CHAPTER FOUR
CONSOLIDATED FINANCIAL STATEMENTS

Consolidated financial statements refer to 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.

IFRS 10, *Consolidated Financial Statements*, establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities, and introduces a single model for identifying control to replace the previous concepts of control contained within the former IAS 27 and SIC-12.

DEFINITIONS OF TERMS

Control of an investee: An investor controls an investee 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.

Decision maker: An entity with decision-making rights that is either a principal or an agent of the principal.

Associate: An entity over which an investor has significant influence.

Equity method: A method of accounting whereby the investment is initially recorded at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets. The investor's profit or loss includes its share of the investee's profit or loss and the investor's other comprehensive income includes its share of the investee's other comprehensive income.

Group: A parent and its subsidiaries.

Interest in another entity: An interest in another entity refers to contractual and non contractual involvement that exposes an entity to variability of returns from the performance of the other entity.

Investment entity: An entity that obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services; commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income or both; and measures and evaluates the performance of substantially all of its investments on a fair value basis.

Parent: An entity that controls one or more entities.

Power: Existing rights that give the current ability to direct the relevant activities

IFRS 10 sets out related guidance to apply the principle of control to identify whether an investor controls an investee and therefore must consolidate the investee. IFRS 10 also sets out the accounting requirements for the preparation of consolidated financial statements. IFRS 10 requires that an entity that is a parent must present consolidated financial statements that include all subsidiaries of the parent. Only three exceptions to this rule are available.

Firstly, a parent need not present consolidated financial statements if all the following criteria are met:

- The parent itself is a wholly-owned subsidiary or it is a partially-owned subsidiary of another entity and all of its owners, including those not normally entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;
- Its debt and equity instruments are not traded in a public market;

- It did not file, nor is it in the process of filing, its financial statements with a securities exchange commission or other regulatory organisation for the purpose of issuing any class of its instruments in a public market; and
- Its ultimate or intermediate parent produces consolidated financial statements that are available for public use and comply with IFRS.

Secondly, post-employment benefit plans or other long-term employee benefits plans to which IAS 19, *Employee Benefits*, apply are also excluded from the scope of IFRS 10.

Thirdly, an investment entity need not present consolidated financial statements if it is required to measure those subsidiaries at fair value through profit or loss in accordance with IFRS 9, *Financial Instruments*. Investment entities are discussed later in this chapter.

Identification of a subsidiary

Under IFRS 10 an investor shall determine if it is a parent by assessing whether it controls the investee. A subsidiary is defined as "an entity that is controlled by another entity" (IFRS 10 App A). An investor controls an investee 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. The definition contains three requirements that must be present in order for control to exist:

- Power over the investee;
- Exposure, or rights, to variable returns; and
- The ability to use the power over the investee to affect the amount of returns.

The three requirements are interrelated. The ability to use power to affect the returns creates a link between the first two requirements. Only when the power could be used to affect the returns is the definition of control met. An investor must assess all facts and circumstances to determine whether it controls an entity. Appendix B to IFRS 10 contains the following factors that investors should use in order to determine if they control a subsidiary:

(1) The purpose and design of the investee; (2) what the relevant activities are; (3) how decisions about those activities are made; (4) whether the rights of the investors give it the current ability to direct the relevant activities; (5) whether the investor is exposed, or has the rights to variable returns from its involvement with the investee; and (6) whether the investor has the ability to use its power over the investee to affect the amount of the investor's return.

These facts and circumstances should be continuously monitored, and if there are any changes to the facts or circumstances, control should be reassessed.

Power

Regarding the first requirement, an investor has power over an investee when the investor has existing rights that give it the current ability to direct the relevant activities that significantly affect the investee's returns. Returns will only be affected if the investor can control the activities that generate the returns.

Examples of activities that could, depending on the circumstances, be principal activities include: the purchase and sale of goods or services, the selection, acquisition or sale of assets, research and development for new products or procedures, and the establishment of finance structures or the procurement of funds. If two or more investors currently have the ability to manage the principal activities

and these activities take place at different times, the investors must determine which of them has the ability to manage those activities that have the greatest effect on these returns.

Example of more than one investor

Two investors agree to form an entity to develop and market a new product. The one investor has unilateral decision-making power regarding the research and development of the product and the other has unilateral decision-making power regarding the manufacture and sale of the product

To determine whether one or any of the investors controls the entity, the ability to direct the relevant activities must be assessed. This is achieved by first clarifying which activities are actually classified as relevant. If all activities—i.e., development as well as production and marketing—are relevant, each investor must determine whether he has the ability to direct the activities that most significantly affect the entity's returns.

Power arises from rights, and could arise in any of the following circumstances: (1) rights in the form of voting rights (or potential voting rights) of an investee; (2) rights to appoint, reassign or remove members of an investee's key management personnel who have the ability to direct the relevant activities; (3) rights to appoint or remove another entity that directs the relevant activities; (4) rights to direct the investee to enter into, or veto any changes to, transactions for the benefit of the investor; and (5) other rights that give the holder the ability to direct the relevant activates. The lower one moves down this hierarchy, the more complex the assessment becomes. In the assessment, all the rights of others must be considered. An investor assessing whether he has decision-making power is only assessing substantive rights. Consequently, an investor that only holds protective rights does not have the power to direct the activities. A right is substantive when the holder has the practical ability to exercise the right.

This requires judgment, taking into account all facts and circumstances. The following factors can be used in the assessment:

- Whether there are barriers (economic or otherwise) that prevents the holder from exercising the rights.
- Financial penalties and incentives that would prevent (or deter) the holder from exercising the rights.
- Terms and conditions that make it unlikely that the rights would be exercised.
- The absence of an explicit, reasonable mechanism in the founding documents of an investee or in the applicable laws or regulations that would allow the holder to exercise the rights.
- The inability of the holder of the rights to obtain the information necessary to exercise the rights.
- Operational barriers or incentives that would prevent the holder from exercising the rights.
- Legal or regulatory requirements that prevent the holder from exercising the rights.

Usually the substantive rights need to be exercisable when the decision regarding the direction of the relevant activities needs to be made. Rights may, however, also be of a substantial nature even if they cannot be exercised at present.

Majority of voting rights

Control is presumed if the majority of voting rights is held, unless other factors indicate that the majority of voting rights does not create control. Holding the majority of voting rights normally results in control if:

- The relevant activities are directed by the vote of the majority holder; or
- The holder of the majority of voting rights may appoint the majority of members of the governing body that directs the activities (for example, the board of directors).

For a majority of voting rights to result in control, those rights must be substantive. If another party, which is not an agent, has existing rights that provide the other party with the ability to direct the operating activities, the majority of voting rights presumption is rebutted. The test is to determine who has power over the activities.

Example of majority of voting rights

Investor B has a 51% interest in an investment vehicle (T). B is only a passive investor and is not involved in the decision-making process. Since investor B is passive, the rights of others must be considered to determine if they have power to direct the activities. In the absence of other facts and circumstances, the assumption is that B will exercise his voting rights to prevent resolutions being adopted that are not in his interests. As such, B currently has the power to direct relevant activities, even though he may not have exercised that power in the past. B must therefore consolidate T.

Less than a majority of voting rights

Control could also exist when a party has less than a majority of voting rights. The following are examples of instances where control could exist even though less than a majority of voting rights is held:

- A contractual arrangement between the investor and other parties that provides the investor with a right to direct the relevant activities.
- Rights arising from other contractual arrangements. Other decision-making rights together with voting rights might provide the party with the right to direct the relevant activities.
- The extent of the investor’s voting rights. Although an investor may not hold the majority of the voting rights, the rights that are held could be so significant as to give it power to have the practical ability to direct the relevant activities unilaterally. This is referred to as de facto control.
- The investor may hold potential voting rights that are substantive. Potential voting rights are rights to obtain voting rights of an investee, such as convertible instruments and options. To be substantive, potential voting rights needs to be exercisable when decisions about the direction of the relevant activities need to be made. Usually they must be presently exercisable in order to be classified as substantial, although sometimes rights may be substantial even if they cannot be exercised at present.

Example: An investor is the contracting partner in a forward contract for the acquisition of a majority holding in the associate company. The settlement value of the forward contract is due within 25 days. The existing shareholders cannot change the company’s current policy with regard to its principal activities because extraordinary general meetings cannot be held in less than 30 days, at which time the forward contract will already have been fulfilled. By virtue of his possession of the forward contract, the investor is in a position to make decisions on the management of those principal activities. The investor’s forward contract is a substantive right that

gives him the ability to manage those principal activities now, before the forward contract is fulfilled.

Any combination of the above scenarios could result in an investor having control of an investee. In assessing de facto control, the size of the investor's holdings relative to size and dispersion of other investors are considered, together with the other considerations listed above.

Examples of less than a majority of voting rights

Example 1: Investor A holds 45% of an entity's voting rights and no other investor holds more than 3%. De facto control might be present if no other consideration indicates that investor A has control, because the absolute size of his stake and the relative size of the other shareholdings indicate that A holds a sufficiently dominant share of the voting rights.

Example 2: Investor B holds 48% of an entity's voting rights and the other two investors hold 28% and 24%, respectively. Beyond that, no other agreements exist that might influence the adoption of resolutions. The size of the other investors' rights indicates that investor B does not hold de facto control. The other two investors only need to join forces to prevent investor B from directing the relevant activities of the joint venture.

Exposure, or rights, to variable returns from an investee

An investor is exposed, or has rights to, variable returns when the investor's returns from the involvement have the potential to vary as a result of the investor's performance, whether negative or positive. Variable returns can arise in various forms, for example:

- Dividends or other distributions of economic benefits from an investee and changes in the value of the investment.
- Remuneration for servicing an investee's assets or liabilities, fees and exposure to loss from providing credit or liquidity support, residual interests in the investee's assets and liabilities on liquidation of that investee, tax benefits, and access to future liquidity that an investor has from its involvement with an investee.
- Returns that are not available to other interest holders. For example, combining operating functions to achieve economies of scale, cost savings, sourcing scarce products, gaining access to proprietary knowledge or limiting some operations or assets to enhance the value of the investor's other assets.

Consolidation Procedures

Consolidated financial statements shall present fairly the financial position, financial performance and cash flows of the group. IFRS 10 contains only a little guidance on the preparation of consolidated financial statements. A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances. Consolidation begins from the date the investor obtains control and ceases when the investor loses control.

What is to be consolidated?

- If dissolution takes place, appropriate account balances are physically consolidated in the surviving company's financial records.
- If separate incorporation is maintained, only the financial statement information (not the actual records) is consolidated.

When does the consolidation take place?

- If dissolution takes place, a permanent consolidation occurs at the date of the combination.
- If separate incorporation is maintained, the consolidation process is carried out at regular intervals whenever financial statements are to be prepared.

How are the accounting records affected?

- If dissolution takes place, the surviving company's accounts are adjusted to include appropriate balances of the dissolved company. The dissolved company's records are closed out. If separate incorporation is maintained, each company continues to retain its own records. Using worksheets facilitates the periodic consolidation process without disturbing the individual accounting systems.

Intercompany transactions and balances

In preparing consolidated financial statements an entity combines the items presented in the financial statements line by line, adding together like items of assets, liabilities, equity, income and expenses. In order to present financial information about the group as that of a single economic entity, the following procedures are followed:

- Like items of assets, liabilities, equity, income, expenses and cash flows of the parent are combined with those of the subsidiary.
- The carrying amount of the parent's investment in each subsidiary is eliminated (offset) against the parent's portion of equity of each subsidiary.
- Intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions of the entities in the group are eliminated. For example, a parent may sell merchandise to its subsidiary, at cost or with a profit margin added, before the subsidiary ultimately sells the merchandise to unrelated parties in arm's-length transactions. Furthermore, any balances due to or from members of the consolidated group at the end of the reporting period must also be eliminated. If assets have been transferred among the entities in the controlled group at amounts in excess of the transferor's cost, and they have not yet been further transferred to outside parties (e.g., inventories) or not yet consumed (e.g., plant assets subject to depreciation) by the end of the reporting period, the amount of profit not yet realized through an arm's length transaction must be eliminated.

Non-controlling interests

When less than 100% of the shares of the acquired entity are owned by the acquirer, a complication arises in the preparation of consolidated statements, and a non-controlling interest must be determined and presented. According to IFRS 10.22, non-controlling interests must be presented in the consolidated statement of financial position within equity, separately from the equity of controlling interests (the owners of the parent). If a company holds non controlling interests in several subsidiaries, the various non-controlling interests can be reported within a single position. This method complies with the economic unit concept that is employed in the world of Anglo-Saxon accounting. The profit or loss and each component of other comprehensive income to the owners of the parent and to the non-controlling interests must be attributed separately. This applies even if this allocation brings about a situation in which the non-controlling interests post or will in future post a negative equity balance. Not even the nonexistence of an additional-funding obligation on the part of the non-controlling interests makes any difference to this

allocation. In this event a negative share of the non-controlling interests must consequently be reported within equity.

The control concept of IFRS 10 and the economic unit concept can jointly lead to a situation where a parent company, even though it has a minority holding in an entity, controls the relevant activities of the subsidiary—by virtue of other agreements, for example—and hence also controls the subsidiary itself. Since shares in the equity and the profit or loss are determined on the basis of ownership interest (for which see below), this leads to a situation in which consolidation includes 100% of an entity's assets and liabilities while the majority of the equity must be allocated to non-controlling interests. In these cases IFRS 12 requires the disclosure of the nature of the relationship between a parent and a subsidiary when less than 50% of voting rights are owned.

Changes in the proportion of non-controlling interests

In the consolidated statement of financial position, non-controlling interest is presented within equity, separately from the equity of the owners of the parent. Changes in a parent's interest in a subsidiary that do not result in the parent losing control are equity transactions and result in transfers to and from the owner's equity to non-controlling interest. The difference between the amount by which the non-controlling interest is adjusted and the fair value of the consideration paid or received is recognized directly in equity attributable to the parent.

Example of recognizing changes in the level of the parent's controlling ownership interest

Konin Corporation (KC) owns a 75% interest in Donna Corporation (DC). KC decided to acquire an additional 10% interest in DC from the non-controlling shareholders in exchange for cash of €100,000. DC has net assets of €800,000. KC accounts for this transaction in the consolidated financial statements as follows:

Equity—Non-controlling interest	80,000	
Equity—Controlling interest	20,000	
Cash		100,000

Profit or loss and each component of other comprehensive income must be allocated to the owners of the parent and non-controlling interest. The total comprehensive income must also be allocated, even if this results in non-controlling interest having a deficit balance.

Non-controlling interests in the net assets consist of (1) the amount recognized at the date of the original business combination (calculated in accordance with IFRS 3), and (2) the no controlling interests' share of changes in equity (net assets) of the subsidiary since the date of combination.

Uniformity of accounting policies

There is a presumption that all the members of the consolidated group should use the same accounting principles to account for similar events and transactions. However, in many cases this will not occur, as, for example, when a subsidiary is acquired that uses cost for investment property while the parent has long employed the fair value method. IFRS 10 requires that the policies of the combining entities should be uniform and therefore appropriate adjustments should be made in the consolidated accounts. When a subsidiary of a corporate group is acquired and different accounting policies exist, the principles of IAS 8 permit the subsidiary to alter its accounting policy to that of the group in its individual financial statements.

Alternatively the subsidiary may retain its previous principles in its individual financial statements. In this event the group should make appropriate adjustments in the consolidated accounts.

Measurement

Income and expenses of the subsidiary are included in the consolidated financial statements from the date control is obtained until the date when control is lost. The income and expenses are based on the amounts of assets and liabilities recognized at the acquisition date. The depreciation charges entered in the consolidated income statement after the date of acquisition, for example, are based on the fair value of the associated depreciable assets reported in the consolidated financial statements on the date of acquisition.

Reporting date

A practical consideration in preparing consolidated financial statements is to have information on all constituent entities current as of the parent's year-end. If a subsidiary has a different reporting date, the subsidiary prepares additional financial information as of the date of the consolidated financial statements to enable the parent to consolidate the subsidiary, unless it is impracticable to do so.

If it is impracticable, the subsidiary is consolidated using the most recent financial statements of the subsidiary adjusted for the effect of significant transactions or events that occur between the date of those financial statements and the date of the consolidated financial statements. The difference between the date of the subsidiary's financial statements and the consolidated financial statements is limited to three months and must be applied consistently from period to period. Of course, if this option is elected, the process of eliminating intercompany transaction and balances may become a bit more complicated, since reciprocal accounts (e.g., sales and cost of sales) will be out of balance for any events occurring after the earlier fiscal year-end but before the later one.

Ownership interest

In the preparation of consolidated financial statements there is usually a question mark over the share of the profit or loss or changes in the equity of the subsidiary that the parent Company must take into account in the preparation of its own consolidated financial statements if, for example, potential voting rights or non-controlling interests exist. IFRS 10 determines that the proportion of profit or loss and changes in equity allocated to the parent and non-controlling interests in preparing consolidated financial statements is determined solely on the basis of existing ownership interests, unless an entity has, in substance, an existing ownership interest as a result of a transaction that currently gives the entity access to the return associated with an ownership interest.

Example

X has a 70% holding in Y and a 20% holding in Z. Y, in its turn, has a 35% holding in Z. Solution: X controls Y and thus also Z, because X directly and indirectly holds 55% of its shares. Y's holding in Z must be allocated in full to X, as X controls Y. Y and Z must consequently be included inX's consolidated financial statements. X's share of Y's profit or loss or changes in equity is 44.5% (20% + (70% of 35%)). X consequently allocates 55.5% of its subsidiary Y to non controlling interests.

Indirect interest

If a parent company has an indirect holding, the treatment of the non-controlling interests is more complicated than in a single-tiered group. Furthermore, the amount

of potential goodwill to be reported is contentious. The non-controlling interests in the parent company's consolidated financial statements are calculated by multiplying the fractions applying to the various tiers of the group. The calculation for the purposes of consolidation can be carried out either in a single step, or first at the level of the indirect holding, then at that of the parent company with a corresponding adjustment of the indirect holding (multi-tier consolidation).

Example

Parent company P holds 85% of the equity of its subsidiary S1 (€400). S1 holds 75% of the equity of second-tier subsidiary S2 (€100). From P's viewpoint the non-controlling interest in S1 must be taken into account first: 15% of €400 = €60. The indirect holding of non-controlling shareholder S1 in S2 is determined by multiplication: 15% of 75% of €100 = €11.25. Finally, the non-controlling shareholder's direct holding in S2 is included: 25% of €100 = €25. A non-controlling interest total of €96.25 must therefore be reported in P's consolidated financial statements.

Example

Assume BigNet Company specializes in communications equipment and business software that provide web-based applications for retail companies. BigNet seeks to expand its operations and plans to acquire Smallport on December 31. Smallport Company owns computers, telecommunications equipment, and software that customize website billing and ordering systems for their customers. BigNet hopes to expand Smallport's customer contracts, utilize its recently developed software, and create other synergies by combining with Smallport. the December 31 account balances for both BigNet and Smallport.

In addition, the estimated fair values of Smallport's assets and liabilities are shown. Although the Smallport's computers and equipment have a $400,000 book value, their current fair value is $600,000. Smallport's software has only a $100,000 value on its books; the internal development costs were primarily expensed. The software's observable fair value, however, is $1,200,000. Similarly, although not reflected in its financial records, Smallport has several large ongoing customer contracts. BigNet estimates the fair value of the customer contracts at $700,000. Smallport also has a $200,000 note payable incurred to help finance the software development. Because interest rates are currently low, this liability (incurred at a higher rate of interest) has a present value of $250,000.

Smallport's net assets (total assets less total liabilities) have a book value of $600,000 but a fair value of $2,550,000. Fair values for only the assets and liabilities are appraised here; the capital stock, retained earnings, dividend, revenue, and expense accounts represent historical measurements rather than any type of future values. Although these equity and income accounts can give some indication of the organization's overall worth, they are not property and thus not transferred in the combination.

	BigNet Company	**Smallport Company**	
	Book Values	**Book Values**	**Fair Values**

	December 31		December 31
December 31			
Current assets	$ 1,100,000	$ 300,000	$ 300,000
Computers and equipment (net) .	1,300,000		400,000 600,000
Capitalized software (net)	500,000		100,000 1,200,000
Customer contracts	–0–		–0– 700,000
Notes payable	(300,000)		(200,000) (250,000)
Net assets	**$ 2,600,000**		**$ 600,000 $2,550,000**
Common stock—$10 par value . .	$ (1,600,000)		
Common stock—$5 par value		$ (100,000)	
Additional paid-in capital	(40,000)	(20,000)	
Retained earnings, 1/1	(870,000)	(370,000)	
Dividends declared	110,000	10,000	
Revenues	(1,000,000)	(500,000)	
Expenses	800,000	380,000	
Owners' equity 12/31	**$(2,600,000)**	**$(600,000)**	
Retained earnings, 12/31	(960,000)	(480,000)	

Legal as well as accounting distinctions divide business combinations into several separate categories. To facilitate the introduction of consolidation accounting, we present the various procedures utilized in this process according to the following sequence:

1. Acquisition method when dissolution takes place.
2. Acquisition method when separate incorporation is maintained.

Acquisition Method When Dissolution Takes Place

Consideration Transferred Exceeds Net Amount of Fair Values of Identified Assets Acquired and Liabilities Assumed

BigNet agrees to pay $3,000,000 in exchange for all of Smallport's assets and liabilities. BigNet transfers to the former owners of Smallport consideration of $1,000,000 in cash plus 20,000 shares of common stock with a fair value of $100 per share. The resulting consideration paid is $450,000 more than the $2,550,000 fair value of Smallport's net assets.

Several factors may have affected BigNet's $3,000,000 acquisition offer. First, BigNet may expect its assets to act in concert with those of Smallport, thus creating synergies that will produce profits beyond the total expected for the separate companies. In our earlier examples, Campbell Soup, Microsoft, and Duke Energy all clearly anticipated substantial synergies from their acquisitions. Other factors such as Smallport's history of profitability, its reputation, the quality of its personnel, and the economic condition of the industry in which it operates may also enter into acquisition offers. In general, if a target company is projected to generate unusually high profits relative to its asset base, acquirers are frequently willing to pay a

premium price. When the consideration transferred in an acquisition exceeds total net fair value of the identified assets and liabilities, the excess is allocated to an unidentifiable asset known as goodwill. 15 Unlike other assets, we consider goodwill as unidentifiable because we presume it emerges from several other assets acting together to produce an expectation of enhanced profitability. Goodwill essentially captures all sources of profitability beyond what can be expected from simply summing the fair values of the acquired firm's assets and liabilities.

Acquisition Method: Consideration Transferred Exceeds Net Identified Asset Fair Values—Subsidiary Dissolved

Returning to BigNet's $3,000,000 consideration, $450,000 is in excess of the fair value of

Smallport's net assets. Thus, goodwill of that amount is entered into BigNet's accounting system along with the fair value of each individual asset and liability. BigNet makes the following journal entry at the date of acquisition:

BigNet Company's Financial Records—December 31

Current Assets	300,000	
Computers and Equipment	600,000	
Capitalized Software 1,200,000		
Customer Contracts.	700,000	
Goodwill	450,000	
Notes Payable..		250,000
Cash (paid by BigNet)		1,000,000
Common Stock (20,000 shares issued by BigNet at $10 par value). . .		200,000
Additional Paid-In Capital		1,800,000

(To record acquisition of Smallport Company. Assets acquired and liabilities assumed are recorded at individual fair values with excess fair value attributed to goodwill).

Once again, BigNet's financial records now show $1,900,000 in the Computers and Equipment account ($1,300,000 former balance $600,000 acquired), $1,700,000 in Capitalized Software ($500,000 1 $1,200,000), and so forth. As the only change, BigNet records goodwill of $450,000 for the excess consideration paid over the net identified asset fair values.

Bargain Purchase—Consideration Transferred Is Less Than Net Amount of Fair Values of Identified Assets Acquired and Liabilities Assumed

Occasionally, the fair value received in an acquisition will exceed the fair value of the consideration transferred by the acquirer. Such bargain purchases typically are considered anomalous. Businesses generally do not sell assets or businesses at prices below their fair values. Nonetheless, bargain purchases do occur—most often in forced or distressed sales.

To demonstrate accounting for a bargain purchase, our third illustration begins with BigNet transferring consideration of $2,000,000 to the owners of Smallport in exchange for their business. BigNet conveys no cash and issues 20,000 shares of common stock that has a $100 per share fair value.

In accounting for this acquisition, at least two competing fair values are present. First, the $2,000,000 consideration transferred for Smallport represents a negotiated transaction value for the business. Second, the net amount of fair values individually assigned to the identified assets acquired and liabilities assumed produces $2,550,000.

Additionally, based on expected synergies with Smallport, BigNet's management may believe that the fair value of the business exceeds the net asset fair value. Nonetheless, because the consideration transferred is less than the net asset fair value, a bargain purchase has occurred.

The acquisition method records the identified assets acquired and liabilities assumed at their individual fair values. In a bargain purchase situation, this net asset fair value effectively replaces the consideration transferred as the acquired firm's valuation basis for financial reporting. The consideration transferred serves as the acquired firm's valuation basis only if the consideration equals or exceeds the net amount of fair values for the assets acquired and liabilities assumed (as in the first two examples). In this case, however, the $2,000,000 consideration paid is less than the $2,550,000 net asset fair value, indicating a bargain purchase. Thus, the $2,550,000 net asset fair value serves as the valuation basis for the combination. A $550,000 *gain on bargain purchase* results because the $2,550,000 recorded value is accompanied by a payment of only $2,000,000.

The acquirer recognizes this gain on its income statement in the period the acquisition takes place.

Acquisition Method: Consideration Transferred Is Less Than Net Identified Asset

Fair Values—Subsidiary Dissolved

BigNet Company's Financial Records—December 31

Current Assets	300,000	
Computers and Equipment	600,000	
Capitalized Software	1,200,000	
Customer Contracts	700,000	
Notes Payable		250,000
Common Stock (20,000 shares issued by BigNet at $10 par value)		200,000
Additional Paid-In Capital		1,800,000
Gain on Bargain Purchase		550,000

To record acquisition of Smallport Company. Assets acquired and liabilities assumed are each recorded at fair value. Excess net asset fair value is attributed to a gain on bargain purchase).

A consequence of implementing a fair-value concept to acquisition accounting is the recognition of an unrealized gain on the bargain purchase. A criticism of the gain recognition is that the acquirer recognizes profit from a buying activity that occurs prior to traditional accrual measures of earned income (i.e., selling activity). Nonetheless, an exception to the general rule of recording business acquisitions at fair value of the consideration transferred occurs in the rare circumstance of a bargain purchase. Thus, in a bargain purchase, the fair values of the assets received and all liabilities assumed in a business combination are considered more relevant for asset valuation than the consideration transferred.

Related Costs of Business Combinations

Three additional categories of costs typically accompany business combinations, regardless of whether dissolution takes place. First, firms often engage attorneys, accountants, investment bankers, and other professionals for combination-related services. The acquisition method does not consider such expenditures as part of the fair value received by the acquirer. Therefore, professional service fees are expensed in the period incurred.

The second category concerns an acquiring firm's internal costs. Examples include secretarial and management time allocated to the acquisition activity. Such indirect costs are reported as current year expenses, too. Finally, amounts incurred to

register and issue securities in connection with a business combination simply reduce the otherwise determinable fair value those securities.

To illustrate the accounting treatment of these costs that frequently accompany business combinations, assume the following in connection with BigNet's acquisition of Smallport.

- BigNet pays an additional $100,000 in accounting and attorney fees.
- Internal secretarial and administrative costs of $75,000 are indirectly attributable to BigNet's combination with Smallport.
- Costs to register and issue BigNet's securities issued in the combination total $20,000. Following the acquisition method, regardless of whether dissolution occurs or separate incorporation is maintained, BigNet would record these transactions as follows:

  BigNet Company's Financial Records

  Professional Services Expense 100,000
  Cash. 100,000
  To record as expenses of the current period any direct combination costs.

  Salaries and Administrative Exp. 75,000
  Accounts Payable (or Cash). 75,000
  To record as expenses of the current period any indirect combination costs.

  Additional Paid-In Capital. 20,000
  Cash. 20,000
  To record costs to register and issue stock in connection with the Smallport acquisition.

The Acquisition Method When Separate Incorporation Is Maintained

When each company retains separate incorporation in a business combination, many aspects of the consolidation process are identical to those demonstrated in the previous section. Fair value, for example, remains the basis for initially consolidating the subsidiary's assets and liabilities.

However, several significant differences are evident in combinations in which each company remains a legally incorporated separate entity. *Most noticeably, the consolidation of the financial information is only simulated; the acquiring company does not physically record the acquired assets and liabilities. Because dissolution does not occur, each company maintains independent record-keeping.* To facilitate the preparation of consolidated financial statements, a worksheet and consolidation entries are employed using data gathered from these separate companies.

Example

Assume that BigNet acquires Smallport Company on December 31 by issuing 26,000 shares of $10 par value common stock valued at $100 per share (or $2,600,000 in total). BigNet pays fees of $40,000 to a third party for its assistance in arranging the transaction. Then to settle a difference of opinion regarding Small port's fair value, BigNet promises to pay an additional $83,200 to the former owners if Smallport's earnings exceed $300,000 during the next annual period. BigNet estimates a 25 percent probability that the $83,200 contingent payment will be required. A discount rate of 4 percent (to represent the time value of money) yields an expected present value of $20,000 for the contingent liability ($83,200 * 25% *0.961538). The fair-value approach of the acquisition method views such contingent payments as part of the consideration transferred. According to this view, contingencies have value to those who receive the consideration and represent measurable obligations of the

acquirer. Therefore, the fair value of the consideration transferred in this example consists of the following two elements:

Fair value of securities issued by BigNet	$2,600,000
Fair value of contingent performance liability	20,000
Total fair value of consideration transferred	$ 2,620,000

To facilitate a possible future spinoff, BigNet maintains Smallport as a separate corporation with its independent accounting information system intact. Therefore, whenever financial statements for the combined entity are prepared, BigNet utilizes a worksheet in simulating the consolidation of these two companies. Although the assets and liabilities are not transferred, BigNet must still record the payment made to Smallport's owners.

When the subsidiary remains separate, the parent establishes an investment account that initially reflects the acquired firm's acquisition-date fair value. Because Smallport maintains its separate identity, BigNet prepares the following journal entries on its books to record the business combination.

Acquisition Method—Subsidiary Is Not Dissolved

BigNet Company's Financial Records—December 31

Investment in Smallport Company (CT) 2,620,000
Contingent Performance Liability 20,000
Common Stock (26,000 shares issued by BigNet at $10 par value) . . . 260,000
Additional Paid-In Capital. 2,340,000
To record acquisition of Smallport Company, which maintains its separate legal identity.
Professional Services Expense 40,000
Cash (paid for third-party fees) 40,000
To record combination costs.

Worksheet can be prepared on the date of acquisition to arrive at consolidated totals for this combination. The entire process consists of seven steps.

Step 1

Prior to constructing a worksheet, the parent prepares a formal allocation of the acquisition date fair value . Thus, the following schedule is appropriate for BigNet's acquisition of Smallport:

Acquisition-Date Fair-Value Allocation Schedule

Fair value of consideration transferred by BigNet		$2,620,000
Book value of Smallport (see Exhibit 2.3)		(600,000)
Excess of fair value over book value		$2,020,000
Allocations to specific accounts		
Computers and equipment ($600,000 - $400,000)	$ 200,000	
Capitalized software ($1,200,000 -$100,000)	1,100,000	
Customer contracts ($700,000 - 0)	700,000	
Notes payable ($250,000 - $200,000).	(50,000)	(1,950,000)
Excess fair value not identified with specific items—Goodwill.		$ 70,000

Step 2

The first two columns of the worksheet show the separate companies' acquisition-date book value financial figures. BigNet's accounts have been adjusted for the journal entries recorded earlier for the investment and the combination costs. As another preliminary step, Smallport's revenue, expense, and dividend accounts have been closed into its Retained Earnings account. The subsidiary's operations prior to the December 31 takeover have no direct bearing on the operating results of the business combination.

These activities occurred before Smallport was acquired; thus, the new owner should not include any pre combination subsidiary revenues or expenses in the consolidated statements.

Step 3

Consolidation Entry S eliminates Smallport's stockholders' equity accounts (S is a reference to beginning subsidiary stockholders' equity) as follows:

Consolidation Entry S

Common Stock (Smallport Company)	100,000	
Additional Paid-In Capital (Smallport Company)	20,000	
Retained Earnings (Smallport Company)	480,000	
Investment in Smallport Company		600,000

These balances (Common Stock, Additional Paid-In Capital, and Retained Earnings) represent ownership accounts held by the parent in their entirety and thus no longer are outstanding. By removing these account balances on the worksheet, only Smallport's assets and liabilities remain to be combined with the parent company figures.

Step 4

Consolidation Entry S also removes the $600,000 component of the Investment in Smallport Company account that equates to the book value of the subsidiary's net assets. For external reporting purposes, BigNet should include each of Smallport's assets and liabilities rather than a single investment balance. In effect, this portion of the Investment in Smallport Company account is deleted and replaced by the specific assets and liabilities that it represents.

Step 5

Consolidation Entry A removes the $2,020,000 excess payment in the Investment in Smallport Company and assigns it to the specific accounts indicated by the fair-value allocation schedule as follows:

Consolidation Entry A

Computers and Equipment	200,000	
Capitalized Software	1,100,000	
Customer Contracts	700,000	
Goodwill		70,000
Note Payable		50,000
Investment in Smallport Company		2,020,000

Consequently, Computers and Equipment is increased by $200,000 to agree with Smallport's fair value: $1,100,000 is attributed to Capitalized Software, $700,000 to Customer Contracts, and $50,000 to Notes Payable. The unidentified excess of $70,000 is allocated to Goodwill. This entry for the consolidation worksheet is labeled Entry A to indicate that it represents the Allocations made in connection with Smallport's acquisition-date fair value. It also completes the Investment in Smallport Company account balance elimination.

Step 6

All accounts are extended into the Consolidated Totals column. For accounts such as Current Assets, this process simply adds Smallport and BigNet book values. However, when applicable, this extension also includes any allocations to establish the acquisition date fair values of Smallport's assets and liabilities. Computers and Equipment, for example, is increased by $200,000. By increasing the subsidiary's book value to fair value, the reported balances are the same as in the previous

examples when dissolution occurred. The use of a worksheet does not alter the consolidated figures but only the method of deriving those numbers.

Accounts	BigNet	Smallport	Consolidation entries		Consolidated total
			Debits	Credits	
Income statement					
Revenues	(1,000,000)				(1,000,000)
Expenses	840,000				840,000
Net income	(160,000)				(160,000)
St. of R E					
Beg Retained earnings	(870,000)				(870,000)
Net income	(160,000)				(160,000)
Dividends	110,000				110,000
End Retained earnings	(920,000)				(920,000)
Balance Sheet					
Current assets	1,060,000	300,000			1,360,000
Inv.t in S. Company	2,620,000	–0–		(S) 600,000 (A) 2,020,000	–0–
Computers and equipment	1,300,000	400,000	(A) 200,000		1,900,000
Capitalized software	500,000	100,000	(A) 1,100,000		1,700,000
Customer contracts	–0–	–0–	(A) 700,000		700,000
Goodwill	–0–	–0–	(A) 70,000		70,000
Total assets	5,480,000	800,000			5,730,000
Notes payable	(300,000)	(200,000)		A) 50,000	(550,000)
Contingent performance liability	(20,000)				(20,000)
Common stock	(1,860,000)	(100,000)	(S) 100,000		(1,860,000)
Additional paid-in capital	(2,380,000)	(20,000)	(S) 20,000		(2,380,000)
Retained earnings, 12/31 (above)	(920,000)	(480,000)	(S) 480,000		(920,000)
Total liabilities and equities	(5,480,000)	(800,000)			(5,730,000)

Step 7

We subtract consolidated expenses from revenues to arrive at a $160,000 net income. Note that because this is an acquisition-date worksheet, we consolidate no amounts for Smallport's revenues and expenses. Having just been acquired, Smallport has not yet earned any income for BigNet owners. Consolidated revenues, expenses, and net income are identical to BigNet's balances. Subsequent to acquisition, of course, Smallport's income accounts will be consolidated with BigNet's.

Partial Ownership Consolidations (Acquisition Method)

Having reviewed the basic concepts of accounting for a non controlling interest, we now concentrate on the mechanical aspects of the consolidation process when an outside ownership is present. More specifically, we examine consolidations for time periods subsequent to the date of acquisition to analyze the full range of accounting complexities created by a non controlling interest. As indicated previously, this

discussion centers on the acquisition method as required under generally accepted accounting principles.

The acquisition method focuses on incorporating in the consolidated financial statements 100 percent of the subsidiary's assets and liabilities at their acquisition-date fair values. Note that subsequent to acquisition, changes in fair values for assets and liabilities are not recognized. 5 Instead, the subsidiary assets acquired and liabilities assumed are reflected in future consolidated financial statements using their acquisition-date fair values net of subsequent amortizations (or possibly reduced for impairment).

PAWN COMPANY
Account Balances
January 1, 2018

	Book Value	Fair Value	Difference
Current assets	$ 440,000	$440,000	$ –0–
Trademarks (indefinite life)	260,000	320,000	60,000
Patented technology (20-year remaining life) . . .	480,000	600,000	120,000
Equipment (10-year remaining life)	110,000	100,000	(10,000)
Long-term liabilities (8 years to maturity)	(550,000)	(510,000)	40,000
Net assets	$ 740,000	$950,000	$210,000
Common stock	$(230,000)		
Retained earnings, 1/1/18	(510,000)		

Illustration—Partial Acquisition with No Control Premium

To illustrate, assume that King Company acquires 80 percent of Pawn Company's 100,000 outstanding voting shares on January 1, 2018, for $9.75 per share or a total of $780,000 cash consideration. Further assume that the 20 percent non controlling interest shares traded both before and after the acquisition date at an average of $9.75 per share. The total fair value of Pawn to be used initially in consolidation is

Consideration transferred by King ($9.75 3 80,000 shares)	$780,000
Noncontrolling interest fair value ($9.75 3 20,000 shares)	195,000
Pawn's total fair value at January 1, 2018.	$975,000

Thus King did not pay a control premium to acquire its share of Pawn—both sets of shares have identical per share fair values. Annual amortization relating to these allocations also is included. Although expense figures are computed for only the initial years, some amount of amortization is recognized in each of the 20 years following the acquisition (the life assumed for the patented technology). The following schedule shows first that all identifiable assets acquired and liabilities assumed are adjusted to their full individual fair values at the acquisition date. The non controlling

KING COMPANY AND 80% OWNED SUBSIDIARY PAWN COMPANY		
Fair-Value Allocation and Amortization		
January 1, 2018		
	Allocation	**Remaining Life (years)**
Annual Excess Amortizations		
Pawn's acquisition-date fair value (100%)	$975,000	
Pawn's acquisition-date book value (100%)	(740,000)	
Fair value in excess of book value	$235,000	
Adjustments (100%) to		

Trademarks	$ 60,000	indefinite	$ –0–
Patented technology	120,000	20	6,000
Equipment	(10,000)	10	(1,000)
Long-term liabilities (8 years to maturity)	40,000	8	5,000
Goodwill	$ 25,000	indefinite	$ –0–
Annual amortizations of excess fair value over book value (initial years)			$ 10,000

Goodwill Allocation to the Controlling and Non controlling Interests			
	Noncontrolling Interest	**Controlling Interest**	**Total**
Fair value at acquisition date	$780,000	$195,000	$975,000
Relative fair value of Pawn's identifiable net assets (80% and 20%)	760,000	190,000	950,000
Goodwill	$ 20,000	..... $ 5,000	. $ 25,000

All identifiable assets acquired and liabilities assumed are adjusted to their full individual fair values at the acquisition date. The non controlling interest will share proportionately in these fair-value adjustments. The schedule shows that any excess fair value not attributable to Pawn's identifiable net assets is assigned to goodwill. Because the controlling and non controlling interests' acquisition-date fair values are identical at $9.75 per share, the resulting goodwill is allocated proportionately across these ownership interests. Consolidated financial statements will be produced for the year ending December 31, 2019. This date is arbitrary. Any time period subsequent to 2018 could serve to demonstrate the applicable consolidation procedures. Having already calculated the acquisition date
fair-value allocations and related amortization, the accountant can construct a consolidation of these two companies along the lines demonstrated in Chapter 3. Only the presence of the 20 percent non controlling interest alters this process.
To complete the information needed for this combination, assume that Pawn
Company reports the following changes in retained earnings since King's acquisition:

Current year (2019)
Net income $90,000
Less: Dividends declared . . . . . (50,000)
Increase in retained earnings $40,000
Prior years (only 2018 in this illustration):
Increase in retained earnings $70,000

Assuming that King Company applies the equity method, the Investment in Pawn Company account as of December 31, 2019, can be constructed as shown in worksheet . Note that the $852,000 balance is computed based on applying King's 80 percent ownership to Pawn's income (less amortization) and dividends. Although 100 percent of the subsidiary's assets, liabilities, revenues, and expenses will be combined in consolidation, the internal accounting for King's investment in Pawn is based on its 80 percent ownership.

KING COMPANY
Investment in Pawn Company Equity Method December 31, 2019
Acquisition price for 80% interest $780,000
Prior year (2018):

Increase in retained earnings (80% * $70,000) . .	$56,000	
Excess amortization expenses (80% * $10,000). . .	(8,000)	48,000
Current year (2019):		
Income accrual (80% * $90,000)	72,000	
Excess amortization expense (80% 3 $10,000) . . .	(8,000)	
Equity in subsidiary earnings	64,000	
Dividends from Pawn (80% 3 $50,000)	(40,000)	24,000
Balance, 12/31/19		$852,000

This technique facilitates worksheet adjustments that allocate various amounts to the non controlling interest.

Consolidated Totals

Although the inclusion of a 20 percent outside ownership complicates the consolidation process, the 2019 totals to be reported by this business combination can nonetheless be determined without the use of a worksheet:

- *Revenues* $1,340,000. The revenues of the parent and the subsidiary are added together. The acquisition method includes the subsidiary's revenues in total although King owns only 80 percent of the stock.
- *Cost of Goods Sold* $544,000. The parent and subsidiary balances are added together.
- *Depreciation Expense* $79,000. The parent and subsidiary balances are added together along with the $1,000 reduction in equipment depreciation .
- *Amortization Expense* $181,000. The parent and subsidiary balances are added together along with the $6,000 additional patented technology amortization expense
- *Interest Expens* $120,000. The parent and subsidiary balances are added along with an additional $5,000. The schedule shows Pawn's long-term debt reduced by $40,000 to fair value. Because the maturity value remains constant, the $40,000 represents a discount amortized to interest expense over the remaining 8-year life of the debt.
- *Equity in Subsidiary Earnings* (investment income) –0–. The parent's investment income is eliminated so that the subsidiary's separate revenues and expenses can be included in the consolidated totals.
- *Consolidated Net Income* $416,000. The consolidated entity's total earnings before allocation to the controlling and non controlling ownership interests.
- *Net Income Attributable to Non controlling Interest* $16,000. The outside owners are assigned 20 percent of Pawn's reported net income of $90,000 less $10,000 total excess fair-value amortization. The acquisition method shows this amount as an allocation of consolidated net income.

KING COMPANY AND PAWN COMPANY
Separate Financial Statements
For the Year Ended December 31, 2019

	King	**Pawn**
Revenues	$ (910,000)	$ (430,000)
Cost of goods sold	344,000	200,000
Depreciation expense	60,000	20,000
Amortization expense	100,000	75,000
Interest expense	70,000	45,000
Equity in subsidiary earnings	(64,000)	–0–
Net income	$ (400,000)	$ (90,000)
Retained earnings, 1/1/19.	$(860,000)	$ (580,000)
Net income (above)	(400,000)	(90,000)
Dividends declared	60,000	50,000
Retained earnings, 12/31/19	$(1,200,000)	$ (620,000)
Current assets	$ 726,000	$ 445,000

Trademarks	304,000	295,000
Patented technology	880,000	540,000
Equipment (net)	390,000	160,000
Investment in Pawn Company	852,000	–0–
Total assets	$ 3,152,000	$ 1,440,000
Long-term liabilities	$(1,082,000)	$ (590,000)
Common stock	(870,000)	(230,000)
Retained earnings, 12/31/19	(1,200,000)	(620,000)
Total liabilities and equities	$(3,152,000)	$(1,440,000)

- *Net Income Attributable to King Company (Controlling Interest)* $400,000. The acquisition method shows this amount as an allocation of consolidated net income.
- *Retained Earnings, 1/1* $860,000. The parent company figure equals the consolidated total because the equity method was applied. If the initial value method or the partial equity method had been used, the parent's balance would require adjustment to include any unrecorded figures.
- *Dividends Declared* $60,000. Only the parent company balance is reported. Eighty percent of the subsidiary's dividends are distributable to the parent and are thus eliminated. The remaining distribution goes to the outside owners and serves to reduce the Non controlling interest balance.
- *Retained Earnings, 12/31* $1,200,000. The balance is found by adding the controlling interest's share of consolidated net income to the beginning Retained Earnings balance and then subtracting the dividends to the controlling interest. Because the equity method is utilized, the parent company figure reflects the total for the business combination.
- *Current Assets* $1,171,000. The parent's and subsidiary's book values are added.
- *Trademarks* $659,000. The parent's book value is added to the subsidiary's book value plus the $60,000 allocation of the acquisition-date fair value
- *Patented Technology* $1,528,000. The parent's book value is added to the subsidiary's book value plus the $120,000 excess fair-value allocation less two years' excess amortizations of $6,000 per year
- *Equipment* $542,000. The parent's book value is added to the subsidiary's book value less the $10,000 acquisition-date fair-value reduction plus two years' expense reductions of $1,000 per year).
- *Investment in Pawn Company* –0–. The balance reported by the parent is eliminated so that the subsidiary's assets and liabilities can be included in the consolidated totals.
- *Goodwill* $25,000.
- *Total Assets* $3,925,000. This balance is a summation of the consolidated assets.

- *Long-Term Liabilities* $1,642,000. The parent's book value is added to the subsidiary's book value less the $40,000 acquisition-date fair-value allocation net of two years' amortizations of $5,000 per year.
- *Non controlling Interest in Subsidiary* $213,000. The outside ownership is 20 percent of the subsidiary's year-end book value adjusted for any unamortized excess fair value attributed to the non controlling interest:

Non controlling interest at 1/1/19
20% of $810,000 beginning book value—common stock
,,,,,plus 1/1/19 retained earnings $162,000
20% of unamortized excess fair-value allocations as of 1/1 . . . . . .,,,, . 45,000

Net income attributable to non controlling interest,,,,,,,,,,,,,,,,,,,,,,,,. 16,000
Dividends distributable to non controlling interest (20% of $50,000 total) . .. . . (10,000)
Non controlling interest at 12/31/19 . . . . . $213,000

- *Common Stock* $870,000. Only the parent's balance is reported.
- *Retained Earnings, 12/31* $1,200,000. Computed on page 159.
- *Total Liabilities and Equities* $3,925,000. This total is a summation of consolidated liabilities, non controlling interest, and equities.

Worksheet Process—Acquisition Method

The consolidated totals for King and Pawn also can be determined by means of a worksheet. The presence of a non controlling interest does not create a significant number of changes in the consolidation procedures. The worksheet still includes elimination of the subsidiary's stockholders' equity accounts (Entry **S**) although, as explained next, this entry is expanded to record the beginning non controlling interest for the year. The second worksheet entry (Entry **A**) recognizes the excess acquisition-date fair-value allocations at January 1 after one year of amortization with an additional adjustment to the beginning non controlling interest.

KING COMPANY AND PAWN COMPANY
Consolidation Worksheet
Investment: Equity Metho d **For Year Ending December 31, 2019**
Ownership: 80%

Accounts	King Company	Pawn Company	Consolidation Entries		NCI	Cos.Tptal
			Dr	Cr		
Revenues	(910,000)	(430,00 0)				(1,340,000)
Cost of goods sold	344,000	200,000				544,000
Depreciation expense	60,000	20,000		(E) 1,000		79,000
Amortization expense	100,000	75,000	(E) 6,000			181,000
Interest expense	70,000	45,000	(E) 5,000			120,000
Inv.t income	(64,000)	–0–	(I) 64,000			–0–
Separate company net income	(400,000)	(90,000)				
Consolidated net income						(416,000)
Net income **NCI**				(16,000)		16,000
Net income K.comp						(400,000)
Retained earnings, 1/1	(860,000)	(580,00 0)	(S) 580,000			(860,000)
Net income	(400,000)	(90,000)				
Dividends declared	60,000	50,000		(D) 40,000	10,000	60,000
Retained earnings, 12/31	(1,200,0 00)	(620,00 0)				(1,200,000)
Current assets	726,000	445,000				1,171,000
Trademarks	304,000	295,000	(A) 60,000			659,000
Patented technology	880,000	540,000	(A) 114,000	(E) 6,000		1,528,000
Equipment (net)	390,000	160,000	(E) 1,000	(A) 9,000		542,000
Investment in Pawn Com	852,000	–0–	(D) 40,000	(S) 648,000 (A) 180,000 (I) 64,000		–0–
Goodwill	–0–	–0–	(A) 25,000			25,000
Total assets	3,152,00 0	1,440,0 00				3,925,000
Long-term liabilities	(1,082,0 00)	(590,00 0)	(A) 35,000	(E) 5,000		(1,642,000)
Common stock	(870,000)	(230,00 0)	(S) 230,000			(870,000)

Noncontrolling interest in Pawn 1/1				(S) 162,000 A) 45,000	(207,000)	
Noncontrolling interest in Pawn 12/31					(213,000	(213,000
Retained earnings, 12/31	(1,200,000)	(620,000)				(1,200,000)
Total liabilities and equities	(3,152,000)	1,440,000	1,160,000	1,160,000		3,925,000

Consolidation entries:

(S) Elimination of subsidiary's stockholders' equity along with recognition of January 1 non controlling interest.

(A) Allocation of subsidiary total fair value in excess of book value, unamortized balances as of January 1.

(I) Elimination of intra-entity income (equity accrual less amortization expenses).

(D) Elimination of intra-entity dividends.

(E) Recognition of amortization expenses of fair-value allocations.

Consolidation Entry S

Common Stock (Pawn) 230,000
Retained Earnings, 1/1/19 (Pawn). 580,000
Investment in Pawn Company (80%) 648,000
Non controlling Interest in Pawn Company, 1/1/19 (20%) 162,000

To eliminate beginning stockholders' equity accounts of subsidiary along with book value portion of investment (equal to 80 percent ownership). Non controlling interest of 20 percent is also recognized.

Consolidation Entry A

Trademarks 60,000
Patented Technology 114,000
Liabilities 35,000
Goodwill 25,000
Equipment 9,000
Investment in Pawn Company (80%) 180,000
Non controlling Interest in Pawn Company, 1/1/15 (20%) 45,000

To recognize unamortized excess fair value as of January 1, 2019, to Pawn's assets acquired and liabilities assumed in the combination. Also to allocate the unamortized fair value to the non controlling interest. Goodwill is attributable proportionately to controlling and non controlling interests

Consolidation Entry I

Equity in Pawn's Earnings. 64,000
Investment in Pawn Company. 64,000

To eliminate intra-entity income accrual comprising subsidiary income less excess acquisition-date fair-value amortizations.

Consolidation Entry D

Investment in Pawn Company 40,000
Dividends Declared 40,000

To eliminate intra-entity dividends.

Consolidation Entry E

Amortization Expense 6,000
Interest Expense. 5,000
Equipment (net) 1,000
Depreciation Expense 1,000
Patented Technology 6,000
Long-Term Liabilities 5,000

To recognize current year excess fair-value amortizations.

Income Statement
Year Ended December 31, 2015

Revenues	$1,340,000
Cost of goods sold	(544,000)
Depreciation expense	(79,000)
Amortization expense	(181,000)
Interest expense	(120,000)
Consolidated net income	$ 416,000
To non controlling interest	16,000
To King Company (controlling interest)	.,,,, $ 400,000

Statement of Changes in Owners' Equity
Year Ended December 31, 2015

	King Company Owners		
	Retained Earnings	**Common Stock**	**Non controlling Interest**
Balance, January 1	$ 860,000	$870,000	$207,000
Net income	.. 400,000		16,000
Less: Dividends	(60,000)		(10,000)
Balance, December 31	$1,200,000	$870,000	$213,000

Balance Sheet
On December 31, 2019

Assets	
Current assets	$1,171,000
Trademarks	659,000
Patented technology	1,528,000
Equipment (net)	542,000
Goodwill	25,000
Total assets	.... $3,925,000
Liabilities	
Long-term liabilities	$1,642,000
Owners' Equity	
Common stock—King Company	870,000
Noncontrolling interest in subsidiary	213,000
Retained earnings	1,200,000
Total liabilities and owners' equity	$3,925,000