OF THE LEARNING UNIT

The learning unit consists of the following sections:

- 1.1 Introduction
- 1.2 At acquisition
- 1.3 Disclosure
- 1.4 Purchase of shares (cum div)
- 1.5 Assessment criteria

STUDY

Refer to the chapters on business combinations, consolidations at and after acquisition dates in the **Group statements** textbook.

1.1 INTRODUCTION

1.1.1 Standards covered in this module

The International Financial Reporting Standards that specifically apply to this module are as follows:

- IAS 1 — Presentation of Financial Statements
- IFRS 3 — Business Combinations
- IFRS 10 — Consolidated Financial Statements
- IFRS 11 — Joint Arrangements
- IFRS 12 — Disclosure of Interests in Other Entities
- IAS 27 — Separate Financial Statements
- IAS 28 — Investments in Associates and Joint Ventures

It is important to understand the difference between the standards as well as the objective of each standard, which will in turn assist you in preparing consolidated financial statements.

IFRS 3 — Business Combinations 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.

IFRS 10 — Consolidated Financial Statements 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.

IFRS 11 — Joint Arrangements applies to all parties that are party to a joint arrangement. A joint arrangement is an arrangement of which two or more parties have joint control. The IFRS defines joint control as the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities (i.e. activities that significantly affect the returns of the arrangement) require the unanimous consent of the parties sharing control. (Please refer to learning unit 5.)

IFRS 12 — Disclosure of Interest in Other Entities relates to the disclosure requirements of subsidiaries, associates, joint arrangements and unconsolidated structured entities. The disclosure requirements require an entity to disclose information that enables users of the financial statements to evaluate the nature, risk and interests in other entities, as well as the effect of the interest in other entities on the financial position, financial performance and cash flows (IFRS 12.IN8).

IAS 27 — Separate Financial Statements applies when an entity prepares separate financial statements that comply with the International Financial Reporting Standards. The standard contains accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. The standard requires an entity preparing separate financial statements to account for those investments at cost **or** in accordance with IFRS 9 — *Financial Instruments* **or** using the equity method.

IAS 28 — Investments in Associates and Joint Ventures prescribes the accounting for investments in associates and joint ventures, and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures. (Please refer to learning units 4 and 5.)

1.1.2 Topics covered in second-year accounting (FAC2602)

In FAC3704 we will build on certain topics that have been 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 the effect of tax, which is covered in this module)
8	Interim acquisition of an interest in a subsidiary

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

1.1.3 Theory

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 arrangement with the other investor.

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

It is important to note that an investor (parent) may control an investee (subsidiary) regardless of the percentage interest held by the investor in that investee. An investor controls an investee when it has **all three** of the following (IFRS 10.7):

- **power over the investee**
An investor has power over an investee when
 - it has existing rights
 - that give it the current ability
 - to direct the relevant activities of the investee.
- **exposure (or rights) to variable returns through its relationship with the investee**
- **the ability to use its power over the investee to affect the amount of returns to which it is exposed**

NOTE: Only one investor can control an investee at any given time.

ILLUSTRATION 1

P Ltd owns 55% of the shares of S Ltd. Each share entitles the holder to one vote at the annual general meeting (AGM). The decisions made at the AGM direct the relevant activities of S Ltd.

P Ltd currently holds the majority of the voting rights (55%) at the AGM. These rights give P Ltd the **current ability** to use its majority vote at the AGM to direct the relevant activities of S Ltd. P Ltd therefore has power over S Ltd.

P Ltd is exposed to variable returns from S Ltd through dividends and the value of its investment in S Ltd.

P Ltd has the ability to use its majority voting rights (power) at the AGM to affect its returns (through dividend policies, operating decisions, etc.).

P Ltd has control over S Ltd and S Ltd is a subsidiary of P Ltd.

ILLUSTRATION 2

P Ltd owns 45% of the shares of S Ltd. P Ltd can appoint or remove four of the six directors on the board of S Ltd. Each director is entitled to one vote at the directors' meeting. The decisions made at the directors' meetings direct the relevant activities of S Ltd.

P Ltd currently holds the majority of the voting rights ($4/6 = 66,6\%$) at the directors' meeting. These rights give P Ltd the **current ability** to use its majority vote at the directors' meeting to direct the relevant activities of S Ltd. P Ltd therefore has power over S Ltd.

P Ltd is exposed to variable returns from S Ltd through dividends and the value of its investment in S Ltd.

P Ltd has the ability to use its majority voting rights (power) at the directors' meeting to affect its returns (through dividend policies, operating decisions, etc.).

P Ltd has control over S Ltd and S Ltd is a subsidiary of P Ltd.



LECTURER'S COMMENT

It is important to note that an investor can have control over an investee even if it holds less than 50% of the shares of the investee. Students should be able to answer discussion questions on whether one entity has control over another (see the illustrations above).

1.1.3.1 Definitions

Consolidated financial statements are the financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity.

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

A **subsidiary** is an entity that is controlled by another entity (known as a parent).

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

1.1.3.2 Presentation of consolidated financial statements as required by the International Financial Reporting Standards

Consolidation of subsidiaries

A parent is required to present consolidated financial statements in which it consolidates its investments in subsidiaries (IFRS 10.2(a)), except in the following situations listed:

A parent need not present consolidated financial statements only if all of the following four conditions are met (IFRS 10.4):

- The parent is itself a wholly-owned subsidiary or is a partially-owned subsidiary of another entity, and all 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.
- 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 the parent's domestic and foreign subsidiaries presented as those of a single economic entity. There is no exception for a subsidiary whose business is of a different nature than the parent's, 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, or as a joint arrangement under IFRS 11, or as an equity investment under IFRS 9 (IFRS 10.25(b)).

1.1.3.3 Accounting for investments

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

- simple share investments; and
- 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 are set out as follows:

Degree of influence	Applicable to	Accounting method
Control	Subsidiary	Consolidation – IFRS 10
Joint control	Joint venture	Equity method – IAS 28
Joint control	Joint operation	Account for the assets, liabilities, revenues and expenses relating to its interest in a joint operation in accordance with the IFRSs applicable to the particular assets, liabilities, revenues and expenses – IFRS 11
Significant influence	Associate	Equity method – IAS 28
No influence	Simple investments	Fair value – IFRS 9

In order to determine the degree of influence, it is necessary to understand the definitions of control, joint control and significant influence. 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 the consolidated group financial statements using the equity method, except when the investment is acquired and held with a view to dispose in the near future. In such a case it should be accounted for under IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*, if all requirements are met. The accounting treatment of investments in associates is set out in IAS 28 and will be discussed in learning unit 4.

Joint arrangements

A joint arrangement can either be classified as a joint operation or a joint venture in accordance with IFRS 11.04.

The benchmark accounting treatment that should be used to account for **joint ventures** in the consolidated financial statements is in accordance with IFRS 11.24A. A joint venturer shall recognise its interest in a joint venture as an investment and shall account for that investment using the equity method in accordance with IAS 28, *Investments in Associates and Joint Ventures*, unless the entity is exempt from applying the equity method as specified in that standard.

The benchmark accounting treatment that should be used to account for **joint operations** in the consolidated financial statements is in accordance with IFRS 11.21. A joint operator shall account for the assets, liabilities, revenues and expenses relating to its interest in a joint operation in accordance with the IFRSs applicable to the particular assets, liabilities, revenues and expenses. Joint arrangements are discussed in learning unit 5.

Simple share investments

Simple equity investments are to be measured at fair value in the statement of financial position, with the fair value changes recognised in profit or loss (FVTPL – fair value through profit and loss). The entity has an option to elect to recognise the fair value changes in other comprehensive income (FVTOCI – fair value through other comprehensive income) (IFRS 9.5.4.1).

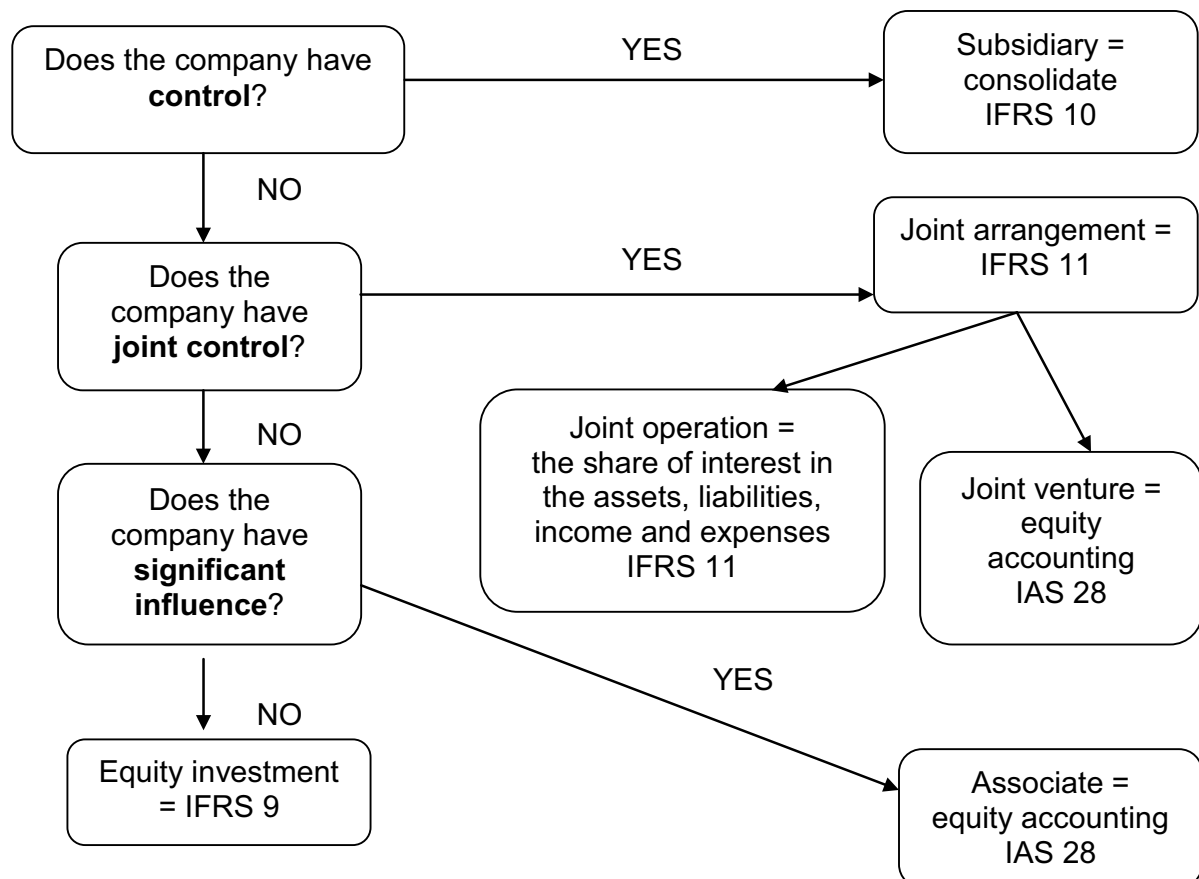
The FVTOCI election can only be made if the equity investment is not held for trading; if it is held for trading the fair value adjustment will be recognised in profit or loss (FVTPL).

Unquoted equities also have to be measured at fair value (not at cost). Despite the fair value measurement requirement for all equity investments, IFRS 9.B5.5 contains guidance on when cost may be the best estimate of fair value and also when it might not be representative of fair value.

1.1.3.4 Separate financial statements

Separate financial statements are those presented in addition to consolidated financial statements. When preparing separate financial statements an entity could elect to account for its investments in subsidiaries, joint ventures and associates **either** at cost, **or** in accordance with IFRS 9, *Financial Instruments*, **or** using the equity method as described in IAS 28, *Investments in Associates and Joint ventures* (IAS27.4).

1.1.3.5 Summary



1.2 AT ACQUISITION

IFRS 3 — Business Combinations

1.2.1 Definitions (IFRS 3 – appendix A and IFRS 10)

Acquiree	The business or businesses which the acquirer obtains control of in a business combination
Acquirer	The entity that obtains control of the acquiree.
Acquisition date	The date on which the acquirer obtains control of the acquiree.
Business	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.
Business combination	A transaction or other event that gives an acquirer control of one or more businesses.
Control	<p>An investor controls an investee when it has <u>all three</u> of the following (IFRS 10.7):</p> <ul style="list-style-type: none"> • power over the investee An investor has power over an investee when it has existing rights that give it the current ability to direct the relevant activities of the investee. • exposure (or rights) to variable returns through its relationship with the investee • the ability to use its power over the investee to affect the amount of returns to which it is exposed
Fair value	The amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction.
Goodwill	An asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised.
Identifiable	<p>An asset is identifiable if it either</p> <ul style="list-style-type: none"> • is separable, (that is 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 <p>OR</p> <ul style="list-style-type: none"> • 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.
Non-controlling interests	The equity in a subsidiary not directly or indirectly attributable to a parent.
Owners	For the purpose of IFRS 3, "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 3.1)

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

- recognise and measure the identifiable assets acquired, the liabilities assumed and any non-controlling interests 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 3.2)

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

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

1.2.4 Identifying a business combination

Take note of the process to be followed on acquiring a business combination. Refer to the schematic summary in the chapter on IFRS 3 in **Group statements** (volume 1) for more information about this process.

Apply the definition of a business combination to determine 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 3.3).

	<p>LECTURER'S COMMENT</p> <p>A business is an integrated set of activities and assets capable of being conducted and managed for the purpose of providing a return.</p> <p>A business combination is a transaction or other event in which the acquirer obtains control of one or more businesses.</p>
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1.2.5 The acquisition method (IFRS 3.4)

The following steps are taken in applying the acquisition method to account for business combinations:

- 1 Identifying the acquirer
- 2 Determining the acquisition date
- 3 Identifying the consideration transferred
- 4 Measuring the consideration transferred
- 5 Identifying and measuring the identifiable assets acquired and liabilities assumed
- 6 Measuring the non-controlling interests
- 7 Determining the amount of goodwill or the gain on a bargain purchase
- 8 Accounting for any measurement period adjustments

	<p>LECTURER'S COMMENT</p> <p>It is important that you realise that the abovementioned process only happens once, namely on the date that control is acquired. This process is determined by IFRS 3. The subsequent consolidation of subsidiaries after the acquisition date is prescribed by IFRS 10.</p>
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Step 1: Identifying the acquirer

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.

	<p>LECTURER'S COMMENT</p> <p>The relationship between the combining entities determines which entity obtains control. IFRS 10.7 defines control. An investor controls an investee when it is exposed or has rights to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.</p> <p>If the acquirer cannot be clearly identified, additional factors should be considered, such as</p> <ul style="list-style-type: none"> — the form of consideration transferred — the relative size of the combining entities — relative voting rights — the composition of the board of directors or senior management
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Step 2: Determining the acquisition date

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. The following are examples of such situations:

- A written agreement provides that the acquirer obtains control of the acquiree on a date before the closing date.
- Certain suspensive legal conditions are met (such as the completion of a due diligence review).

	<p>LECTURER'S COMMENT</p> <p>It is only from the acquisition date that the results of the subsidiary are included in the consolidated financial statements of the group (IFRS 10.20).</p> <p>The acquisition date is also the date on which the fair values of the assets acquired and liabilities assumed, non-controlling interests and goodwill/gain on bargain purchase are measured.</p>
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Step 3: Identifying 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, a transfer of assets, taking over 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 interests. Furthermore it is important to note that the purchase price can be settled in a combination of the aforementioned ways.

Step 4: Measuring 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 judgement and it may be necessary to obtain independent valuations.

For illustrative purposes examples explaining this concept have been compiled. They show that the purchase price may be settled using a combination of options.

Let us look at a few different scenarios:

(a) Consideration only consists of cash.

EXAMPLE 1.1

Information provided:

Assume the P Ltd Group uses the partial goodwill method to account for goodwill and non-controlling interests.

P Ltd obtained control with the acquisition of an 80% equity interest in the share capital of S Ltd on 1 January 2015 and paid R140 000 cash to the sellers of the shares (previous shareholder(s)) to settle the purchase price.

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

	R
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 previous shareholders, the following journals are recorded:

JOURNALS IN THE SEPARATE ACCOUNTING RECORDS OF P LTD

	Dr R	Cr R
Investment in S Ltd	140 000	
Bank (cash)		140 000

PRO FORMA CONSOLIDATION JOURNALS FOR THE P LTD 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 Ltd		140 000
Non-controlling interests ((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 P Ltd 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 the previous shareholder(s) 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 transferred from the parent to the previous shareholder(s) as well as a vehicle, the following journals are recorded:

JOURNALS IN THE SEPARATE ACCOUNTING RECORDS OF P LTD

	Dr R	Cr R
Investment in S Ltd	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 P Ltd's records.

PRO FORMA CONSOLIDATION JOURNALS FOR THE P LTD 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 Ltd		140 000
Non-controlling interests ((100 000 + 50 000) x 20%)		30 000

**LECTURER'S COMMENT**

The asset is transferred to the previous shareholder(s) at the market value of the asset.

There is no difference between the at acquisition date pro forma consolidation journals in examples 1.1 and 1.2. The only difference is in the separate records of P Ltd. P Ltd derecognises the vehicle transferred, as P Ltd no longer owns the vehicle.

- (c) Consideration consists of a combination of cash and an investment in equity shares.

EXAMPLE 1.3

Assume the same information provided as in example 1.1, except that P Ltd paid R100 000 cash and transferred 10 000 ordinary equity shares in W Ltd, with a market value of R4 per share, to settle the purchase price of R140 000 for the acquisition of an 80% interest.

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

JOURNALS IN THE SEPARATE ACCOUNTING RECORDS OF P LTD

	Dr R	Cr R
Investment in S Ltd	140 000	
Bank (cash)		100 000
Investment in W Ltd (10 000 shares x R4)		40 000

PRO FORMA CONSOLIDATION JOURNALS FOR THE P LTD 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 Ltd		140 000
Non-controlling interests ((100 000 + 50 000) x 20%)		30 000

EXAMPLE 1.4

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

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

JOURNALS IN THE SEPARATE ACCOUNTING RECORDS OF P LTD

	Dr R	Cr R
Investment in S Ltd	140 000	
Bank (cash)		100 000
Share capital (10 000 shares x R4)		40 000

JOURNALS IN THE SEPARATE ACCOUNTING RECORDS OF S LTD

There is no separate journal entry in S Ltd's own records, since P Ltd acquired its interest directly from the previous shareholders. Thus, the shares in P Ltd are the investment of the previous shareholders of S Ltd and not S Ltd itself.

PRO FORMA CONSOLIDATION JOURNALS FOR THE P LTD 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 Ltd		140 000
Non-controlling interests ((100 000 + 50 000) x 20%)		30 000

	<p>LECTURER'S COMMENT</p> <p>If P Ltd had issued its own shares to S Ltd as settlement of the purchase price of its investment in S Ltd, S Ltd would have had an investment in P Ltd that would need to be eliminated on consolidation.</p> <p>For consolidation purposes the P Ltd Group is seen as one legal entity and thus cannot have an investment in itself. This type of investment of P Ltd in S Ltd and S Ltd in P Ltd is referred to as crossholdings, which is not covered in FAC3704.</p>
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Step 5: Recognising and measuring the identifiable assets acquired and liabilities assumed

IFRS 3.18 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.

At the acquisition date, the acquirer shall recognise the following separately from goodwill:

- the identifiable assets acquired;
- the liabilities assumed; and
- any non-controlling interests 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; and
- existing goodwill (in the books of the subsidiary) is not an identifiable intangible asset.

	<p>LECTURER'S COMMENT</p> <p>The following are not liabilities at the acquisition date as there is no present obligation to pay them:</p> <ul style="list-style-type: none"> • costs that the acquirer expects but is not obliged to incur in the future; • costs to terminate the employment of an acquiree's employees or to relocate these employees; and • costs incurred due to the acquisition, such as the cost of restructuring the acquiree. <p>These costs are only recognised after the date of acquisition when an obligation arises to pay them.</p>
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(i) Exceptions to the recognition and measurement principle:

Exception:

Recognition principle
Measurement principle

Recognition and measurement principle

Item:

- Contingent liabilities
- Reacquired rights
- Share-based payment awards
- Assets held for sale
- Income taxes
- Employee benefits
- Indemnification assets

(ii) Adjustments at date of acquisition

(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 value 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 (such as land) has been revalued to its fair value which is higher than its carrying amount, then a revaluation surplus will be included in the calculation of the net identifiable assets and liabilities (i.e. equity) of the subsidiary at the acquisition date. A part of the revaluation surplus will be allocated to the non-controlling interests.

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 subsection (d) for a discussion of the tax implications of the revaluation.)

— Depreciable asset

If a depreciable asset (such as plant and equipment) has been revalued to its fair value which is higher than its carrying amount, then a revaluation surplus will be included in the calculation of the net identifiable assets and liabilities (i.e. equity) of the subsidiary at the acquisition date. 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 is allocated to the non-controlling interests.

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 subsection (d) for a discussion of the tax implications of the revaluation.)

(c) Investments in equity instruments

When a parent acquires an investment in a subsidiary, the investment may be treated in any of the following three ways in the separate financial statements of the parent:

The equity investment can be measured at fair value through profit or loss (FVTPL).

OR

The entity can elect to measure the equity investment at fair value through other comprehensive income (FVTOCI).

OR

The entity can elect to measure the equity investment using the equity method described in IAS 28, *Investments in Associates and Joint Ventures*.

The option selected by the parent company will be specified in questions.

Refer to subsection (d) for a discussion of the tax implications when investments in equity instruments are remeasured to fair value.

ILLUSTRATION 1

P Ltd paid R110 000 for a 100% investment in S Ltd on 1 January 2016. The retained earnings on this date were R22 000. P Ltd has controlled S Ltd since this date.

At the acquisition date of S Ltd, there were no unidentified assets, liabilities or contingent liabilities in existence, and the fair values of all assets, liabilities and contingent liabilities of S Ltd were equal to the carrying amounts thereof.

P Ltd measures its equity investments at fair value through profit and loss.

The company tax rate is 28% and CGT is calculated at 80% thereof.

The movements in fair value for this investment are as follows:

	R
Current year: gain in fair value	25 000

The financial information for P Ltd and S Ltd as shown in columns 1 and 2 is the financial information for the year ended 31 December 2016:

	1	2	3	4	5
	P Ltd	S Ltd	J1	J2	Consolidated financial information
Debits	R	R	R	R	R
Property, plant and equipment	180 000	120 000	—	—	300 000
Investment in S Ltd	135 000	—	(25 000)	(110 000)	—
Goodwill	—	—	—	8 000	8 000
Current assets	40 000	23 600	—	—	63 600
Income tax expense	18 200	8 400	(5 600)	—	21 000
	<u>372 200</u>	<u>152 000</u>	<u>(30 600)</u>	<u>(102 000)</u>	<u>392 600</u>
Credits					
Share capital					
(100 000 and 80 000 ordinary shares)	100 000	80 000	—	(80 000)	100 000
Retained earnings	160 000	38 000	—	(22 000)	176 000
Deferred tax	5 600	—	(5 600)	—	—
Gross profit	45 000	30 000	—	—	75 000
Other income (gain on fair value adjustment (P/L))	25 000	—	(25 000)	—	—
Current liabilities	37 600	4 000	—	—	41 600
	<u>372 200</u>	<u>152 000</u>	<u>(30 600)</u>	<u>(102 000)</u>	<u>392 600</u>

The effect of the following pro forma consolidation journals on the consolidated financial statements is shown in columns 3 and 4:

	Dr R	Cr R
J1 Other income (gain on fair value adjustments) (P/L)	25 000	
Investment in S Ltd (SFP)		25 000
Deferred tax (SFP) (25 000 x 28% x 80%)	5 600	
Income tax expense (P/L)		5 600
Reversal of fair value adjustments by P Ltd for equity investments on consolidation		
J2 Share capital	80 000	
Retained earnings at acquisition	22 000	
Goodwill (110 000 – 80 000 – 22 000)	8 000	
Investment in S Ltd (SFP)		110 000
Elimination of owners' equity in S Ltd at acquisition		

ILLUSTRATION 2

P Ltd paid R110 000 for a 100% investment in S Ltd on 1 January 2015. The retained earnings on this date were R22 000. P Ltd has controlled S Ltd since this date.

At the acquisition date of S Ltd, there were no unidentified assets, liabilities or contingent liabilities in existence, and the fair values of all assets, liabilities and contingent liabilities of S Ltd were equal to the carrying amounts thereof.

P Ltd measures its equity investments at fair value through profit and loss.

The company tax rate is 28% and CGT is calculated at 80% thereof.

The movements in fair value for this investment were as follows:

	R
From 1 January 2015 to 31 December 2015: gain in fair value	15 000
Current year: loss in fair value	7 000

The financial information for P Ltd and S Ltd as shown in columns 1 and 2 is the financial information for the year ended 31 December 2016:

	1	2	3	4	5	6
	P Ltd	S Ltd	J1	J2	J3	Consolidated financial information
	R	R	R	R	R	R
Debits						
Property, plant and equipment	180 000	120 000	—	—	—	300 000
Investment in S Ltd	118 000	—	(15 000)	7 000	(110 000)	—
Goodwill	—	—	—	—	8 000	8 000
Current assets	30 000	23 600	—	—	—	53 600
Other expenses (loss on fair value adjustment (P/L))	7 000	—	—	(7 000)	—	—
Income tax expense	11 032	8 400	—	1 568	—	20 020
	<u>346 032</u>	<u>152 000</u>	<u>(15 000)</u>	<u>1 568</u>	<u>(102 000)</u>	<u>381 620</u>
Credits						
Share capital (100 000 and 80 000 ordinary shares)	100 000	80 000	—	—	(80 000)	100 000
Retained earnings	159 944	38 000	(11 640)	—	(22 000)	163 100
Deferred tax	1 568	—	(3 360)	1 568	—	—
Gross profit	45 000	30 000	—	—	—	75 000
Current liabilities	39 520	4 000	—	—	—	43 520
	<u>346 032</u>	<u>152 000</u>	<u>(15 000)</u>	<u>1 568</u>	<u>(102 000)</u>	<u>381 620</u>

The effect of the following pro forma consolidation journals on the consolidated financial statements is shown in columns 3, 4 and 5:

	Dr	Cr
	R	R
J1 Retained earnings – Opening balance	11 640	
Deferred tax (15 000 x 28% x 80%)	3 360	
Investment in S Ltd (SFP)		15 000
Reversal of fair value adjustments for equity investments on consolidation		
J2 Investment in S Ltd (SFP)	7 000	
Other expenses (loss on fair value adjustment) (P/L)		7 000
Income tax expense (P/L)	1 568	
Deferred tax (SFP) (7 000 x 28% x 80%)		1 568
Reversal of fair value adjustments for equity investments on consolidation		
J3 Share capital	80 000	
Retained earnings at acquisition	22 000	
Goodwill (110 000 – 80 000 – 22 000)	8 000	
Investment in S Ltd (SFP)		110 000
Elimination of owners' equity in S Ltd at acquisition		

The consolidated financial information is shown in column 6.

ILLUSTRATION 3

P Ltd paid R110 000 for a 100% investment in S Ltd on 1 January 2016. The retained earnings on this date were R22 000. P Ltd has controlled S Ltd since this date.

At the acquisition date of S Ltd, there were no unidentified assets, liabilities or contingent liabilities in existence, and the fair values of all assets, liabilities and contingent liabilities of S Ltd were equal to the carrying amounts thereof.

P Ltd measures its equity investments at fair value through other comprehensive income.

The company tax rate is 28% and CGT is calculated at 80% thereof.

The movements in fair value for this investment were as follows:

Current year: gain in fair value R 15 000

The financial information for P Ltd and S Ltd as shown in columns 1 and 2 is the financial information for the year ended 31 December 2016:

	1	2	3	4	5
	P Ltd	S Ltd	J1	J2	Consolidated financial information
Debits	R	R	R	R	R
Property, plant and equipment	180 000	120 000	—	—	300 000
Investment in S Ltd	125 000	—	(15 000)	(110 000)	—
Goodwill	—	—	—	8 000	8 000
				000	
Current assets	44 000	23 600	—	—	67 600
Income tax expense	12 600	8 400	—	—	21 000
	361 600	152 000	(15 000)	(102 000)	396 600
Credits					
Share capital					
(100 000 and 80 000 ordinary shares)	100 000	80 000	—	(80 000)	100 000
Retained earnings	160 000	38 000	—	(22 000)	176 000
Mark-to-market reserve	11 640	—	(11 640)	—	—
Gross profit	45 000	30 000	—	—	75 000
Deferred tax	3 360	—	(3 360)	—	—
Current liabilities	41 600	4 000	—	—	41 600
	361 600	152 000	(15 000)	(102 000)	396 600

The effect of the following pro forma consolidation journals on the consolidated financial statements is shown in columns 3 and 4:

	Dr	Cr
	R	R
J1 Mark-to-market reserve (OCI)	11 640	
Deferred tax (SFP) (15 000 x 28% x 80%)	3 360	
Investment in S Ltd (SFP)		15 000
Reversal of fair value adjustments for equity investments on consolidation		
	Dr	Cr
	R	R
J2 Share capital	80 000	
Retained earnings at acquisition	22 000	
Goodwill (110 000 – 80 000 – 22 000)	8 000	
Investment in S Ltd (SFP)		110 000
Elimination of owners' equity in S Ltd at acquisition		

The consolidated financial information is shown in column 5.

ILLUSTRATION 4

P Ltd paid R110 000 for a 100% investment in S Ltd on 1 January 2015. The retained earnings on this date were R22 000. P Ltd has controlled S Ltd since this date.

At the acquisition date of S Ltd, there were no unidentified assets, liabilities or contingent liabilities in existence, and the fair values of all assets, liabilities and contingent liabilities of S Ltd were equal to the carrying amounts thereof.

P Ltd measures its equity investments at fair value through other comprehensive income.

The company tax rate is 28% and CGT is calculated at 80% thereof.

The movements in fair value for this investment were as follows:

	R
From 1 January 2015 to 31 December 2015: gain in fair value	15 000
Current year: gain in fair value	7 000

The financial information for P Ltd and S Ltd as shown in columns 1 and 2 is the financial information for the year ended 31 December 2016:

	1	2	3	4	5	6
	P Ltd	S Ltd	J1	J2	J3	Consolidated financial information
	R	R	R	R	R	R
Debits						
Property, plant and equipment	180 000	120 000	—	—	—	300 000
Investment in S Ltd	132 000	—	(15 000)	(7 000)	(110 000)	—
Goodwill	—	—	—	—	8 000	8 000
Current assets	44 000	23 600	—	—	—	67 600
Income tax expense	12 600	8 400	—	—	—	21 000
	<u>368 600</u>	<u>152 000</u>	<u>(15 000)</u>	<u>(7 000)</u>	<u>(102 000)</u>	<u>396 600</u>
Credits						
Share capital (100 000 and 80 000 ordinary shares)	100 000	80 000	—	—	(80 000)	100 000
Retained earnings	160 000	38 000	—	—	(22 000)	176 000
Mark-to-market reserve	17 898	—	(11 640)	(5 432)	—	—
Gross profit	45 000	30 000	—	—	—	75 000
Deferred tax	4 102	—	(3 360)	(1 568)	—	—
Current liabilities	41 600	4 000	—	—	—	45 600
	<u>368 600</u>	<u>152 000</u>	<u>(15 000)</u>	<u>(7 000)</u>	<u>(102 000)</u>	<u>396 600</u>

The effect of the following pro forma consolidation journals on the consolidated financial statements is shown in columns 3, 4 and 5:

		Dr R	Cr R
J1	Mark-to-market reserve (OCI) (SOCIE)	11 640	
	Deferred tax (SFP) (15 000 x 28% x 80%)	3 360	
	Investment in S Ltd (SFP)		15 000
	Reversal of fair value adjustments for equity investments on consolidation		
J2	Mark-to-market reserve (OCI)	5 432	
	Deferred tax (SFP) (7 000 x 28% x 80%)	1 568	
	Investment in S Ltd (SFP)		7 000
	Reversal of fair value adjustments for equity investments on consolidation		
J3	Share capital	80 000	
	Retained earnings at acquisition	22 000	
	Goodwill (110 000 – 80 000 – 22 000)	8 000	
	Investment in S Ltd (SFP)		110 000
	Elimination of owners' equity in S Ltd at acquisition		

The consolidated financial information is shown in column 6.

(d) Tax implications of 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 the capital profit after 1 October 2001. It forms part of current tax. The proceeds up until the asset's cost price are taxed at the current tax rate of 28%.

80% 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 $80\% \times 28\% = 22,4\%$.

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

From 1 March 2016 the capital gains tax (CGT) inclusion rate changed from 66,6% to 80%. The effective CGT tax rate has therefore also changed from **18,648%** ($66,6\% \times 28\%$) to **22,4%** ($80\% \times 28\%$).

EXAMPLE 1.5

Blue Ltd 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 28%. CGT is calculated at 80% thereof.

	R		R
Profit on sale of motor vehicle	$600\,000 - 400\,000$	$= 200\,000$	
Calculation of capital gains tax:			
Selling price – cost price	$600\,000 - 500\,000$	$= 100\,000 \times 80\% \times 28\%$	22 400
Cost price – tax base	$500\,000 - 400\,000$	$= 100\,000 \times 28\%$	28 000
			<u>50 400</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. Deferred tax will need to be raised on the revaluation surplus that will reflect the tax consequences of selling the asset (such as 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 12.20). 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 12.51). 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 22,4% (80% x 28%), as this portion of the taxable gain would only be realised through selling the asset (see example above).

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 22,4% ($80\% \times 28\%$), 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 22,4% ($80\% \times 28\%$) (CGT rate).
- (4) Deferred tax relating to the revaluation should be charged directly to equity.

— Capital gains tax on an investment in equity instruments

The remeasurement of equity investments (mark-to-market reserve) also has a capital gains tax implication. 80% of the potential capital gain above cost (assumed to be the 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 22,4% ($80\% \times 28\%$).

Step 6: Measuring the non-controlling interests

Each identifiable asset and liability is measured at its acquisition-date fair value. Any non-controlling interests 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 the examples in **Group statements**.

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

LECTURER'S COMMENT

The acquirer can elect, on a transaction-by-transaction basis, to measure any non-controlling interests 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 separate component of equity in the consolidated statement of financial position and is described as non-controlling interests.

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 profit or loss and other comprehensive income.

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

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED ...

	R
Total profit or loss for the year	xxx
Other comprehensive income for the year	xxx
Total comprehensive income for the year	xxx
Total profit or loss attributable to:	
Owners of the parent	xxx
Non-controlling interests	xxx
	xxx
Total comprehensive income attributable to:	
Owners of the parent	xxx
Non-controlling interests	xxx
	xxx



Step 7: Recognising and measuring goodwill or gain on bargain purchase (IFRS 3.32 – 3.36)

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, IFRS 3.36 requires the following before such a gain is recognised:

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 requires to be recognised at the acquisition date for all the following:

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

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

(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 amount (credit), then a gain from a bargain purchase is recognised.



LECTURER'S COMMENT

Goodwill is recognised as a non-current asset in the statement of financial position.

Gain on bargain purchase is recognised as a gain (other income) in the profit or loss section of the statement of profit or loss and other comprehensive income in the year in which the acquisition took place.

If the gain on bargain purchase relates to a subsidiary acquired in a prior period, it will be recognised as part of opening retained earnings in the statement of changes in equity.

EXAMPLE 1.6

A Ltd acquired control with the acquisition of an 80% interest in B Ltd for R1 100 000 on 1 January 2015. On this date the share capital of B Ltd 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 Ltd amounted to R1 000 000 on 1 January 2015.

The market value of the shares of B Ltd on 1 January 2015 amounted to R7 per share.

Partial goodwill method

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

ANALYSIS OF OWNERS' EQUITY OF B LTD

	100%	80%		20%
	Total R	At R	Since R	NCI R
At acquisition				
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

**LECTURER'S COMMENT**

The fair value of the net assets of B Ltd amounts to R1 000 000. The non-controlling interests are measured using the partial goodwill method, thus the non-controlling interests amount to R200 000 (R1 000 000 x 20% = R200 000).

Full goodwill method

Non-controlling interests in the acquiree measured at fair value

ANALYSIS OF OWNERS' EQUITY OF B LTD

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

¹ 200 000(SC) x 20% x R7 = 280 000

² 280 000¹ – 200 000^a = 80 000



LECTURER'S COMMENT

The non-controlling interests are measured at fair value, thus the non-controlling interests amount to 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 Ltd acquired control with the acquisition of a 60% interest in B Ltd for R1 000 000 on 1 January 2016. On this date the share capital of B Ltd was R500 000 consisting of 500 000 ordinary shares. The retained earnings of B Ltd amounted to R700 000 and the revaluation surplus was R300 000.

On 1 January 2016 the fair value of the net assets of B Ltd amounted to R1 500 000.

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

Ignore tax implications.

Partial goodwill method

ANALYSIS OF OWNERS' EQUITY OF B LTD

	100%	60%		40%
	Total R	At R	Since R	NCI R
At acquisition				
Share capital	500 000	300 000		200 000
Retained earnings	700 000	420 000		280 000
Revaluation surplus	300 000	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	1 000 000		600 000

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		Dr R	Cr R
J1	Share capital	500 000	
	Retained earnings at acquisition	700 000	
	Revaluation surplus	300 000	
	Non-controlling interests (SFP)		600 000
	Investment in B Ltd		1 000 000
	Goodwill	100 000	
	Elimination of owners' equity in B Ltd at acquisition		



LECTURER'S COMMENT

The fair value of the net assets of B Ltd amounts to R1 500 000. The non-controlling interests are measured using the partial goodwill method, thus the non-controlling interests amount to R600 000 ($R1\ 500\ 000 \times 40\% = R600\ 000$).

This represents the non-controlling interests' proportionate share of the acquiree's net identifiable assets.

Full goodwill method

ANALYSIS OF OWNERS' EQUITY OF B LTD

	100%	60%		40%
	Total R	At R	Since R	NCI R
At acquisition				
Share capital	500 000	300 000		200 000
Retained earnings	700 000	420 000		280 000
Revaluation surplus	300 000	180 000		120 000
	1 500 000	900 000		600 000 ³
Equity represented by goodwill – parent and NCI	150 000	100 000		50 000 ²
Consideration and NCI at fair value	1 650 000	1 000 000		650 000 ¹

¹ 650 000 (given)

² $650\ 000^1 - 600\ 000^3 = 50\ 000$

³ $(500\ 000 + 700\ 000 + 300\ 000) \times 40\% = 600\ 000$

PRO FORMA CONSOLIDATION JOURNAL

		Dr R	Cr R
J1	Share capital	500 000	
	Retained earnings at acquisition	700 000	
	Revaluation surplus	300 000	
	Non-controlling interests (SFP) (given)		650 000
	Investment in B Ltd		1 000 000
	Goodwill	150 000	
	Elimination of owners' equity in B Ltd at acquisition		



LECTURER'S COMMENT

The non-controlling interests are measured at fair value, thus the non-controlling interests 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) = $R150\ 000$.

THE DIFFERENCE BETWEEN THE FULL GOODWILL METHOD AND THE PARTIAL GOODWILL METHOD

The acquirer can choose which method to apply per acquisition (transaction by transaction). Therefore this is an accounting choice, not an accounting policy.

Full goodwill method

The full goodwill method means that the NCI is recognised at fair value at acquisition date.

The question can provide the fair value of the NCI at the acquisition date or it can provide enough information to calculate the fair value (for example, provide the share price at acquisition date). See example 1.6.

If the NCI is measured at fair value there will usually be a portion of goodwill or gain on a bargain purchase attributable to the NCI. This will be the difference between the fair value of the NCI at acquisition date and the proportionate share of the identifiable net assets of the NCI at acquisition date.

The total amount of goodwill to be disclosed as per the consolidated SFP will be the goodwill amount attributable to the parent as well as the goodwill amount attributable to the NCI.

Partial goodwill method

The partial goodwill method means that the NCI is recognised at its proportionate share of the identifiable net assets at acquisition date.

The proportionate share means that NCI will merely be the percentage interest of the identifiable net assets at acquisition date.

If the NCI is measured at the proportionate share of the net identifiable assets, no portion of goodwill or gain on a bargain purchase will ever be attributable to the NCI, because the value of NCI is the proportionate or partial value of the net identifiable assets at acquisition date.

The total amount of goodwill to be disclosed as per the consolidated SFP will only be a goodwill amount attributable to the parent as there is no goodwill amount attributable to the NCI under the partial goodwill method.

Step 8: Accounting for any measurement period adjustments

Refer to **Group statements** for examples and theory.

EXAMPLE 1.8

On 1 April 2015 Aden Ltd paid R2 300 000 to acquire a 75% interest in Baden Ltd. Aden Ltd has controlled Baden Ltd since this date.

The information relating to Baden Ltd's assets on 1 April 2015 is as follows:

Plant

Original cost price	R2 200 000
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 Ltd had a fair value of R1 000 000 on that date.

Aden Ltd decided to obtain an independent appraisal of the fair value of the plant. The appraisal was only finalised on 31 August 2015. The independent appraisal determined the fair value of the plant to be R1 800 000. The difference in the fair values related to circumstances that existed on the date of acquisition of Baden Ltd.

The non-controlling interests are measured at their proportionate share of Baden Ltd's identifiable net assets.

The company's financial year-end is 30 June 2015.

The consolidation journal entries to account for the plant of Baden Ltd in the consolidated financial statements for the year ended 30 June 2015 will be as follows:

PRO FORMA CONSOLIDATION JOURNALS (30 JUNE 2015)

		Dr R	Cr R
J1	Plant (2 000 000 – 1 500 000) Revaluation surplus – Plant	500 000	500 000
J2	Equity – Baden Ltd (1 000 000 + 2 000 000) Non-controlling interests (3 000 000 x 25%) Investment in Baden Ltd Goodwill	3 000 000 50 000	 750 000 2 300 000
J3	Depreciation (500 000 x 10% x $\frac{3}{12}$) Accumulated depreciation	12 500	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 corrected retrospectively in the 2016 financial statements.

PRO FORMA CONSOLIDATION JOURNALS (30 JUNE 2016)

		Dr R	Cr R
J1	Plant (1 800 000 – 1 500 000) Revaluation surplus – Plant	300 000	300 000
J2	Equity – Baden Ltd (1 000 000 + 1 800 000) Non-controlling interests (2 800 000 x 25%) Investment in Baden Ltd Goodwill	2 800 000 200 000	700 000 2 300 000
J3	Retained earnings (300 000 x 10% x $\frac{3}{12}$) Accumulated depreciation	7 500	7 500
J4	Depreciation for 2016 (300 000 x 10%) Accumulated depreciation	30 000	30 000

LECTURER'S COMMENT

According to IFRS 3, goodwill needs to be calculated on the acquisition date (in this example 1 April 2015). To calculate goodwill we need to know what the fair value of the identifiable assets and liabilities of the acquiree is at this date. Sometimes the actual fair value of the assets takes some time to determine and therefore the company needs to make an estimate of that fair value.

In this example the company estimated that the fair value was R2 000 000 and calculated goodwill of R50 000 based on its best estimate. The IFRS states that a company has 12 months to finalise this estimation.

On 31 August 2015 (within 12 months of the acquisition date) the company received independent advice that at acquisition date the asset was actually worth R1 800 000 and not R2 000 000, as had originally been estimated.

As the new fair value was determined within 12 months of the acquisition date, the company could use this R1 800 000 to determine what the goodwill should have been at the acquisition date (R200 000).

The journals for 2016 are then drawn up as if the fair value of the plant at acquisition date was determined to be R1 800 000 (retrospectively).



1.3 DISCLOSURE

IFRS 3 — 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 3.59)

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
 - 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
 - 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
 - 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 unLtd, the acquirer shall disclose that fact.
- h) for acquired receivables
 - the fair value of the receivables
 - the gross contractual amounts receivable
 - the best estimate at the acquisition date of the contractual cash flows not expected to be collected

The disclosures shall be provided by the major classes of receivables, 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, *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 37.86 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
 - 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 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 profit or loss and other 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
 - the line item in the statement of profit or loss and other comprehensive income in which the gain is recognised
 - 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 interests in the acquiree recognised at the acquisition date and the measurement basis for that amount
 - for each non-controlling interests 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
 - 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
 - the line item in the statement of profit or loss and other 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 profit or loss and other comprehensive income for the reporting period
- 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 impractical, the acquirer shall disclose that fact and explain why the disclosure is impractical. IFRS 3 uses the term “impractical” with the same meaning as in IAS 8, *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) to (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 paragraphs (a) to (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 3.61).

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
 - the nature and amount of any measurement period adjustments recognised during the reporting period in accordance with IFRS 3.49
- 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
 - 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 37.85 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, *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 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, *Impairment of Assets*. IAS 36 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, *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 and other IFRSs do not meet the objectives set out above, the acquirer shall disclose whatever additional information is necessary to meet those objectives.

Consolidated and separate financial statements

Please refer to the chapters in **Group 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 (for example 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 over the equity attributable to owners of the parent (IFRS 12.18)
- f) if control of a subsidiary is lost, the parent shall disclose the gain or loss, if any, recognised and (IFRS 12.19):
 - 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
 - the line item or items in the statement of profit or loss and other comprehensive income in which the gain or loss is recognised (if not presented separately in the statement of profit or loss and other comprehensive income)

When separate financial statements are prepared for a parent that is exempt from preparing consolidated financial statements, those separate financial statements shall disclose (IAS 27.16)

- 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 the 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
- c) a description of the method used to account for the investments listed under (b)

When a parent (other than a parent that is exempt from preparing consolidated financial statements), a 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 (IAS 27.17)

- 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
- c) a description of the method used to account for the investments listed under (b)

Furthermore, it shall identify that the consolidated financial statements are prepared in accordance with IFRS 10, IFRS 11 or IAS 28 to which they relate.

1.4 PURCHASE OF SHARES (CUM DIV)

IFRS references:

Dividends from a subsidiary, a joint venture or an associate are recognised in the separate financial statements of an entity when the entity's right to receive the dividend has been established. Dividends are recognised in profit and loss unless the entity elects to use the equity method, in which case the dividend is recognised as a reduction from the carrying amount of the investment. (IAS 27.12)

Dividends are recognised in profit or loss when:

- (a) the entity's right to receive payment of the dividend is established;
- (b) it is probable that the economic benefits associated with the dividend will flow to the entity; and
- (c) the amount of the dividend can be reliably measured. (IFRS 9.5.7.1A)

Dividends on investments are recognised in profit or loss in accordance with IFRS 9, unless the dividend clearly represents a recovery of part of the cost of the investment. (IFRS 9 B5.7.1).

An investment in a subsidiary, joint venture or associate must be tested for impairment if the dividend exceeds the total comprehensive income of that entity in the period the dividend is declared (IAS 36 (h)(ii)).

ILLUSTRATION 1

On 30 June 2016 the parent purchased an investment in the subsidiary for R200 000. The subsidiary proposed and declared an ordinary dividend on 15 July 2016, payable to shareholders registered on 25 July 2016. The parent received a dividend of R10 000.

Dr Investments in S Ltd	200 000	
Cr Bank		200 000
Dr Bank	10 000	
Cr Dividend income (P/L)		10 000

ILLUSTRATION 2

On 20 July 2016 the parent purchased an investment in the subsidiary for R210 000. The subsidiary proposed and declared an ordinary dividend on 15 July 2016, payable to shareholders registered on 25 July 2016. The parent received a dividend of R10 000.

At the acquisition date (20 July 2016) the subsidiary's shares traded cum div and the parent effectively also paid for the dividend to be received as the dividend had already been declared.

Dr Investments in S Ltd	200 000	
Dr Debtors (dividend receivable)	10 000	
Cr Bank		210 000
Dr Bank	10 000	
Cr Debtors (dividend receivable)		10 000

ILLUSTRATION 3

On 30 June 2016 the parent purchased 50 000 R2, 10% cumulative non-redeemable non-convertible preference shares of a subsidiary for R105 000.

At the acquisition date (30 June 2016) the preference shares most likely traded cum div as the preference dividends would be known and determinable.

On 31 December 2016 the parent received a dividend of R10 000.

Dr Investments in S Ltd – Preference shares	100 000	
Dr Debtors (dividend receivable)		
(50 000 shares x R2 x 10% x first $\frac{6}{12}$ months)	5 000	
Cr Bank		105 000
Dr Bank	10 000	
Cr Debtors (dividend receivable)		5 000
Cr Dividend income (P/L)		
(50 000 shares x R2 x 10% x last $\frac{6}{12}$ months)		5 000

1.5 ASSESSMENT CRITERIA

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



- describe a group of companies
- distinguish between a subsidiary, an associate and a joint arrangement
- define and interpret control, significant influence and joint control
- distinguish between the accounting treatment of a subsidiary, an associate, a joint arrangement and an investment
- apply and account for the measurement criteria of identifiable assets acquired and liabilities assumed (including contingent liabilities) at their acquisition date fair values, in terms of IFRS 3
- account for non-controlling interests according to IFRS 10
- account for the consideration at acquisition as well as any acquisition costs in terms of IFRS 3
- account for goodwill or gain on bargain purchase according to IFRS 3

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LEARNING UNIT 2

CONSOLIDATIONS AFTER THE DATE OF ACQUISITION



Group Financial Reporting

5 LEARNING UNIT 2

Consolidations after the date of acquisition

Learning outcome 2

After studying this learning unit, you should be able to prepare group financial statements after the date of acquisition according to the requirements of the International Financial Reporting Standards (IFRS).

OVERVIEW OF THE LEARNING UNIT

The learning unit consists of the following sections:

- 2.1 Introduction
- 2.2 Since acquisition — application of IFRS 10, Consolidated Financial Statements
- 2.3 Impairment of goodwill
- 2.4 Losses incurred by a subsidiary
- 2.5 Revision example
- 2.6 Assessment criteria

STUDY

Refer to the chapter on consolidations after acquisition date in **Group statements**.

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. However, certain adjustments need to be made before we can speak of consolidated statements. The principles, procedures and the adjustments that are needed to prepare and present the consolidated financial statements for a group of companies will be discussed in this learning unit.

2.2 SINCE ACQUISITION — APPLICATION OF IFRS 10

2.2.1 Objective

IFRS 10 deals with the following:

- the circumstances in which an entity must consolidate the financial statements of another entity (being a subsidiary);
- the principle of control and establishing control as the basis for consolidation;
- how to apply the principle of control and how to identify whether an investor controls an investee;
- the accounting requirements for the preparation of consolidated financial statements;
- accounting for changes in ownership interests in a subsidiary;
- 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 IFRS 10.B86 to B93. The consolidation procedures are as follows:

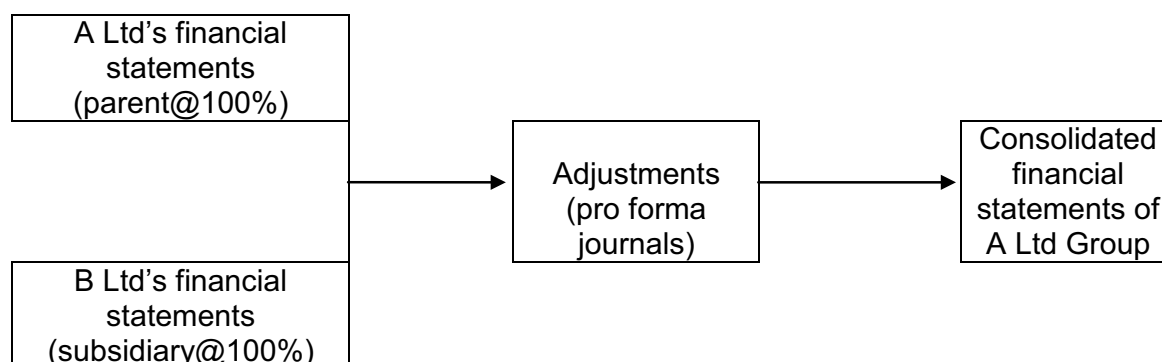
- (i) The financial statements of the parent entity and its subsidiaries are combined on a line-by-line basis by adding together like items of assets, liabilities, equity, income and expenses.
- (ii) The following steps must be taken to ensure that the consolidated financial statements present financial 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 in accordance with IFRS 3.
 - Non-controlling interests in the profit or loss of consolidated subsidiaries for the reporting period must be identified.
 - 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; and
 - the non-controlling interests' 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, Income Taxes.
- (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.
- (vi) Consolidated financial statements should be prepared using uniform accounting policies for like transactions and other events in similar circumstances (IFRS 10.19).
- (vii) The results of operations of a subsidiary are included in the consolidated financial statements from the acquisition date as defined by IFRS 3. This is the date on which control of the acquired subsidiary is effectively transferred to the buyer (IFRS 10.20).
- (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 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 impractical to do so (IFRS 10.B92).
- (x) If it is impractical 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 (IFRS 10.B93).

- (xi) Non-controlling interests should be presented in the consolidated statement of financial position within equity, but separate from the parent's owners' equity (IFRS10.22).
- (xii) Non-controlling interests in the profit or loss of the group should also be presented separately (IFRS 10.22). 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 or are payable to the non-controlling interests are shown in the non-controlling interests' column of the consolidated statement of changes in equity as a reduction of the amount attributable to the non-controlling interests.

	<p>LECTURER'S COMMENT</p> <p>IFRS 10 does not deal with the methods of accounting for business combinations at the acquisition date, including goodwill arising on a business combination. This is dealt with in IFRS 3, Business Combinations.</p>
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2.2.3 Simple group

Consolidations can be schematically represented as follows:



A Ltd drafts its financial statements from its financial records, as does B Ltd. 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 Ltd and B Ltd are never amended during the consolidation process. Pro forma consolidation journal entries are used to effect the consolidation adjustments.

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

The basic consolidation procedures can be summarised as follows:

- consolidation of all items
- elimination of common items
- elimination of intragroup 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 2016

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



REQUIRED:

Prepare the consolidated statement of financial position for the A Ltd Group as at 30 June 2016. Assume that A Ltd acquired its controlling interest on that date. B Ltd was incorporated on 30 June 2014.

SOLUTION 2.1

Pro forma consolidation journal

	Dr R	Cr R

J1	Share capital of B Ltd Investment in B Ltd Elimination of owners' equity of B Ltd at acquisition	10 000	10 000
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The consolidated statement of financial position will now be drafted as follows:

A LTD GROUP

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 2016

	R
ASSETS	
Cash and cash equivalents (10 000 + 10 000)	<u>20 000</u>
EQUITY AND LIABILITIES	
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:

EXAMPLE 2.2

STATEMENTS OF FINANCIAL POSITION AS AT 30 JUNE 2016

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

Additional information

The equity investments are measured at fair value through profit and loss (FVTPL).

The fair value of the equity investment is equal to the cost price thereof.

A Ltd acquired its controlling interest on 30 June 2014 when B Ltd was incorporated.



REQUIRED:

Prepare the consolidated statement of financial position of the A Ltd Group as at 30 June 2016.

SOLUTION 2.2

PRO FORMA CONSOLIDATION JOURNAL

		Dr R	Cr R
J1	Share capital of B Ltd Investment in B Ltd Elimination of owners' equity of B Ltd at acquisition	10 000	10 000

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

A LTD GROUP

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 2016

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

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

- 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 Ltd.

The above two examples have been kept simple to highlight the at acquisition procedures for consolidating a subsidiary. IFRS 3, Business Combinations, establishes principles and requirements the acquirer (parent) should adhere to or meet:

- The acquirer should recognise and measure in its financial statements the identifiable assets acquired, the liabilities assumed and any non-controlling interests in the acquiree.

- The acquirer should recognise and measure the goodwill acquired in the business combination or the gain acquired from a bargain purchase.
- The acquirer should determine 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

Refer to the chapter on the elimination of intragroup items in **Group statements**.

Please also refer to **Group statements** (volume 1) for an explanation of the deferred tax implications.

General approach to the allocation of income tax and the elimination of unrealised profits

According to IFRS 10.B86(c), 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 are 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 will be realised.

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 a debtor is created).

Different types of intragroup transactions

(a) Bank overdrafts and guarantees

STUDY

Refer to the chapter on the elimination of intragroup balances (bank overdrafts and guarantees) in **Group statements**.

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 their 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.

(b) 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.

STUDY

Refer to the chapter on the elimination of intragroup transactions relating to inventory in **Group statements**.

• Inventories

— Unrealised profit in closing inventory

If a subsidiary sells inventory to its parent and the parent still has some of this inventory on hand at year-end, 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, namely closing inventory in the profit or loss section of the statement of profit or loss and other 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 profit or loss and other 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 profit or loss and other comprehensive income often show 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, therefore the entity will 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 company's 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; they 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 profit or loss and other 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 profit or loss section of the statement of profit or loss and other comprehensive income, 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 profit or loss and other 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

B Ltd is a subsidiary of A Ltd.

During 2015 and 2016 A Ltd sold inventory to B Ltd at a profit of 25% on the cost of the inventory.

On 31 December 2015 B Ltd had inventory on hand of R300 000, which had been bought from A Ltd.

On 31 December 2016 B Ltd had inventory on hand of R200 000, which had been bought from A Ltd.

Assume a tax rate of 28%.



REQUIRED:

Prepare the consolidation pro forma journal entries for the years ended 31 December 2015 and 31 December 2016.

SOLUTION 2.3

THE PRO FORMA CONSOLIDATION JOURNALS FOR THE YEAR ENDED 31 DECEMBER 2015 WILL BE AS FOLLOWS:

	Dr R	Cr R
31/12/2015		
Cost of sales (P/L) (A) ($300\,000 \times \frac{25}{125}$)	60 000	
Inventory (SFP) (B)		60 000
Deferred tax (SFP) ($60\,000 \times 28\%$)	16 800	
Income tax expense (P/L) (A)		16 800
Elimination of unrealised profit in closing inventory of B Ltd		

THE PRO FORMA CONSOLIDATION JOURNALS FOR THE YEAR ENDED 31 DECEMBER 2016 WILL BE AS FOLLOWS:

	Dr R	Cr R
31/12/2016		
Retained earnings – beginning of year (A)	60 000	
Cost of sales (P/L) (A)		60 000
Income tax expense (P/L) (A)	16 800	
Retained earnings – beginning of year (A)		16 800
Elimination of unrealised profit in opening inventory of B Ltd		

	Dr R	Cr R
31/12/2016		
Cost of sales (P/L) (A) ($200\,000 \times \frac{25}{125}$)	40 000	
Inventory (SFP) (B)		40 000
Deferred tax (SFP) ($40\,000 \times 28\%$)	11 200	
Income tax expense (P/L) (A)		11 200
Elimination of unrealised profit in closing inventory of B Ltd		

	<p>LECTURER'S COMMENT</p> <p>Note that the profit for the year and the retained earnings of B Ltd are not adjusted because it is not B Ltd that is making the unrealised profit, but A Ltd.</p> <p>Therefore the unrealised profit in the inventory will not be shown in the analysis of owners' equity of B Ltd. The adjustments will only be taken into account in the consolidated statement of profit or loss and other comprehensive income (profit or loss section).</p>
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EXAMPLE 2.4

B Ltd is a subsidiary of A Ltd.

During 2015 and 2016 B Ltd sold inventory to A Ltd at a profit of 25% on the cost of the inventory.

On 31 December 2015 A Ltd had inventory on hand of R300 000, which was purchased from B Ltd.

On 31 December 2016 A Ltd had inventory on hand of R200 000, which was purchased from B Ltd.

Assume a tax rate of 28%.

	<p>REQUIRED:</p> <p>Prepare the pro forma consolidation journal entries for the years ended 31 December 2015 and 31 December 2016.</p>
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SOLUTION 2.4

THE PRO FORMA CONSOLIDATION JOURNALS FOR THE YEAR ENDED 31 DECEMBER 2015 WILL BE AS FOLLOWS:

	Dr R	Cr R
31/12/2015		
Cost of sales (P/L) (B) $(300\,000 \times \frac{25}{125})$	60 000	
Inventory (SFP) (A)		60 000
Deferred tax (SFP) $(60\,000 \times 28\%)$	16 800	
Income tax expense (P/L) (B)		16 800
Elimination of unrealised profit in closing inventory of A Ltd		

THE PRO FORMA CONSOLIDATION JOURNALS FOR THE YEAR ENDED 31 DECEMBER 2016 WILL BE AS FOLLOWS:

	Dr R	Cr R
31/12/2016		
Retained earnings – beginning of year (B)	60 000	
Cost of sales (P/L) (B)		60 000
Income tax expense (P/L) (B)	16 800	
Retained earnings – beginning of year (B)		16 800
Elimination of unrealised profit in opening inventory of A Ltd		

	Dr R	Cr R
31/12/2016		
Cost of sales (P/L) (B) ($200\,000 \times \frac{25}{125}$)	40 000	
Inventory (SFP) (A)		40 000
Deferred tax (SFP) ($40\,000 \times 28\%$)	11 200	
Income tax expense (P/L) (B)		11 200
Elimination of unrealised profit in closing inventory of A Ltd		

THE ALTERNATIVE PRO FORMA CONSOLIDATION JOURNALS FOR THE OPENING UNREALISED PROFIT FOR THE YEAR ENDED 31 DECEMBER 2016 WILL BE AS FOLLOWS (FIRST JOURNAL ENTRY FOR 2016):

	Dr R	Cr R
31/12/2016		
Retained earnings ($60\,000 - 16\,800$)	43 200	
Deferred tax (SFP)	16 800	
Cost of sales (P/L)		60 000
Restatement of the opening balances due to unrealised profit in opening inventory		
Inventory (SFP)	60 000	
Cost of sales (P/L)		60 000
Realisation of unrealised profit in opening inventory		
Income tax expense (P/L)	16 800	
Deferred tax (SFP)		16 800
Realisation of tax effect on unrealised profit in opening inventory		

	<p>LECTURER'S COMMENT</p> <p>Note that the profit for the year and retained earnings of B Ltd are adjusted because it is B Ltd that is making the unrealised profit and not A Ltd.</p> <p>Therefore the unrealised profit in the inventory will be shown in the analysis of owners' equity of B Ltd. The adjustments will also be taken into account in the consolidated statement of profit or loss and other comprehensive income (profit or loss section).</p>
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- **Property, plant and equipment**

STUDY
Refer to the chapter on the elimination of intragroup transactions relating to property, plant and equipment in Group statements .

— 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 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 (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 Ltd has held a 100% interest in B Ltd since 2014. A Ltd controls B Ltd.

On 2 January 2015 A Ltd sold land to B Ltd for R20 000.

The carrying amount of the land for A Ltd was R15 000.

Both entity's year-ends fall on 31 December.

Assume a normal tax rate of 28%; capital gains tax is calculated at 66,6% thereof.



REQUIRED:

Prepare the pro forma consolidation journal entries for the years ended 31 December 2015 and 31 December 2016.

SOLUTION 2.5

THE PRO FORMA CONSOLIDATION JOURNALS FOR THE YEAR ENDED 31 DECEMBER 2015 WILL BE AS FOLLOWS:

	Dr R	Cr R
31/12/2015		
Profit on sale of land (P/L) (A)	5 000	
Property, plant and equipment (SFP) (B)		5 000
Elimination of unrealised intragroup profit included in the property, plant and equipment of B Ltd (20 000 – 15 000)		
Deferred tax (SFP)	932	
Income tax expense (P/L) (A)		932
Tax implication of elimination of unrealised intragroup profit included in property, plant and equipment of B Ltd (5 000 x 28% x 66,6%)		

THE PRO FORMA CONSOLIDATION JOURNALS FOR THE YEAR ENDED 31 DECEMBER 2016 WILL BE AS FOLLOWS:

	Dr R	Cr R
31/12/2016		
Retained earnings — beginning of year (SOCIE) (A) (5 000 – 932)	4 068	
Deferred tax (SFP)	932	
Property, plant and equipment (SFP) (B)		5 000
Correction to agree opening balances for 2016 with closing balances for 2015		

	LECTURER'S COMMENT
<p>The journal entry above is passed every year until the asset is sold to a third party outside the group. The unrealised profit of a non-depreciable asset only realises when the asset is sold to a third party outside the group.</p>	

— 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 are sold to parties outside the group. This unrealised profit, which realises each year, must be included in the consolidated profit.

EXAMPLE 2.6

A Ltd has held an 80% interest in B Ltd since 2012. Since this date A Ltd has exercised control over B Ltd.

On 31 December 2013 B Ltd sold manufacturing machinery to A Ltd for R20 000.

The carrying amount of the machinery in the books of B Ltd 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 28%.

**REQUIRED:**

Prepare the pro forma consolidation journal entries for the years ended 31 December 2013 and 31 December 2014.

SOLUTION 2.6

THE PRO FORMA CONSOLIDATION JOURNALS FOR THE YEAR ENDED 31 DECEMBER 2013 WILL BE AS FOLLOWS:

	Dr R	Cr R
31/12/2013		
Profit on sale of machinery/other income (P/L) (B)	5 000	
Property, plant and equipment (SFP) (A)		5 000
Elimination of unrealised intragroup profit included in the property, plant and equipment of A Ltd (20 000 – 15 000)		
Deferred tax (SFP)	1 400	
Income tax expense (P/L) (B)		1 400
Tax implication of elimination of unrealised intragroup profit included in property, plant and equipment of A Ltd (5 000 x 28%)		

THE PRO FORMA CONSOLIDATION JOURNALS FOR THE YEAR ENDED 31 DECEMBER 2014 WILL BE AS FOLLOWS:

	Dr R	Cr R
31/12/2014		
Retained earnings — beginning of year (B) (5 000 – 1 400)	3 600	
Deferred tax (SFP)	1 400	
Property, plant and equipment (A)		5 000
Correction to agree opening balances for 2014 with closing balances for 20.6		
Accumulated depreciation (SFP) (A)	1 000	
Depreciation (P/L) (B)		1 000
Recording of unrealised intragroup profit realised during 2014 (5 000 x 20%)		
Income tax expense (P/L) (B)	280	
Deferred tax (SFP)		280
Tax implication of realising a portion of intragroup profit during 2014 (1 000 x 28%)		

THE PRO FORMA CONSOLIDATION JOURNALS FOR THE YEAR ENDED 31 DECEMBER 2015 WILL BE AS FOLLOWS:

	Dr R	Cr R
31/12/2015		
Retained earnings — beginning of year (B) (3 600 – 1 000 + 280)	2 880	
Deferred tax (SFP) (1 400 – 280)	1 120	
Accumulated depreciation (SFP) (A)	1 000	
Property, plant and equipment (SFP) (A)		5 000
Correction to agree opening balances for 20.8 with closing balances for 2014		
Accumulated depreciation (SFP)(A)	1 000	
Depreciation (P/L) (B)		1 000
Recording of unrealised intragroup profit realised during 2015 (5 000 x 20%)		
Income tax expense (P/L) (B)	280	
Deferred tax (SFP)		280
Tax implication of realising a portion of intragroup profit during 2015 (1 000 x 28%)		

THE PRO FORMA CONSOLIDATION JOURNALS FOR THE YEAR ENDED 31 DECEMBER 2016 WILL BE AS FOLLOWS:

	Dr R	Cr R
31/12/2016		
Retained earnings — beginning of year (B) (2 880 – 1 000 + 280)	2 160	
Deferred tax (SFP) (1 120 – 280)	840	
Accumulated depreciation (SFP) (A)	2 000	
Property, plant and equipment (A)		5 000
Correction to agree opening balances for 2016 with closing balances for 2015		
Accumulated depreciation (SFP) (A)	1 000	
Depreciation (P/L) (B)		1 000
Recording of unrealised intragroup profit realised during 2016 (5 000 x 20%)		
Income tax expense (P/L) (B)	280	
Deferred tax (SFP)		280
Tax implication of realising of a portion of intragroup profit during 2016 (1 000 x 28%)		

(c) 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.

(d) Dividends of the subsidiary**STUDY**

Refer to the chapter on the elimination of intragroup transactions (dividends paid by the subsidiary) in **Group statements**.

(e) Debentures/loans within a group**STUDY**

Refer to the chapter on the elimination of intragroup balances (debentures/loans within a group) in **Group statements**.

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 profit or loss and other 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**STUDY**

Refer to the chapter on the impairment of goodwill in **Group statements**.

Goodwill arising from a business combination is an intangible asset as defined by IAS 38, *Intangible Assets*. Goodwill arising from a business combination should be tested annually for possible impairment according to IAS 36, *Impairment of Assets*, 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 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” (debited) and goodwill (asset) is credited with the same amount.

If no information is given on the impairment of the goodwill, the goodwill is 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 to you in questions.

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

Students are required to account for and disclose the impairment loss in the consolidated annual financial statements.

(a) Impairment of goodwill when the non-controlling interests are 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. No goodwill is recognised for the non-controlling interests 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

Work through the following simplified examples:

EXAMPLE 2.7

Impairment by an amount in the current year

Information provided:

Assume the P Ltd Group uses the partial goodwill method to account for goodwill and non-controlling interests.

P Ltd obtained an 80% equity interest in the share capital of S Ltd on 1 January 2016 and paid R140 000 cash to settle the purchase price. P Ltd has controlled S Ltd since 1 January 2016. At acquisition date the equity of S Ltd consisted of the following:

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

S Ltd made a profit of R10 000 for the year ended 31 December 2016. The goodwill that arose from the business combination was assumed to be impaired with R2 000 at 31 December 2016.

SOLUTION 2.7

(Only the analysis of owners' equity of S Ltd is illustrated.)

ANALYSIS OF OWNERS' EQUITY OF S LTD

	100%	P Ltd 80%		20%
	Total R	At R	Since R	NCI R
At acquisition – 1 January 2016				
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
Current year				
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 P Ltd Group as at 31 December 2016 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 provided:**

On 1 January 2015 P Ltd acquired 80 000 ordinary shares in S Ltd for R140 000. P Ltd has controlled S Ltd since 1 January 2015. The owners' equity of S Ltd 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.

On 1 January 2016 the retained earnings of S Ltd amounted to R150 000.

On 31 December 2016 the goodwill of S Ltd had been impaired to R5 000.

The profit for the current year of S Ltd was R30 000.

The group applies the **partial goodwill method** to account for goodwill.

**REQUIRED:**

Prepare the pro forma consolidation journal entries for the year ended 31 December 2016

SOLUTION 2.8

ANALYSIS OF OWNERS' EQUITY OF S LTD

	100% Total R	80% At R	80% Since R	20% NCI R
At acquisition – 1 January 2015				
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

PRO FORMA CONSOLIDATION JOURNALS

		Dr R	Cr R
J1	Share capital Retained earnings Goodwill Non-controlling interests (SFP) Investment in S Ltd Elimination of owners' equity at acquisition of S Ltd	100 000 50 000 20 000	30 000 140 000
J2	Retained earnings Non-controlling interests (SFP) Recording of non-controlling interests in since acquisition reserves of S Ltd ((150 000 – 50 000) x 20%)	20 000	20 000
J3	Other expenses (impairment loss) (P/L) Goodwill Recording of impairment of goodwill at 31 December 20.16 (20 000 – 5 000)	15 000	15 000
J4	Non-controlling interests (P/L) Non-controlling interests (SFP) Recording of non-controlling interests in profit after tax of S Ltd (30 000 x 20%)	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, Business Combinations, brought in the full goodwill method where the non-controlling interests are measured at their 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 or the full goodwill method is used.

(b) Impairment of goodwill when the non-controlling interests are 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 interests. Remember that the ratio of the goodwill at acquisition attributable to both the parent and to the non-controlling interests 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 interests at acquisition is the excess between the fair value of the non-controlling interests' 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 interests as at acquisition, as calculated in the analysis of the owners' 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 interests' shares in the subsidiary's profit for the year according to the profit-sharing ratio, the non-controlling interests 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 the owners' equity of the subsidiary will therefore be affected, however, 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 interests in the subsidiary's profit is decreased with the percentage interest of the non-controlling interests in the recognised impairment loss on goodwill:

	Dr	Cr
	R	R
Impairment loss (P/L)	xxx	
Goodwill (SFP)		xxx
Non-controlling interests (SFP)	xxx	
Non-controlling interests (P/L)		xxx
(Impairment loss recognised above x NCI % in subsidiary's profit)		

EXAMPLE 2.9

Impairment by an amount in the current year

Information provided:

Assume the P Ltd Group uses the **full goodwill method** to account for goodwill and non-controlling interests.

P Ltd obtained an 80% equity interest in the share capital of S Ltd on 1 January 2016 and paid R140 000 cash to settle the purchase price. The fair value of the non-controlling interests was estimated to be R35 000 at acquisition date. P Ltd has controlled S Ltd since 1 January 2016.

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

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

S Ltd made a profit for the year ended 31 December 2016 of R10 000. The goodwill that arose from the business combination was assumed to be impaired at 31 December 2016 with R2 000.

SOLUTION 2.9

(Only the analysis of the owners' equity of S Ltd is illustrated.)

ANALYSIS OF OWNERS' EQUITY OF S LTD

	100%	P Ltd 80%	20%
	Total R	At R	Since R
At acquisition – 1 January 2016			NCI R
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 ²	20 000	5 000 ¹
Consideration and NCI	175 000	140 000	35 000
Current year			
Profit for the year	8 000		6 400
Given	10 000		8 000
Impairment of goodwill	(2 000)		(1 600)
	183 000		6 400
			36 600

¹ Balancing figure 35 000 – 30 000 = 5 000

² 20 000 + 5 000 = 25 000

The goodwill in the consolidated statement of financial position for the P Ltd Group as at 31 December 2016 will be:

Non-current assets:

Goodwill (25 000 – 2 000) R23 000

It is the non-controlling interests' share in S Ltd'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 provided:**

On 1 January 2015 P Ltd acquired 80 000 ordinary shares in S Ltd for R140 000. P Ltd has controlled S Ltd since 1 January 2015. The owners' equity of S Ltd 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 Ltd amounted to R150 000 at 1 January 2016.

At 31 December 2016 the goodwill of S Ltd had been impaired to R5 000.

The profit for the year of S Ltd was R30 000.

The group applies the **full goodwill method** to account for goodwill.

The fair value of the non-controlling interests on 1 January 2015 was R35 000.

**REQUIRED:**

Prepare the pro forma consolidation journal entries for the year ended 31 December 2016.

SOLUTION 2.10**ANALYSIS OF OWNERS' EQUITY OF S LTD**

At acquisition – 1 January 2015

Share capital

Retained earnings

Equity represented by goodwill

— parent and NCI

Consideration and NCI at fair value

100%	P Ltd 80%		20%
Total R	At R	Since R	NCI R
100 000	80 000		20 000
50 000	40 000		10 000
150 000	120 000		30 000
25 000 ²	20 000		5 000 ¹
175 000	140 000		35 000

¹ Balancing figure 35 000 – 30 000 = 5 000

² 20 000 + 5 000 = 25 000

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 Ltd Elimination of owners' equity at acquisition of S Ltd	100 000 50 000 25 000	35 000 140 000
J2	Retained earnings Non-controlling interests (SFP) Recording of non-controlling interests in since acquisition reserves of S Ltd $((150\,000 - 50\,000) \times 20\%)$	20 000	20 000
J3	Profit for the year (as part of "other expenses") Goodwill Recording of impairment of goodwill at 31 December 2016 $(25\,000 - 5\,000)$	20 000	20 000
J4	Non-controlling interests (P/L) Non-controlling interests (SFP) Recording of non-controlling interests in profit after tax of S Ltd $((30\,000 - 20\,000(J3)) \times 20\%)$	2 000	2 000

2.4 LOSSES INCURRED BY A SUBSIDIARY

2.4.1 General

The non-controlling interests are the portion of equity (net assets) in a subsidiary not directly or indirectly attributable to a parent.

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

2.4.2 Accumulated losses (or insolvency) at date of acquisition

STUDY
Refer to the chapter on accumulated losses at date of acquisition in Group statements .

EXAMPLE 2.11

THE FOLLOWING ARE THE ABRIDGED TRIAL BALANCES OF VISION LTD AND STAR LTD FOR THE YEAR ENDED 31 DECEMBER 2016:

	Vision Ltd Dr/(Cr) R	Star Ltd Dr/(Cr) R
Investment in Star Ltd 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 2015	(180 000)	40 000
Long-term loan from Vision Ltd	—	(80 000)
Trade and other payables	(45 000)	(35 000)
Profit for the year	(5 000)	(70 000)
	<u>—</u>	<u>—</u>

Additional information

1. Vision Ltd purchased 80% of the share capital of Star Ltd on 1 January 2014, when Star Ltd had an accumulated loss of R100 000 and no other components of equity, other than share capital. The fair value of the identifiable assets, liabilities and contingent liabilities at the acquisition date of Star Ltd was considered to be equal to the carrying amounts of these items. Vision Ltd has controlled Star Ltd since 1 January 2014.
2. On 31 December 2014, due to the poor financial position of Star Ltd, Vision Ltd wrote the loan of R80 000 to Star Ltd off against retained earnings in its own financial records.
3. The share capital of both companies has remained unchanged since incorporation of the companies.
4. Goodwill that arose at the acquisition of Star Ltd was considered to be impaired by R41 000 on 31 December 2016. Adjustments to the carrying amount of goodwill have no tax effect. The group uses the partial (proportionate) goodwill method to recognise goodwill.
5. The fair value of the equity investment is equal to the original cost price thereof. The equity investments are measured at fair value through profit or loss (FVTPL).
6. Each share carries one vote.



REQUIRED:

Prepare the following for Vision Ltd Group for the year ended 31 December 2016:

- (a) the consolidation journals
- (b) the consolidated statement of changes in equity
- (c) the consolidated statement of financial position

Your answer must comply with the requirements of the International Financial Reporting Standards.

Only the note on "Goodwill" is required. Comparative figures are not required.

All calculations are to be done to the nearest R1.

SOLUTION 2.11

PART (a)

VISION LTD GROUP PRO FORMA CONSOLIDATION JOURNALS

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

PART (b)**VISION LTD GROUP****CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2016**

	Share capital	Retained earnings	Total	Non-controlling interests	Total equity
	R	R	R	R	R
Balance at 1 January 2016	20 000	308 000 ¹	328 000	(6 000)	322 000
Changes in equity for 2016					
Total comprehensive income for the year:					
Profit for the year		20 000 ²	20 000	14 000 ³	34 000
Balance at 31 December 2016	20 000	328 000	348 000	8 000	356 000

¹ 180 000 + 80 000 (loan) + 48 000^a (60 000 x 80%) = 308 000

² 5 000 + 70 000 – 14 000^b – 41 000^c = 20 000 or 5 000 + 56 000^d (70 000 x 80%) – 41 000^c = 20 000

³ 70 000 x 20% = 14 000

PART (c)**VISION LTD GROUP****CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2016****ASSETS**

	Notes	R
Non-current assets		282 000
Property, plant and equipment (150 000 + 100 000)		250 000
Goodwill (73 000 – 41 000)	1	32 000
Current assets		154 000
Inventories (50 000 + 25 000)		75 000
Trade receivables (49 000 + 30 000)		79 000
Total assets		436 000

EQUITY AND LIABILITIES

Total equity	356 000
Equity attributable to owners of the parent	348 000
Share capital	20 000
Retained earnings	328 000
Non-controlling interests	8 000
Non-current liabilities	80 000
Trade and other payables (45 000 + 35 000)	80 000
Total liabilities	80 000
Total equity and liabilities	436 000

VISION LTD GROUP

NOTES FOR THE YEAR ENDED 31 DECEMBER 2016

1. GOODWILL

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

CALCULATIONS

C1 ANALYSIS OF OWNERS' EQUITY OF STAR LTD

	100%	Vision Ltd 80%	20%
	Total R	At R	Since R
At acquisition			NCI R
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)
Since acquisition			
Retained earnings			
((40 000) – (–100 000))	60 000		48 000 ^a
	43 000		12 000
			(6 000)
Current year			
Profit for the year	70 000		56 000 ^d
	113 000	73 000	14 000 ^b
			8 000
Impairment of goodwill			
Current year		(41 000) ^c	
Carrying amount – 31 December 2016		32 000	

C2 Proof of goodwill of Star Ltd (IFRS 3.32)

	R
Consideration transferred at acquisition date	1 000
Fair value of non-controlling interests ((10 000 – 100 000) x 20%)	(18 000)
	<u>(17 000)</u>
Less: Net amounts of identifiable assets acquired and liabilities assumed at acquisition date (10 000 – 100 000)	(90 000)
Goodwill (–17 000 – (–90 000))	73 000
Impairment (given)	(41 000)
Carrying amount – 31 December 2016	<u><u>32 000</u></u>

2.4.3 Post-acquisition losses (or insolvency) of subsidiaries**STUDY**

Refer to the chapter on post-acquisition losses of subsidiaries in **Group statements**.

EXAMPLE 2.12

The following are the trial balances of Pritt Ltd and Stick Ltd for the year ended 28 February 2016:

	Pritt Ltd Dr/(Cr) R	Stick Ltd Dr/(Cr) R
Share capital – 525 000 ordinary shares	(525 000)	—
– 90 000 ordinary shares	—	(90 000)
Retained earnings – 1 March 2015	(497 335)	—
Accumulated loss – 1 March 2015	—	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 2016	80 000	20 000
Loan from Pritt Ltd	—	(100 000)
Trade and other payables	(40 470)	(14 320)
Property, plant and equipment	621 609	162 000
Investment in Stick Ltd: – Ordinary shares at fair value	65 000	—
– Loan	100 000	—
Investment in equity instruments	175 000	—
Trade receivables	23 960	24 184
Inventories	108 000	29 300
	<u>—</u>	<u>—</u>

Additional information

1. On 1 March 2013, Pritt Ltd acquired a 60% interest in Stick Ltd. Pritt Ltd has controlled Stick Ltd since this date. On the date of acquisition the equity of Stick Ltd consisted of the following items:

	R
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 values of all assets, liabilities and contingent liabilities were confirmed to be equal to the carrying amounts thereof, unless stated otherwise.

2. During the current year Pritt Ltd made a loan to Stick Ltd. 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 2016.
3. Pritt Ltd charges Stick Ltd a management fee of R7 000 per annum. Management fees paid have been included in “other expenses”. The management of Pritt Ltd considers it possible to turn Stick Ltd into a profitable entity.
4. The fair value of the equity investment is equal to the cost price thereof, unless otherwise stated. The equity investments are measured at fair value through other comprehensive income (FVTOCI).
5. Since 1 March 2013 the normal tax rate has been 28%.
6. The value of goodwill was tested for impairment at 28 February 2016 and it was determined that the goodwill in Stick Ltd 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 Ltd Group for the year ended 28 February 2016.

Your answer must comply with the requirements of the International Financial Reporting Standards.

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

Round off all amounts to the nearest R1.

SOLUTION 2.12**PRITT LTD GROUP****CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 28 FEBRUARY 2016****ASSETS****Non-current assets**

Property, plant and equipment (621 609 + 162 000)

Investment in equity instruments

Goodwill (3 800 – 2 800)

R

959 609

783 609

175 000

1 000

Current assets

185 444

Inventories (108 000 + 29 300)

137 300

Trade receivables (23 960 + 24 184)

48 144

Total assets1 145 053**EQUITY AND LIABILITIES****Total equity**

1 090 263

Equity attributable to owners of the parent1 049 797

Share capital

525 000

Retained earnings

524 797

Non-controlling interests40 466**Current liabilities**

54 790

Trade and other payables (40 470 + 14 320)

54 790**Total liabilities**

54 790

Total equity and liabilities1 145 053**PRITT LTD GROUP****CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 28 FEBRUARY 2016**

Gross profit (183 525 + 195 000)

R
378 525

Other income (54 500 – 7 000 (management fee) – 12 000 (dividend received) – 10 000 (interest received))

25 500

Other expenses (96 630 + 31 300 – 7 000 (management fee) – 10 000 (interest paid) + 2 800 (impairment))

(113 730)**Profit before tax**

290 295

Income tax expense (30 631 + 45 836)

(76 467)**PROFIT FOR THE YEAR**213 828**TOTAL COMPREHENSIVE INCOME FOR THE YEAR**213 828

Profit for the year and total comprehensive income attributable to:

Owners of the parent

166 682

Non-controlling interests (C1^b)

47 146

213 828

PRITT LTD GROUP
**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED
28 FEBRUARY 2016**

	Share capital	Retained earnings	Total	Non- controlling interests	Total equity
	R	R	R	R	R
Balance at 1 March 2015	525 000	438 115 ¹	963 115	1 320 ²	964 435
Changes in equity for 2016					
Dividends		(80 000)	(80 000)	(8 000)	(88 000)
Total comprehensive income for the year:					
Profit for the year		166 682	166 682	47 146	213 828
Balance at 28 February 2016	525 000	524 797	1 049 797	40 466	1 090 263

¹ 497 335 – 59 220 = 438 115

² C1^a

CALCULATIONS
C1 ANALYSIS OF OWNERS' EQUITY OF STICK LTD

	100%	Pritt Ltd 60%		40%
	Total R	At R	Since R	NCI R
At acquisition				
Share capital	90 000	54 000		36 000
Retained 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
Since acquisition				
Accumulated loss (86 700 + 12 000)	(98 700)		(59 220)	(39 480)
	7 100			1 320 ^a
Current year				
Profit for the year (C2)	117 864		70 718	47 146 ^b
Dividends paid	(20 000)		(12 000)	(8 000)
	104 964	3 800	(502)	40 466
Impairment of goodwill				
Current year (3 800 – 1 000)		(2 800)		
Carrying amount – 28 February 2016		1 000		

C2 PROFIT FOR THE YEAR

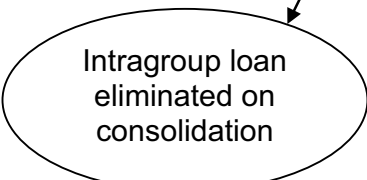
	R
Gross profit	195 000
Other expenses	(31 300)
Income tax expense	(45 836)
	<u>117 864</u>

2.5 REVISION EXAMPLE

EXAMPLE 2.13

THE FOLLOWING ARE THE TRIAL BALANCES OF AUTO LTD AND MOBILE LTD FOR THE YEAR ENDED 31 DECEMBER 2016:

	Auto Ltd Dr/(Cr) R	Mobile Ltd Dr/(Cr) R
Property, plant and equipment	535 000	462 000
Investment in Mobile Ltd 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 Ltd	80 000	—
Trade and other 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 2016	(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>
		-



Additional information

1. Auto Ltd acquired 120 000 ordinary shares in Mobile Ltd on 1 January 2014. The retained earnings of Mobile Ltd at this date were R47 000 and there were no other reserves. Auto Ltd has controlled Mobile Ltd since 1 January 2014.
2. On the date of acquisition, the land and buildings of Mobile Ltd with a carrying amount of R120 000 were revalued to R140 000. No entries relating to the revaluation were made in the books of Mobile Ltd. (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 Ltd R	Mobile Ltd R
Gross profit	Includes dividends received from Mobile Ltd of R16 000 (20 000 x 80%) to be eliminated on consolidation	419 800	328 000
Other income		67 200	53 200
Other expenses		(32 500)	(22 600)
Finance costs		(8 000)	(11 200)
		<u>446 500</u>	<u>347 400</u>

Includes intragroup profit of R40 000 (140 000 – 100 000) to be eliminated on consolidation (point 6)	Intragroup interest of R11 200 (80 000 x 14%) to be eliminated on consolidation
---	---

- On 1 January 2016 a long-term loan of R80 000 was made by Auto Ltd to Mobile Ltd and it was repayable in full on 1 January 2020. Interest was calculated at 14% per annum and had been paid to Auto Ltd for the current year.
- Mobile Ltd purchased a machine from Auto Ltd for R140 000 on 1 July 2016. The carrying amount of the machine on 1 July 2016 was R100 000. The machine was originally purchased by Auto Ltd on 1 July 2013 for R250 000. Both companies depreciate machinery over the useful life of five years using the straight-line method, which is in line with the tax allowance used by the South African Revenue Service. The expected useful life of the machine remained unchanged.
- In all companies, each share carries one vote.
- The fair value of the equity investment is equal to the cost price thereof, unless otherwise stated. The equity investment is measured at fair value through other comprehensive income (FVTOCI).
- At the end of the current year goodwill was assessed for impairment and it was found that goodwill had not been impaired. The group uses the partial goodwill method to recognise goodwill.



REQUIRED:

Prepare the consolidated annual financial statements of the Auto Ltd Group for the year ended 31 December 2016.

Your answer must comply with the requirements of the International Financial Reporting Standards.

Tax implications can be ignored.

No notes or comparative figures are required.

Round off all calculations to the nearest R1.

SOLUTION 2.13

AUTO LTD GROUP**CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2016****ASSETS****Non-current assets**

Property, plant and equipment

(535 000 + 462 000 – 40 000 (C1) (unrealised profit) + 10 000 (C1) + 20 000)

Goodwill

R

993 400

987 000

6 400^a**Current assets**

Trade and other receivables (76 755 + 63 554)

Cash and cash equivalents (260 320 + 302 000)

702 629

140 309

562 320

Total assets1 696 029**EQUITY AND LIABILITIES****Total equity**

1 277 129

Equity attributable to owners of the parent

1 086 498

Share capital

300 000

Retained earnings

786 498

Non-controlling interests (110 631^f + 80 000 (preference shares))190 631**Non-current liabilities**

200 000

Long-term borrowings (200 000 + 80 000 – 80 000)

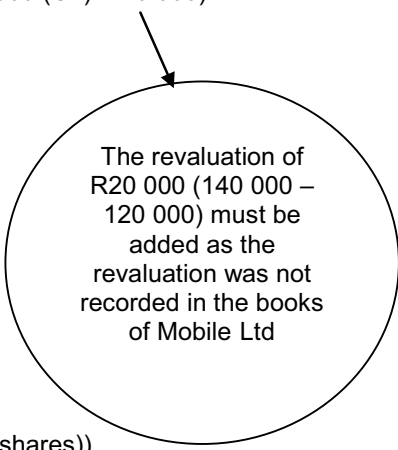
200 000**Current liabilities**

218 900

Trade and other payables (84 500 + 134 400)

218 900**Total liabilities**

418 900

Total equity and liabilities1 696 029


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

AUTO LTD GROUP

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2016

	R
Gross profit (419 800 + 328 000)	747 800
Other income (67 200 + 53 200 – 16 000 (dividend) – 40 000(C1) – 11 200 (interest))	53 200
Other expenses (32 500 + 22 600 – 10 000(C1) (depreciation))	(45 100)
Finance costs (8 000 + 11 200 – 11 200)	<u>(8 000)</u>
Profit before tax	747 900
Income tax expense (129 485 + 100 746)	<u>(230 231)</u>
PROFIT FOR THE YEAR	<u>517 669</u>
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	<u>517 669</u>
Profit for the year and total comprehensive income attributable to:	
Owners of the parent (balancing)	461 938
Non-controlling interests (47 731 ^c + 8 000 (preference dividends))	55 731
	<u>517 669</u>

AUTO LTD GROUP

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2016

	Share capital	Retained earnings	Total	Non controlling interests	Total equity
	R	R	R	R	R
Balance at 1 January 2016	300 000	339 560 ¹	639 560	146 900 ²	786 460
Changes in equity for 2016					
Total comprehensive income for the year:					
Profit for the year		461 938	461 938	55 731	517 669
Dividends paid		(15 000)	(15 000)	(12 000) ³	(27 000)
Balance at 31 December 2016	<u>300 000</u>	<u>786 498</u>	<u>1 086 498</u>	<u>190 631⁴</u>	<u>1 277 129</u>

¹ 245 560 + 94 000^b = 339 560

² 66 900^g + 80 000 (pref) = 146 900

³ 4 000^e + 8 000 (pref div) = 12 000

⁴ Check: 110 631^f + 80 000 (pref shares) = 190 631

CALCULATIONS**C1 Gain on sale of machinery (Auto Ltd to Mobile Ltd)**

	R
Selling price	140 000
Carrying amount	<u>(100 000)</u>
	<u>40 000</u>
Excess depreciation ($40\,000 / 2 \text{ years} \times \frac{6}{12}$)	<u>10 000</u>

LECTURER'S COMMENT

Auto Ltd (parent) sold a machine to Mobile Ltd (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 profit or loss and other comprehensive income (other income). The parent made the profit, thus there is no effect on the non-controlling interests.

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

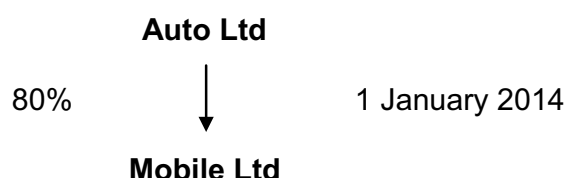
		R
1 Jul 2013	Cost price	250 000
31 Dec 2013	Depreciation ($250\,000 \times 20\% \times \frac{6}{12}$)	(25 000) 6 months
31 Dec 2014	Depreciation ($250\,000 \times 20\%$)	(50 000) 1 year
31 Dec 2015	Depreciation ($250\,000 \times 20\%$)	(50 000) 1 year
30 Jun 2016	Depreciation ($250\,000 \times 20\% \times \frac{6}{12}$)	(25 000) 6 months
	Carrying amount on date of sale	<u>100 000 3 years</u>

The useful life of the machine is five years ($\frac{100}{20} = 5 \text{ years}$).

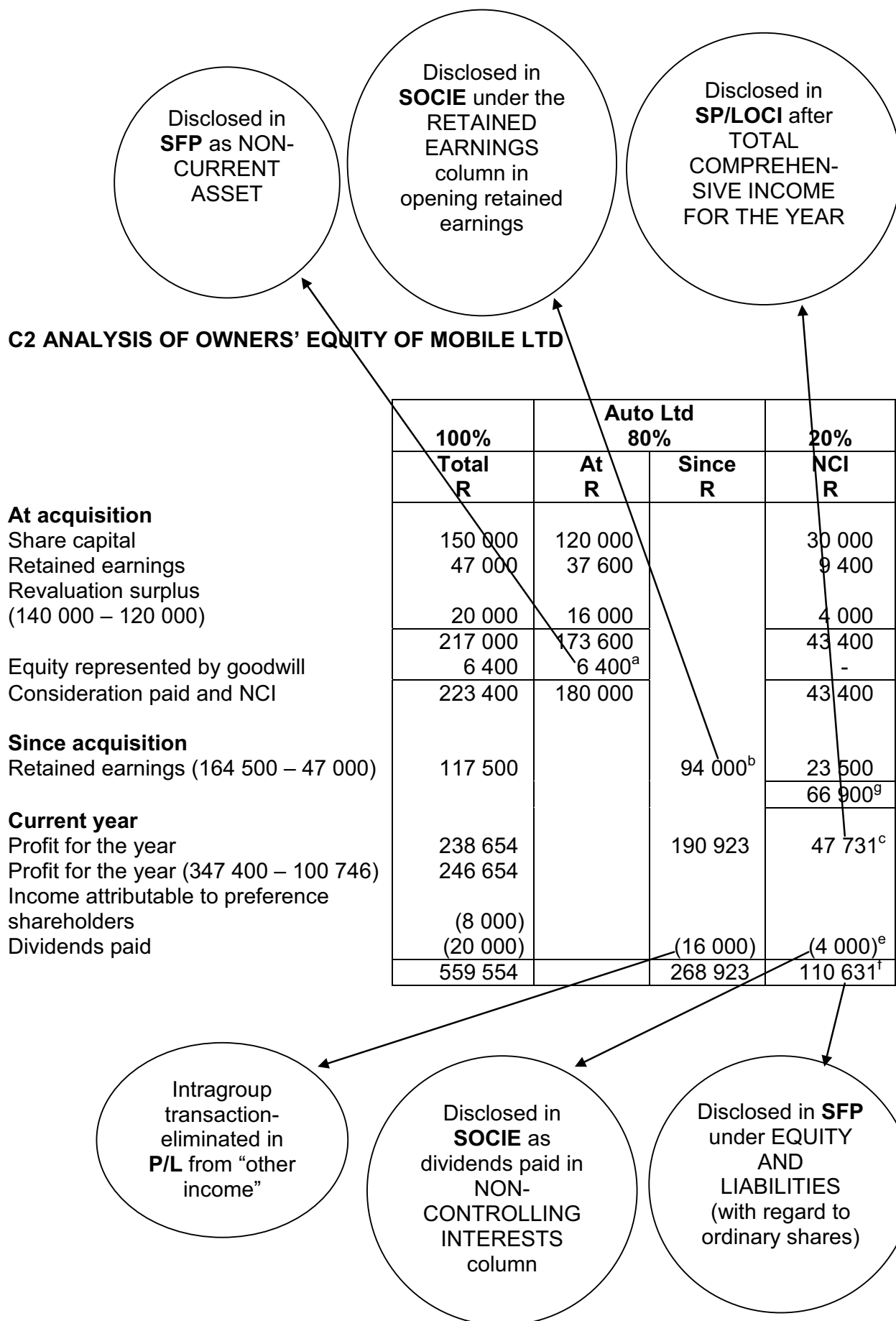
Three years had already been written off before the asset was sold, therefore the remaining useful life of the machine is two years. The intragroup profit is thus realised over two years through depreciation. The asset was sold on 1 July 2016, thus the excess depreciation is calculated pro rata for half the year (refer to calculation 1).

Percentage interest that Auto Ltd has in
Mobile Ltd: $120\,000 / 150\,000 = 80\%$

Structure of group:



The acquisition took place on 1 January 2014. When the analysis of Mobile Ltd is prepared, there will be since acquisition reserves as the group is being consolidated on 31 December 2016.



C3 PRO FORMA CONSOLIDATION JOURNALS

	Dr R	Cr R	NCI R
At acquisition			
J1 Property, plant and equipment	20 000		
Revaluation surplus		20 000	
Recording of land and buildings of Mobile Ltd revalued to fair value at acquisition (140 000 – 120 000)			
J2 Share capital	150 000		
Retained earnings	47 000		
Revaluation surplus	20 000		
Non-controlling interests (SFP)		43 400	43 400
Investment in Mobile Ltd		180 000	
Goodwill	6 400		
Elimination of owners' equity of Mobile Ltd at acquisition			
Since acquisition			
J3 Retained earnings – beginning of the year	23 500		
Non-controlling interests (SFP)		23 500	23 500
Recording of non-controlling interests in retained earnings of Mobile Ltd ((164 500 – 47 000) x 20%)			
			66 900 ^g
Current year			
J4 Non-controlling interests (P/L)	47 731		
Non-controlling interests (SFP)		47 731	47 731 ^c
Recording of non-controlling interests in profit after tax of Mobile Ltd ((347 400 – 100 746 – 8 000 (pref dividends)) x 20%)			
J5 Other income (P/L)	16 000		
Non-controlling interests (SFP)	4 000		(4 000) ^e
Dividends paid		20 000	
Elimination of intragroup ordinary dividend and recording of non-controlling interests therein			
			<u>110 631^f</u>
Preference share capital			
J6 Preference share capital	80 000		
Non-controlling interests (SFP)		80 000	80 000
Allocation of preference owners' equity of Mobile Ltd at acquisition			
J7 Non-controlling interests (P/L)	8 000		
Preference dividend paid		8 000	
Allocation of intragroup preference dividend and recording of non-controlling interests therein			
Non-controlling interests – Statement of Financial Position			<u>190 631</u>



LECTURER'S COMMENT

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.)

C2 ANALYSIS OF OWNERS' EQUITY OF MOBILE LTD

At acquisition

Share capital
Retained earnings
Revaluation surplus (140 000 – 120 000)

Equity represented by goodwill
Consideration paid and NCI

Since acquisition

Retained earnings (164 500 – 47 000)

Current year

Profit for the year
Profit for the year (347 400 – 100 746)
Income attributable to preference owners
Dividends paid

100%	Auto Ltd 80%		20%
Total R	At R	Since R	NCI R
150 000	120 000		30 000
47 000	37 600		9 400
20 000	16 000		4 000
217 000	173 600		43 400
6 400	6 400 ^a		-
223 400	180 000		43 400
117 500		94 000 ^b	23 500
			66 900 ^g
238 654		190 923	47 731 ^c
246 654			
(8 000)			
(20 000)		(16 000)	(4 000) ^e
559 554		268 923	110 631 ^f

Journal 2

Journal 3

Journal 4

Journal 5

2.6 ASSESSMENT CRITERIA

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



- apply the consolidation procedures in IFRS 10
- 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 profit or loss and other comprehensive income, statement of changes in equity and statement of financial position of a group

FAC3704

LEARNING UNIT 3

COMPLEX GROUPS



Group Financial Reporting

6 LEARNING UNIT 3

Complex groups

Learning outcome 3

After studying this learning unit, you should be able to identify different group structures in order to apply the relevant consolidation procedures for the preparation of consolidated annual financial statements of a complex group.

OVERVIEW OF THE LEARNING UNIT

This learning unit consists of the following sections:

- 3.1 Composition of a group of entities
- 3.2 Horizontal groups
- 3.3 Vertical groups
- 3.4 Financial instruments (mark-to-market reserve)
- 3.5 Assessment criteria

STUDY

Refer to the chapter on complex groups in **Group statements**.

3.1 COMPOSITION OF A GROUP OF ENTITIES

STUDY

Refer to the chapter on the composition of a group of entities in **Group statements**.

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 groups

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

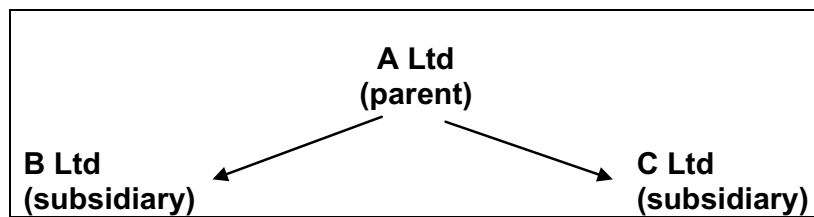
Complex groups

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 groups (single-level structures)

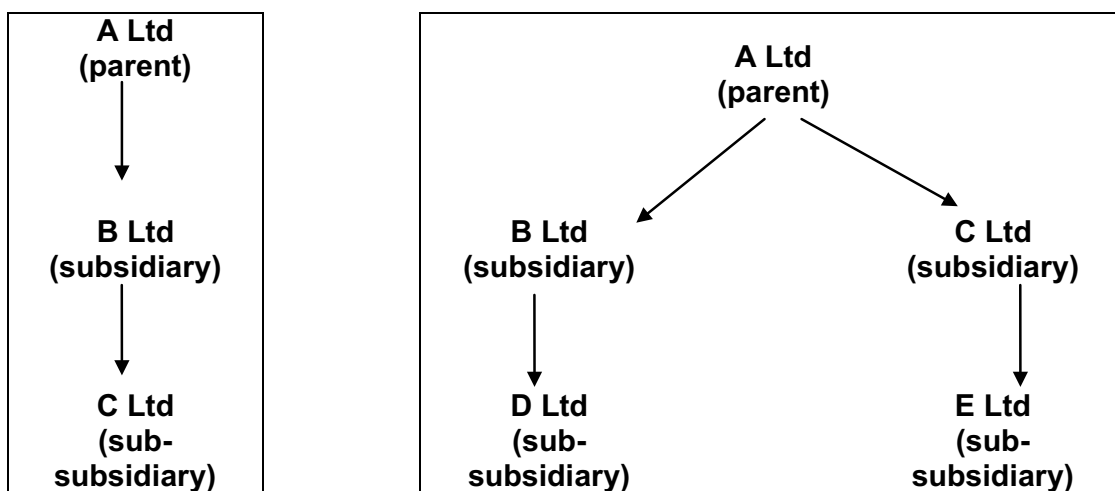
A horizontal group is a group consisting of a parent which holds a direct interest in several other entities (subsidiaries).

This group can be schematically illustrated as follows:



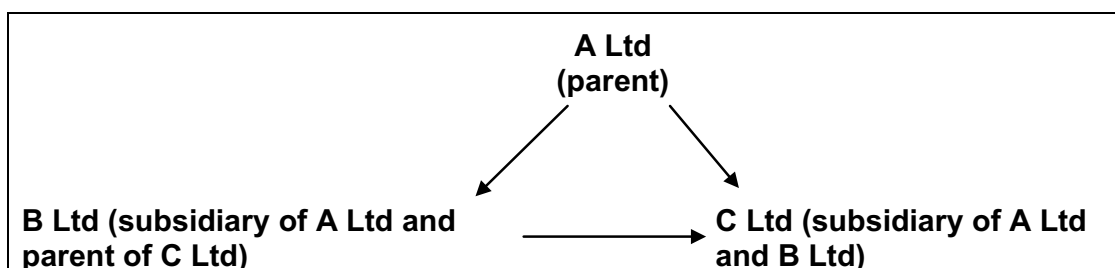
Vertical groups (multiple-level structures)

A vertical group is a group consisting of a parent that 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. This group can be schematically illustrated as follows:



Mixed groups (not examinable in FAC3704)

The group can be schematically illustrated as follows:



In a mixed group the parent itself owns the controlling equity shareholding in at least one subsidiary, and the parent and such subsidiary together own the controlling interest in another company. Please refer to **Group statements** (volume 1) for more schematic illustrations of mixed groups.

Please note that mixed groups as defined in this learning unit and in the Group statements textbook will **not** be examined in FAC3704. Horizontal and vertical groups will be examined in FAC3704. Horizontal and vertical groups can include associates and joint arrangements. Refer to the tutorial letter with integrated questions for more examples.

3.2 HORIZONTAL GROUPS

EXAMPLE 3.1

The following are the abridged trial balances of A Ltd, B Ltd and C Ltd at 31 December 2016:

	A Ltd R	B Ltd R	C Ltd R
Credits			
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
	<u>645 000</u>	<u>450 000</u>	<u>265 000</u>
Debits			
Property, plant and equipment	266 500	284 000	136 500
Investment in equity instruments:			
– Investment in B Ltd at fair value	110 000	—	—
– Investment in C Ltd 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
	<u>645 000</u>	<u>450 000</u>	<u>265 000</u>

Additional information

1. A Ltd purchased 60 000 shares in B Ltd on 1 January 2013, when B Ltd's retained earnings amounted to R60 000. On 1 January 2014 A Ltd acquired 27 000 shares in C Ltd, when the retained earnings of C Ltd amounted to R40 000. On both acquisition dates A Ltd acquired control over the respective companies. 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 interests are measured at their proportionate interest in the net identifiable assets of the acquiree. Goodwill was not considered to be impaired at the 2016 year-end.
4. The fair values of investments in equity instruments are equal to the cost price thereof. The equity investments are measured at fair value through other comprehensive income (FVTOCI).



REQUIRED:

Prepare the consolidated annual financial statements of the A Ltd Group for the year ended 31 December 2016.

Your answer must comply with the requirements of the International Financial Reporting Standards.

No notes are required.

Ignore comparative figures.

SOLUTION 3.1

A LTD GROUP

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2016

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

A LTD GROUP**CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2016**

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

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

	Share capital	Retained earnings	Total	Non- controlling interests	Total equity
	R	R	R	R	R
Balance at 1 January 2016	100 000	330 500 ¹	430 500	74 500 ²	505 000
Changes in equity for 2016					
Dividends paid		(30 000)	(30 000)	(13 500) ³	(43 500)
Total comprehensive income for the year:					
Profit for the year		355 350	355 350	45 150	400 500
Balance at 31 December 2016	<u>100 000</u>	<u>655 850</u>	<u>755 850</u>	<u>106 150⁴</u>	<u>862 000</u>

¹ 200 000 + 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

² 57 500^c + 17 000ⁱ = 74 500

³ 10 000^e + 3 500^k = 13 500

⁴ Check: 86 000^f + 20 150^m = 106 150

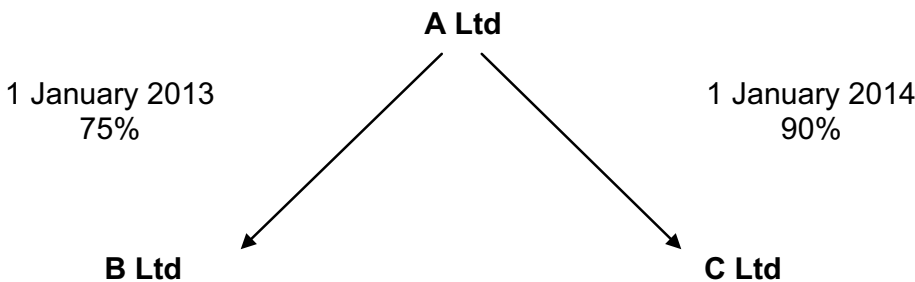
CALCULATIONS

C1 ANALYSIS OF OWNERS' EQUITY OF B LTD

	100%	A Ltd 75%		25%
	Total R	At R	Since R	NCI R
At acquisition				
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 ^a		
Consideration paid and NCI	145 000	110 000		35 000
Since acquisition				
Retained earnings (150 000 – 60 000)	90 000		67 500 ^b	22 500
	235 000		67 500	57 500 ^c
Current year				
Profit for the year (220 000 – 66 000)	154 000		115 500	38 500 ^d
Dividends paid	(40 000)		(30 000)	(10 000) ^e
	349 000	110 000	153 000	86 000 ^f

C2 ANALYSIS OF OWNERS' EQUITY OF C LTD

	100%	A Ltd 90%		10%
	Total R	At R	Since R	NCI R
At acquisition				
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 ^g		
Consideration and NCI	110 000	100 000		10 000
Since acquisition				
Retained earnings (110 000 – 40 000)	70 000		63 000 ^h	7 000
	180 000		63 000	17 000 ⁱ
Current year				
Profit for the year (95 000 – 28 500)	66 500		59 850	6 650 ^j
Dividends paid	(35 000)		(31 500)	(3 500) ^k
	211 500	100 000	91 350	20 150 ^m

	LECTURER'S COMMENT
	<p>Percentage interest that A Ltd has in</p> <p>B Ltd: $60\,000/80\,000 = 75\%$ C Ltd: $27\,000/30\,000 = 90\%$</p> <p>Structure of group:</p> <div style="text-align: center;">  </div> <p>From the above it is clear that A Ltd has a direct interest in B Ltd and a direct interest in C Ltd, therefore the group is a horizontal group.</p> <p>An analysis is prepared for B Ltd and C Ltd. An analysis is prepared for each subsidiary individually as the group is a horizontal group and there is no direct relationship between B Ltd and C Ltd.</p>

C3 PRO FORMA CONSOLIDATION JOURNALS

		Dr	Cr	NCI
J1	Share capital	80 000		
	Retained earnings	60 000		
	Goodwill	5 000 ^a		
	Non-controlling interests (SFP)		35 000	35 000
	Investment in B Ltd		110 000	
	Elimination of owners' equity in B Ltd at acquisition			
J2	Retained earnings – beginning of year	22 500		
	Non-controlling interests (SFP)		22 500	22 500
	Recording of non-controlling interests in retained earnings of B Ltd [(150 000 – 60 000) x 25%]			
				57 500 ^c
J3	Non-controlling interests (P/L)	38 500		
	Non-controlling interests (SFP)		38 500	38 500 ^d
	Recording of non-controlling interests in profit for the year of B Ltd [(220 000 – 66 000) x 25%]			

J4	Profit before tax (other income)	30 000		
	Non-controlling interests (SFP)	10 000		(10 000) ^e
	Dividends paid		40 000	
	Elimination of intragroup dividend and recording portion of non-controlling interests therein			<u>86 000^f</u>
J5	Share capital	60 000		
	Retained earnings	40 000		
	Goodwill	10 000 ^g		
	Non-controlling interests (SFP)		10 000	10 000
	Investment in C Ltd		100 000	
	Elimination of owners' equity in C Ltd at acquisition			
J6	Retained earnings – beginning of year	7 000		
	Non-controlling interests (SFP)		7 000	7 000
	Recording of non-controlling interests in retained earnings of C Ltd [(110 000 – 40 000) x 10%]			<u>17 000ⁱ</u>
J7	Non-controlling interests (P/L)	6 650		
	Non-controlling interests (SFP)		6 650	6 650 ^j
	Recording of non-controlling interests in profit for the period of C Ltd [(95 000 – 28 500) x 10%]			
J8	Profit before tax (other income)	31 500		
	Non-controlling interests (SFP)	3 500		(3 500) ^k
	Dividends paid		35 000	
	Elimination of intragroup dividend and recording of the portion of non-controlling interests therein			<u>20 150^m</u>

EXAMPLE 3.2**ABRIDGED ANNUAL FINANCIAL STATEMENTS OF UTAH LTD, OHIO LTD AND THE MAINE LTD GROUP:****STATEMENTS OF FINANCIAL POSITION AS AT 31 AUGUST 2016**

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

STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 AUGUST 2016

	Utah Ltd	Ohio Ltd	Maine Ltd Group
	R	R	R
Profit before tax	500 000	375 000	672 000
Income tax expense	(150 000)	(112 500)	(201 600)
PROFIT FOR THE YEAR	<u>350 000</u>	<u>262 500</u>	<u>470 400</u>
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	<u>350 000</u>	<u>262 500</u>	<u>470 400</u>
Profit and total comprehensive income attributable to:			
Owners of the parent	350 000	262 500	398 400
Non-controlling interests	—	—	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 2016

	Utah Ltd	Retained earnings Ohio Ltd	Maine Ltd Group
	R	R	R
Balance at 1 September 2015	240 000	240 000	200 000
Changes in equity for 2016			
Dividends paid	(40 000)	(25 000)	(30 000)
Total comprehensive income for the year			
Profit for the year	350 000	262 500	398 400
Balance at 31 August 2016	550 000	477 500	568 400

Additional information

- Utah Ltd acquired its controlling interest in Maine Ltd Group on 1 September 2015. The fair value of the identifiable assets, liabilities and contingent liabilities at the acquisition date of Maine Ltd Group was considered to be equal to the carrying amount of these items.
- Utah Ltd acquired its controlling interest in Ohio Ltd on 1 September 2015. The identifiable assets, liabilities and contingent liabilities at the acquisition date of Ohio Ltd were considered to be fairly reflected, except for the following items:

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

- The group uses the partial goodwill method to recognise goodwill. The non-controlling interests are recognised at their proportionate share of the acquiree's net identifiable assets. The goodwill that arose on the acquisition of Maine Ltd was considered to be impaired by R20 000 at the end of the current year.
- Each share carries one vote.
- The fair value of the equity investments is equal to the cost price thereof. The equity investments are measured at fair value through other comprehensive income (FVTOCI).
- The normal company tax rate is 28%, and capital gains tax is calculated at 80% thereof.

	<p>REQUIRED:</p> <p>Prepare the consolidated annual financial statements of Utah Ltd Group for the year ended 31 August 2016.</p> <p>Your answer must comply with the requirements of the International Financial Reporting Standards.</p> <p>No notes are required. Ignore comparative figures.</p>
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SOLUTION 3.2**UTAH LTD GROUP****CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 AUGUST 2016**

	R
ASSETS	
Non-current assets	1 687 700
Property, plant and equipment (541 000 + 337 500 + 778 400 + 20 800(C3) / (J5))	1 677 700
Goodwill (30 000 ^a – 20 000 ^f)	10 000
Current assets	1 082 000
Trade receivables (394 000 + 220 000 + 103 000)	717 000
Inventories (100 000 + 85 000 + 180 000)	365 000
Total assets	<u>2 769 700</u>
EQUITY AND LIABILITIES	
Total equity	1 652 041
Equity attributable to owners of the parent	1 180 905
Share capital	200 000
Retained earnings	980 905
Non-controlling interests (120 000 (given) + 133 680 ^e + 217 456 ^k)	471 136
Non-current liabilities	904 659
Long-term borrowings (600 000 + 50 000 + 250 000)	900 000
Deferred tax (4 659 – 3 472 + 3 472 (J9))	4 659
Current liabilities	213 000
Trade and other payables (125 000 + 65 000 + 23 000)	213 000
Total liabilities	1 117 569
Total equity and liabilities	<u>2 769 700</u>

UTAH LTD GROUP**CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 AUGUST 2016**

	R
Profit before tax ¹	1 508 729
Income tax expense ²	(467 572)
PROFIT FOR THE YEAR	<u>1 041 156</u>
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	<u>1 041 156</u>
Profit and total comprehensive income attributable to:	
Owners of the parent	780 905
Non-controlling interests ³	260 251
	<u>1 041 156</u>

¹ 500 000 – 15 000 (60% x 25 000(div)) – 24 000 (80% x 30 000(div)) + 375 000 + 12 400 (C3) + 672 000 – 20 000^f + 8 328^g = 1 508 729

² 150 000 + 112 500 + 3 472(C3) + 201 600 = 467 572

³ 72 000 (given) + 79 680^c + 108 571ⁱ = 260 251



LECTURER'S COMMENT

The gain on bargain purchase (R8 328) that arose on the acquisition of Ohio Ltd is included in profit before tax because the acquisition of Ohio Ltd by Utah Ltd took place in the current year (1 September 2015).

UTAH LTD GROUP

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 AUGUST 2016

	Share capital	Retained earnings	Total	Non-controlling interests	Total equity
	R	R	R	R	R
Balance at 1 September 2015	200 000	240 000	440 000	—	440 000
Changes in equity for 2016					
Acquisition of subsidiaries				226 885 ¹	226 885
Dividends paid		(40 000)	(40 000)	(16 000) ²	(56 000)
Total comprehensive income for the year:					
Profit for the year		780 905	780 905	260 251	1 041 156
Balance at 31 August 2016	200 000	980 905	1 180 905	471 136	1 652 041

¹ 60 000^b + 118 885^h + (120 000 (given) (SFP) – 72 000 (given) (SP/LOCI)) = 226 885

² 10 000^j + 6 000^d = 16 000

CALCULATIONS

C1 ANALYSIS OF OWNERS' EQUITY OF MAINE LTD GROUP

	100%	Utah Ltd 80%		20%
	Total R	At R	Since R	NCI R
At acquisition				
Share capital	100 000	80 000		20 000
Retained earnings	200 000	160 000		40 000
	300 000	240 000		60 000 ^b
Equity represented by goodwill	30 000	30 000 ^a		—
Consideration paid and NCI	330 000	270 000		60 000
Current year				
Profit for the year (given)	398 400		318 720	79 680 ^c
Dividends paid	(30 000)		(24 000)	(6 000) ^d
	698 400	(30 000)	294 720	133 680 ^e
Impairment of goodwill				
Current year (given)		20 000 ^f		
Carrying amount – 31/08/2016		(10 000)		

C2 ANALYSIS OF OWNERS' EQUITY OF OHIO LTD

	100%	Utah Ltd 60%		40%
	Total R	At R	Since R	NCI R
At acquisition				
Share capital	50 000	30 000		20 000
Retained earnings (240 000 – 8 928 (C3))	231 072	138 643		92 429
Revaluation surplus (C3)	16 141	9 685		6 456
	297 933	178 329		118 885
Equity represented by gain on bargain purchase	(8 323)	(8 323) ^g		—
Consideration paid and NCI	289 197	170 000		118 885 ^h
Current year				
Profit for the year (262 500 + 8 928 (C3))	271 428		162 857	108 571 ⁱ
Dividends paid	(25 000)		(15 000)	(10 000) ^j
	535 313		147 857	217 456 ^k

C3 CALCULATION OF EFFECT OF FAIR VALUE ADJUSTMENTS AT ACQUISITION

	Carrying amount R	Fair value R	Revaluation R	Tax effect R	After tax revaluation R
Land	180 000	200 800	20 800	(4 659) ¹	16 141
Inventories	70 000	57 600	(12 400)	3 472 ²	(8 928)

¹ 20 800 x 80% x 28% = 4 659

² 12 400 x 28% = 3 472

LECTURER'S COMMENT

Percentage interest that Utah Ltd has in

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

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

Structure of group:

```
graph TD; Utah[Utah Ltd] -- "1 September 2015 60%" --> Ohio[Ohio Ltd]; Utah -- "1 September 2015 80%" --> Maine["Maine Ltd Group"]
```

From the above it is clear that Utah Ltd has a direct interest in Ohio Ltd and a direct interest in the Maine Ltd Group, therefore the group is a horizontal group.

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

C4 PRO FORMA CONSOLIDATION JOURNALS

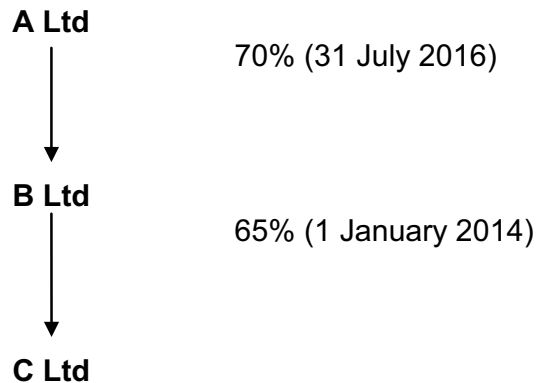
	Dr R	Cr R	NCI R
J1 Share capital	100 000		
Retained earnings	200 000		
Goodwill	30 000 ^a		
Non-controlling interests (SFP)		60 000	60 000 ^b
Investment in Maine Ltd		270 000	
Elimination of owners' equity in Maine Ltd Group at acquisition by Utah Ltd			
J2 Non-controlling interests (P/L)	79 680		
Non-controlling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

J4	Profit before tax	20 000		
	Goodwill		20 000 ^f	
	Impairment of goodwill of Maine Ltd Group			
J5	Property, plant and equipment	20 800		
	Deferred tax (4 659 – 3 472)		1 187	
	Inventories		12 400	
	Revaluation surplus		16 141	
	Retained earnings	8 928		
	Recording of fair value adjustments at acquisition (C3)			
J6	Share capital	50 000		
	Retained earnings (240 000 – 8 928)	231 072		
	Revaluation surplus	16 141		
	Non-controlling interests (SFP)		118 885 ^h	118 885
	Investment in Ohio Ltd		170 000	
	Gain on bargain purchase (profit before tax)		8 328 ^g	
	Elimination of owners' equity in Ohio Ltd at acquisition			
J7	Non-controlling interests (P/L)	108 571		
	Non-controlling interests (SFP)		108 571 ⁱ	108 571
	Recording of non-controlling interests in profit for the year of Ohio Ltd ((262 500 + 8 928 (C3)) x 40% = 108 571)			
J8	Profit before tax	15 000		
	Non-controlling interests (SFP)	10 000		(10 000) ^j
	Dividends paid		25 000	
	Elimination of intragroup dividend and recording portion of non-controlling interests therein of Ohio Ltd			
J9	Inventories (SFP)	12 400		
	Income tax (P/L)	3 472		
	Deferred tax (SFP)		3 472	
	Cost of sales (profit before tax) (P/L)		12 400	
	Realisation of inventories fairly valued at acquisition date			
				<u>217 456^k</u>

3.3 VERTICAL GROUPS

NOTE:

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.



LECTURER'S COMMENT

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

The owners' equity of C Ltd is always analysed **before** the owners' equity of B Ltd. The date of acquisition of an interest in a subsidiary is therefore very important.

If B Ltd purchased its interest in C Ltd on 1 January 2014 and A Ltd purchased its interest in B Ltd on 31 July 2016, C Ltd would only become a subsidiary of A Ltd on 31 July 2016, the date when the A Ltd Group was formed.

In simple terms there was no "connection" between A Ltd and C Ltd before 31 July 2016. We therefore only include the profits of the sub-subsidiary, C Ltd, from 31 July 2016 in the A Ltd Group (the date when the A Ltd Group was formed.)



EXAMPLE 3.3

THE FOLLOWING ARE THE ABRIDGED TRIAL BALANCES OF A LTD, B LTD AND C LTD AT 31 DECEMBER 2016:

	A Ltd R	B Ltd R	C Ltd R
Credits			
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
	<u>820 000</u>	<u>530 000</u>	<u>665 000</u>
Debits			
Property, plant and equipment	345 000	150 000	437 000
Investment in equity instruments:			
– Investment in B Ltd at fair value	165 000	—	—
– Investment in C Ltd 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
	<u>820 000</u>	<u>530 000</u>	<u>665 000</u>

Additional information

1. A Ltd purchased 98 000 shares in B Ltd on 1 January 2013, when B Ltd's retained earnings amounted to R90 000. On this date A Ltd acquired control of B Ltd. The fair values of the identifiable assets, liabilities and contingent liabilities at the acquisition date of B Ltd were considered to be equal to the carrying amounts of these items.
2. B Ltd acquired 127 500 shares in C Ltd on 1 January 2014, when C Ltd's retained earnings amounted to R120 000. On this date B Ltd acquired control of C Ltd. The fair values of the identifiable assets, liabilities and contingent liabilities at the acquisition date of C Ltd 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 interests are recognised at their proportionate share of the acquiree's net identifiable assets. Goodwill was not considered to be impaired at year-end.
5. The fair value of the equity investments is equal to the cost price thereof. The equity investments are measured at fair value through profit and loss (FVTPL).



REQUIRED:

Prepare the consolidated annual financial statements of the A Ltd Group for the year ended 31 December 2016.

Your answer must comply with the requirements of the International Financial Reporting Standards.

Ignore the implications of secondary tax on companies.

No notes are required.

Ignore comparative figures.

SOLUTION 3.3

A LTD GROUP

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2016

R

ASSETS

Non-current assets

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

Goodwill (4 000^g + 1 750^o (2 500^a x 70%))

937 750

932 000

5 750

Current assets

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

383 000

383 000

Total assets

1 320 750

EQUITY AND LIABILITIES

Total equity

1 155 750

Equity attributable to owners of the parent

905 190

Share capital

200 000

Retained earnings

705 190

Non-controlling interests (70 800^f + 179 760ⁿ)

250 560

Non-current liabilities

165 000

Long-term borrowings (70 000 + 95 000)

165 000

Total liabilities

165 000

Total equity and liabilities

1 320 750

A LTD GROUP**CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED**

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

A LTD GROUP**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2016**

	Share capital	Retained earnings	Total	Non-controlling interests	Total equity
	R	R	R	R	R
Balance at 1 January 2016	200 000	423 550 ¹	623 550	175 200 ²	798 750
Changes in equity for 2016					
Total comprehensive income for the year:					
Profit for the year	—	311 640	311 640	92 610	404 250
Dividends paid	—	(30 000)	(30 000)	(17 250) ³	(47 250)
Balance at 31 December 2016	<u>200 000</u>	<u>705 190</u>	<u>905 190</u>	<u>250 560⁴</u>	<u>1 155 750</u>

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

² 54 000^c + 121 200^j = 175 200

³ 5 250^e + 12 000^m = 17 250

⁴ Check: 70 800^f + 179 760ⁿ = 250 560

CALCULATIONS

C1 ANALYSIS OF OWNERS' EQUITY OF C LTD

	100%	B Ltd 85%		15%
	Total R	At R	Since R	NCI R
At acquisition				
Share capital	150 000	127 500		22 500
Retained earnings – 01/01/2014	120 000	102 000		18 000
	270 000	229 500		40 500
Equity represented by goodwill	2 500	2 500 ^a		
Consideration paid and NCI	272 000	232 000		40 500
Since acquisition				
Retained earnings (210 000 – 120 000)	90 000		76 500 ^b	13 500
				54 000 ^c
Current year				
Profit for the year (210 000 – 63 000)	147 000		124 950	22 050 ^d
Dividends paid	(35 000)		(29 750)	(5 250) ^e
	474 000		171 700	70 800 ^f

C2 ANALYSIS OF OWNERS' EQUITY OF B LTD

	100%	A Ltd 70%		30%
	Total R	At R	Since R	NCI R
At acquisition				
Share capital	140 000	98 000		42 000
Retained earnings – 01/01/2013	90 000	63 000		27 000
	230 000	161 000		69 000
Equity represented by goodwill	4 000	4 000 ^g		
Consideration paid and NCI	234 000	165 000		69 000
Since acquisition				
Retained earnings (190 000 – 90 000)	100 000		70 000 ^h	30 000
Retained earnings – C Ltd	76 500 ^b		53 550 ⁱ	22 950
Goodwill – C Ltd	(2 500) ^a	(1 750)		(750)
	408 000			121 200 ^j
Current year				
Profit for the year – B Ltd (200 000 – 60 000)	140 000		98 000	42 000 ^k
Profit for the year – C Ltd (124 950 – 29 750)	95 200		66 640	28 560 ^l
Dividends paid	(40 000)		(28 000)	(12 000) ^m
	603 200		260 190	179 760 ⁿ

C3 PROFIT BEFORE TAX

	R
Profit before tax – A Ltd	250 000
Intragroup dividends received from B Ltd (40 000 x 70%)	(28 000)
Profit before tax – B Ltd	200 000
Intragroup dividends received from C Ltd (35 000 x 85%)	(29 750)
Profit before tax – C Ltd	210 000
Profit before tax – Group	<u>602 250</u>

LECTURER'S COMMENT**Percentage interest that A Ltd has in**B Ltd: $98\,000/140\,000 = 70\%$ C Ltd: $127\,500/150\,000 = 85\%$

Structure of group:

**A Ltd**1 January 2013
70%**B Ltd**1 January 2014
85%**C Ltd**

A Ltd acquired its interest in B Ltd before B Ltd acquired its interest in C Ltd. The A Ltd Group therefore was formed on the date that A Ltd acquired its interest in B Ltd (1 January 2013).

From the above it is clear that A Ltd has a direct interest in B Ltd and an indirect interest in C Ltd (because B Ltd has a direct interest in C Ltd), thus the group is a vertical group.

An analysis is first prepared for C Ltd and then for B Ltd because the group is 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 ^a		
Non-controlling interests (SFP)		40 500	40 500
Investment in C Ltd		232 000	
Elimination of owners' equity in C Ltd at acquisition			
J2 Retained earnings – beginning of year	13 500		
Non-controlling interests (SFP)		13 500	13 500
Recording of the non-controlling interests in retained earnings of C Ltd [(210 000 – 120 000) x 15%]			
			<u>54 000^c</u>
J3 Non-controlling interests (P/L)	22 050		
Non-controlling interests (SFP)		22 050	22 050 ^d
Recording of non-controlling interests in profit for the year of C Ltd [(210 000 – 63 000) x 15%]			
J4 Profit before tax	29 750		
Non-controlling interests (SFP)	5 250		(5 250) ^e
Dividends paid		35 000	
Elimination of intragroup dividend and recording of portion of non-controlling interests therein			
			<u><u>70 800^f</u></u>
J5 Share capital	140 000		
Retained earnings	90 000		
Goodwill	4 000 ^g		
Non-controlling interests (SFP)		69 000	69 000
Investment in B Ltd		165 000	
Elimination of owners' equity in B Ltd at acquisition			
J6 Retained earnings – beginning of year	30 000		
Non-controlling interests (SFP)		30 000	30 000
Recording of non-controlling interests in retained earnings of B Ltd [(190 000 – 90 000) x 30%]			
J7 Retained earnings – beginning of year	22 950		
Non-controlling interests (SFP)		22 950	22 950
Recording of non-controlling interests of B Ltd in retained earnings of C Ltd [(210 000 – 120 000) x 85% x 30%]			
J8 Non-controlling interests (SFP)	750		(750)
Goodwill		750	
Recording of non-controlling interests of B Ltd in goodwill of C Ltd (2 500 x 30%)			

	Dr R	Cr R	NCI R
			121 200 ^j
J9 Non-controlling interests (P/L)	42 000		
Non-controlling interests (SFP)		42 000	42 000 ^k
Recording of non-controlling interests in profit for the year of B Ltd [(200 000 – 60 000) x 30%]			
J10 Non-controlling interests (P/L)	28 560		
Non-controlling interests (SFP)		28 560	28 560 ^l
Recording of non-controlling interests of B Ltd in profit for the year of C Ltd [(210 000 – 63 000 – 35 000) x 85% x 30%]			
J11 Profit before tax (other income)	28 000		
Non-controlling interests (SFP)	12 000		(12 000) ^m
Dividends paid		40 000	
Elimination of intragroup dividend and recording of portion of non-controlling interests therein			
			<u>179 760ⁿ</u>

EXAMPLE 3.4

Use the same information as in example 3.3, but change the following:

Additional information

1. A Ltd purchased 98 000 shares in B Ltd on 1 January 2016. B Ltd acquired 127 500 shares in C Ltd on 1 January 2014 when C Ltd's retained earnings were R120 000.
2. A Ltd has controlled B Ltd and B Ltd has controlled C Ltd since the respective acquisition dates.
3. Assume that the fair values of the identifiable assets, liabilities and contingent liabilities at the time of both acquisitions were reassessed and were considered to be reasonable.



REQUIRED:

Prepare the consolidated annual financial statements of the A Ltd Group for the year ended 31 December 2016.

Your answer must comply with the requirements of the International Financial Reporting Standards.

No notes are required.

Ignore comparative figures.

SOLUTION 3.4

A LTD GROUP

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2016

	R
ASSETS	
Non-current assets	932 000
Property, plant and equipment (345 000 + 150 000 + 437 000)	<u>932 000</u>
Current assets	383 000
Trade and other receivables (205 000 + 48 000 + 130 000)	<u>383 000</u>
Total assets	<u><u>1 315 000</u></u>
EQUITY AND LIABILITIES	
Total equity	1 150 000
Equity attributable to owners of the parent	<u>899 440</u>
Share capital	<u>200 000</u>
Retained earnings	<u>699 440</u>
Non-controlling interests (70 800 ^e + 179 760 ⁱ)	<u>250 560</u>
Non-current liabilities	165 000
Long-term borrowings (70 000 + 95 000)	<u>165 000</u>
Total liabilities	<u>165 000</u>
Total equity and liabilities	<u><u>1 315 000</u></u>

A LTD GROUP

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2016

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

A LTD GROUP**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2016**

	Share capital	Retained earnings	Total	Non-controlling interests	Total equity
	R	R	R	R	R
Balance at 1 January 2016	200 000	300 000	500 000	—	500 000
Changes in equity for 2016					
Non-controlling interests in respect of investment acquired	—		—	175 200 ¹	175 200
Total comprehensive income for the year:					
Profit for the year	—	429 440	429 440	92 610	522 050
Dividends paid	—	(30 000)	(30 000)	(17 250) ²	(47 250)
Balance at 31 December 2016	<u>200 000</u>	<u>699 440</u>	<u>899 440</u>	<u>250 560³</u>	<u>1 150 000</u>

¹ 54 000^b + 121 200^k = 175 200

² 5 250^d + 12 000ⁱ = 17 250

³ Check: 70 800^e + 179 760^j = 250 560

CALCULATIONS**C1 ANALYSIS OF OWNERS' EQUITY OF C LTD**

	100%	B Ltd 85%		15%
	Total R	At R	Since R	NCI R
At acquisition				
Share capital	150 000	127 500		22 500
Retained earnings – 01/01/2016	210 000	178 500		31 500
	360 000	306 000		54 000 ^b
Equity represented by bargain purchase	(74 000)	(74 000) ^a		—
Consideration paid and NCI	286 000	232 000		54 000
Current year				
Profit for the year (210 000 – 63 000)	147 000		124 950	22 050 ^c
Dividends paid	(35 000)		(29 750)	(5 250) ^d
	398 000		95 200	70 800 ^e

C2 ANALYSIS OF OWNERS' EQUITY OF B LTD

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

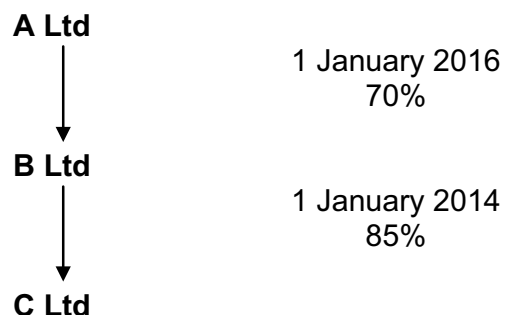
C3 PROFIT BEFORE TAX

	R
Profit before tax – A Ltd	250 000
Intragroup dividends received from B Ltd (40 000 x 70%)	(28 000)
Profit before tax – B Ltd	200 000
Intragroup dividends received from C Ltd (35 000 x 85%)	(29 750)
Profit before tax – C Ltd	210 000
Recognition of gain on bargain purchase (C2) (refer to comments)	117 800 ^f
Profit before tax – Group	<u>720 050</u>

LECTURER'S COMMENT**Percentage interest that A Ltd has in:**

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

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

Structure of group:

A Ltd acquired its interest in B Ltd after B Ltd had acquired its interest in C Ltd. The A Ltd Group was therefore formed on the date that A Ltd acquired its interest in B Ltd (1 January 2016).

From the above it is clear that A Ltd has a direct interest in B Ltd and an indirect interest in C Ltd (because B Ltd has a direct interest in C Ltd), thus the group is a vertical group.

An analysis is first prepared for C Ltd and then for B Ltd as the group is a vertical group.

Gain on bargain purchase

A Ltd acquired its interest in B Ltd after B Ltd had acquired its interest in C Ltd, thus the gain on bargain purchase (R74 000) of C Ltd is included in the at acquisition reserves of B Ltd. The gain on bargain purchase (R117 800) of B Ltd is included in the consolidated profit for the year (other income) in the statement of profit or loss and other 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 interests (SFP)		54 000	54 000 ^b
Gain on bargain purchase		74 000 ^a	
Investment in C Ltd		232 000	
Elimination of owners' equity in C Ltd at acquisition			
J2 Non-controlling interests (P/L)	22 050		
Non-controlling interests (SFP)		22 050	22 050 ^c
Recording of non-controlling interests in profit for the year of C Ltd [(210 000 – 63 000) x 15%]			
J3 Profit before tax	29 750		
Non-controlling interests (SFP)	5 250		(5 250) ^d
Dividends paid		35 000	
Elimination of intragroup dividend and recording portion of non-controlling interests therein			
			<u>70 800^e</u>
J4 Share capital	140 000		
Retained earnings	190 000		
Gain on bargain purchase – C Ltd	74 000 ^a		
Non-controlling interests (SFP)		121 200	121 200 ^k
Gain on bargain purchase		117 800 ^f	
Investment in B Ltd		165 000	
Elimination of owners' equity in B Ltd at acquisition			
J5 Non-controlling interests (P/L)	42 000		
Non-controlling interests (SFP)		42 000	42 000 ^g
Recording of non-controlling interests in profit for the period of B Ltd [(200 000 – 60 000) x 30%]			
J6 Non-controlling interests (P/L)	28 560		
Non-controlling interests (SFP)		28 560	28 560 ^h
Recording of non-controlling interests of B Ltd in profit for the year of C Ltd [(210 000 – 63 000 – 35 000) x 85% x 30%]			
J7 Profit before tax	28 000		
Non-controlling interests (SFP)	12 000		(12 000) ⁱ
Dividends paid		40 000	
Elimination of intragroup dividend and recording portion of non-controlling interests therein			
			<u>179 760^j</u>

EXAMPLE 3.5

THE FOLLOWING BALANCES WERE TAKEN FROM THE ACCOUNTING RECORDS OF LEFT LTD, RIGHT LTD AND CENTRE LTD AT 30 JUNE 2016:

	Left Ltd Dr/(Cr) R	Right Ltd Dr/(Cr) R	Centre Ltd Dr/(Cr) R
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
Investments in equity instruments:			
Investment in Right Ltd – 60 000 ordinary shares at fair value	1 800 000	—	—
Investment in Centre Ltd – 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 2015	(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)	—
	<u>—</u>	<u>—</u>	<u>—</u>

Additional information

- On 1 July 2013 Left Ltd purchased 60 000 ordinary shares in Right Ltd for R1 800 000. On the same day Right Ltd purchased 40 000 ordinary shares in Centre Ltd and paid R1 600 000 for the investment. Left Ltd has controlled Right Ltd and Right Ltd has controlled Centre Ltd since 1 July 2013.

- On 1 July 2013 the following information was applicable:

	Right Ltd R	Centre Ltd R
Retained earnings	1 500 000	1 200 000

- On 1 July 2013 Right Ltd valued Centre Ltd's land at R1 600 000. The revaluation was not recorded in the books of Centre Ltd. The fair values of the remaining assets, liabilities and contingent liabilities of Right Ltd and Centre Ltd on 1 July 2013 were considered to be equal to the carrying amounts of these items.

4. During the current year Left Ltd sold inventories to Centre Ltd at a profit of 50% on cost price. On 30 June 2016 Centre Ltd had inventories on hand that were purchased from Left Ltd for R300 000.
5. During the current year Centre Ltd sold inventories to Right Ltd at a profit of $33\frac{1}{3}\%$ on cost price. On 30 June 2016 Right Ltd had inventories on hand that were purchased from Centre Ltd for R100 000.
6. Included in the trade receivables of Left Ltd is a loan of R15 000 to Centre Ltd. The loan is included in the trade and other payables of Centre Ltd.
7. The group uses the partial goodwill method to recognise goodwill. The non-controlling interests are recognised at their proportionate share of the acquiree's net identifiable assets.
8. The goodwill that arose on the acquisition of Right Ltd was considered to be impaired by R200 000 at year-end.
9. Assume a normal tax rate of 28% and capital gain tax calculated at 80% thereof.
10. The fair value of the equity investments is equal to the cost price thereof. The equity investments are measured at fair value through other comprehensive income (FVTOCI).
11. Each share carries one vote.

	<p>REQUIRED:</p> <p>Prepare the consolidated annual financial statements of the Left Ltd Group for the year ended 30 June 2016.</p> <p>Your answer must comply with the requirements of the International Financial Reporting Standards.</p> <p>No notes are required.</p> <p>Ignore comparative figures.</p>
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SOLUTION 3.5**LEFT LTD GROUP****CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 2016**

	R
ASSETS	
Non-current assets	8 718 496
Property, plant and equipment (C8)	8 256 480
Goodwill (662 016 ^g – 200 000 ^m)	462 016
Current assets	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
Total assets	<u>14 109 638</u>
EQUITY AND LIABILITIES	
Total equity	12 725 616
Equity attributable to owners of the parent	10 675 600
Share capital	100 000
Retained earnings	10 575 600
Non-controlling interests (666 120 ^f + 1 383 896 ^l)	2 050 016
Non-current liabilities	233 400
Deferred tax (C6)	233 400
Current liabilities	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
Total liabilities	<u>1 384 022</u>
Total equity and liabilities	<u>14 109 638</u>

LEFT LTD GROUP**CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 2016**

	R
Profit for the year (C5)	1 780 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	<u>1 780 000</u>
Profit for the year and total comprehensive income attributable to:	
Owners of the parent	1 347 280
Non-controlling interests (180 000 ^z + 112 320 ^k + 140 400 ^e)	432 720
	<u>1 780 000</u>

LEFT LTD GROUP

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 30 JUNE 2016

	Share capital	Retained earnings	Total	Non-controlling interests	Total equity
	R	R	R	R	R
Balance at 1 July 2015	100 000	9 228 320 ¹	9 328 320	1 617 296 ²	10 945 616
Changes in equity for 2016					
Total comprehensive income for the year:					
Profit for the year	—	1 347 280	1 347 280	432 720	1 780 000
Balance at 30 June 2016	100 000	10 575 600	10 675 600	2 050 016 ³	12 725 616

¹ $6\,000\,000 + 3\,228\,320^h = 9\,228\,320$ or $6\,000\,000 + (2\,113\,000 - 1\,200\,000 - 182\,600(J3)) + (4\,805\,000 - 1\,500\,000 - 661\,000(J8)) - 146\,080(J9) = 9\,228\,320$

² $525\,720^d + 1\,091\,576^i = 1\,617\,296$

³ Check: $666\,120^f + 1\,383\,896^l = 2\,050\,016$

CALCULATIONS

C1 ANALYSIS OF OWNERS' EQUITY OF CENTRE LTD

	100%	Right Ltd 80%		20%
	Total R	At R	Since R	NCI R
At acquisition				
Share capital	50 000	40 000		10 000
Retained earnings	1 200 000	960 000		240 000
Revaluation surplus (600 000 – 134 400 (C2))	465 600	372 480		93 120
	1 715 600	1 372 480		343 120
Equity represented by goodwill	227 520	227 520 ^a		-
Consideration paid and NCI	1 943 120	1 600 000		343 120
Since acquisition				
Retained earnings (2 113 000 – 1 200 000)	913 000		730 400 ^b	182 600
	2 856 120			525 720 ^d
Current year				
Profit for the year	702 000		561 600 ^c	140 400 ^e
Profit for the year (given)	720 000			
Unrealised profit (100 000 x 33 ¹ / ₃ /133 ¹ / ₃)	(25 000)			
Tax effect (25 000 x 28%)	7 000			
	3 558 120		1 292 000	666 120 ^f

C2 REVALUATION OF LAND

	R
Fair value	1 600 000
Carrying amount	(1 000 000)
Revaluation surplus	<u>600 000</u>
Deferred tax (600 000 x 80% x 28%)	<u>134 400</u>

	<p>LECTURER'S COMMENT</p> <p>Revaluation not recorded in the records of the subsidiary</p> <p>Land belonging to Centre Ltd was revalued at acquisition; however, the revaluation was not recorded in the books of Centre Ltd. An adjustment is required for consolidation purposes to recognise the revalued assets of the subsidiary (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 J1).</p> <p>Deferred tax on revaluation</p> <p>If land is revalued, deferred tax should be provided for on the total surplus above original cost at 22,4% (80% 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 sale.</p>
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C3 ANALYSIS OF OWNERS' EQUITY OF RIGHT LTD

	100%	Left Ltd 80%		20%
	Total R	At R	Since R	NCI R
At acquisition				
Share capital	150 000	120 000		30 000
Retained earnings	1 500 000	1 200 000		300 000
Goodwill – Centre Ltd (C1)	(227 520) ^a	(182 016)		(45 504)
	1 422 480	1 137 984		284 496
Equity represented by goodwill	662 016	662 016 ^g		-
Consideration paid and NCI	2 084 496	1 800 000		284 496
Since acquisition				
Retained earnings	4 035 400		3 228 320 ^h	807 080
– Right Ltd (4 805 000 – 1500 000)	3 305 000			661 000
– Centre Ltd (C1)	730 400 ^b			146 080
	6 119 896			1 091 576 ⁱ
Current year				
Profit for the year	1 461 600		1 169 280 ^c	292 320
– Right Ltd (given)	900 000			180 000 ^z
– Centre Ltd (C1)	561 600 ^c			112 320 ^k
	7 581 496	662 016	4 397 600	1 383 896 ^l
Impairment of goodwill				
Current year (given)		(200 000) ^m		
Carrying amount – 30/06/2016		462 016		



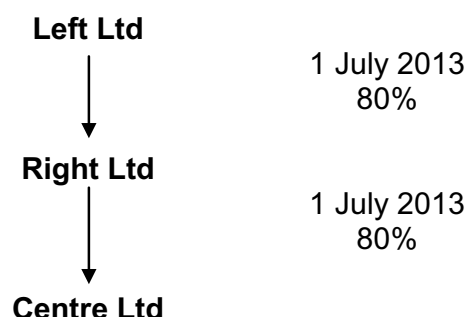
LECTURER'S COMMENT

Percentage interests held by parent (Left Ltd):

Right Ltd: $60\,000/75\,000 = 80\%$

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

Structure of group:



Left Ltd acquired its interest in Right Ltd on the same date that Right Ltd acquired its interest in Centre Ltd. Therefore, the Left Ltd Group was formed on the date that Left Ltd acquired its interest in Right Ltd (1 July 2013).

From the above it is clear that Left Ltd has a direct interest in Right Ltd and an indirect interest in Centre Ltd (because Right Ltd has a direct interest in Centre Ltd). Thus the group is a vertical group.

An analysis is first prepared for Centre Ltd and then for Right Ltd because the group is a vertical group.

C4 UNREALISED PROFIT INCLUDED IN INVENTORIES

	R
Inventories purchased by Centre Ltd from Left Ltd:	
Unrealised profit in closing inventory ($300\,000 \times \frac{50}{150}$)	100 000
Deferred tax ($100\,000 \times 28\%$)	<u>28 000</u>
Inventories purchased by Right Ltd from Centre Ltd:	
Unrealised profit in closing inventory ($100\,000 \times \frac{33\frac{1}{3}}{133\frac{1}{3}}$)	25 000
Deferred tax ($25\,000 \times 28\%$)	<u>7 000</u>

C5 PROFIT FOR THE YEAR

	R
Profit for the year:	
– Left Ltd	450 000
– Right Ltd	900 000
– Centre Ltd	720 000
Unrealised profit in closing inventory ($300\,000 \times \frac{50}{150}$)	(100 000)
Tax effect on unrealised profit ($100\,000 \times 28\%$)	28 000
Unrealised profit in closing inventory ($100\,000 \times 33\frac{1}{3} / 133\frac{1}{3}$)	(25 000)
Tax effect on unrealised profit ($25\,000 \times 28\%$)	7 000
Goodwill impaired	(200 000)
Consolidated profit	<u>1 780 000</u>

C6 DEFERRED TAX

	R
Deferred tax (given):	
– Left Ltd	48 000
– Right Ltd	62 000
– Centre Ltd	24 000
Revaluation of land (C2)	134 400
Deferred tax on unrealised intragroup profit:	
– Centre Ltd (C4)	(28 000)
– Right Ltd (C4)	(7 000)
	<u>233 400</u>

C7 TAX PAYABLE

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

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 ¹	3 266 000 ²	8 685 000
Accumulated depreciation	—	(428 520) ³	(428 520)

¹ $1\,419\,000 + 2\,400\,000 + 1\,000\,000 + 600\,000$ (C2) = 5 419 000

² $1\,228\,000 + 1\,420\,000 + 618\,000 = 3\,266\,000$

³ $221\,040 + 170\,400 + 37\,080 = 428\,520$

LECTURER'S COMMENT

Unrealised profits included in inventories

Sale of inventories from Left Ltd to Centre Ltd

Left Ltd sold inventories to Centre Ltd (parent to subsidiary). Left Ltd made the intragroup profit. Cost of sales of Left Ltd was thus debited and this decreased the group profit. Centre Ltd purchased the inventories from Left Ltd, thus the unrealised profit was included in the closing inventories of Centre Ltd at year-end. Inventories were decreased with the unrealised profit to eliminate the unrealised intragroup profit.

Left Ltd (parent) was making the profit, thus the unrealised profit in the inventories was not shown in the analysis of owners' equity of Centre Ltd. In other words: the non-controlling interests were not affected. The adjustments were taken into account in the consolidated statement of profit or loss and other comprehensive income (cost of sales) and consolidated statement of financial position (inventories).

Sale of inventories from Centre Ltd to Right Ltd

Centre Ltd sold inventories to Right Ltd (subsidiary to parent). Centre Ltd made the intragroup profit. Cost of sales of Centre Ltd was thus debited and this decreased the group profit. Right Ltd purchased the inventories from Centre Ltd, thus the unrealised profit was included in the closing inventories of Right Ltd at year-end. The inventories were decreased with the unrealised profit to eliminate the unrealised intragroup profit.

Centre Ltd (subsidiary) was making the profit, thus the unrealised profit in the inventories was shown in the analysis of owners' equity of Centre Ltd. In other words, the non-controlling interests were also adjusted. The adjustments were also taken into account in the consolidated statement of profit or loss and other comprehensive income (cost of sales) and the consolidated statement of financial position (inventories).



C9 PRO FORMA CONSOLIDATION JOURNALS

	Dr R	Cr R	NCI R
J1 Land	600 000		
Deferred tax (SFP)			
(600 000 x 80% x 28%)		134 400	
Revaluation surplus		465 600	
Revaluation of land of Centre Ltd at acquisition			
J2 Share capital	50 000		
Retained earnings	1 200 000		
Revaluation surplus (600 000 – (600 000 x 80% x 28%))	456 600		
Goodwill	227 520		
Non-controlling interests (SFP)		343 120	343 120
Investment in Centre Ltd		1 600 000	
Elimination of owners' equity in Centre Ltd at acquisition			
J3 Retained earnings	182 600		
Non-controlling interests (SFP)		182 600	182 600
Recording of non-controlling interests in retained earnings since acquisition of Centre Ltd			
[(2 113 000 – 1 200 000) x 20%]			
			<u>525 720^d</u>
J4 Profit for the year (Cost of sales) (C4)	25 000		
Inventory (SPF)		25 000	
Elimination of unrealised profit in closing inventory of Right Ltd			
J5 Deferred tax (SFP) (C4)	7 000		
Profit for the year (Income tax expense)		7 000	
Tax implication of elimination of intragroup profit in closing inventory			
J6 Non-controlling interests (P/L)	140 400		
Non-controlling interests (SFP)		140 400	140 400 ^e
Recording of non-controlling interests in profit for the year of Centre Ltd			
[(720 000 – 25 000 + 7 000) x 20%]			
			<u>666 120^f</u>
J7 Share capital	150 000		
Retained earnings	1 500 000		
Goodwill	662 016 ^g		
Goodwill – Centre Ltd		227 520 ^a	
Non-controlling interests (SFP)		284 496	284 496
Investment in Right Ltd		1 800 000	
Elimination of owners' equity in Right Ltd at acquisition			

	Dr R	Cr R	NCI R
J8 Retained earnings – beginning of year Non-controlling interests (SFP) Recording of non-controlling interests in profit for the year of Centre Ltd [(4 805 000 – 1 500 000) x 20%]	661 000	661 000	661 000
J9 Retained earnings – beginning of year Non-controlling interests (SFP) Recording of non-controlling interests in retained earnings since acquisition of Centre Ltd [(2 113 000 – 1 200 000) x 80% x 20%]	146 080	146 080	146 080
			<u>1 091 576^l</u>
J10 Non-controlling interests (P/L) (900 000 x 20%) Non-controlling interests (SFP) Recording of non-controlling interests in profit for the year of Right Ltd	180 000	180 000	180 000 ^z
J11 Non-controlling interests (P/L) (561 600 x 20%) Non-controlling interests (SFP) Recording of non-controlling interests in profit for the year of Centre Ltd for the current year	112 320	112 320	112 320 ^k
J12 Profit for the year Goodwill Impairment of goodwill	200 000	200 000 ^m	
J13 Profit for the year (Cost of sales) Inventory (SFP) (300 000 x ⁵⁰ / ₁₅₀) Elimination of intragroup profit in closing inventory of Centre Ltd	100 000	100 000	
J14 Deferred tax (SFP) (100 000 x 28%) Profit for the year (Income tax expense) Tax implication of elimination of intragroup profit in closing inventory	28 000	28 000	
J15 Trade and other payables (Centre Ltd) Trade receivables (Left Ltd) Elimination of intragroup loan	15 000	15 000	<u>1 383 896^l</u>

3.4 MARK-TO-MARKET RESERVE

Classification of investments in equity instruments:

According to IFRS 9 an entity can choose whether to measure its investments in equity instruments at cost price or at fair value. If the entity elects to measure its investments in equity instruments at **fair value**, it must also classify them into one of the following two categories:

1. Equity investments at **fair value through profit or loss**
or
2. Equity investments at **fair value through other comprehensive income**

1. Equity investments at fair value through profit or loss

The fair value adjustment and the tax effect are recognised in the profit or loss section of the statement of profit or loss and other comprehensive income. From there the profit or loss for the period is transferred to the statement of changes in equity's in the "retained earnings column".

The following journal entry will be processed in the investors **own separate** accounting records:

	Dr R	Cr R
J1 Investment in A Ltd (SFP)	xxx	
Other income (fair value adjustment (P/L))		xxx
Income tax expense (P/L)	xxx	
Deferred tax (SFP)		xxx
Recognition of fair value adjustment on investment in A Ltd		

2. Equity investments at fair value through other comprehensive income

The fair value adjustment and the tax effect are recognised in the other comprehensive income section of the statement of profit or loss and other comprehensive income. From there the other comprehensive income for the period is transferred to the statement of changes in equity's "mark-to-market reserve column".

The following journal entry will be processed in the investors **own separate** accounting records:

	Dr R	Cr R
J1 Investment in A Ltd (SFP)	xxx	
Mark-to-market reserve(MTMR)(fair value adjustment)(OCI)		xxx
Mark-to-market reserve(MTMR)(fair value adjustment)(OCI)	xxx	
Deferred tax (SFP)		xxx
Recognition of fair value adjustment of investment in A Ltd		

What is the mark-to-market reserve?

The mark-to-market reserve is the fair value adjustments on investments in equity instruments (financial assets) measured at fair value through **other comprehensive income** according to IFRS 9.

ILLUSTRATION 1

P Ltd bought shares in A Ltd for R10 000 and passed the following journal in its **own separate** accounting records:

	Dr R	Cr R
J1 Investment in A Ltd (SFP)	10 000	
Bank (SFP)		10 000
Recognition of investment in A Ltd at cost price		

Then: If at the end of the year the fair value of the investment in A Ltd was R12 000, P Ltd would pass the following journal entry in its **own separate** accounting records if its accounting policy was to remeasure equity investments at fair value through other comprehensive income:

	Dr R	Cr R
J2 Investment in A Ltd (SFP) (12 000 – 10 000)	2 000	
Mark-to-market reserve (OCI)		1 552
Deferred tax (SFP) (2 000 x 22.4%(80% x 28%))		448
Remeasurement of investment in A Ltd to fair value		

NOTE: Mark-to-market reserve is always an after tax amount. This mark-to-market reserve of R1 552 is disclosed as part of other comprehensive income in the statement of profit or loss and other comprehensive income. It will then be transferred to the statement of changes in equity's "mark-to-market reserve column".

(Please note that the profit or loss section of the statement of profit or loss and other comprehensive income is transferred to the statement of changes in equity's retained earnings column. Please refer to IFRS 9 for more details on financial assets.)

NOTE: The journals above are passed in the separate financial statements of the parent or investor company.

THEN on consolidation (therefore when consolidated financial statements are prepared), if A Ltd is either a subsidiary, an associate, a joint venture or a joint operation of P Ltd, the fair value adjustment made by P Ltd in its own separate accounting records relating to its investment in A Ltd must be **eliminated**. How it is eliminated? By simply *reversing* the journal that P Ltd originally passed to account for it.

(The principle is that consolidated financial statements are drawn up to show the users what the financial statements would look like if A Ltd and P Ltd were one economic entity. It is impossible for one company to have an investment in itself or to fair value that investment in itself. For this reason any fair value adjustments on either subsidiaries, associates, joint ventures or joint operations, are eliminated on consolidation.)

The following **pro forma consolidation journal** entry is passed when the consolidated financial statements of the P Ltd Group are compiled:

	Dr R	Cr R
J3 Mark-to-market reserve (OCI)	1 552	
Deferred tax (SFP) (2 000 x 22.4%(80% x 28%))	448	
Investment in A Ltd (SFP) (12 000 – 10 000)		2 000
Elimination of fair value adjustment on investment in A Ltd on consolidation		

Treatment of mark-to-market reserve in the consolidated financial statements of the group:

In the consolidated financial statements, this mark-to-market reserve should be reversed to present accurate financial statements for the group:

- The investment in the subsidiary is required to be recognised at cost on acquisition date as this represents the fair value of the consideration transferred at acquisition date. (Please refer to IFRS 3.37). Any subsequent remeasurement of an investment in a subsidiary to fair value in the books of the holding company is reversed on consolidation (refer to the journal entry above).
- The investment in the associate or joint venture is initially recognised at cost according to the equity method. (Please refer to IAS 28.10). Any subsequent remeasurement of an investment in an associate or joint venture to fair value in the books of the investor company is reversed on consolidation (refer to the journal entry above).

This reversal is essential to calculate any goodwill or gain on bargain purchase at acquisition date correctly.

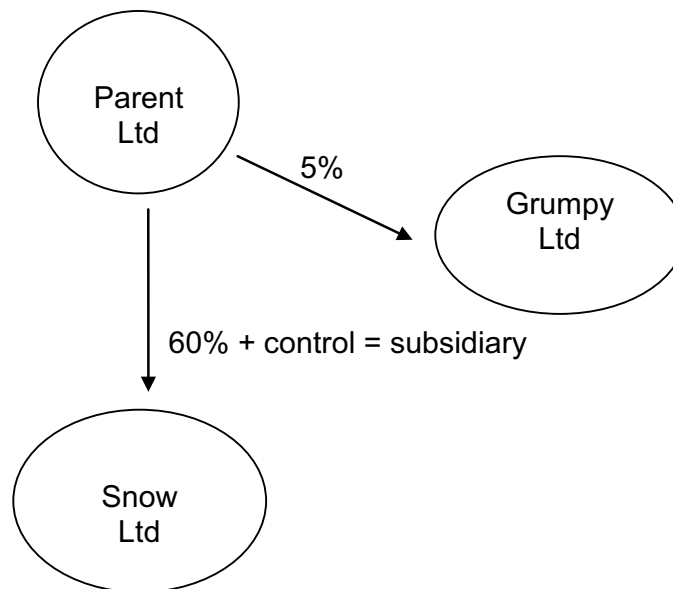
Please note that any mark-to-market reserve in the separate financial statements of a subsidiary relates to investments in equity instruments that the **subsidiary holds** and it should be treated accordingly. This means if the mark-to-market reserve relates to a simple investment (not a sub-subsidiary, an associate, a joint venture or a joint operation) of that subsidiary, it will not be eliminated on consolidation. On the other hand, if it relates to a sub-subsidiary or associate or joint venture, it will be reversed on consolidation. See J3 above.

3.4.1 MARK-TO-MARKET RESERVE WITHIN COMPLEX GROUPS

ILLUSTRATION 1:

Extract of the trial balance of the parent at year-end:

	R
<u>Mark-to-market reserve as per trial balance:</u>	23 280
— Investment in subsidiary – Snow Ltd	7 760
— Simple investment – Grumpy Ltd	15 520



MARK-TO-MARKET RESERVE IN THE RECORDS OF THE PARENT RELATING TO THE INVESTMENT IN THE SUBSIDIARY, SNOW LTD:

- When the parent has an investment in a subsidiary, the investment is usually classified as an equity instrument held at fair value through other comprehensive income. See above.
- The fair value adjustment, R7 760 in the accounting records of the parent relating to the investment in the subsidiary, Snow Ltd, **will be reversed** at acquisition date when preparing the consolidated financial statements of the group.

	Dr R	Cr R
Mark-to-market reserve (OCI)	7 760	
Deferred tax (SFP) (10 000 x 22.4%(80% x 28%))	2 240	
Investment in Snow Ltd (SFP) (12 000 – 10 000)		10 000
Elimination of fair value adjustment on investment in Snow Ltd on consolidation		

- Therefore there will be no fair value adjustment (mark-to-market reserve) relating to the investment in the subsidiary, Snow Ltd, in the consolidated financial statements.

MARK-TO-MARKET RESERVE IN THE RECORDS OF THE PARENT RELATING TO THE SIMPLE INVESTMENT, GRUMPY LTD:

- The parent has a simple investment, Grumpy Ltd (5%), which is just a normal investment and will not be consolidated in the consolidated statements, the investment can also be classified as an equity instrument held at fair value through other comprehensive income. See above.
- The investment in Grumpy Ltd together with the fair value adjustment of R15 520 in the accounting records of the parent relating to this simple investment, Grumpy Ltd, **will remain** just as it is in the parent's records (in the consolidated financial statements). This is because, like PPE and any other asset, assets should be included at 100% in consolidated group statements. The simple investment, Grumpy Ltd, is just a financial asset in the records of the parent, therefore the

investment (asset) and fair value adjustments on the investment will be disclosed in the consolidated statements.

Taking the above into account, the amount that will be disclosed as the mark-to-market reserve in the consolidated financial statements of the group will be R15 520.

Alternative explanation:

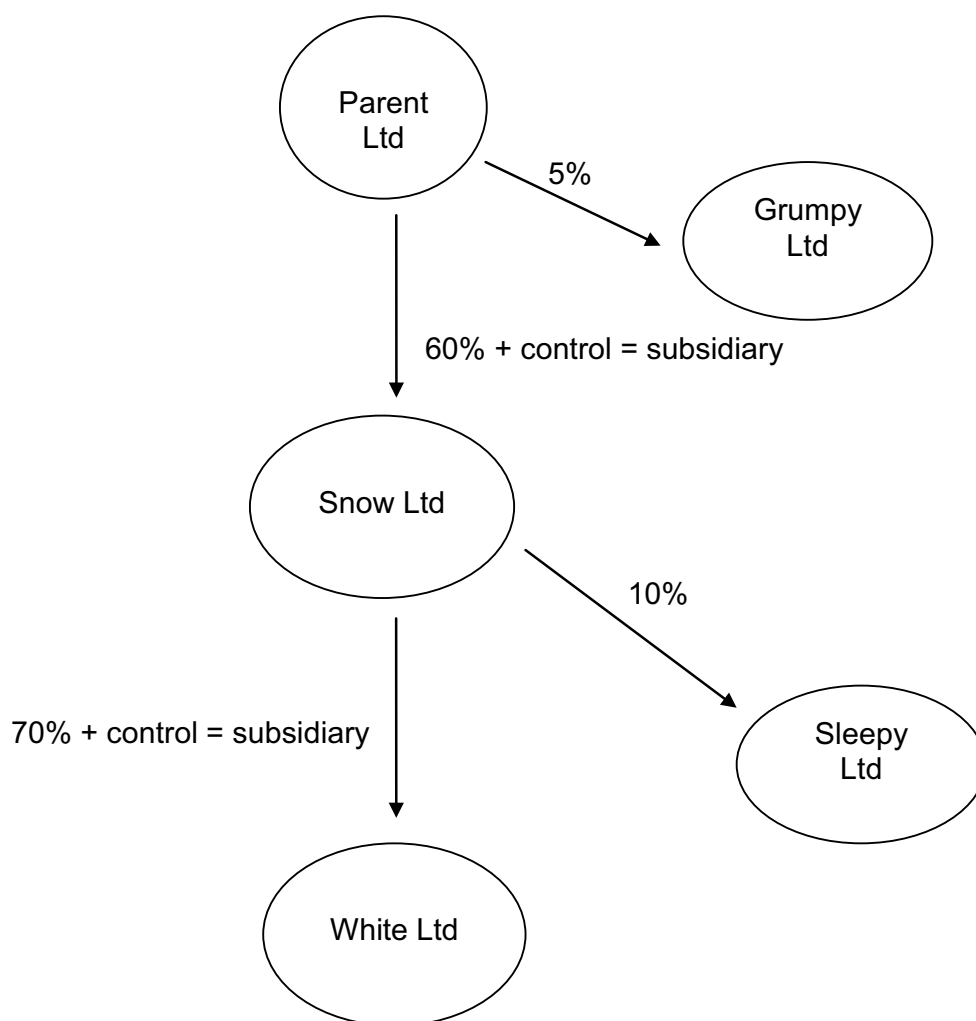
	R
Parent Ltd mark-to-market reserve as per trial balance (total)	23 280
— Elimination of investment in subsidiary – Snow Ltd (see journal above)	(7 760)
Mark-to-market reserve as per consolidated financial statements	<u>15 520</u>

ILLUSTRATION 2:

Extract of the trial balances at year-end:

Mark-to-market reserve as per trial balance relating to:

	Parent Ltd	Snow Ltd
	R	R
	23 280	17 848
— Investment in subsidiary – Snow Ltd	7 760	-
— Simple investment – Grumpy Ltd	15 520	-
— Investment in subsidiary – White Ltd	-	11 640
— Simple investment – Sleepy Ltd	-	6 208



MARK-TO-MARKET RESERVE IN THE RECORDS OF SNOW LTD RELATING TO THE INVESTMENT IN THE SUBSIDIARY, WHITE LTD:

- Taking into account what we have learnt in illustration 1, the fair value adjustment of R11 640 in the accounting records of Snow Ltd relating to the investment in the subsidiary, White Ltd, will be reversed at acquisition date when preparing the consolidated financial statements of the group.

	Dr R	Cr R
Mark-to-market reserve (OCI)	11 640	
Deferred tax (SFP) (15 000 x 80% x 28%)	3 360	
Investment in A Ltd (SFP) (11 640 x 100%/77.6%)		15 000
Elimination of fair value adjustment on investment in White Ltd on consolidation		

- Therefore there will be no fair value adjustment (mark-to-market reserve) relating to the investment in subsidiary, White Ltd, in the consolidated financial statements.

MARK-TO-MARKET RESERVE IN THE RECORDS OF SNOW LTD RELATING TO THE SIMPLE INVESTMENT, SLEEPY LTD:

- If Snow Ltd has a simple investment, Sleepy Ltd, which will not be consolidated in the group statements, the investment can also be classified as an equity instrument held at fair value through other comprehensive income. See above.
- The investment in Sleepy Ltd together with the fair value adjustment on the investment of R6 208 in the records of Snow Ltd **will remain** in the consolidated financial statements.
- The investments in Sleepy Ltd and Grumpy Ltd will be included at 100% in the consolidated group financial statements because, like PPE and any other assets, assets of the subsidiary should be included at 100% line-by-line (consolidation) in the consolidated group financial statements.
- Since the mark-to-market reserve is an equity account of the subsidiary, the portion attributable to NCI should be accounted for in the consolidated statements. This will be done in the same way that profits or retained earnings of the subsidiary are allocated to the parent and NCI.

Taking the above into account, the amount that will be disclosed as mark-to-market reserve in the consolidated financial statements of the group will be (R15 520 + 3 725 (6 208 x 60%)) = R19 245.

Alternative explanation:

	R
Parent mark-to-market reserve as per trial balance	23 280
Snow Ltd mark-to-market reserve as per trial balance	17 848
Elimination of investment in subsidiary – Snow Ltd	(7 760)
Elimination of investment in subsidiary – White Ltd	(11 640)
Allocation of portion of mark-to-market reserve relating to Sleepy Ltd to NCI (6 208 x 40%)	(2 483)
Mark-to-market reserve as per consolidated financial statements	<u>19 245</u>

3.5 ASSESSMENT CRITERIA

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

	<ul style="list-style-type: none">• 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; and• prepare and present the consolidated annual financial statements of a complex group.
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LEARNING UNIT 4

ACCOUNTING FOR INVESTMENTS IN ASSOCIATES (IAS 28)



Group Financial Reporting

7 LEARNING UNIT 4

Accounting for investments in associates (IAS 28)

Learning outcome 4

After having studied this learning unit, you should be able to prepare consolidated annual financial statements when a investor holds a direct or indirect interest in an associate, and the results of the associate are accounted for according to the equity method, in terms of IAS 28, *Investments in associates and Joint ventures*.

OVERVIEW OF THE LEARNING UNIT

The learning unit consists of the following sections:

- 4.1 Basic concepts
- 4.2 Accounting for investments in associates in the separate financial statements of the investor
- 4.3 Accounting for investments in associates in the consolidated financial statements of the investor
- 4.4 Application of the equity method
- 4.5 Disclosure
- 4.6 Assessment criteria

4.1 BASIC CONCEPTS

STUDY

Refer to the chapter on investments in associates in **Group statements**.

4.2 ACCOUNTING FOR INVESTMENTS IN ASSOCIATES IN THE SEPARATE FINANCIAL STATEMENTS OF THE INVESTOR

STUDY

Refer to the chapter on investments in associates in **Group statements**.

4.3 ACCOUNTING FOR INVESTMENTS IN ASSOCIATES IN THE CONSOLIDATED FINANCIAL STATEMENTS OF THE INVESTOR

STUDY

Refer to the chapter on investments in associates in **Group statements**.

4.4 APPLICATION OF THE EQUITY METHOD

STUDY

Refer to the chapter on investments in associates in **Group statements**.

4.4.1 Theory

The equity method is an accounting method that initially recognises the investment at cost and thereafter the investment is 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 or 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
- 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 28.26)

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. Therefore such unrealised profits and losses are recognised in the investor's financial statements only to the extent of unrelated investors' interest in the associate. (IAS 28.28)

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 or loss that is attributable to the interests of the other investors in the associate.

EXAMPLE 4.1**Investor sells to associate**

A Ltd has a 25% interest in B Ltd and has significant influence over B Ltd. A Ltd sold inventory to B Ltd at a profit. At year-end B Ltd still had inventory amounting to R100 000 on hand. A Ltd sells inventory to B Ltd at a profit markup of 20% on the selling price. Assume a South African normal tax rate of 28%.

**REQUIRED:**

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

SOLUTION 4.1

		Dr R	Cr R
J1	Revenue (100 000 x 25%)	25 000	
	Cost of sales ($(100\,000 \times \frac{80}{100}) \times 25\%$)		20 000
	Investment in B Ltd ($(100\,000 \times \frac{20}{100}) \times 25\%$)		5 000
	Elimination of the investor's share of the unrealised profit		
J2	Deferred tax (SFP) (5 000 x 28%)	1 400	
	Income tax (P/L)		1 400
	Tax implication of elimination of investor's share of unrealised profit		

The investor made a profit of R5 000 on the sale of the inventory. 100% of all the income and expense line items of the investor (including revenue and cost of sales) have been included in the consolidated statement of profit and loss and other comprehensive income. The profit that the investor made on the inventory (i.e. gross profit) is therefore eliminated from the 'revenue' and 'cost of sales' line items (see J1).

The inventory of R100 000 is included in the books of the associate at year end. The investors' share of all the assets and liabilities of the associate have been included in **one line item** in the consolidated statement of financial position, namely 'investment in associate' (remember assets less liabilities is equity). The 'inventory' line item cannot be credited (as the associates inventory is not included in the inventory line item in the consolidated statement of financial position), therefore we need to credit the 'investment in associate' line item to eliminate the unrealised profit of R5 000 (see J1).

EXAMPLE 4.2

Associate sells to investor

A Ltd has a 25% interest in B Ltd and has significant influence over B Ltd. B Ltd sold inventory to A Ltd at a profit of R20 000. At year-end A Ltd still had this inventory on hand. Assume a South African normal tax rate of 28%.



REQUIRED:

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

SOLUTION 4.2

		Dr R	Cr R
J1	Share of profit of associate (P/L) (20 000 x 25%)	5 000	
	Inventories (SFP)		5 000
	Elimination of the unrealised profit in inventory of A Ltd		
J2	Deferred tax (SFP) (5 000 x 28%)	1 400	
	Share of profit of associate (P/L)		1 400
	Tax implication of elimination of unrealised profit in inventory of A Ltd		

The associate made a profit on the sale of the inventory. The investors' share of all the income and expenses of the associate (including revenue and cost of sales) have been included in **one line item** in the consolidated statement of profit and loss and other comprehensive income, namely 'share of profit of associate'. Therefore, the gross profit that the associate made is eliminated from 'share of profit of associate'.

The inventory is in the books of the investor at year end. 100% of all the assets and liabilities (including the inventory) of the investor have been included in the consolidated statement of financial position. The unrealised profit is therefore eliminated from this 'inventory' line item.

NOTE: A Ltd only recognised its 25% share in B Ltd's profit for the period, and therefore only 25% of the unrealised profit is eliminated.

If B Ltd made a profit of R100 000 for the period, the 'share of profit of associate' would have been calculated as follows:

	A Ltd 25% R
B Ltd's profit for the period (100 000 x 25%)	25 000
Unrealised profit in intragroup inventory after tax	(3 600)
Share of profit of associate	<u>21 400</u>

4.4.3 Goodwill or gain from a bargain purchase 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 28.32(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 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 and is as such included in the carrying amount of the investment. (IAS 28.32(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 28.42)

EXAMPLE 4.3

On 1 July 2016 Pretty Ltd acquired a 30% interest in the equity share capital of Lucky Ltd for R24 000 when the retained earnings of Lucky Ltd were R61 000. The share capital consisted of 10 000 shares amounting to R10 000.

On this date the land of Lucky Ltd was revalued at R5 000 above the original carrying amount. Pretty Ltd has had significant influence over Lucky Ltd since 1 July 2016.

The financial year-end of Pretty Ltd is 30 June.



REQUIRED:

Calculate the goodwill at acquisition of the investment in Lucky Ltd. Ignore tax implications on the revaluation of land.

SOLUTION 4.3

	R
Share capital	10 000
Retained earnings	61 000
Revaluation of land	5 000
Net asset value on 1 July 2016	<u>76 000</u>
30% interest (76 000 x 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 Ltd on acquisition in the records of Pretty Ltd in accordance with the equity method will be as follows:

	Dr R	Cr R
Investment in Lucky Ltd (net asset value)	22 800	
Investment in Lucky Ltd (goodwill)	1 200	
Bank		24 000
Recording of the investment in Lucky Ltd		

4.5 DISCLOSURE

The disclosure requirements for associates and joint ventures are set out in IFRS 12, *Disclosure of Interests in Other Entities*.

The following information must be disclosed for each associate and joint venture:

NOTE: the disclosure requirements below relate both to associates and joint ventures.

- the name of the associate;
- the nature of the entities relationship with the associate;
- the principle place of business and the country of incorporation of the associate;
- the ownership interest and if different, the proportion of of voting rights held;
- whether the investment in the associate is accounted for using the equity method or at fair value;
- summarised financial information of the associate (the totals and not only the investors share), including dividends received, non-current and current assets, non-current and current liabilities, revenue, profit or loss from continuing and discontinuing operations, other comprehensive income and total comprehensive income;
- the fair value of the investments in associates for which there are published prices;
- a reconciliation between the summarised financial information and the carrying amount of the investment in associate;
- any unrecognised share of losses from the associate.

4.5.1 Example of equity method and related disclosure

Work through the following example on the application of the equity method and related disclosure:

EXAMPLE 4.4

TRIAL BALANCES OF STEREO LTD AND SOUND LTD FOR THE YEAR ENDED 30 JUNE 2016:

	Stereo Ltd R	Sound Ltd R
Debits		
Property, plant and equipment at carrying amount	323 600	28 000
Investment in Sound Ltd at fair value	15 400	—
Inventories	21 900	18 100
Accumulated loss – 1 July 2015	—	14 500
Cost of sales	147 800	68 000
Income tax expense	20 600	8 100
Dividends paid	12 500	12 000
	<u>541 800</u>	<u>148 700</u>
Credits		
Share capital: - 130 000 ordinary shares	162 500	—
- 18 000 ordinary shares	—	36 000
Retained earnings – 1 July 2015	122 500	—
Revenue	220 000	100 000
Other income (profit on sale of land) (tax effect – Rnil)	—	5 500
Dividends received	11 500	—
Trade and other payables	25 300	7 200
	<u>541 800</u>	<u>148 700</u>

Additional information

- On 1 July 2013, Stereo Ltd acquired 8 100 ordinary shares for R15 400 in Sound Ltd, a company in the motor industry when the retained earnings of Sound Ltd amounted to R8 000. Stereo Ltd exercises significant influence over the management and financial policies of Sound Ltd.
- 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.
- During the current financial year, Stereo Ltd purchased inventory from Sound Ltd at cost plus 20%. At year-end on 30 June 2016, Stereo Ltd had inventory amounting to R5 700 on hand that had been bought from Sound Ltd during the year.
- The South African normal tax rate has been 28% since 2013.
- The published market price for the investment in Sound Ltd is R16 000.
- The Stereo Ltd Group accounts for investments in associates using the equity method in accordance with IAS 28, *Investments in Associates and Joint Ventures*.

7. Stereo Ltd accounts for investments in associates at fair value through profit and loss in its separate financial statements. The fair value of the equity investment is equal to the cost price thereof.
8. Each share carries one vote.
9. Sound Ltd is incorporated in South Africa and its principal place of business is in Durban. Sound Ltd produces inventory used in the operational process of Stereo Ltd.

	<p>REQUIRED:</p> <ol style="list-style-type: none"> (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 annual financial statements of the Stereo Ltd Group for the year ended 30 June 2016. <p>Only the following note is required:</p> <p style="padding-left: 40px;">— investment in associate</p> <p>Your answer must comply with the requirements of the International Financial Reporting Standards.</p> <p>Comparative figures are not required.</p> <p>All calculations are to be done to the nearest R1.</p>
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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 separately for impairment. 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 (gain on bargain purchase) is 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, and as such is included in the carrying amount of the investment.

PART (c)

Unrealised profits or losses should be eliminated only to the extent of the investor's interest in the associate; or they should be recognised in the investor's financial statements only to the extent of unrelated investors' interest in the associate on that portion of the gain or loss.

Part (d)**STEREO LTD GROUP****STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 2016**

	Notes	R
ASSETS		
Non-current assets		341 225
Property, plant and equipment		323 600
Investment in associate	1	17 505
Deferred tax ($5\,700 \times \frac{20}{120} \times 45\% \times 28\%$)		120
Current assets		21 472
Inventories ($21\,900 - 428 (5\,700 \times \frac{20}{120} \times 45\%)$)		21 472
Total assets		<u>362 697</u>
EQUITY AND LIABILITIES		
Total equity		337 397
Share capital		162 500
Retained earnings		174 897
Current liabilities		25 300
Trade and other payables		25 300
Total liabilities		25 300
Total equity and liabilities		<u>362 697</u>

STEREO LTD GROUP**STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 2016**

	R
Revenue	220 000
Cost of sales	(147 800)
Gross profit	<u>72 200</u>
Other income (11 500 – 5 400 (12 000 x 45%) (div))	6 100
Share of profit of associate (13 230 – 428 + 120)	<u>12 922</u>
Profit before tax	91 222
Income tax expense	(20 600)
PROFIT FOR THE YEAR	<u>70 622</u>
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	<u>70 622</u>

STEREO LTD GROUP**STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 30 JUNE 2016**

	Share capital R	Retained earnings R	Total R
Balance at 1 July 2015	162 500	116 775 ¹	279 275
Changes in equity for 2016			
Total comprehensive income for the year:			
Profit for the year		70 622	70 622
Dividends paid		(12 500)	(12 500)
Balance at 30 June 2016	<u>162 500</u>	<u>174 897</u>	<u>337 397</u>

¹ 122 500 - 5 725^a = 116 775

STEREO LTD GROUP**NOTES FOR THE YEAR ENDED 30 JUNE 2016****1. Investment in associate**

Stereo Ltd owns a 45% interest in Sound Ltd, a company operating in the motor industry. Sound Ltd is incorporated in South Africa and its principal place of business is Durban. Sound Ltd produces inventory used in the operational process of Stereo Ltd. The interest is equity accounted for.

1.1 Summarised financial information of Sound Ltd

	R
Non-current assets	28 000
Current assets	18 100
Total assets	<u>46 100</u>
Non-current liabilities	—
Current liabilities	7 200
Total liabilities	<u>7 200</u>

	R
Revenue	100 000
Dividends received	—
Profit for the year (100 000 – 68 000 + 5 500 – 8 100)	29 400
Other comprehensive income	—
Total comprehensive income for the year	29 400

1.2 Reconciliation of the summarised financial information to the carrying amount of the investment in the associate

	R
Net assets of associate at 30 June 2016 (46 100 – 7 200)	<u>38 900</u>
45% interest in the net assets of associate (38 900 x 45%)	17 505
Plus: Goodwill at acquisition included in the cost price of the investment	—
Carrying amount of the investment in associate	<u><u>17 505</u></u>

1.3 Fair value of the investment in the associate

	R
Fair value of the investment in the associate (published price)	<u><u>16 000</u></u>

1.4 Unrecognised share of losses

	R
Unrecognised share of losses of the associate	<u><u>—</u></u>

Calculations

Analysis of owners equity of Sound Ltd

	100%	Stereo Ltd 45%		Carrying amount
	Total R	At R	Since R	R
At acquisition				
Share capital	36 000	16 200		
Retained earnings	8 000	3 600		
	44 000	19 800		
Investment in Sound Ltd		(15 400)		
Excess of fair value over cost		4 400		
				15 400
Since acquisition				
Accumulated loss (14 500 + 8 000)	(22 500)		(10 125)	(10 125)
Excess of fair value over cost			4 400	4 400
Current year				
Profit for the year				
(100 000 – 68 000 + 5 500 – 8 100)	29 400		13 230	13 230
Unrealised profit in inventory				
(5 700 x ²⁰ / ₁₂₀ x 72%)	(684)		(308)	—
Dividends paid	(12 000)		(5 400)	(5 400)
	38 216		(1 797)	17 505

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		Dr R	Cr R	CA R
	Investment at cost			15 400
J1	Retained earnings – beginning of year ((14 500 + 8 000) x 45%) Investment in associate (SFP) Recording of Stereo Ltd's interest in the loss since acquisition to beginning of current year	10 125	10 125	(10 125)
J2	Investment in associate (SFP) Share of profit of associate (P/L) ((100 000 – 68 000 + 5 500 – 8 100) x 45%) Recording of Stereo Ltd's interest in the profit for the current year	13 230	13 230	13 230
J3	Other income (dividend received) (12 000 x 45%) Investment in associate (SFP) Elimination of the intragroup dividend received by Stereo Ltd	5 400	5 400	(5 400)
J4	Investment in associate (SFP) Retained earnings – beginning of year (19 800 ((36 000 + 8 000) x 45%)) – 15 400 Recognition of excess of fair value above cost at acquisition (see lecturers comment below)	4 400	4 400	4 400
J5	Share of profit of associate (P/L) Inventories (5 700 x $\frac{20}{120}$ x 45%) (SFP) Elimination of unrealised profit in closing inventories of Stereo Ltd	428	428	
J6	Deferred tax (SFP) Share of profit of associate (428 x 28%) (P/L) Tax implication of unrealised profit in closing inventories of Stereo Ltd	120	120	
Carrying amount of investment in the associate as per SFP				<u>17 505</u>



LECTURER'S COMMENT

The excess of fair value above cost (i.e. gain on bargain purchase) at acquisition is included in the 'share of profit of associate' and the 'investment in associate' in the period in which the investment is acquired.

As 'share of profit from associate' is accumulated in retained earnings, a gain on bargain purchase that arose in a prior period, would be included in 'retained earnings' and 'investment in associate'. Refer J2.

4.5.2 Summary

Significant influence

An investment is classified as an investment in an associate if the investor has significant influence over the financial and operating policy decisions. **Significant influence** is the power to participate in the financial and operating policy decisions of an economic entity, but is not control or joint control over those decisions.

Equity method

The investment is initially recognised at cost and increased / decreased by taking into account the following:

- The investor's share in the profits and losses of associate after the acquisition date
- The investor's share in the 'other comprehensive income' of the associate after the acquisition date
- Dividends received by the investor from the associate
- Unrealised intragroup profits and losses

Important considerations

Goodwill

Goodwill is included as part of the carrying amount of the investment in the associate and is not separately identified. Therefore the goodwill is not separately tested for impairment.

Gain on bargain purchase

A gain on bargain purchase is included in 'share of profit of associate' and 'investment in associate' in the period in which the investment is acquired.

As 'share of profit from associate' is accumulated in retained earnings, if the gain on bargain purchase arose in a prior period, it would be included in 'retained earnings' and 'investment in associate'.

Unrealised intragroup profits and losses

IAS 28, *Investments in Associates and Joint Ventures* requires the elimination of unrealised profit and losses only. (i.e. transactions that affect both the statement of profit or loss and other comprehensive income and statement of financial position.)

Income and expenses, such as interest received and paid, and management fees are not eliminated. Total sales for the year and loans between the associate and the investor are also not eliminated.

The focus is therefore on the elimination and realisation of intragroup profits rather than on intragroup transactions.

NOTE:

Joint ventures are also covered in IAS 28.

A joint venture is a joint arrangement and the parties that have joint control of the arrangement have rights to the net assets of the arrangement. (IAS 28.3)

An interest in a joint venture will be accounted for using the equity method in accordance with IAS 28.

Please refer to learning unit 5 for more information about investments in joint arrangements.

4.6 ASSESSMENT CRITERIA

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



- define an associate in terms of IAS 28;
- describe the methods to account for an investment in an associate in terms of IAS 28;
- differentiate between an associate, a 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;
- in the case of intragroup transactions, calculate the percentage of unrealised profit or loss in inventories or property, plant and equipment sold;
- record the pro forma journals for the elimination of the intragroup profit or loss;
- record the tax implications of the elimination of the intragroup profit or loss;
- 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 and when the intragroup profit or loss between the investor and the associate is eliminated.

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LEARNING UNIT 5

ACCOUNTING FOR INTERESTS IN JOINT ARRANGEMENTS



Group Financial Reporting

8 LEARNING UNIT 5

Accounting for interests in joint arrangements (IFRS 11 and IAS 28)

Learning outcome 5

After having studied this learning unit, you should be able to prepare consolidated annual financial statements when a investor holds a direct or indirect interest in a joint venture or joint operation in terms of IFRS 11, *Joint Arrangements* and IAS 28, *Investments in associates and Joint ventures*.

OVERVIEW OF THE LEARNING UNIT

This learning unit consists of the following sections:

- 5.1 Basic principles and accounting practice
- 5.2 Disclosure
- 5.3 Assessment criteria

STUDY

Refer to the chapter on interests in joint arrangements in **Group statements**.

5.1 BASIC PRINCIPLES AND ACCOUNTING PRACTICE

5.1.1 Basic outline of accounting for investments in joint arrangements (IFRS 11 and IAS 28)

An entity applies IFRS 11 to determine the type of joint arrangement in which it is involved. A joint arrangement is an agreement of which two or more parties have joint control.

A joint arrangement has the following characteristics (IFRS 11.5):

- The parties are bound by a contractual arrangement.
- The contractual arrangement gives two or more of those parties joint control of the arrangement.

Two types of joint arrangements exist, namely

- **joint operations**
- **joint ventures**

IFRS 11 requires a party to a joint arrangement to determine the type of joint arrangement in which it is involved by assessing its rights and obligations arising from the arrangement. (IFRS 11.14)

The entity's rights and obligations will be assessed by considering the structure and legal form, contractual terms as well as other facts and circumstances when relevant.

Once it has determined that it has an investment in a **joint operation**, the entity will recognise the assets, liabilities and related revenue and expenses in relation to its interest in the arrangement in accordance with the IFRS applicable to the particular assets, liabilities, revenue and expenses.

Once it has determined that it has an interest in a **joint venture**, the entity will recognise the investment in the joint venture following the equity method in accordance with IAS 28, *Accounting for Investments in Associates and Joint Ventures*.

5.1.2 Definitions (IFRS 11 – Appendix A)

Joint arrangement: This is an arrangement of which two or more parties have joint control.

Joint control: This is a contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

Remember the definition of control over an investee as per IFRS 10: "... when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee".

Joint operation: A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets and obligations for the liabilities relating to the arrangement.

Joint operator: A party to a joint operation that has joint control of that joint operation.

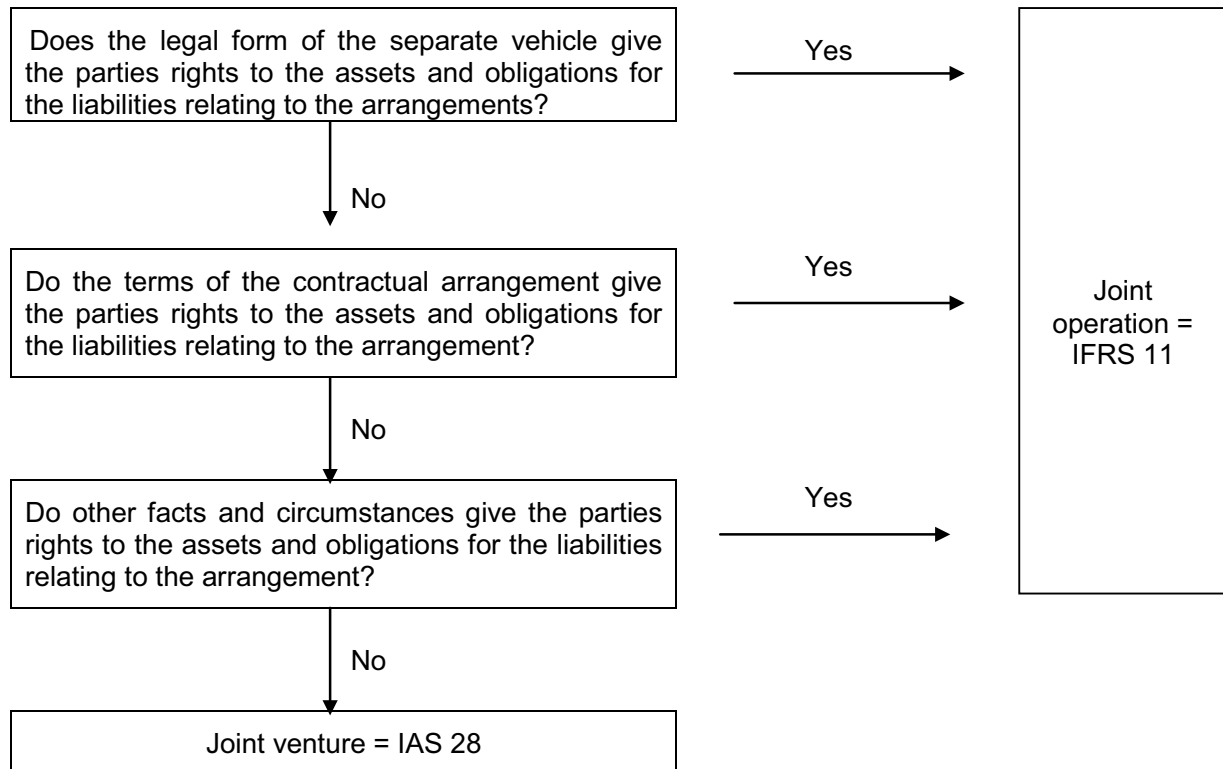
Joint venture: A joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

Joint venturer: A party to a joint venture that has joint control of that joint venture.

Party to a joint arrangement: An entity that participates in a joint arrangement, regardless of whether that entity has joint control of the arrangement or not.

Equity method: This is a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the net assets of the investee. The profit or loss of the investor includes its share of the profit or loss of the investee and the other comprehensive income of the investor includes its share of other comprehensive income of the investee. (IAS 28.IN7)

5.1.3 CLASSIFICATION OF A JOINT ARRANGEMENT



Joint operations

A jointly controlled operation is created when two or more operators combine their operations, resources and expertise to jointly operate an operation.

The establishment of a separate entity is not necessary, because each operator uses its own property, plant and equipment, carries its own inventory, and incurs its own expenses and liabilities. The joint agreement provides a means by which revenue and certain common expenses are shared among the operators.

A joint operator recognises the following in relation to its interest in a joint operation: (IFRS11.20)

- its assets, including its share of any assets held jointly
- its liabilities, including its share of any liabilities incurred jointly
- its revenue generated from the sale of its share of the output arising from the joint operation
- the share of the revenue from the sale of the output by the joint operation
- its expenses, including its share of any expenses incurred jointly

No adjustments or other consolidation procedures are required when the operator prepares consolidated annual financial statements, because the assets, liabilities, income and expenses of the joint operation are already recognised in the separate accounting records of the operator. Thus the separate and consolidated financial statements of the joint operators will have no difference.

Each operator usually contributes cash or other resources to the joint operation. These contributions are included in the accounting records of the operator and recognised in the annual financial statements of the operator as per the IFRS applicable to those assets and liabilities.

EXAMPLE 5.1

H Ltd and J Ltd are two separate companies which have combined their expertise and resources to develop a computer package to compile timetables for schools.

The contractual arrangement between H Ltd and J Ltd specifies that at least 51% of the voting rights are required to make decisions about the relevant activities of the arrangement. Even though H Ltd can block any decision, it does not control the arrangement because it needs the agreement of J Ltd. The terms of their contractual arrangement requiring at least 51% of the voting rights to make decisions about the relevant activities, imply that H Ltd and J Ltd have joint control of the arrangement because decisions about the relevant activities of the arrangement cannot be made without both H Ltd and J Ltd agreeing.

As a separate entity is not established and each entity has direct rights to a specified percentage of certain assets. Each entity can have differing rights to and percentages of other assets, and different obligations for various liabilities. Each company includes its share of the development costs, assets and liabilities and income and expenses from the sale of the package in the agreed upon ratio in its separate annual financial statements, because the arrangement is a **joint operation**.

EXAMPLE 5.2

A Ltd and B Ltd are parties to a joint arrangement and they have agreed to manufacture a product together. The manufacturing agreement is structured in a separate vehicle, entity P. The legal form causes it to be considered in its own right, and thus the assets and liabilities held in entity P are the assets and liabilities of entity P and not the assets and liabilities of the parties A Ltd and B Ltd.

The contractual agreement between the parties state that the parties will purchase the entire production of the product manufactured by entity P. Entity P will sell the product to the parties at a price as agreed by A Ltd and B Ltd. Any cash flow shortages of entity P will be financed by A Ltd and B Ltd in accordance with their ownership interests.

Although a separate entity is established and the legal structure creates separation between the parties and the entity, and the contractual agreement does not specify that the parties have rights to the assets and obligations for the liabilities, other relevant facts and circumstances conclude that the joint arrangement is a **joint operation**. The parties have committed themselves to purchasing the entire production manufactured, thus A Ltd and B Ltd have rights to all the economic benefits of the assets of the agreement. The dependence of entity P on A Ltd and B Ltd, which provide all financial assistance, results in A Ltd and B Ltd having direct obligations for the liabilities of entity P.

Each party to the joint operation should recognise in its separate financial statements the share of the assets and liabilities used for the specific task, and recognise its share of the revenues and expenses in accordance with the contractual arrangement.

EXAMPLE 5.3

A Ltd, B Ltd and C Ltd structured a joint arrangement in a separate incorporated entity, entity D; each party owns a third of entity D. Entity D enters into contracts with clients, and the assets and liabilities relating to the arrangement are held in entity D. The legal form of entity D indicates that the parties, and not entity D, have rights to the assets and obligations for the liabilities held in entity D according to their percentage interest held.

Accordingly, the legal form of entity D and the terms of the contractual arrangement indicate that the arrangement is a **joint operation**.

A Ltd has joint control over a block of flats (cost price and fair value = R24 000 000) in terms of the contractual arrangement. A Ltd has a one-third interest in the joint operation (entity D). If the total rental income for the year ended 30 June 2016 amounts to R1 500 000, maintenance to R750 000 and administration costs to R300 000, the following will be disclosed in the annual financial statements of **A Ltd**:

EXTRACT FROM THE STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 2016

	R
Investment property (33% x 24 000 000)	8 000 000

EXTRACT FROM THE STATEMENT OF PROFIT AND LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 2016

	R
Income	
Rental income (33% x 1 500 000)	500 000
Administrative expenses	
Maintenance of investment property generating rental income (33% x 750 000)	250 000
Administration costs (33% x 300 000)	100 000

NOTES FOR THE YEAR ENDED 30 JUNE 2016

1. Joint operation

The joint arrangement is based on a contractual agreement in place between A Ltd, B Ltd and C Ltd, which entails that each party owns 33% of entity D. The legal form of entity D indicates that the parties, and not entity D, have rights to the assets and obligations for the liabilities held in entity D according to their percentage interest held.

EXAMPLE 5.4

A Ltd, B Ltd and C Ltd structured a joint arrangement in a separate incorporated entity, entity D, in which each party has a third part in ownership interest. The legal form of entity D through which the activities are conducted indicates that the assets and liabilities held in entity D are the assets and liabilities of entity D. The contractual arrangement between the parties does not specify that the parties have rights to the assets or obligations for the liabilities of entity D.

Accordingly, the legal form of entity D and the terms of the contractual arrangement indicate that the arrangement is a **joint venture**, because the parties of the arrangement only have rights to the net assets of the arrangement.

A Ltd will recognise the investment in the joint venture following the **equity method** in accordance with IAS 28, Accounting for Investments in Associates and Joint Ventures.

If A Ltd has joint control over a block of flats (cost price and fair value of R24 000 000) as determined in the contractual arrangement, and A Ltd paid R8 000 000 for its interest in the joint venture (entity D) on 1 July 2015, A Ltd has a one-third interest in the joint venture. If the total rental income for the year ended 30 June 2016 amounts to R1 500 000, maintenance to R750 000 and administration costs to R300 000, the following will be disclosed in the annual financial statements of A Ltd Group:

EXTRACT FROM THE STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 2016

	R
Investment in joint venture	8 150 000
$8\,000\,000 + (33\% \times (1\,500\,000 - 750\,000 - 300\,000))$	

EXTRACT FROM THE STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 30 JUNE 2016

	R
Share of profit of joint venture $((1\,500\,000 - 750\,000 - 300\,000) \times 33\%)$	150 000

NOTES FOR THE YEAR ENDED 30 JUNE 2016

1. Interest in joint venture

A Ltd has a 33% interest in a joint venture, entity D, according to a contractual arrangement. The investment in the joint venture is measured using the equity method. Entity D owns a block of flats; the property is kept for investment purposes. The summarised financial information for entity D is as follows:

	R
Non-current assets	
Investment property	24 000 000
Revenue	
Rental income	1 500 000
Profit from continuing operations $(1\,500\,000 - 750\,000 - 300\,000)$	450 000
Total comprehensive income	450 000

EXAMPLE 5.5

B Ltd invests in a joint operation, called entity G, and is entitled to 33,33% of all the profits. The board of entity G consists of a director from each party. Each party has a 33,33% shareholding in entity G. The unanimous consent of the directors is required for any resolution to be passed.

A 33,33% share of all the statement of profit or loss and other comprehensive income items and statement of financial position items of entity G will be included in the statement of profit or loss and other comprehensive income and the statement of financial position of B Ltd. (B Ltd recognises in its financial statements its own share of the assets and of any liabilities resulting from the arrangement on the basis of their agreed participating interest. On that basis, each party also recognises its share of the revenue – from the sale of their share of the production – and its share of the expenses.)

However, where the joint operator has rights to a specified percentage of certain assets and differing rights to (and percentages of) other assets, and different obligations for various liabilities, the financial statements would look very different when accounting for those individual rights and obligations than when consolidating a blended percentage of all assets and liabilities.

EXAMPLE 5.6

Intragroup sale of property, plant and equipment

A Ltd acquired a 30% interest in B Ltd for R300 000 on incorporation of B Ltd (3 January 2016). In terms of a contractual agreement A Ltd, together with other operators, exercises joint control over the economic activities of B Ltd.

The contractual agreement specifies that all revenues, expenses, assets and liabilities are allocated according to the respective interests held by the operators. The arrangement is classified as a joint operation as per the requirements of IFRS 11, Joint Arrangements.

The following are extracts of the financial statements of the A Ltd Group and B Ltd for the year ended 31 December 2016:

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION AT 31 DECEMBER 2016

	A Ltd Group R	B Ltd R
ASSETS		
Property, plant and equipment	1 200 000	650 000
Investment in B Ltd at cost	300 000	-
Inventory	200 000	800 000
Total assets	1 700 000	1 450 000
EQUITY AND LIABILITIES		
Share capital	500 000	1 000 000
Retained earnings	800 000	450 000
Non-controlling interests	400 000	-
Total equity and liabilities	1 700 000	1 450 000

CONSOLIDATED STATEMENTS OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2016

	A Ltd Group	B Ltd
	R	R
Revenue	2 500 000	1 800 000
Cost of sales	(1 400 000)	(1 100 000)
Gross profit	1 100 000	700 000
Other income	534 000	325 000
Other expenses	(120 000)	(125 000)
Profit before tax	1 514 000	900 000
Income tax expenses	(480 000)	(270 000)
PROFIT FOR THE YEAR	1 034 000	630 000
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	1 034 000	630 000
Total comprehensive income attributable to:		
Owners of the parent	770 000	630 000
Non-controlling interests	264 000	-
	<u>1034 000</u>	<u>630 000</u>

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2016

	A Ltd Group	B Ltd
	R	R
RETAINED EARNINGS		
Balance as at 1 January 2016	150 000	-
Changes in equity for 2016		
Total comprehensive income for the year:		
– Profit for the year	770 000	630 000
Dividends paid	(120 000)	(180 000)
Balance as at 31 December 2016	800 000	450 000

Additional information

- On 1 March 2016, the A Ltd Group sold land to the joint operation, B Ltd, at its fair value of R350 000. The land had a carrying amount of R120 000 in the records of A Ltd Group.
- On 1 October 2016, B Ltd sold plant to the A Ltd Group at a profit of R120 000. It is the entity's policy to depreciate plant using the straight-line method. At the date of sale the remaining useful life of the plant is five years, which is consistent with the tax allowance of the South African Revenue Service. The profit on sale of the plant is included in other income in the records of B Ltd.
- The South African normal tax rate is 28% and capital gains tax is calculated at 80% thereof.



REQUIRED:

- (a) Prepare the pro forma journal entries to account for the joint operation in the A Ltd Group's financial statements for the year ended 31 December 2016.
- (b) Prepare ONLY the ASSET section (including deferred tax asset) of the consolidated statement of financial position of the A Ltd Group as at 31 December 2016.
- (c) Prepare the consolidated statement of profit or loss and other comprehensive income for the A Ltd Group for the year ended 31 December 2016.

Your answer must comply with the requirements of the International Financial Reporting Standards.

Comparative figures are not required.

All calculations are to be done to the nearest R1

SOLUTION 5.6

PART (a)

		Dr R	Cr R
J1	Property, plant and equipment (650 000 x 30%)	195 000	
	Inventories (800 000 x 30%)	240 000	
	Dividends paid (180 000 x 30%)	54 000	
	Cost of sales (1 100 000 x 30%)	330 000	
	Other expenses (125 000 x 30%)	37 500	
	Income tax expense (270 000 x 30%)	81 000	
	Revenue (1 800 000 x 30%)		540 000
	Other income (325 000 x 30%)		97 500
	Share capital (1 000 000 x 30%)		300 000
	Accounting for the joint operation – 30% of B Ltd		
J2	Share capital (1 000 000 x 30%)	300 000	
	Investment in B Ltd at cost (given)		300 000
	Elimination of investment at acquisition date		
J3	Other income (dividend received)	54 000	
	Dividends paid (180 000 x 30%)		54 000
	Elimination of intragroup dividend		
J4	Other income (profit on sale of land) (P/L)	69 000	
	Property, plant and equipment (land) (SFP)		69 000
	Elimination of unrealised profit on intragroup sale of land ((350 000 – 120 000) x 30%)		
J5	Deferred tax (SFP)	15 456	
	Income tax expense (P/L)		15 456
	Tax implication of the elimination of unrealised profit on intragroup sale of land (69 000 (J4) x 28% x 80%)		

	Dr R	Cr R
J6 Other income (profit on sale of plant) (P/L)	36 000	
Property, plant and equipment (plant) (SFP)		36 000
Elimination of unrealised profit on intragroup sale of plant (120 000 (given) x 30%)		
J7 Deferred tax (SFP)	10 080	
Income tax expense (P/L)		10 080
Tax implication of the elimination of unrealised profit on intragroup sale of plant (36 000 (J6) x 28%)		
J8 Accumulated depreciation (SFP)	1 800	
Other expenses (depreciation) (P/L)		1 800
Accounting for realised portion of profit on sale of plant through use ((120 000 (given) / 5 years x $\frac{3}{12}$) x 30%)		
J9 Income tax expense (P/L)	504	
Deferred tax (SFP)		504
Tax implication of realised portion of profit on sale of plant (1 800 (J8) x 28%)		

PART (b)**A LTD GROUP****CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2016**

ASSETS	R
Property, plant and equipment	
(1 200 000 + 195 000 (J1) – 69 000 (J4) – 36 000 (J6) + 1 800 (J8))	1 291 800
Deferred tax asset (15 456 (J5) + 10 080 (J7) – 504 (J9))	25 032
Inventory (200 000 + 240 000 (J1))	440 000
Total assets	1 756 832
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	
Share capital (500 000 + 300 000 (J1) – 300 000 (J2))	500 000
Retained earnings	856 832
Non-controlling interests (given)	400 000
Total equity and liabilities	1 756 832

NOTE: The question did not require the inclusion of equity and liabilities, but they are provided for tuition purposes.

PART (c)

A LTD GROUP

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2016

	R
Revenue (2 500 000 + 540 000 (J1))	3 040 000
Cost of sales (1 400 000 + 330 000 (J1))	<u>(1 730 000)</u>
Gross profit	1 310 000
Other income	
(534 000 + 97 500 (J1) – 54 000 (J3) – 69 000 (J4) – 36 000 (J6))	472 500
Other expenses (120 000 + 37 500 (J1) – 1 800 (J8))	<u>(155 700)</u>
Profit before tax	1 626 800
Income tax expense	
(480 000 + 81 000 (J1) – 15 456 (J5) – 10 080 (J7) + 504 (J9))	<u>(535 968)</u>
PROFIT FOR THE YEAR	1 090 832
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	1 090 832
Total comprehensive income attributable to:	
Owners of the parent (balancing)	826 832
Non-controlling interests (given)	<u>264 000</u>
	1 090 832

A LTD GROUP

EXTRACT FROM CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2016

	Retained earnings R
Balance as at 1 January 2016	150 000
Changes in equity for 2016	
Total comprehensive income for the year:	
Profit for the year	826 832
Dividends paid	<u>(120 000)</u>
Balance as at 31 December 2016	856 832

Assume that B Ltd is a joint venture as per the requirements of IFRS 11, Joint Arrangements.

The amount that will be disclosed as **investment in joint venture** in the consolidated statement of financial position of the A Ltd Group as at 31 December 2016 is:

	R
Investment in B Ltd at cost price	300 000
A Ltd's share of the joint venture's profit for the year (630 000 (given) x 30%)	189 000
Elimination of intragroup dividend (180 000 x 30%)	(54 000)
Elimination of unrealised profit on sale of land ((350 000 – 120 000) x 30%)	<u>(69 000)</u>
	366 000

The amount that will be disclosed as **share of profit of joint venture** in the consolidated statement of profit or loss and other comprehensive income for the year ended 31 December 2016 is:

	R
A Ltd's share of the joint venture's profit for the year (630 000 (given) x 30%)	189 000
Elimination of unrealised intragroup profit on sale of plant (120 000 x 30%)	(36 000)
Tax effect of elimination of unrealised profit (36 000 x 28%)	10 080
Realised profit on sale of plant through use or depreciation for 3 months ($(120\,000 / 5 \text{ years} \times \frac{3}{12}) \times 30\% = 1\,800$)	1 800
Tax effect of the realisation of profit on sale of plant (1 800 x 28%)	(504)
	<u>164 376</u>

STUDY

All the examples in the chapter on interests in joint arrangements in **Group statements**.

5.2 DISCLOSURE

STUDY

Study the section on disclosure in the chapter on interests in joint arrangements in **Group statements**.

The disclosure requirements for joint operations and joint ventures are set out in IFRS 12, Disclosure of interests in Other entities.

The following information must be disclosed for each **joint operation**:

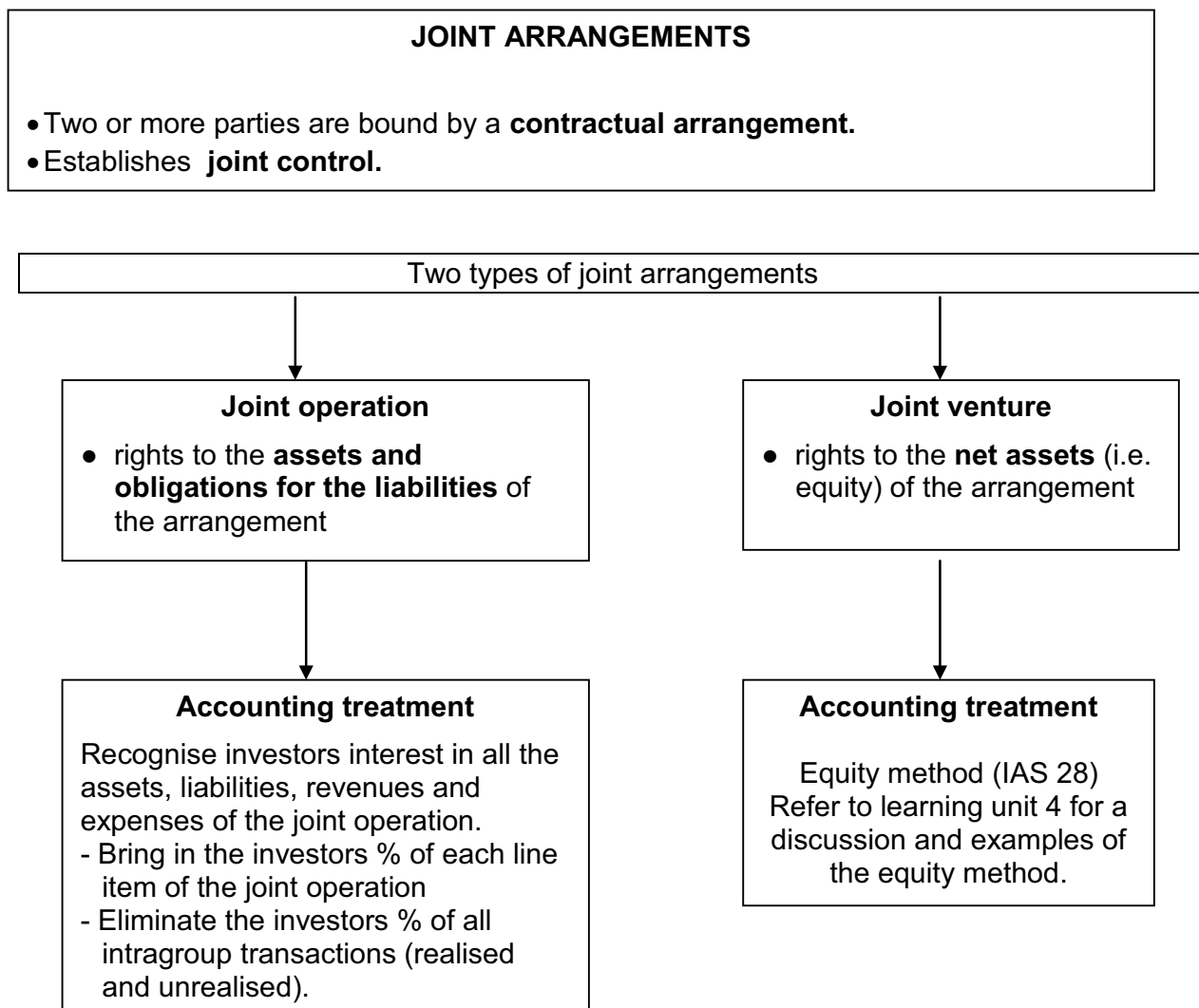
- the name of the joint operation
- the nature of the entities relationship with the joint operation
- the principle place of business and the country of incorporation of the joint operation
- the ownership interest and if different, the proportion of of voting rights held

The following information must be disclosed for each **joint venture**:

NOTE: the disclosure requirements are the same for associates and joint ventures.

Please refer to the section on disclosure, as well as the example on the equity method and related disclosure in learning unit 4.

5.2.1 Summary



5.3 ASSESSMENT CRITERIA

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



- define a joint arrangement, joint operation and joint venture in terms of IFRS 11;
- differentiate between the types of joint arrangements: joint operations and joint ventures;
- differentiate between an associate, a subsidiary, a joint operation and a joint venture;
- **Joint operations**
 - describe the method to account for a joint operation;
 - record and disclose a joint operation;
 - prepare and present consolidated annual financial statements when a joint operator has an interest in a joint operation.
- **Joint ventures**
 - describe the method used to account for joint ventures;
 - record and disclose a joint venture;
 - prepare and present consolidated annual financial statements when a joint venturer has an interest in a joint venture.
- in the case of intragroup transactions, calculate the percentage of unrealised profit or loss in inventories or property, plant and equipment sold;
- prepare the pro forma journals for the elimination of the intragroup profit/loss;
- prepare the pro forma journals in respect of the tax implications on the elimination of the intragroup profit/loss.

FAC3704

LEARNING UNIT 6

CHANGES IN OWNERSHIP



Group Financial Reporting

9 LEARNING UNIT 6

Changes in ownership

Learning outcome 6

After studying this learning unit, you should be able to apply consolidation procedures to prepare the consolidated annual financial statements for a group where there has been a change in ownership.

OVERVIEW OF THE LEARNING UNIT

The learning unit consists of the following sections:

- 6.1 Introduction
- 6.2 Step acquisitions of interests in investees
- 6.3 Disposals of interests in investees
- 6.4 Assessment criteria

STUDY

The following circumstances giving rise to changes in ownership are examinable in FAC3704 and must be studied:

Acquisition of interests in subsidiaries:

- Acquisition of an additional interest in an existing subsidiary where the subsidiary remains a subsidiary
- Acquisition of an additional interest where an IFRS 9 simple investment becomes a subsidiary

Disposals of interests in subsidiaries:

- Partial disposal of an interest in a subsidiary where it remains a subsidiary after the disposal (i.e. control is not lost)
- Partial disposal of an interest in a subsidiary and an IFRS 9 simple investment is retained.

Refer to the chapters on changes in ownership in **Group statements** and work through the examinable scenario's listed above.

Rights issues, share buy backs and capitalisation shares are **not examinable**.

6.1 INTRODUCTION

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 should be applied at the acquisition date, which is the date that control is obtained.

A change in status implies that either there was control over a company, and after the change in ownership control no longer exists (decrease in degree of control) or that there was no control before the change in ownership and thereafter there is control (increase in

the degree of control).

6.1.1 Methods of change in ownership

Changes in ownership can occur in many different ways, only the sections covered in this module are discussed:

(a) Increase of interest (increase in degree of control)

- Additional ordinary shares in the investee are acquired from the other shareholders.

(b) Decreases of interest (decrease in degree of control):

- Ordinary shares in an investee are sold to the other shareholders.

6.2 STEP ACQUISITIONS OF INTERESTS IN INVESTEEES

(a) Acquisition of an additional interest in an existing subsidiary

- subsidiary → remains a subsidiary, with parent company holding a greater interest

In this case it is important to realise that there is no change in status: the subsidiary remains a subsidiary, only with the parent company holding a greater interest. The following steps are taken:

- (i) The carrying amount of the non-controlling interests, including any goodwill attributable to the non-controlling interests (if applicable), needs to be adjusted to reflect the non-controlling interests' reduced interest in the subsidiary.
- (ii) The difference between the non-controlling interests' adjustment amount (as discussed above) and the consideration transferred by the parent for the additional interest, must be recognised directly in equity in the **change in ownership reserve**.
- (iii) No additional goodwill or gain on bargain purchase is recognised.
- (iv) No gain or loss should be recognised in the statement of profit or loss and other comprehensive income.

(b) Acquisition of an additional interest where an IFRS 9 simple investment becomes a subsidiary

- IFRS 9 simple investment → subsidiary

In this case it is important to realise that there is a change in status: control is obtained.

The following steps are taken:

- (i) On the acquisition date (the date when control is obtained over the investee), remeasure the previously held interest (i.e. the IFRS 9 simple investment) to its fair value. The resulting gain or loss is recognised in the profit or loss section of the consolidated statement of profit or loss and other comprehensive income.
- (ii) Any other comprehensive income (i.e. mark-to-market reserve) that relates to previous fair value adjustments on the previously held interest (i.e. the IFRS 9 simple investment) must be transferred from mark-to-market reserve to retained earnings.

3. On 1 October 2016 Bon Ltd acquired an additional 6 000 ordinary shares in Aqua Ltd. On this date there was no change in the fair value of assets, liabilities or contingent liabilities as was determined on 1 January 2014. The profit of Aqua Ltd other than the effect of the intragroup transaction (refer point 5) was earned evenly throughout the year.
4. The equity investments are measured at fair value through profit and loss. The cost price of the investment in the subsidiary is considered to be equivalent to the fair value thereof.
5. On 2 October 2016 Aqua Ltd sold machinery with a carrying amount of R80 000 to Bon Ltd for R120 000. The depreciation policy of the group is to depreciate machinery over the expected useful life of five years using the straight-line method. Machinery is depreciated over the same number of years as is allowed for tax purposes.
6. On 1 January 2014 Bon Ltd acquired control of Aqua Ltd. Assume that Bon Ltd continued to control Aqua Ltd throughout the period.
7. Assume that each share carries one vote.
8. The South African normal tax rate is 28%. You may assume the tax rate has been 28% since 1 January 2014 and CGT is calculated at 80% thereof.
9. The companies use the partial goodwill method to account for non-controlling interests. The value of goodwill was tested for impairment at the end of 2016 and it was found not to be impaired.

	<p>REQUIRED:</p> <p>(a) Prepare the following for the Bon Ltd Group for the year ended 31 December 2016:</p> <ol style="list-style-type: none"> (i) consolidated statement of financial position (ii) consolidated statement of profit or loss and other comprehensive income (iii) consolidated statement of changes in equity <p>Your answer must comply with the requirements of the International Financial Reporting Standards.</p> <p>The notes to the consolidated annual financial statements and comparative figures are not required.</p> <p>All calculations are to be done to the nearest R1.</p>
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SOLUTION 6.1

PART (a)(i)**BON LTD GROUP****CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 2016**

ASSETS	R
Non-current assets	
Property, plant and equipment (823 000 + 651 000 – 40 000 (machinery) + 2 000 (C2))	1 436 000
Deferred tax (11 200 (40 000 x 28%) – 560 (C2))	10 640
	<u>1 446 640</u>
Current assets	
Trade receivables (78 800 + 36 800)	115 600
	<u>115 600</u>
Total assets	<u>1 562 240</u>
EQUITY AND LIABILITIES	
Equity attributable to owners of the parent	966 980
Share capital	300 000
Retained earnings	677 180
Other components of equity (change in ownership reserve)	(10 200)
Non-controlling interests	116 360 ⁿ
Total equity	<u>1 083 340</u>
Non-current liabilities	
Long-term borrowings (270 000 + 175 000)	445 000
	<u>445 000</u>
Current liabilities	
Trade and other payables (13 900 + 20 000)	33 900
	<u>33 900</u>
Total liabilities	<u>478 900</u>
Total equity and liabilities	<u>1 562 240</u>

PART (a)(ii)**BON LTD GROUP****CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2016**

	R
Profit before tax	369 500
(190 000 + 240 000 – 22 500 (div) – 40 000 (machinery) + 2 000 (C2))	
Income tax expense (53 200 + 67 200 – 11 200 (40 000 x 28%) + 560 (C2))	(109 760)
PROFIT FOR THE YEAR	<u>259 740</u>
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	<u>259 740</u>
Total profit and other comprehensive income attributable to:	
Owners of the parent	207 180
Non-controlling interests (43 200 ^a + 9 360 ^b)	52 560
	<u>259 740</u>

PART (a)(iii)

BON LTD GROUP

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2016

	Share capital R	Retained earnings R	Change in ownership R	Total R	Non- control- ling interests R	Total equity R
Balance at 1 January 2015	300 000	520 000 ¹	—	820 000	140 000 ⁱ	960 000
Changes in equity for 2016						
Total comprehensive income for the year:						
Profit for the year		207 180		207 180	52 560	259 740
Purchase additional interest			(10 200) ^g	(10 200)	(68 700) ^e	(78 900)
Dividends paid		(50 000)		(50 000)	(7 500) ^f	(57 500)
Balance at 31 December 2016	300 000	677 180	(10 200)	966 980	116 360	1 083 340

¹ 500 000 + 17 064^c + 2 936^d = 520 000 or
500 000 + (150 000 – 75 000 – 46 560 – 10 476 (J4)) + 2 936^d = 520 000

LECTURER'S COMMENT

Calculation of percentage interest

The share capital consists of 40 000 ordinary shares with a value of R200 000. When calculating Bon Ltd's percentage interest in Aqua Ltd, the number of shares acquired by Bon Ltd is divided by the total number of shares issued by Aqua Ltd.

First acquisition:

Acquired 60%; Bon Ltd purchased 24 000 shares (60% x 40 000)

Second acquisition:

Acquired 6 000 shares; Bon Ltd's interest increased to 75%
[(24 000 + 6 000) / 40 000]

Subsequent disposal of land revalued at acquisition date

On 1 January 2014 (additional information — note 1), when Bon Ltd acquired a controlling interest in Aqua Ltd, the fair value of a piece of vacant land was R60 000 (after tax - R46 560 (60 000 – (60 000 x 80% x 28%)) more than its carrying amount. The revaluation of the land was done for group purposes only. The revaluation was not accounted for in the separate financial statements of Aqua Ltd.

Aqua Ltd sold the land for R110 000 on 30 June 2015 (additional information — note 2). The profit or loss on disposal of the land will not be the same for the Bon Ltd Group as for Aqua Ltd as carrying amount of the land for the Bon Ltd Group is R60 000 more than for Aqua Ltd (due to the revaluation at the acquisition date). **The profit for the Bon Ltd Group will be R60 000 less than for Aqua Ltd.**

The following pro-forma consolidation journal will be passed to correctly reflect the profit for group purposes (refer also to J3):

	R	R
Dr Retained earnings (profit on sale of land)	60 000	
Cr Property, plant and equipment (land)		60 000
Dr Deferred tax (SFP)	13 440	
Cr Retained earnings (income tax expense)		13 440



CALCULATIONS

C1 ANALYSIS OF OWNERS' EQUITY OF AQUA LTD

	100%	Bon Ltd 60% – 75%		40% – 25%
	Total R	At R	Since R	NCI R
At acquisition				
Share capital	200 000	120 000		80 000
Retained earnings	75 000	45 000		30 000
Revaluation surplus				
(60 000 – 13 440 (60 000 x 80% x 28%))	46 560	27 936		18 624
	321 560	192 936		128 624
Equity represented by gain on bargain purchase	(2 936)	(2 936) ^d		—
Consideration and non-controlling interests	318 624	190 000		128 624
Since acquisition				
Retained earnings (150 000 – 75 000 – 46 560#)	28 440		17 064 ^c	11 376
(#refer to lecturers comment on subsequent disposal of land revalued at acquisition date))	347 064		17 064	140 000 ⁱ
Current year				
Profit for the year (C2)	108 000		64 800	43 200 ^a
	455 064		81 864	183 200
Purchase of 6 000 shares ((455 064 + 2 936 gain on bargain at acquisition date) x 15%)		68 700		(68 700) ^e
Investment in Aqua Ltd (purchase of additional interest) (268 900 – 190 000)		(78 900)		
Change in ownership		(10 200) ^g		
Profit for the year (C2)	37 440		28 080	9 360 ^b
Dividends paid	(30 000)		(22 500)	(7 500) ^f
	462 504		87 444	116 360

LECTURER'S COMMENT



It is important to note that a **gain on bargain purchase** (R2 936) is always attributable to the acquirer (Bon Ltd). It does not form part of the net assets (equity) of Aqua Ltd. Therefore, when 15% of the equity of Aqua Ltd is transferred from NCI to Bon Ltd, it is important to remember to add back the R2 936 to the total of R455 064 (analysis) in order to exclude it.

When there is **no change in status** (i.e. control over the subsidiary before and after the change in ownership), IFRS 3 requires the difference between the additional interest obtained and the amount of consideration paid for that additional interest to be recognised as part of **change in ownership reserve**. The R10 200 will be disclosed in the consolidated statement of changes in equity in the change in ownership reserve column.

C2 PROFIT FOR THE YEAR

	Total R	9 months R	3 months R
Profit before tax (240 000 – 40 000 (intragroup))	200 000	150 000	50 000
Income tax expense (67 200 – 11 200 (40 000 x 28%))	(56 000)	(42 000)	(14 000)
	<u>144 000</u>	<u>108 000</u>	36 000
Profit made on disposal (120 000 – 80 000)			40 000
Tax effect on profit (40 000 x 28%)			(11 200)
Elimination of unrealised profit (subsidiary made the sale and profit, therefore elimination of profit)			(40 000)
Tax effect on unrealised profit			11 200
Realisation of unrealised profit (40 000 / 5 x ³ / ₁₂)			2 000
Tax effect on realisation (2 000 x 28%)			(560)
			<u>37 440</u>

C3 PRO FORMA CONSOLIDATION JOURNALS

	Dr R	Cr R	NCI R
J1 Property, plant and equipment	60 000		
Deferred tax (60 000 x 80% x 28%)		13 440	
Revaluation surplus		46 560	
Revaluation of fixed property at date of acquisition			
J2 Share capital	200 000		
Retained earnings	75 000		
Revaluation surplus	46 560		
Non-controlling interests (SFP)		128 624	128 624
Investment in Aqua Ltd		190 000	
Retained earnings (gain on bargain purchase)		2 936 ^d	
Elimination of investment in Aqua Ltd			
J3 Retained earnings	46 560		
Deferred tax	13 440		
Property, plant and equipment		60 000	
Sale of fixed property revalued at acquisition (refer to lecturers comment)			
J4 Retained earnings (SOCIE)	11 376		
Non-controlling interests (SFP)		11 376	11 376
Recording of non-controlling interests in retained earnings since acquisition to beginning of current year ((150 000 – 75 000 – 46 560) x 40%)			
			<u>140 000ⁱ</u>

	Dr R	Cr R	NCI R
J5 Non-controlling interests (P/L)	43 200		
Non-controlling interests (SFP)		43 200	43 200 ^a
Recording of non-controlling interests in profit for the year for 9 months to 30/09/20.3 (108 000 (C2) x 40%)			
			<hr/> 183 200
J6 Non-controlling interests (SFP)			
(183 200 x 15% / 40%)	68 700		(68 700) ^e
Change in ownership (SOCIE)	10 200		
Investment in Aqua Ltd (268 900 – 190 000)		78 900	
Elimination of additional investment in Aqua Ltd			
J7 Non-controlling interests (P/L)	9 360		
Non-controlling interests (SFP)		9 360	9 360 ^b
Recording of non-controlling interests in profit for the 3-month period to 31/12/20.3 (37 440 (C2) x 25%)			
J8 Dividend received/Other income (P/L)	22 500		
Non-controlling interests (SFP)			
(30 000 x 25%)	7 500		(7 500) ^f
Dividend paid		30 000	
Elimination of intragroup dividends and recording of non-controlling interests in dividends paid			
			<hr/> 116 360

6.3 DISPOSALS OF INTERESTS IN INVESTEEES

(a) Partial disposal of an interest in an existing subsidiary, control not lost

- subsidiary → remains a subsidiary, with parent company holding a smaller interest

In this case it is important to realise that there is no change in status: the subsidiary remains a subsidiary, only with the parent company holding a smaller interest.

The parent will recognise the profit or loss on disposal of the investment in its **separate financial statements**. In addition, if the parent chose to recognise the investment at fair value through other comprehensive income in accordance with IFRS 9, a portion of the mark-to-market reserve will be transferred to retained earnings.

The following steps are taken when preparing consolidated financial statements:

- The profit or loss on disposal, and the transfer of mark-to-market to retained earnings (if applicable) that was recognised in the parents separate financial statements will be reversed upon consolidation.
- The difference between the amount that the non-controlling interests' are adjusted by and the consideration received by the parent on disposal, must be recognised directly in equity in the **change in ownership reserve**.

- (iii) No gain or loss should be recognised in the statement of profit or loss and other comprehensive income.
- (iv) The total amount of goodwill that arose at acquisition date is **not** adjusted. However, allocation of goodwill between the NCI and the parent is adjusted as the parent now has a smaller ownership interest in the net assets (including goodwill) of the subsidiary. It is important to note that additional goodwill will only be allocated to the NCI if goodwill was initially recognised for the NCI (i.e. the full goodwill method is used). If the partial goodwill method is used, the total goodwill that arose on initial acquisition will remain attributable to the parent.

	<p>LECTURER'S COMMENT</p> <p>When a subsidiary remains a subsidiary, albeit with a smaller interest, the goodwill recognised on acquisition of the original interest in the subsidiary will not be derecognised. The goodwill will remain in the financial statements of the parent until such time as the control is relinquished.</p> <p>The ratio of goodwill attributable to the parent and the non-controlling interests can change depending on the method used for recognising goodwill (full goodwill method or partial goodwill method). Refer to examples in Group statements, volume 2.</p>
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(b) Partial disposal of an interest in an existing subsidiary, with a simple investment retained

- subsidiary → IFRS 9 simple investment

In this case it is important to realise that there is a change in status: control is lost.

The parent will recognise the profit or loss on disposal of the investment in its **separate financial statements**. In addition, if the parent chose to recognise the investment at fair value through other comprehensive income in accordance with IFRS 9, a portion of the mark-to-market reserve will be transferred to retained earnings.

The following steps are taken when preparing consolidated financial statements:

- (i) The profit or loss on disposal, and the transfer of mark-to-market reserve to retained earnings (if applicable) that was recognised in the parents separate financial statements will be reversed upon consolidation.
- (ii) A consolidated profit or loss on disposal will be recognised in the consolidated statement of profit and loss and other comprehensive income, calculated as the difference between the proceeds received on disposal and the portion of net assets (including goodwill) disposed of.
- (iii) The remaining investment (i.e. the portion of net assets and goodwill retained) is remeasured to fair value on the date control is lost (i.e. the date of disposal). The remeasurement gain or loss is recognised in the profit and loss section of the consolidated statement of profit and loss and other comprehensive income and is attributable to the parent.

EXAMPLE 6.2**Decrease in interest in subsidiary, no change in status**

The following are the abridged trial balances of Garage Ltd and Workshop Ltd for the year ended 29 February 2016:

	Garage Ltd	Workshop Ltd
	R	R
Debits		
Property, plant and equipment	200 000	150 000
Investment in Workshop Ltd at fair value - 40 000 shares	75 240	-
Trade receivables	34 760	34 000
Income tax expense	34 500	30 000
	<u>344 500</u>	<u>214 000</u>
Credits		
Share capital - 50 000 ordinary shares each	50 000	50 000
Mark-to-market reserve	7 760	-
Retained earnings - 1 March 2015	110 000	75 000
Profit before tax	115 000	85 000
Deferred tax on mark-to-market reserve	2 240	-
Proceeds on disposal of 10 000 shares	55 000	-
Trade and other payables	4 500	4 000
	<u>344 500</u>	<u>214 000</u>

Additional information

- Garage Ltd acquired control of Workshop Ltd and acquired its 40 000 shares in Workshop Ltd on 1 March 2013 when the retained earnings of Workshop Ltd amounted to R28 000.

The fair value of the identifiable assets, liabilities and contingent liabilities were considered to be equal to the carrying amounts thereof on 1 March 2013, except for the following items:

	Fair value	Carrying amount
	R	R
Workshop building	105 000	95 000
Trade receivables	18 000	23 000

- On 28 February 2016 Garage Ltd sold 10 000 shares in Workshop Ltd to non-controlling shareholders. Garage Ltd still controls Workshop Ltd.
- The SA normal tax rate is 28% since 1 March 2013 and CGT is calculated at 80% thereof.
- Goodwill was not considered to be impaired at year-end. Assume that the group elected to measure any non-controlling interests in an acquiree as its proportional share of the acquiree's identifiable net assets at acquisition date (partial goodwill method).
- Garage Ltd measures its investments in equity instruments at fair value through other comprehensive income.



REQUIRED:

(a) Prepare the following for the Garage Ltd Group for the year ended 29 February 2016:

- (i) the consolidated statement of financial position
- (ii) the consolidated statement of profit or loss and other comprehensive income
- (iii) the consolidated statement of changes in equity

Your answer must comply with the requirements of the International Financial Reporting Standards.

The notes to the consolidated annual financial statements and comparative figures are not required.

All calculations are to be done to the nearest R1.

SOLUTION 6.2

PART (a)(i)

GARAGE LTD GROUP

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 28 FEBRUARY 2016

	R
Profit before tax (115 000 + 85 000)	200 000
Income tax expense (34 500 + 30 000 + 7 215(C3))	(71 715)
PROFIT FOR THE YEAR	<u>128 285</u>
Other comprehensive income for the year	<u>–</u>
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	<u><u>128 285</u></u>
Total comprehensive income attributable to:	
Owners' of the parent	117 285
Non-controlling interests	11 000
	<u>128 285</u>

PART (a)(ii)**GARAGE LTD GROUP****CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED
29 FEBRUARY 2016**

	Share capital R	Change in ownership R	Retained earnings R	Total R	Non- control- ling interests R	Total equity R
Balance at 1 Mar 2015	50 000	-	150 520 ¹	200 520	26 440 ^c	226 960
Changes in equity for 2016						
Total comprehensive income for the year:						
Profit for the year	-	-	117 285	117 285	11 000	128 285
Disposal of interest in subsidiary	-	17 560 (C2)	-	17 560	37 440	55 000
Balance at 28 Feb 2016	<u>50 000</u>	<u>17 560</u>	<u>267 805</u>	<u>335 365</u>	<u>74 880</u>	<u>410 245</u>

¹ 110 000 + 40 480^b + 40(gain) = 150 520

or 110 000 + 75 000 – 24 400(J2) – 10 120(J3) + 40(gain) = 150 520

PART (a)(iii)**GARAGE LTD GROUP****CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 29 FEBRUARY 2016
R****ASSETS****Non-current assets**

Property, plant and equipment (200 000 + 150 000 + 10 000(C4)) 360 000

Total non-current assets 360 000

Current assets

Trade receivables (34 760 + 34 000) 68 760

Total current assets 68 760

Total assets 428 760

EQUITY AND LIABILITIES

Total equity 410 245

Equity attributable to owners' of the parent 335 365

Share capital 50 000

Change in ownership reserve 17 560

Retained earnings 267 805

Non-controlling interests 74 880^m

Non-current liabilities

Deferred tax (C5) 2 800

Total non-current liabilities 2 800

Current liabilities

South African Revenue Service (C3) 7 215

Trade and other payables (4 500 + 4 000) 8 500

Total current liabilities 15 696

Total liabilities 18 515

Total equity and liabilities 428 760

CALCULATIONS

C1 Calculation of fair value adjustments at acquisition

	Carrying amount R	Fair value R	Revaluation R	Tax @ 28% R	After tax revaluation R
Workshop building	95 000	105 000	10 000	2 800	7 200
Trade receivables	23 000	18 000	(5 000)	(1 400)	(3 600)

C2 Analysis of owners' equity of Workshop Ltd

	Total	Garage Ltd 80% - 60%		NCI 20% - 40%
	R	At R	Since R	R
At acquisition				
Share capital	50 000	40 000		10 000
Revaluation surplus (C1)	7 200	5 760		1 440
Retained earnings (28 000 – 3 600(C1))	24 400	19 520		4 880
	81 600	65 280		16 320
Equity represented by gain on bargain purchase	(40)	(40)		-
Consideration paid and NCI	81 560	65 240 ¹		16 320
Since acquisition				
Gain on bargain purchase	40		40	-
Retained earnings (75 000 – 28 000 + 3 600(C1))	50 600		40 480 ^b	10 120
			40 520	26 440 ^c
Current year				
Profit for the year (85 000 – 30 000)	55 000		44 000	11 000
	187 200		84 520	37 440
Sale of 10 000 shares				
Transfer of equity share to NCI		(16 320) ²	(21 120) ³	37 440 ⁴
Since acquisition equity transferred to NCI		(21 120)		
		(37 440)		74 880
Proceeds from sale of shares		55 000		
Change in ownership (credit)		(17 560)		
	187 200		63 400	74 880 ^m

¹ 75 240 – 7 760 – 2 240 = 65 240

² 65 280 x $\frac{20}{80}$ = 16 320

³ 84 480 x $\frac{20}{80}$ = 21 120

⁴ (187 200 x 20%(40% - 20%)) or 37 440 x $\frac{20}{20}$

C3 Tax effect of sale of shares in subsidiary

	R
Profit on sale per records of Garage Ltd (55 000 – 16 310(C2))	38 690
Tax effect (38 690 x 22,4%) (80% x 28% = 22,4%)	<u>8 667</u>

C4 Journal entries

	Dr R	Cr R	NCI R
In separate financial statements of parent			
J1 Proceeds on sale of shares	55 000		
Other income (profit on sale of shares)(P/L)		38 690	#
Investment in Workshop Ltd (65 240 x ²⁰ / ₈₀)		16 310	
Recording of profit on sale of investment in Workshop Ltd			
J2 Mark-to-market reserve (7 760 x ²⁰ / ₈₀)	1 940		
Deferred tax (SFP) (2 240 x ²⁰ / ₈₀)	560		
Investment in Workshop Ltd		2 500	
Recording of realisation of portion of mark-to-market reserve			
J3 Income tax expense (C3)	8 667		
South African Revenue Service (SARS)(SFP)		8 667	
Provision for capital gains tax on profit on sale of shares			
Pro-forma consolidation journal entries			
J1 Mark-to-market reserve (7 760 – 1 940(J2))	5 820		
Deferred tax (SFP) (2 240 – 560(J2))	1 860		
Investment in Workshop Ltd		7 500	
Writing back of fair value adjustment			
J2 Property, plant and equipment	10 000		
Revaluation surplus (C1)		7 200	
Deferred tax		2 800	
Recording of at acquisition revaluation surplus for building			
J3 Share capital	50 000		
Revaluation surplus (C1)	7 200		
Retained earnings (28 000 – 3 600(C4))	24 400		
Investment in Workshop Ltd			
(75 240 – (7 760 + 2 240))		65 240	
Non-controlling interests (SFP)		16 320	16 320
Gain on bargain purchase		40	
Elimination of investment in Workshop Ltd			
J4 Retained earnings	10 120		
Non-controlling interests (SFP)		10 120	10 120
Recording of NCI in retained earnings to beginning of current year ((75 000 – 28 000 + 3 600 (C1)) x 20%)			
			<u>26 440^c</u>

	Dr R	Cr R	NCI R
J5 Non-controlling interests (P/L)	11 000		
Non-controlling interests (SFP)		11 000	11 000
Recording of NCI in profit for the year ((85 000 – 30 000) x 20%)			
J6 Investment in Workshop Ltd (C1)	16 310		
Other income (profit on sale of shares)(P/L)	38 690		
Change in ownership reserve (SOCIE) (C1)		17 560	
Non-controlling interests (SFP)		37 440	37 440
Adjustment of controlling and non-controlling interests resulting from sale of 20% interest			
			<u>74 880^m</u>

C5 Deferred tax

	R
Balance as given in trial balance	2 240 Cr
Deferred tax on MTMR relating to part of investments sold (J2)	(560)Dr
Reversal of MTMR (J1)	(1 680)Dr
Deferred tax on revaluation of workshop building at acquisition date (J2)	2 800 Cr
Deferred tax on trade receivables at acquisition date	(1 400)Dr
Realisation of deferred tax on trade receivables in current year	1 400 Cr
	<u>2 800 Cr</u>



LECTURERS COMMENT

IN THE SEPERATE FINANCIAL STATEMENTS

You will notice from the information given in the trial balance, only “proceeds on disposal of 10 000 shares” is shown. From this given information you should realise that Garage Ltd has only passed the following entry in its seperate financial statements:

	Dr R	Kt R
Bank	55 000	
Proceeds on sale of shares		55 000

The profit on sale has therefore not yet been recognised in the seperate financial statements and the investment has also not yet been credited. The profit on sale that must be recognised in the seperate financial statements is calculated as follows:

	R
Consideration (gege)	55 000
Carrying amount of investment sold (75 240 x 10 000/40 000 shares)	(18 810)
Profit on sale of shares	<u>36 190</u>

The total profit on the sale of the shares consists of the following:

	R
Profit on sale of shares	36 190
Realisation of a portion of the mark-to-market reserve on disposal of the investment	2 500
	<u>38 690</u>

**LECTURERS COMMENT****IN THE CONSOLIDATED FINANCIAL STATEMENTS:**

The amount to be disclosed as change in ownership reserve is calculated as follows:

	R
Proceeds	55 000
Less % of net assets (equity) sold	37 440
At acquisition $65\,280 \times \frac{20}{80}$ or $81\,600 \times \frac{20}{100}$	16 320
Since acquisition $(40\,480 + 44\,000) \times \frac{20}{80}$ or $(50\,600 + 55\,000) \times \frac{20}{100}$	21 120
Change in ownership reserve (equity)	17 560

The change in ownership reserve should be disclosed in a separate column in the consolidated statement of changes in equity, and the equity section of the consolidated statement of financial position.

6.4 Assessment criteria

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



- Identify the acquirer in a business combination and determine the acquirer's percentage ownership interest in the acquiree before and after an increase or decrease in holding;.
- Identify the following circumstances giving rise to a change in control:
 - acquisition of an additional interest in an existing subsidiary;
 - acquisition of an additional interest whereby an IFRS 9 investment becomes a subsidiary;
 - disposal of a partial interest in a subsidiary where the subsidiary remains a subsidiary; and
 - disposal of a partial interest in a subsidiary whereby the subsidiary becomes an IFRS 9 investment.
- Account for the effect of a change in ownership interest in the separate and consolidated financial statements.

Notes

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Notes

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Notes

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