CONSOLIDATED FINANCIAL STATEMENT: SUBSEQUENT TO THE DATE OF BUSINESS

CHAPTER THREE

CONSOLIDATED FINANCIAL STATEMENT



3.1. INTRODUCTION

- Subsequent to date of a business combination **the parent company accounts for operating results of subsidiary.**
- That is it accounts for:
  1. Net income or net loss, and
  2. Dividends declared and paid by subsidiary
- In addition, a number of intercompany transactions and event that frequently occur in a Parent- Subsidiary relationship shall be recorded.
- All the three basic financial statements must be consolidated for accounting periods subsequent to the date of purchase type business combination.

3.2. METHOD OF ACCOUNTING FOR CFS

A parent company may choose the **Equity Method** or **the Fair Value Method** to account for the operating results of consolidated purchased subsidiaries.

1. EQUITY METHOD

- The Parent company records its share of subsidiary's net income or net loss, adjusted for depreciation and amortization of differences between current fair values and carrying amounts of a purchased subsidiary's net asset on the date of business combination, as well as its share of dividends declared by subsidiary.
- Proponents claim that equity method stresses the **economic substance** of the parent-subsidiary relationship.

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- Proponents of the method maintain that the method is consistent with the accrual basis of accounting.
- Dividends declared by a subsidiary do not constitute revenue to the parent company.
- It recognizes increases or decreases in the carrying amount of the parent company’s investment in the subsidiary
- When they are realized by the subsidiary as net income or net loss, not when they are paid by the subsidiary as dividends

SAMPLE EQUITY METHOD

Initial Investment---Investment in S.....XX

Cash/other assets.....XX

- Net Income --------Investment in S.....XX

  Income from S.....XX

- Net Loss ----------Loss from S..... XX

  Investment in S.....XX

2. FAIR VALUE METHOD

- Parent company accounts for the operations of a subsidiary only to the extent that dividends are declared by the subsidiary.
- Net income or net loss of the subsidiary is not recognized by the parent company.
- Supporters of the method contend that the method appropriately recognizes the legal form of parent – subsidiary relationship.

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- Dividends declared by subsidiary are recognized as revenue by the parent company.
- The general accounting and reporting rule for these investments is to value the securities at fair value and record gains and losses in PROFIT OR LOSS.

SAMPLE FAIR VALUE METHOD

Initial Investment---Investment in S……XX

Cash/other assets……XX

- Net Income --------- NO JOURNAL ENTRY
- Net Loss ---------- NO JOURNAL ENTRY
- Dividend ----------Dividend receivable/ cash…… ……XX

  Dividend income……XX

Fair value adjustment:

Increase In Fair Value: Investment In S……Xx

Gain From Fair Value

EXAMPLE

- Arthur Company invested Br 400,000.00 for a 80% interest in ARBE Company on January 1, 2019. At December 31, 2019, ARBE reported a Net Income of Br 300,000.00 and also on December 21, 2019 it declared a dividend of Br 100,000.00. At December 31, 2019, the Fair Value of Arthur's 80% Share Was Br 600,000.

ELIMINATIONS AND ADJUSTMENTS FOR EQUITY

The items that must be included in the elimination are:

1. Three components of the subsidiary's stockholders' equity are reciprocal to the parent company's Investment Ledger Account.
2. The subsidiary's beginning-of-year retained earnings

Cont..

3. The debits to the subsidiary's plant assets, patent, and goodwill bring into the consolidated balance sheet the un-amortized differences between current fair values and carrying amounts of the subsidiary's assets on the date of the business combination.

4. The amount of the parent company's inter-company investment income is an element of the balance of the parent's Investment Ledger Account.

CONT…

5. Subsidiary’s dividends are an offset to the subsidiary’s retained earnings.

6. The balance of the parent company’s Investment Ledger Account is net of the dividends received from the subsidiary.

7. The elimination of the subsidiary’s beginning-of-year retained earnings makes

SUMMARY OF ELIMINATION AND ADJUSTMENT ENTRIES

1. The basic elimination entry:

Common Stock (S)	XX	
Additional Paid-in Capital (S)		XX
Retained Earnings, **Beginning Balance** (S)		XX
Income from Sub	XX	
Investment in Sub		BV
Dividends Declared		XX

2. The excess value reclassification entry:

Asset 1	**XX**	
Asset 2	**XX**	
Goodwill	**XX**	
Investment in Sub		**Excess**

SUMMARY OF ELIMINATION AND ADJUSTMENT ENTRIES

3. The amortized excess value reclassification entry:

Cost of Sales	XX		
Other Expenses	XX		
	Income from Sub		XX

This entry reclassifies the equity method amortization of cost in excess of book from Income from Sub to the appropriate expense accounts where the costs would have been had the sub used FMV instead of BV

Accumulated Depreciation	XX		
	Buildings and Equipment		XX

EXAMPLE 1

Pan Corp. purchased 100% of the voting interest of Sen on Jan. 1, 2010 for Br 750,000 Cash.

Sen Corporation's Statement of Financial

Assets	**January 1, 2010**	**December 31, 2010**
Inventory	Br 100,000	Br 40,000
Other Current Asset	100,000	160,000
Land	150,000	150,000
Building	200,000	200,000
Machinery	50,000	90,000
Total	**Br 600,000**	**Br 640,000**
Liabilities and Equities		
Liabilities	Br 100,000	Br 120,000
Common Stock	300,000	300,000
Retained Earning	200,000	220,000
Total	**Br 600,000**	**Br 640,000**

CONT…

Fair Value of Assets of Sen at Jan. 1, 2010

Inventory	Br 105,000	Buildi ng	Br 220,000 EEL of 10 Years
Other Current Asset	100,000	Machi nery	40,000 EEL of 10 Years
Land	160,000		

2. Sen’s Dec. 31, 2010, Net Income and Dividend Payments were Br 140,000 and Br 100,000, Respectively.
3. Sen’s Inventory was sold during 2010.

Cont..

January 1, 2010: Investment in Sen……750,000

Cash……750,000

Goodwill Calculation

- Goodwill = Acquisition Cost – Fair Value of Net Identifiable Asset(FVNIA)

  FVNIA = Fair Value of Assets – Fair Value of Liabilities

  FVNIA = (105,000 + 100,000 + 160,000 + 220,000 + 40,000) - (100,000)

  = Br 625,000 – Br 100,000= Br 525,000

- Goodwill = Br 750,000 – Br 525,000 = Br 225,000

Cont....

Elimination and Adjustment Entry for Jan. 1/ 2010

Common Stock.....300,000

Retained Earning.....200,000

Inventory..... 5,000

Land..... 10,000

Building..... 20,000

Goodwill.....225,000

Investment in Starr.....750,000

Machinery..... 10,000

Cont..

Dec. 31, 2010

Sen: Dividend Declared.....100,000

Cash.....100,000

Pan: 1. Investment in Sen.....140,000

Income from Sen.....
140,000

2. Cash.....100,000

Investment in
Sen.....100,000

Cont..

Adjustments for Previously increased or decreased assets

	Jan. 1/ 2010	Expensed	Dec. 31/2010
Inventory	Increased By 5,000	CGS= 5,000 (B/C Inventory was sold)	0
Land	Increased By 10,000	Zero (B/C Land is Undepreciated Asset)	10,000
Building	Increased By 20,000	20,000/10 = 2,000	18,000
Machin	Decreased By 10,000	10,000/10 = 1,000	9,000
Total Expense Increased by 6,000 = (5,000+2,000-1000)			

Cont..

After the adjustment total expenses of Sen increased by 6,000. So, the following adjustment will be made at Dec. 31/2010:

Income from Sen.....6,000

Investment in Sen.....6,000

Investment in Sen	
Br 750,000	Br 100,000
140,000	6,000
Br 890,000	Br 106,000
Br 784,000	

Income from Sen	
Br 6,000	Br 140,000
	Br 134,000

Cont....

Elimination and Adjustment Entry for Dec. 31/ 2010

Common Stock.....300,000
Retained Earning.....200,000
Cost of Goods Sold.....5,000
Land.....10,000
Building.....18,000
Income from Sen.....134,000
Operating Expenses.....1,000
Goodwill.....225,000
Investment in Starr.....784,000
Machinery.....9,000
Dividend Declared.....100,000

Example 2

1. Assume that Starr Company had net income of Br 60,000 for the year ended December 31, 2003, and dividends of Br 24,000 are declared on December 20, 2003

	December 31, 2002
Inventories (FIFO)	Br 25,000
Plant Assets, net:	
Land	15,000
Building (10 Years)	30,000
Machinery (10 Years)	20,000
Patent (5 Years)	5,000
Goodwill (No Impairment)	15,000
Total	110,000

Cont....

Palm Corporation and Subsidiary Working Paper For Consolidated Financial Statements For Year Ended Dec.31,2003		
Types of financial statements:	**Palm Corporation**	**Starr Company**
Income statement		
Revenue:		
Net Sales	1,100,000	680,000
Income from Starr	29,000	---
Total Revenue	***1,129,000***	***680,000***
Cost of goods sold	700,000	450,000
Operating expenses	217,667	130,000
Interest expense	49,000	---
Income tax expenses	53,333	40,000
Total Costs and Expenses	***1,020,000***	***620,000***
Net income	**109,000**	**60,000**
Statement of Retained Earnings		
Retained Earnings Jan.1, 2003	74,000	132,000
Net income for the year	109,000	60,000
Subtotal	**183,000**	**192,000**
Dividend Declared	30,000	24,000
Retained Earnings end of year	**153,000**	**168,000**

CONT…

Balance Sheet		
Cash	5,900	72,100
Dividend Receivables from Starr Com.	24,000	---
Inventories	136,000	115,000
Other current assets	88,000	131,000
Investment in Starr Company	505,000	–
Plant asset, net	440,000	340,000
Patent, net	–	16,000
Goodwill, net	–	–
Total Asset	**1,198,900**	**674,100**
Liability and SHE		
Income tax payable	40,000	20,000
Dividend Payables to Palm corporation		24,000
Other liabilities	190,900	204,100
Common stock Br 10 par	400,000	–
Common stock Br 5 par	–	200,000
Additional paid-in capital	415,000	58,000
Retained Earnings	153,000	168,000
Total Liability & SHE	**1,198,900**	**674,100**

Cont..

STARR:

Dec. 20, 2003: Dividend Declared…….24,000

Dividend Payable……24,000

PALM:

Dec. 20, 2003: Dividend Receivable……24,000

Investment in Starr……24,000

Dec. 31, 2003: Investment. in Starr……60,000

Income from Starr…… 60,000

Cont..

Adjustments for Previously increased or decreased assets

	Dec. 31/ 2002	Expensed	Dec. 31/2003
Inventory	Increased By 25,000	CGS= 25,000 (B/C Inventory was sold)	0
Land	Increased By 15,000	Zero (B/C Land is Undepreciated Asset)	15,000
Building	Increased By 30,000	30,000/10 = 3,000	27,000
Patent	**Increased By 5,000**	**5,000/5 = 1,000**	**4,000**
Goodwill	Increased By 15,000	0 (No Impairment of Goodwill)	15,000

(25,000+3,000+2,000+1,000)

Cost of Goods Sold is Br 25,000 and Operating Expense is

Total Plant Asset Increased By 60,000 = (15,000+27,000+18,000)

Cont..

After the adjustment total expenses of Starr increased by 31,000. So, Its Net Income Decreased by 31,000. The following adjustment will be made at Dec. 31/2003:

Income from S

Investment in Sen	
Br 500,000	Br 24,000
60,000	31,000
Br 560,000	Br 55,000
Br 505,000	

Income from Sen	
Br 31,000	Br 60,000
	Br 29,000

Cont....

Elimination and Adjustment Entry for Dec. 31/ 2003

Common Stock.....200,000
Retained Earning.....132,000
Additional Paid In Capital-In Excess of Capital.....58,000
Dividend Payable.....24,000
Cost of Goods Sold.....25,000
Plant Asset.....60,000
Patent.....4,000
Income from Starr.....29,000
Operating Expenses.....6,000
Goodwill.....15,000
Investment in Starr.....505,000
Dividend Declared.....24,000
Dividend Receivable.....24.000

Cont...

Palm Corporation and Subsidiary
Working Paper For Consolidated Financial Statements
For Year Ended Dec.31,2003

Types of financial statements:	Palm Corporation	Starr Company	Elimination		Consolidated
			Debit	Credit	
Income statement					
Revenue:					
Net Sales	1,100,000	680,000	---	---	1,780,000
Income from Starr	29,000	---	29,000	---	0
Total Revenue	***1,129,000***	***680,000***	***29,000***	---	***1,780,000***
Cost of goods sold	700,000	450,000	25,000	--	1,175,000
Operating expenses	217,667	130,000	6,000	--	353,667
Interest expense	49,000	---	---	---	49,000
Income tax expenses	53,333	40,000	---	---	93,333
Total Costs and Expenses	***1,020,000***	***620,000***	**31,000**		***1,671,000***
Net income	**109,000**	**60,000**	**60,000**	---	**109,000**
Statement of Retained Earnings					
Retained Earnings Jan.1, 2003	74,000	132,000	132,000	---	74,000
Net income for the year	109,000	60,000	60,000	--	109,000
Subtotal	**183,000**	**192,000**	**192,000**	--	**183,000**
Dividend Declared	30,000	24,000	---	24,000	30,000
Retained Earnings end of year	**153,000**	**168,000**	**192,000**	**24,000**	**153,000**

CONT…

Balance Sheet					
Cash	5,900	72,100	---	---	78,000
Dividend Receivables from Starr Com.	24,000	---	---	24,000	0
Inventories	136,000	115,000	---	---	251,000
Other current assets	88,000	131,000	---	---	219,000
Investment in Starr Company	505,000	–	---	505,000	0
Plant asset, net	440,000	340,000	60,000	---	840,000
Patent, net	–	16,000	4,000	---	20,000
Goodwill. net	–	–	15.000	---	15.000
Total Asset	**1,198,900**	**674,100**	**79,000**	**529,000**	**1,423,000**
Liability and SHE					
Income tax payable	40,000	20,000	---	----	60,000
Dividend Payables to Palm corporation		24,000	24,000	----	0
Other liabilities	190,900	204,100	---	---	395,000
Common stock Br 10 par	400,000	–	---	---	400,000
Common stock Br 5 par	–	200,000	200,000	---	0
Additional paid-in capital	415,000	58,000	58,000	---	415,000
Retained Earnings	153,000	168,000	192,000	24,000	153,000
Total Liability & SHE	**1,198,900**	**674,100**	**474,000**	**24,000**	**1,423,000**

Example 3

1. Assume that on December 5, 2004 **Sage** Company declared dividend of Br 1 per Share Payable on December 19, 2004 and net income of Sage for the year was Br 90,000.

	Excess Cost
Inventories (FIFO)	26,000
Plant Assets, net:	
Land	60,000
Building (20 Years)	80,000
Machinery (5 Years)	50,000
Leasehold (6Years)	30,000
Total	246,000

Cont..

Post Corporation and Subsidiary Working paper for consolidated Financial statements For year Ended Dec.31,2004		
	Post Corporation	Sage Company
INCOME STATEMENT		
Revenue:		
Net Sales	5,611,000	1,089,000
Income from Sage com.	42,750	---
Total Revenue	*5,653,750*	*1,089,000*
Cost of goods sold	3,925,000	700,000
Operating expenses	556,000	129,000
Interest and income tax expense	710,000	170,000
Total costs and Expenses	*5,191,000*	*999,000*
Consolidated Net income	462,750	90,000
Non-Controlling Interest in the net income of Sage	---	---
Controlling Interest in the net income of Sage	462,750	90,000
STATEMENT OF RETAINED EARNING		
Retained Earnings Jan.1.2004	997,750	334,000
Controlling Interest Net income for the year	462,750	90,000
Subtotal	1,460,500	424,000
Dividend Declared	158,550	40,000
Retained Earnings end of year	1,301,950	384,000

Cont..

BALANCE SHEET		
Assets:		
Inventories	861,000	439,000
Other Current Assets	639,000	371,000
Investment in Sage Company CS	1,334,750	---
Plant asset(net)	3,600,000	1,150,000
Leasehold(net)	---	---
Goodwill (net)	95,000	---
Total Asset	6,529,750	1,960,000
Liability and SHE:		
Liabilities	2,420,550	941,000
Common stock Br 1 par	1,066,500	---
Common stock Br 10 par	---	400,000
Additional paid-in capital	1,740,750	235,000
Retained Earnings	1,301,950	384,000
Non-Controlling Interest	---	---
Total Liability & SHE	6,529,750	1,960,000

Cont..

SAGE:

Dec. 5, 2004: Dividend Declared.....40,000

Dividend Payable.....40,000

Dec. 19, 2004: Dividend Payable.....40,000

Cash.....40,000

Cont..

PALM:

Dec. 05, 2003: Dividend Receivable..(40,000 0.95)……38,000

Investment in Sage…….38,000

Dec. 19, 2003: Cash……38,000

Dividend Receivable……38,000

Dec. 31, 2003: Investment in Sage..(90,000 0.95)……85,500

Income from Sage……85,500

NCI's Share of Dividend is Br 2,000

NCI's Share of Net Income is Br 4,500

Cont..

Adjustments for Previously increased or decreased assets

	Dec. 31/ 2003	Expensed	Dec. 31/2004
Inventory	Increased By 26,000	CGS= 26,000 (B/C Inventory was sold)	0
Land	Increased By 60,000	Zero (B/C Land is Undepreciated Asset)	60,000
Building	Increased By 80,000	80,000/20 = 4,000	76,000
Machin	Increased By	50,000/5 = 10,000	40,000
Leasehold	**Increased By 30,000**	**30,000/6 = 5,000**	**25,000**
Goodwill	Increased By 185,000	0 (No Impairment of Goodwill)	185,000

(26,000+4,000+10,000+5,000)

Cost

Total Plant Asset Increased By 176,000 =

Cont..

After the adjustment total expenses of Starr increased by 45,000. So, Its Net Income Decreased by 45,000. The following adjustment will be made at Dec. 31/2003:

Income from Sage...(45,000 0.95) 42,750

Investment in Sage	
Br 1,330,000	Br 38,000
85,500	42,750
Br **1,415,500**	**Br 80,750**

Income from Starr	
Br 42,750	Br 85,500
	Br 42,750

Cont..

Non Controlling Interest	
Br 2,000	Br 70,000
2,250	4,500
Br **4,250**	**Br 74,500**
	Br 70,250

NCI's Share of Sage's Net Income	
Br 2,250	Br 4,500
	Br 2,250

Cont....

Elimination and Adjustment Entry for Dec. 31/ 2003

Common Stock.....400,000
Retained Earning.....334,000
Additional Paid In Capital-In Excess of Capital.....235,000
Cost of Goods Sold.....26,000
Plant Asset.....176,000
Leasehold.....25,000
Income from Starr.....42,750
NCI's Share of Sage's Net Income.....2,250
Operating Expenses.....19,000

Goodwill.....185,000
Investment in Sage. 1,334,750
Non Controlling Interest.....70,250
Dividend Declared.....40,000

Cont...

Post Corporation and Subsidiary
Working paper for consolidated Financial statements
For year Ended Dec.31,2004

	Post Corporation	Sage Company	Elimination		Consolidated
			Debit	Credit	
Income Statement					
Revenue:					
Net Sales	5,611,000	1,089,000	---	---	6,700,000
Income from Sage com.	42,750	---	42,750	---	0
Total Revenue	***5,653,750***	***1,089,000***	***42,750***	---	***6,700,000***
Cost of goods sold	3,925,000	700,000	26,000	---	4,651,000
Operating expenses	556,000	129,000	19,000	---	704,000
Interest and income tax expense	710,000	170,000	---	---	880,000
Total costs and Expenses	***5,191,000***	***999,000***	***45,000***	---	***6,235,000***
Consolidated Net income	**462,750**	**90,000**	**87,750**	---	**465,000**
Non-Controlling Interest in the net income of Sage	---	---	**2,250**	---	**(2,250)**
Controlling Interest in the net income of Sage	**462,750**	**90,000**	**90,000**		**462,750**
Statement of Retained Earrings					
Retained Earnings Jan.1.2004	997,750	334,000	334,000	---	997,750
Controlling Interest Net income for the year	462,750	90,000	90,000	---	462,750
Subtotal	**1,460,500**	**424,000**	**424,000**	---	**1,460,000**
Dividend Declared	158,550	40,000	---	40,000	158,550
Retained Earnings end of year	**1,301,950**	**384,000**	**424,000**	**40,000**	**1,301,950**

Cont…

Balance Sheet					
Assets:					
Inventories	861,000	439,000	---	---	1,300,000
Other Current Assets	639,000	371,000	--	---	1,010,000
Investment in Sage Company CS	1,334,750	---	---	1,334,750	0
Plant asset(net)	3,600,000	1,150,000	176,000	---	4,926,000
Leasehold(net)	---	---	25,000	---	25,000
Goodwill (net)	95,000	---	185,000	---	280,000
Total Asset	**6,529,750**	**1,960,000**	**386,000**	**1,334,750**	**7,541,000**
Liability and SHE:					
Liabilities	2,420,550	941,000	---	---	3,361,550
Common stock Br 1 par	1,066,500	---	---	---	1,066,500
Common stock Br 10 par	---	400,000	400,000	---	0
Additional paid-in capital	1,740,750	235,000	235,000	---	1,740,750
Retained Earnings	1,301,950	384,000	424,000	40,000	1,301,950
Non-Controlling Interest	---	---	---	70,250	70,250
Total Liability & SHE	**6,529,750**	**1,960,000**	**1,059,000**	**110,250**	**7,541,000**

SUMMARY OF CFS

- In effect, the elimination of the inter-company investment income comprises a reclassification of the inter-company investment income to the adjusted components of the subsidiary's net income in the consolidated income statement.
- The increases in the subsidiary's cost of goods sold and operating expenses, in effect, reclassify the comparable decrease in the parent company's Investment ledger account under the equity method of accounting.
- The inter-company receivable and payable, placed in adjacent columns on the same line, are offset without a formal elimination.
- The elimination cancels all inter-company transactions and balances not dealt with by the offset described above.

Cont..

- The elimination cancels the subsidiary's retained earnings balance at the ***beginning-of-year***, so that each of the three basic financial statements may be consolidated in turn.
- The first-in, first-out method is used by subsidiary to account for inventories; thus the difference attributable to subsidiary's beginning inventories is allocated to cost of goods sold for the year ended.
- Income tax effects of the elimination's increase in subsidiary's expenses are not included in the elimination.

Cont..

- One of the effects of the elimination is to reduce the differences between the current fair values and the carrying amounts of the subsidiary's net assets, except land and goodwill, on the business combination date.
- The parent company's use of the equity method of accounting results in the equalities described below:
- Parent Company Net Income = Consolidated Net Income

Cont..

- Parent Company Retained Earnings = Consolidated Retained Earnings
- Despite the equalities, **consolidated financial statements are superior to parent company financial statements** for the presentation of financial position and operating results of parent and subsidiary companies.



THANK YOU FOR
YOUR LİSTENİNG

DO YOU HAVE
ANY QUESTİONS?