7

Changes to Group Structures

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7

Learning Outcomes

After studying this chapter students should be able to:

- demonstrate the impact on group financial statements when a subsidiary is acquired part way through an accounting period, and where shareholdings, or control, are acquired in stages;

7.1 Introduction

In this chapter we look specifically at where there have been changes to the group structure in the period. We will consider acquisitions, disposals and business reorganisations. There will be more opportunities in this chapter to practice the basic principles of consolidation, being the calculation of goodwill on acquisition, group retained earnings and non-controlling interest; however, time apportionment within these calculations will be necessary.

Acquisitions will be covered in the following way:

- In Section 7.2 we will introduce acquisitions in the period with a simple example.
- In Section 7.3 we will apply the fair value requirements of IFRS 3 *Business Combinations*, introduced in Chapter 2, in a worked example and look at how that impacts the calculation of goodwill and non-controlling interest, and adjusts consolidated net assets.
- The last area of acquisitions that we will consider is the impact on the group accounts where the investment in another entity is built up over time, known as piecemeal acquisitions (Section 7.4).

Disposals in the accounting period will be covered in Section 7.5 and again the accounting treatment will depend on the amount of the investment being disposed of. We will consider:

- Full disposal
- Disposal resulting in a subsidiary becoming an associate
- Disposal resulting in a subsidiary becoming a trade investment
- Disposal resulting in the controlling interest being retained

Business reorganisations will be covered in Section 7.6.

7.2 Acquisitions in the accounting period

7.2.1 Introduction

When a group entity is acquired during the accounting period it is not consolidated for the whole period, only from the date of acquisition. This means that, when preparing the consolidated income statement, the profits must be time-apportioned and only post-acquisition profits included. Unless the question clearly indicates to the contrary, you can assume the profits accrue on a time basis.

An additional problem is that the figure for pre-acquisition profits is unknown. This is needed to compute the goodwill on acquisition. However, the figure can be calculated: accumulated profit in the entity brought forward at the beginning of the year is added to profit for the year up to the date of acquisition.

Example 7.A

Income statements for the year ended 31 March 20X0

	Pig	*Pinky*	*Perky*
	$'000	$'000	$'000
Revenue	80,700	25,000	11,000
Operating expenses	(49,000)	(20,000)	(8,000)
Profit from operations	31,700	5,000	3,000
Investment income	1,400	–	–
Profit before taxation	33,100	5,000	3,000
Income tax expense	(13,500)	(2,000)	(1,200)
Profit for the period	19,600	3,000	1,800

Summarised statements of changes in equity for the year ended 31 March 20X0

	Pig	*Pinky*	*Perky*
	$'000	$'000	$'000
Equity at 1 April 20W9	56,000	23,000	20,200
Profit for the period	19,600	3,000	1,800
Dividends paid in March 20X0	(10,000)	(1,000)	(800)
Equity at 31 March 20X0	65,600	25,000	21,200

The equity of the three entities in the statement of financial positions as at 31 March 20X0 showed the following:

	Pig	*Pinky*	*Perky*
	$'000	$'000	$'000
Share capital ($1 shares)	20,000	15,000	10,000
Share premium account	8,000	5,000	3,000
Retained earnings	37,600	5,000	8,200
	65,600	25,000	21,200

On 30 June 20W7, when the retained earnings of Pinky showed a balance of $1.5 million and the equity of Pinky showed a balance of $21.5 million, Pig bought 12 million shares in Pinky for a cash price of $18 million. On 1 October 20W9 Pig bought 7.5 million shares in Perky for a cash price of $16 million. The share premium accounts of Pinky and Perky both arose prior to the investment by Pig.

The main point of principle to bear in mind when preparing the consolidated income statement (see below) is that only the *post*-acquisition profits of subsidiaries should be included. Therefore, for *the year ended 31 March 20X0 only* the results of Perky must be time apportioned, and only 6 months' worth included in the consolidated income statement.

Consolidated income statement

	$'000
Revenue (Pig + Pinky + 6/12 × Perky)	111,200
Operating expenses (Pig + Pinky + 6/12 × Perky)	(73,000)
Profit from operations before tax	38,200
Income tax expense (Pig + Pinky + 6/12 × Perky)	(16,100)
Profit for the period	22,100
Attributable to:	
Equity holders of parent	21,275
Non-controlling interest (W1)	825
	22,100

Consolidated statement of changes in equity

	Attributable to equity holders of the parent $	*Non-controlling interest* $	*Total equity* $
Balance at the start of the year (W2)	57,200	4,600	61,800
Non-controlling interest upon acquisition of Perky (W3)		5,275	5,275
Profit for the period	21,275	825	22,100
Dividends (W4)	(10,000)	(400)	(10,400)
Balance at the end of the year	68,475	10,300	78,775

Workings

1. *Non-controlling interest*

	$'000
Pinky ($3,000,000 × 20%)	600,000
Perky ($1,800,000 × 6/12 × 25%)	225,000
	825,000

2. *Balance at the start of the period*
   Attributable to equity shareholders of the parent:

	$'000
Pig	56,000
Pinky [80% × ($23 m − $21.5 m)]	1,200
	57,200

   The balance attributable to the non-controlling interest is 20% of the brought forward balance in Pinky of $23 million: $23 m × 20% = $4.6 m.

3. *Non-controlling interest upon acquisition of Perky*
   Equity in Perky at the date of acquisition on 1 October 20W9:

	$'000
Brought forward at the beginning of the year	20,200
6/12 × profit for the year ($1.8 × 6/12)	900
	21,100

   Minority share (25% × $21.1 m) = $5,275,000

4. *Dividends*

	$'000
Pinky (20% × $1 m)	200
Perky (25% × $0.8 m)	200
	400

The closing balance in respect of the minority in the statement of changes in equity can be proved as follows:

	'000
Pinky (20% × $25 m)	5,000
Perky (25% × $21,200)	5,300
	10,300

7.2.2 Dividends paid by the subsidiary out of profits earned in the year of acquisition in the financial statements of the parent

Dividend paid after date of acquisition

Treatment of dividends paid in the year of acquisition depends on whether or not the new parent has *received* (or is to receive) the dividend. If the parent is to receive the dividend, then (as shown in the above example) the group share is regarded as income of the parent.

Dividend causing a reduction in the carrying value of the investment

There is a minor exception to the general treatment mentioned in the previous paragraph. If a subsidiary pays a large dividend to its parent just after acquisition it may well be that the value of the subsidiary would be considerably diminished by the outflow of cash that was required. If this diminution in value were such as to lead to a reduction in the carrying value of the investment in the books of the parent then the dividend received would be regarded as a payment from the subsidiary in respect of the reduction in carrying value. The parent would account for this as a reduction in the carrying value of the investment rather than as income.

> **!** … It is important to realise that the above matter affects the accounts of the parent but not the consolidated accounts – an intra-group dividend that cancels out on consolidation clearly cannot have an effect on the consolidated financial statements.

7.2.3 Dividend paid before the date of acquisition

If the dividend is paid out *before* the parent makes its investment, then it is clearly paid out of pre-acquisition profits, and so will not be income of the parent at all. However, in computing the goodwill figure in these circumstances, the dividend must be deducted in computing the net assets of the subsidiary at the date of acquisition since the cash has left the subsidiary before the date of acquisition.

7.3 Fair value in acquisition accounting

7.3.1 The requirements of IFRS 3 *Business Combinations* ('IFRS 3')

IFRS 3 requires that whenever a group entity is consolidated for the first time the purchase consideration and the group share of the net assets of the acquired entity are measured at fair values. The difference between these two figures is goodwill.

Net assets of the acquired entity should be recognised separately as at the date of acquisition if they satisfy IFRS 3's criteria for recognition:

- In the case of an asset other than an intangible asset, it is probable that any associated future economic benefits will flow to the acquirer, and its fair value can be measured reliably;

- In the case of a liability other than a contingent liability, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and its fair value can be measured reliably;
- It is an intangible asset that meets the IAS 38 *Intangible Assets* definition;
- In the case of a contingent liability, its fair value can be measured reliably.

7.3.2 Summary of points given in Chapter 2 regarding fair value for individual assets and liabilities

Fair value of consideration

Fair value must be measured at the date of the exchange. In cases where the acquisition is for the asset of cash, measurement of fair value is straightforward. However, in some cases the consideration offered will comprise equity shares, wholly or in part. Where this is the case, the shares must be valued at fair value.

Property, plant and equipment

Fair value should be based on depreciated market value unless (in the case of plant and equipment) there is no evidence of market value. In such cases fair value should be based on depreciated replacement cost.

Inventories

Where inventories are replaced by purchases in a ready market, the fair value = market value. However, where there is no ready market fair value is the current cost to the acquiring entity of obtaining the same inventories. If no current cost figure is readily available it can be approximated by taking inventories at sales values less:

- costs to complete (for work-in-progress inventories)
- incidental costs of disposal
- a realistic allowance for profit.

Listed investments

In most cases, the price quoted at the date of exchange will represent fair value.

Intangible assets

The acquirer should recognise an intangible asset of the acquiree at the date of acquisition provided that it meets the definition of an intangible asset provided by IAS 38 *Intangible Assets*, and that it can be measured reliably. Intangible assets must be separable or they must arise from contractual or legal rights.

Monetary assets and liabilities

The fair value should be based on the amounts due to be received or paid.

Provisions for restructuring

Only the identifiable assets, liabilities and contingent liabilities of the acquiree that exist at the statement of financial position date can be recognised separately by the acquirer as part of allocating the cost of the combination. IFRS 3 states that: 'future losses or other costs expected to be incurred as a result of a combination are not liabilities incurred or assumed

by the acquirer in exchange for control of the acquiree, and are not, therefore, included as part of the cost of the combination' (para. 28).

Contingent liabilities

IFRS 3 requires that the contingent liabilities of an acquiree are recognised at fair value at the date of acquisition provided that their fair value can be measured reliably.

The following example illustrates the application of the requirements to incorporate fair value.

7.3.3 Application of fair value adjustments

Example 7.B

The statement of financial positions of Sea and its subsidiaries River and Stream as at 31 March 20X0 – the accounting reference date for all three entities – are given below:

	Sea		*River*		*Stream*	
ASSETS	$'000	$'000	$'000	$'000	$'000	$'000
Non-current assets						
Intangible assets						5,000
Tangible assets		41,000		30,000		20,000
Investments		17,000				
		58,000		30,000		25,000
Current assets						
Inventories	8,000		6,000		4,000	
Receivables	7,000		5,250		1,500	
Cash	2,000		500		300	
		17,000		11,750		5,800
		75,000		41,750		30,800
EQUITY AND LIABILITIES						
Equity:						
Issued capital ($1 shares)		20,000		17,000		12,000
Share premium account		15,000				1,500
Retained earnings		11,600		18,450		5,948
		46,600		35,450		19,448
Non-current liabilities						
Long-term loans		20,000				8,052
Current liabilities						
Trade payables	5,200		4,000		5,752	
Income tax	3,200		2,300		2,600	
Provision	–		–		3,000	
		8,400		6,300		11,352
		75,000		41,750		30,800

Notes

1. Sea subscribed for 100% of the issued capital of River on the date of its incorporation. No changes have taken place to the issued share capital of River since that date.
2. River supplies a component that is used by Sea in its manufacturing process. River applies a 20% mark-up to the cost of manufacture of the component to arrive at the selling price to Sea. At 31 March 20X0 the inventories of Sea included $600,000 in respect of components purchased from River.
3. Intra-group trading is meant to cease on 25 March each year to enable agreement of intra-group balances at the year-end. On 24 March 20X0 Sea made a payment of $200,000 to River in respect of components purchased in February 20X0. This payment cleared the balances due for purchases up to February 20X0. Purchases of the component from 1 March to 24 March 20X0 by Sea amounted to $180,000. This amount was included in the payables of Sea and the receivables of River at 24 March 20X0. On 30

March 20X0, contrary to normal practice, River despatched goods having an invoiced price of $150,000 and entered the transaction in its books. The transaction was not recorded by Sea in its statement of financial position that is given above.

4. Following protracted negotiations the directors of Sea concluded an agreement whereby Sea acquired 9 million $1 shares in Stream on 31 March 20X0. The terms of the acquisition were that Sea would issue two new $1 shares for every three shares acquired in Stream. On 31 March 20X0 the market value of a $1 share of Sea was $3. The share issue by Sea on 31 March 20X0 is not reflected in the statement of financial position of Sea that appears above.
5. The intangible non-current assets of Stream at 31 March 20X0, consist of the estimated value of a brand that is associated with the entity. This estimate has been made by the directors and no reliable external estimate of the market value of the brand is available.
6. Relevant details of tangible non-current assets of Stream at 31 March 20X0 are:

Description	*Statement of financial position carrying value*	*Market value*	*Depreciated replacement cost*	*Recoverable amount*
	$'000	$'000	$'000	$'000
Property	10,000	12,000	Not given	13,500
Plant	10,000	Not given	11,000	14,000

7. Inventories of Stream at 31 March 20X0 comprise:
   - Obsolete inventory (statement of financial position value: $500,000). This inventory has a net realisable value of $300,000.
   - The balance of inventory (statement of financial position value: $3,500,000). This inventory has a net realisable value of $4,200,000. A reasonable profit allowance for the sale of the inventory would be $400,000.
8. The provision of $1 million in the statement of financial position of Stream is against the reorganisation costs expected to be incurred in integrating the entity into the Sea group. These costs would not be necessary if Stream were to remain outside the group. Although the plan was agreed by the board of directors before 31 March 20X0, it was not made known to those affected by the plan until after 31 March 20X0.
9. No impairment of the goodwill on acquisition of Stream has taken place.

Requirements

(a) Calculate the goodwill that arises on the acquisition of Stream by Sea on 31 March 20X0, providing a brief explanation for each calculation.

(b) Prepare the consolidated statement of financial position of Sea as at 31 March 20X0.

Solution

(a) Goodwill on consolidation of Stream

1. Fair value of investment by Sea:

$$9 \text{ million} \times \frac{2}{3} \times \$3.00 = \$18 \text{ million}$$

2. Fair value of net assets of Stream as at 31 March 20X0:

Asset	*Fair value* $'000	*Reason*
Intangible asset	–	No ascertainable market value
Property	12,000	Market value – less than recoverable amount
Plant	11,000	Depreciated replacement cost – less than recoverable amount
Obsolete inventory	300	Net realisable value (no profit allowance)
Other inventory	3,800	Net realisable value less profit allowance
Other current assets	1,800	Monetary assets that are 'short term'
Trade payables	(5,752)	A short-term liability at carrying value
Taxation	(2,600)	As above
Provision	–	Prohibited by IFRS 3 – also per IAS 37 a 'constructive obligation' does not exist at the statement of financial position date
Net assets at FV	20548	

3. *Goodwill calculation:*
$18,000,000 – (75% × $20,548,000) = $2,589,000

(b) *Consolidated statement of financial position of Sea as at 31 March 20X0*
Note: Unless otherwise indicated, the figures are a simple aggregation of the balance of Sea, River and Stream – with fair-value adjustments as per part (a).

	$'000
Goodwill on consolidation – from part (a)	2,589
Tangible non-current assets	94,000
Inventory (W1)	18,125
Receivables (W2)	13,420
Cash	2,800
	130,934
Issued capital (W4)	26,000
Share premium (W4)	27,000
Retained earnings (W5)	29,925
	82,925
Non-controlling interest (W6)	5,137
	88,062
Loan	20,000
Trade payables (W3)	14,772
Taxation	8,100
	130,934

Workings

1. *Consolidated inventory figure*

	$'000
Sea + River + Stream	18,100
Inventory in transit	150
Unrealised profit on goods in inventory (20/120 × $60)	(100)
Unrealised profit on inventory in transit	(25)
Per consolidated statement of financial position	18,125

2. *Consolidated receivables figure*

Sea + River + Stream	13,750
Amount owed by Sea per River's accounts	(330)
Per consolidated statement of financial position	13,420

3. *Consolidated trade payables figure*

Sea + River + Stream	14,952
Amount owed to River per Sea's accounts	(180)
Per consolidated statement of financial position	13,420

4. *Consolidated issued capital and share premium*
Sea only – the figure in the CBS reflect the issue of six million $1 shares at a price of $3.

5. *Retained earnings*

Sea 1 River (Stream all pre-acquisition)	30,050
Unrealised profit on inventory (W1)	(125)
Per consolidated statement of financial position	29,925

6. *Non-controlling interest*

25% × net assets @ fair value (as part (a)) = 25% × $20,548,000 = $5,137,000

Recording movements in fair value adjustments

The acquisition of Stream was at the end of the year so there was no movement in respect of the non-current assets. Where depreciable assets have had uplift in value on acquisition the movement should represent the cumulative additional depreciation the group will have charged from the acquisition date to the statement of financial position date. It is the net

balance (FV at acquisition date less movement) that should be included in group non-current assets and the non-controlling interest calculation. The retained earnings figure will be adjusted for the cumulative movement.

Example 7.C

The fair value adjustment at 31 December 20X6 for non-current assets was $500,000 and the depreciation policy of the group was 20% straight line. Let's consider the impact of this as at 31 December 20X8.

	At acquisition date 31 December 20X6	Movement	At reporting date 31 December 20X8
	$'000	$'000	$'000
Non-current assets	500	(200)	300

The additional depreciation charged on the uplift in value is $100,000 per annum. The impact on the statement of financial position will be as follows:

- $500,000 will be included in the goodwill calculation as the fair value adjustment at the date of acquisition
- $300,000 will be added to the net assets for non-controlling interest calculation
- $300,000 will be added to consolidated non-current assets
- $200,000 will be deducted from consolidated retained earnings

7.4 Piecemeal acquisitions

7.4.1 General principles

Up until this point, the explanations and exercises have assumed that an investment is made in a subsidiary or associate in a single transaction. While this is often the case in practice, it is also quite common for an acquisition to consist of two or more investments made on different dates. This process, involving successive purchases, is sometimes referred to as 'piecemeal acquisition'.

IFRS 3 prescribes the following treatment for a business combination achieved in stages: '. . . each exchange transaction shall be treated separately by the acquirer, using the cost of the transaction and fair value information at the date of each exchange transaction, to determine the amount of any goodwill associated with that transaction. This results in a step-by-step comparison of the cost of the individual investments with the acquirer's interest in the fair values of the acquiree's identifiable assets, liabilities and contingent liabilities at each step'.

A further investment transaction to acquire the shares of another entity may involve any of the following:

- increasing a stake so that an entity changes from a simple investment to a subsidiary;
- increasing a stake in an entity that is already a subsidiary;
- increasing a stake so that an entity changes from an associate to a subsidiary;

In the next section of the chapter, a detailed example is examined which involved the increase of a stake in an entity that is accounted for as a simple investment to a subsidiary. It should be noted that the principles involved in changing from an associate are the same as explained below.

The following worked example assumes that the investment held in the investor's own accounts is accounted for in accordance with IAS 39 *Financial Instruments: recognition and measurement*. This area is covered in depth in Chapter 11, however to allow effective illustration, the accounting treatment that is adopted is fully explained in the example below.

7.4.2 Piecemeal acquisitions: increasing a stake from a simple investment to a subsidiary

Example 7.D

The simplified income statements for Tiny and its investee entity, Teeny, for the year ended 31 December 20X8, together with simplified statements of financial position at that date, are as follows:

Statements of financial position as at 31 December 20X8

	Teeny $'000	*Tiny* $'000
Investment in Tiny	21,800	
Non-current assets	15,000	21,000
Current assets	11,200	9,000
	48,000	30,000
Issued capital ($1 shares)	12,000	15,000
Retained earnings	29,000	12,000
	41,000	27,000
Current liabilities	7,000	3,000
	48,000	30,000

Income statements for the year ended 31 December 20X8

	Teeny $'000	*Tiny* $'000
Revenue	18,000	6,000
Costs	(12,000)	(4,000)
Profit before tax	6,000	2,000
Income tax	(1,500)	(500)
Profit for the period	4,500	1,500

Investment in Tiny

- Three million shares on 31 December 20X2 when the retained earnings of Tiny were $7.5 million. Although this gave Teeny a 20% equity holding, there was one controlling shareholder and as a result Teeny was unable to exert significant influence over the operating and finanicial policies of Tiny. The investment was therefore held as a simple investment in the consolidated financial statements. The cost of the investment was $5.4 million.
- Six million shares on 30 June 20X8 when the retained earnings of Tiny were $11.25 million. The cost of investment was $15 million.

Fair value of net assets

The fair value and book values of Tiny's net assets on 31 December 20X2 were the same except for a non-current asset of land (non-depreciable). The fair value of the land exceeded its book value by $400,000.

The fair value and book values of Tiny's net assets on 30 June 20X8 were the same except for the same non-current asset of land. The fair value of the land now exceeded book value by $600,000.

Treatment of the investment

The investment in Tiny was accounted for in accordance with IAS 39. It was classified as an available for sale asset and held at fair value from its acquisition. The gains resulting from the fair value assessments totalled $1.2 million up to 30 June 20X8. A further $200,000 was recognised for the 6 months to 31 December 20X8. In line with IAS 39 the gains have been recognised in equity.

The standard requires that any gains recognised at the date of derecognition be transferred to the profit for the period.

The non-controlling interest is measured at the date of acquisition as the proportionate share of the fair value of the net assets of the business.

Requirement

Prepare the consolidated statement of financial position (SOFP) for the Teeny Group as at 31 December 20X8.

Solution

The first investment gave Teeny a 20% holding but without significant influence. The second investment resulted in an increase in the stake to 60 per cent halfway through the year ended 31 December 20X8. This is the point where Teeny gained control over Tiny.

IFRS 3 (revised) requires that the fair value of the net assets be assessed, only at the date that control is gained. The uplift of $600,000 should therefore be included in the net assets acquired. The workings illustrate the point.

Teeny Group: Consolidated statement of financial position as at 31 December 20X8

	$'000
Goodwill (W1)	5,490
Non-current assets (15 + 21 + 0.6)	36,600
Current assets (11.2 + 9)	20,200
	62,290
Issued capital ($1 shares)	12,000
Retained earnings (W2)	29,250
	41,250
Non-controlling interest (W3)	11,040
	52,290
Current liabilities (7 + 3)	10,000
	62,290

Workings

1. *Goodwill on consolidation*
   Calculated at the date control is gained:

		60% stake
	$'000	$'000
Consideration transferred (paid for 40% stake)		15,000
Fair value of previously held interest of 20% (FV at date control is gained)		6,600
Net assets at date of acquisition:		
Issued capital	15,000	
Retained earnings	11,250	
Fair value uplift	600	
	26,850	
Group share (60%)		(16,110)
Goodwill		5,490

2. *Consolidated retained earnings as at 31 December 20X8*
   Retained earnings:

	Teeny	Tiny
	$000	$000
Retained earnings as per SOFP	29,000	12,000
Profit on derecognition of AFS investment (W3)	1,200	
Retained earnings at date control gained		11,250
		750
Share of post-acq (60% × $750)	450	
Less FV gains recognised in Teeny's own retained earnings ($1,200 + $200)	(1,400)	
Consolidated retained earnings	29,250	

3. From the group's perspective the 20% investment is derecognised at the date that control is gained, i.e. 30 June 20X8. On derecognition the gains up to that date must be included in the consolidated retained earnings. We must remember, however to remove the total gains of $1,400 (up to 31 December 20X8) that would have been included in Teeny retained earnings to avoid double counting.
4. *Non-controlling interest*
   40% × net assets of Tiny at 31 December 20X8
   40% × ($27,000 + FV adj 0.6) = $11,040

The NCI in the SOFP is based on the % holding at the year end, as the balance sheet is intended to show the position of the group at the year end date.

The consolidated income statement is relatively straightforward:

Teeny Group: Consolidated income statement for the year ended 31 December 20X8

	$'000
Revenue (18 + 6)	24,000
Costs (12 + 4)	(16,000)
Profit from operation	8,000
Gain on derecognition of AFS investment	1,200
Profit before tax	9,200
Income tax (1.5 + 0.5)	(2,000)
Profit for the period	7,200
Attributable to:	
Equity holders of the parents	6,750
Non-controlling interest (W)	450
	7,200

Working

Non-controlling interest

($1.5m × 6/12 × 40%) + ($1.5m × 6/12 × 20%) = $450,000

The calculation of the NCI in the consolidated income statement is time apportioned as the income statement shows the profits accruing throughout the year.

7.4.3 Piecemeal acquisitions: from associate to subsidiary

Where a piecemeal acquisition takes a stake from that of associate to a subsidiary, the principles of the accounting treatment remain the same as explained in Section 7.4.2. The fair value of the investment previously held in this case would be the carrying value of the associate. The date that control is gained is the trigger for any fair value adjustment for the net assets of the subsidiary acquired.

7.4.4 Piecemeal acquisitions: increasing a controlling interest

The treatment is different where the parent already holds a controlling interest in the subsidiary as it is merely increasing this interest. No gain or loss on derecognition is recorded, instead it is treated as a transaction between owners and any adjustment is to parent's equity (the parent's interest has increased and the non-controlling interest has decreased).

The calculation would be as follows:

FV of consideration paid	(X)
Decrease in NCI in net assets at date of acquisition	X
Decrease in NCI goodwill (only if NCI is held at FV and goodwill has been calculated on their share)	X
= adjustment to parent's equity	(X)

Example 7.E

Using the details of example 7D. Teeny currently holds 60% of the equity shares and purchases a further 3 million equity shares in Tiny at a cost $5.5m on 30 June 20X9. The net assets of Tiny at that date were $28m.

The adjustment to equity in respect of this additional investment is:

	$00
FV of consideration paid	(5,500)
Decrease in NCI in net assets at date of acquisition (20% × 28 m)	5,600
Adjustment to parent's equity	(100)

This will be credited to retained earnings in the period.

7.5 Disposals in the period

The accounting for disposals in the period depends on the amount of the investment that is being sold. There are four possible scenarios:

1. Full disposal
2. Disposal resulting in a subsidiary becoming an associate
3. Disposal resulting in a subsidiary becoming a trade investment
4. Disposal resulting in the controlling interest being retained

7.5.1 Accounting treatment

Full and partial disposals

Partial disposals in the accounting period will usually still require all the basic consolidation adjustments to be made if the group accounts are to be prepared. Where the classification of the investment changes in the group accounts the calculations will include:

- Calculating consolidated profit/loss on the disposal, which will be included in the group income statement:

  Where the parent loses control of a subsidiary it should:
  - Derecognise the assets and liabilities of the subsidiary (including goodwill) at the date control is lost.
  - Derecognise any balance on NCI in the former subsidiary at the date control is lost.
  - Recognise the fair value of the consideration received (proceeds received on disposal).
  - Recognise any investment retained (associate or trade investment) at fair value at date control is lost (this FV will effectively provide a transfer value which will act as the opening cost for investment in associate or trade investment. The loss of control triggers a fair value assessment for the investment retained.
  - Reclassify any gains recognised previously through other comprehensive income relating to the investment, to profit or loss, for example:
    - A revaluation gain of the subsidiary previously recorded in OCI – the whole of this gain can be realised at the date control is lost.
    - A gain recorded in the parent's individual financial statements within equity and included in OCI, on the available for sale investment – can be transferred from equity to profit or loss on the date that control is lost.
  - Recognise any resulting gain or loss in profit or loss attributable to the parent.
- Time apportioning the calculations for subsidiary, associate and trade investment depending on the level of investment is retained.

Disposal where control is retained

A disposal of part of an investment where the controlling interest is retained is accounted for as an adjustment to parent's equity. No gain or loss on disposal is recorded. It is a transaction between owners (the parent and the non-controlling interest) similar to the treatment adopted for increases in controlling interests in piecemeal acquisitions. Any difference between the consideration received and the increase in the NCI amount is recognised directly in the equity and attributed to the owners of the parent.

The table below summarises what will be required – ***read this through carefully and think about each box*** *before working through the example below, a lot of what it says you will know by this stage in your studies*:

	Consolidated income statement /TCI	**Consolidated statement of financial position**
Full disposal	• Consolidate sub and show NCI up to date of disposal • Include profit or loss on disposal	• No consolidation as disposed of at year end date
Sub to associate	• Consolidate sub and show NCI up to date of disposal • Include profit or loss on disposal • Equity account for associate from disposal date to year end (time apportion results)	• Calculate FV of remaining investment (this will act as opening value of investment) • The investment is equity accounted at year end date
Sub to trade investment	• Consolidate sub and show NCI up to date of disposal • Include profit or loss on disposal • Include dividend income from date of disposal to year end date	• Calculate FV of remaining investment (this will act as opening cost of investment) • Account for investment under IAS 39.
Sub to reduced sub	• Full consolidation for whole period • Time apportion the NCI based on % holding × number of months • **No** profit or loss on disposal	• Full consolidation • NCI at % held at year end date • Calculate adjustment to parent's equity

The following example illustrates the treatment for a complete disposal and for a partial disposal resulting in an associate.

Example 7.F

The following extracts are from the draft accounts of A Group. The figures presented for A represents A and its fully owned subsidiary (goodwill for this subsidiary is fully impaired). The extracts shown for B are for the year to 31 December 20X8. None of these figures have yet been included in the group, which is why the figures for A Group are still showing an investment in B.

Extracts from draft income statements	*A Group*	*B*
	$'000	$'000
Revenue	155,500	25,800
Operating costs	(97,750)	(13,900)
Profit before tax	57,750	11,900
Income tax	(25,250)	(4,300)
Profit for period	32,500	7,600

Extracts from draft statements of financial position	*A Group*	*B*
	$000	$000
Investment in B (held at cost)	11,000	-
Other assets	83,400	22,000
	94,400	22,000
Equity and liabilities		
Share capital	30,000	10,000

Retained earnings	54,400	10,000
	84,400	20,000
Liabilities	10,000	2,000
	94,400	22,000

Additional information:

1. A owns 80% of the 10 million equity shares of B, an unlisted entity, which it purchased for £11m when the retained earnings were $1.4m. There has been no goodwill impairment since the date of acquisition.
2. The NCI of B is valued at the proportionate share of the fair value of the net assets.
3. B is an unlisted entity and the fair value of the investment cannot be reliably measured. As a result it is classified as an available for sale investment and is held at cost in the individual accounts of A.

Requirements

Prepare the consolidated statement of income and consolidated statement of financial position for A group assuming the following scenarios:

(a) A Group sells its entire shareholding in B for $18.9 million on 1 October 20X8. Tax arising on the sale amounts to $1.3 million.

(b) A Group sells 5,000 of its 8,000 shares in B for $14 million on 1 October 20X8. Tax arising on the sale amounts to $1 million.

(c) A Group sells 1,000 shares in B for $1.9 million on 1 October 20X8.

The junior accountant who was drafting the accounts was unsure how to record the disposal so none of the entries have been processed.

Solution

(a) The sale will be recorded in A's own accounts as:

Dr	Bank	$18,900
Cr	Investment	$11,000
Cr	Tax liability	$1,300
Cr	Profit on sale	$6,600

This will be the profit in A's own accounts and these entries are included in the consolidated figures below, calculated as proceeds less carrying value. The group profit on sale however will be calculated on the group's share of the carrying value of the subsidiary. See below.

Consolidated income statement for A Group for year ended 31 December 20X8

	$
Revenue ($155,500 + (9/12 × $25,800)) (W1)	174,850
Operating costs ($97,750 + (9/12 × $13,900))	(108,175)
Profit from operations	66,675
Profit on disposal of investment (W2)	2,540
Profit before tax	69,215
Income tax ($25,250 + (9/12 × $4,300) + 1,300 tax on disposal	(29,775)
Profit for the period	39,440
Attributable to:	
Owners of the parent	38,300
Non-controlling interest (W3)	1,140

B is not a subsidiary at the year end date and so the assets and liabilities of B are not included in the group SOFP.

Consolidated statement of financial position for A group as at 31 December 20X8

	$
Assets ($83,400 + proceeds $18,900)	102,300
Equity and liabilities	
Share capital	30,000
Retained earnings (W4)	61,000
	91,000
Liabilities ($10,000 + tax on gain $1,300)	11,300
	102,300

Workings

1. B was a subsidiary until 30 September 20X8 and so the income statement has been consolidated including 9 months of B's trading.
2. *Goodwill on acquisition*

	$'000	$'000
FV of consideration transferred		11,000
Less share of FV of the net assets acquired:		
Share capital	10,000	
Retained earnings at acquisition	1,400	
	11,400	
Group share	80%	(9,120)
Goodwill on acquisition		1,880

3. *Consolidated profit on disposal of investment*

	$'000	$'000
FV of consideration received (proceeds)		18,900
Less share of FV of the consolidated carrying value of the sub at the date of disposal: Share capital	10,000	
Retained earnings at 30 December 20X8	10,000	
Less earnings from 1 Oct to 31 Dec (3/12 × 7600)	(1,900)	
	18,100	
Group share	80%	(14,480)
Goodwill (W2)		(1,880)
Consolidated profit on disposal		2,540

4. *Non-controlling interest*

20% × B's profit for first 9 months = 20% × ($7,600 × 9/12) = 1,140.

5. *Consolidated retained earnings*

	A $'000
As per SOFP	54,400
Plus profit on sale (in individual accounts – as was not recorded in the retained earnings of A)	6,600
	61,000

(b) A Group sells 5,000 of its 8,000 shares in B for $14 million on 1 October 20X8. Tax arising on the sale amounted to $1 million.

The sale will be recorded in A's own accounts as:

Dr	Bank	$14,000
Cr	Investment (50/80 × 11,000)	$6,875
Cr	Tax liability	$1,000
Cr	Profit on sale	$6,125

This will be the profit in A's own accounts and these entries are included in the consolidated figures below, calculated as proceeds less carrying value. The group profit on sale however will be calculated on the group's share of the carrying value of the subsidiary. See below.

B was a subsidiary for 9 months and an associate for the remaining 3 months. The consolidated income statement below reflect that.

Consolidated income statement for A Group for year ended 31 December 20X8

	$
Revenue ($155,500 + (9/12 × $25,800)) (W1)	174,850
Operating costs ($97,750 + (9/12 × $13,900))	(108,175)
Profit from operations	66,675
Share of profit of associate 30% × ($7,600 × 3/12)	570
Profit on disposal of investment (W3)	1,765
Profit before tax	69,010
Income tax ($25,250 + (9/12 × $4,300) + 1,000 tax on disposal	(29,475)
Profit for the period	39,535
Attributable to:	
Owners of the parent	38,395
Non-controlling interest (W4)	1,140

B is not a subsidiary at the year end date and so the assets and liabilities of B are not included in the group SOFP. The 30% shareholding retained is equity accounted.

Consolidated statement of financial position for A group as at 31 December 20X8

	$
Assets ($83,400 + proceeds $14,000)	97,400
Investment in associate (W5)	4,695
	102,095
Equity and liabilities	
Share capital	30,000
Retained earnings (W6)	61,095
	91,095
Liabilities ($10,000 + tax on gain $1,000)	11,000
	102,095

Workings

1. *B was a subsidiary until 30 September 20X8 and so the income statement has been consolidated including 9 months of B's trading.*
2. *Goodwill on acquisition*

	$'000	$'000
FV of consideration transferred		11,000
Less share of FV of the net assets acquired:		
Share capital	10,000	
Retained earnings at acquisition	1,400	
	11,400	
Group share	80%	(9,120)
Goodwill on acquisition		1,880

3. *Consolidated profit on disposal of investment*

	$'000	$'000
FV of consideration received (proceeds)		14,000
Plus FV of 30% retained (30/80 × $11m)		4,125
Less share of FV of the consolidated carrying value of the sub at date control is lost		
Share capital	10,000	
Retained earnings at 30 December 20X8	10,000	
Less earnings from 1 Oct to 31 Dec (3/12 × 7600)	(1,900)	
	18,100	
Group share	80%	(14,480)
Goodwill (W2)		(1,880)
Consolidated profit on disposal		1,765

4. *Non-controlling interest*

20% × B's profit for first 9 months = 20% × ($7,600 × 9/12) = 1,140.

5. *Investment in associate*

	$'000
Cost of investment – amount transferred to investment in associate on disposal (30/80 × $11m)	4,125
Plus group share of post acquisition retained earnings (30% × $7,600 × 3/12)	570
	4,695

6. *Consolidated retained earnings*

	Group
Parent retained earnings as per SOFP	54,000
Plus profit on sale not yet recorded	6,125
Plus post-acquisition retained earnings of associate (30% × $7,600 × 3/12)	570
	61,095

(c) A Group sells 1,000 shares in B for $1.9 million on 1 October 20X8.

Adjustment to parent's equity on disposal of 1,000 shares	$000
FV of consideration received	(1,900)
Increase in NCI in net assets at date of disposal (10% × $18,100)	1,810
Adjustment to parent's equity	(90)

The $90,000 will be credited to A Group's retained earnings.

Disposal resulting in a trade investment

The principles are the same as those adopted for the disposal resulting in an associate. The FV of the interest retained forms the cost transferred as the opening value of the investment e.g. equivalent cost of retaining 1,000 shares in the example above would result in $1,800,000 being transferred to cost of investment. The gain of $175,000 ($1,800,000 less $1,625,000 (1,000/8,000 × $13 million)) would be recognised. The investment would then be accounted for in accordance with IAS 39 *Financial instruments: recognition and measurement*.

Disposals and IAS 39 Financial instruments: recognition and measurement

The above examples have been slightly simplified for illustrative purposes. The treatment of the investments in the parent's own accounts will be in accordance with IAS 39. IAS 27 requires that where a parent loses control of a subsidiary, it will be treated as a disposal of an IAS 39 investment. If gains on that investment have, to date, been recognised through other comprehensive income (i.e. it is classified as an available for sale asset in the parent's own accounts) then all previously recognised gains will be reclassified through the income statement and included in realised retained earnings.

IAS 39 is covered in depth in Chapter 11 and a full example will be incorporated in the revision section of this study system.

7.5.2 Interim dividends paid in the year of disposal

Were a dividend to be paid in the year of disposal occurs on a date before the shares were disposed of, the gain on disposal will change as the net assets of the subsidiary at the date of disposal will have reduced by the amount of the dividend paid.

The profits (represented by an increase in net assets) out of which the dividend was paid would have been transferred from the subsidiary to the parent entity, and would form part of the parent's reserves. The fact that a subsequent disposal of shares takes place does not alter the fact that the dividend transfer has already taken place.

It is important to compare the date of disposal with the date of any interim dividend payment, to see whether the disposal preceded the interim payment. In the previous example where full disposal occurs, if B paid a dividend on 30 September 20X8 of $4,000 then the calculations will be as follows:

Step 1: Calculate profit or loss on disposal

The profit on disposal in Wolf's own financial statements remains the same. However, the profit on disposal in the consolidated financial statements differs because the net assets at the date of disposal are lower following the dividend payout.

The calculation is now as follows:

Working

Net assets of B at the date of disposal

	$'000
Net assets at date of disposal (calc above)	18,100
Dividend paid 30 Sept 20X8	(4,000)
Revised NA 1 Oct 20X8	14,100

Profit on disposal in the consolidated financial statements:

	$'000
Sale proceeds	18,900
Less: share of net assets at date of disposal [$14,100 (W1) × 80%]	(11,280)
Less goodwill	(1,800)
Consolidated profit on disposal	5,820

The gain recorded in part (a) in Example 7.F above was $2,620 based on share of consolidated net assets of $18,100. If a dividend is paid by the subsidiary immediately prior to the disposal then the profit reported increases as the net assets have reduced.

7.6 Business reorganisations

Motives for reorganisation

Reorganisations are likely to be undertaken in the following circumstances:

- There is a debit balance on retained earnings.
- Reorganisation is forced by a group of stakeholders, for example, by lenders where debt covenants are breached or are in danger of breach.
- A group that has grown by haphazard acquisition requires an improved management structure or a more logical hierarchy of ownership.
- A new structure will facilitate flotation.
- A new structure will facilitate the disposal of an investment in a subsidiary.
- Part of a business or of a group of entities is hived off into a separate group (this would be an example of a 'demerger' arrangement).

In many jurisdictions entities are permitted to:

- reduce their share capital or share premium;
- enter into a scheme of arrangement with their stakeholders;
- liquidate an entity and transfer its business to a new entity;
- purchase their own shares.

Any of these mechanisms may be involved in a reorganisation scheme.

Little guidance on reconstructions is currently offered by international accounting standards. IFRS 3 *Business combinations* discusses reverse acquisitions relatively briefly. Reverse acquisitions are a type of business combination where, for example, a business entity arranges to have itself 'acquired' by a smaller public entity as a means of obtaining a stock exchange listing. It is usually the case that entities have to build up a respectable record of regular and timely reporting in order to obtain a listing. Arranging for a reverse acquisition via a smaller public entity can be a short-cut to listing. IFRS 3 counsels careful consideration of the pertinent facts of the case when determining which party, in substance, is the parent. Although in this type of example legal form suggests that the smaller listed entity is the parent, it may be that the legal subsidiary is the acquirer, if it has control over the financial and operating policies of the legal parent.

7.6.1 Future developments

The IASB's project on business combinations is complete only as to phase I (which resulted in the issue of IFRS 3). More guidance on accounting for business combinations

can be expected in due course in phase II of the project, and some of the issues relating to reconstructions and demergers are likely to be covered in a future financial reporting standard. These may include:

- Accounting for business combinations in which separate legal entities or parts of businesses are brought together to form a joint venture. The IASB has discussed the possibility of applying 'fresh start' accounting to such combinations. 'Fresh start' accounting is based on the principle that such business combinations result in a completely new entity. Therefore, the assets and liabilities of each of the combining entities should be recorded by the new entity at their fair value. Contrast this approach with the 'purchase' or 'acquisition' method of accounting that is set out in IFRS 3. 'Purchase' method accounting requires only that the net assets of a new subsidiary should be measured at fair value; the net assets of the parent continue to be measured in line with its existing policies. Therefore, in a typical group, consolidated net assets comprise net assets that have been brought in at fair value together with net assets at outdated values from earlier acquisitions and the net assets of the parent that may be valued at depreciated historical cost.
- Issues arising in respect of business combinations achieved by contractual arrangements only (i.e. not involving ownership). For example, business entities may be brought together by contractual arrangements to form a reporting entity that obtains dual listing on a stock exchange.

7.6.2 Intra-group reconstructions

In this section we will consider four reconstruction scenarios that may occur within a group of entities.

The transfer of a shareholding in a subsidiary from one group entity to another

Example 7.G

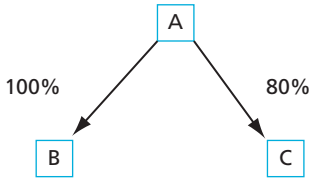
Subsidiary moved down

Suppose A, B and C have the following statement of financial positions at the date of reconstruction. A's investments in B and C were made at the dates of incorporation of B and C.

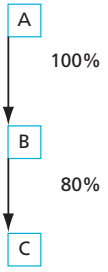
	A	B	*C*	*Consolidated*
	$'000	$'000	$'000	$'000
Investment in B (8 m shares)	8,000			
Investment in C (4 m shares)	4,000			
Other net assets	9,000	12,000	9,000	30,000
	21,000	12,000	9,000	30,000
$1 equity shares	10,000	8,000	5,000	10,000
Reserves	11,000	4,000	4,000	18,200
	21,000	12,000	9,000	28,200
Non-controlling interest (20% × $9 m)				1,800
	21,000	12,000	9,000	30,000

The investment in C is transferred to B by B issuing 3 million new shares to A in return for A's investment in C.

The group structure before the reconstruction would be as follows:



The group structure after the reconstruction would then be:



It should be clear that the overall effect on the A group is nil and the consolidated statement of financial position would not change. Such a reorganisation might be appropriate if:

- the directors of A wished to change the operating and reporting structure of the group to reduce the number of direct subsidiaries and achieve a more 'hierarchical' style of management;
- the directors of A wished to create a sub-group to sell off as a separate economic entity.

Where the new owner of the transferred investment issues shares in exchange for the investment then the consolidation is made easier if the investment can be transferred across at its existing carrying value.

In the above example this means that B would take the investment in C at cost from A ($4 million). Since B issues 3 million $1 shares then the credit to share premium will be $1 million ($4 million–$3 million). The statement of financial positions would be as shown below:

	A	*B*	*C*	*Consolidated*
	$'000	$'000	$'000	$'000
Investment in B	12,000			
Investment in C		4,000		
Other net assets	9,000	12,000	9,000	30,000
	21,000	16,000	9,000	30,000
$1 equity shares	10,000	11,000	5,000	10,000
Share premium		1,000		
Reserves	11,000	4,000	4,000	18,200
	21,000	16,000	9,000	28,200
Non-controlling interest				1,800
	21,000	16,000	9,000	30,000

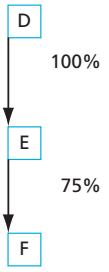
Example 7.H

Subsidiary moved up

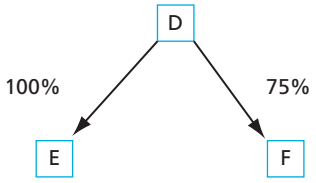
Suppose D, E and F have the following statement of financial positions at the date of incorporation (once again the investments are both made at the date of incorporation of the relevant entity).

	D	*E*	*F*	*Consolidated*
	$'000	$'000	$'000	$'000
Investment in E (8 m shares)	8,000			
Investment in F (3 m shares)		3,000		
Other net assets	8,000	10,000	7,000	25,000
	16,000	13,000	7,000	
$1 equity shares	10,000	8,000	4,000	10,000
Reserves	6,000	5,000	3,000	13,250
	16,000	13,000	7,000	23,250
Non-controlling interest (25% × $7 m)				1,750
	16,000	13,000	7,000	25,000

The initial group structure was:



The group reconstruction transfers E's shareholding in entity F to entity D and the group structure becomes:



A reconstruction of this type *cannot* be effected by entity D making a share issue to entity E in exchange for its investment in entity F. This is because entity E is entity D's subsidiary and it is illegal for a parent to issue shares to its subsidiary. Therefore in these situations the investment would be transferred by entity E declaring a special dividend, known as a *dividend in specie*. The effect on the individual statement of financial positions and on the consolidated statement of financial position will be as shown below:

	D	*E*	*F*	*Consolidated*
	$'000	$'000	$'000	$'000
Investment in E	8,000			
Investment in F	3,000			
Other net assets	8,000	10,000	7,000	25,000
	19,000	10,000	7,000	25,000
$1 equity shares	10,000	8,000	4,000	10,000
Reserves	9,000	2,000	3,000	13,250
	19,000	10,000	7,000	23,250
Non-controlling interest (25% × $7m)				1,750
	19,000	10,000	7,000	25,000

This type of reconstruction might be appropriate if:

- the group wished to move to a 'flatter' management style. The sub-subsidiaries could become 'direct' subsidiaries through a reorganisation;
- the group wished to dispose of the subsidiary (entity E in the above example) but keep the sub-subsidiary (entity F in the above example).

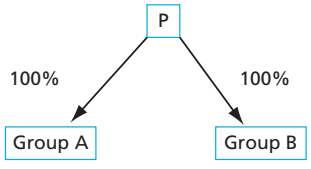
Note that the reserves of entity D are increased and the reserves of entity E reduced by the *dividend in specie*. This dividend is often very large in practice so the 'paying' entity might need to internally reconstruct its statement of financial position (see the beginning of this unit) to create sufficient distributable reserves (not necessary in the above example, though).

The addition of a new parent entity to the group

- Suppose a group has a parent entity, P, that is a private entity. If the group is expanding quickly it may wish to obtain a listing and so would need the ultimate parent to be a public limited entity. This *could* be achieved by incorporating a new parent public limited entity that gained ownership of the shares in entity P by 'purchasing' them from the existing shareholders, probably by an issue of its own equity shares.
- One method of combining two separate economic entities is for the two entities to form a group that has a newly incorporated parent.

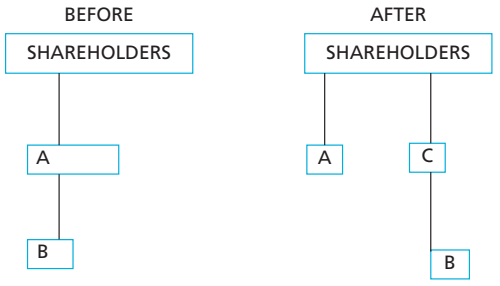
Example 7.1

Two separate existing groups, group A and group B, become a single group by the shareholders of the parents of the two individual groups exchanging their shares for shares in the new parent to create a group as shown below:



The transfer of shares in one or more subsidiary undertakings of a group to a new entity that is not a group entity, but whose shareholders are the same as those of the group's parent

Suppose a parent entity, A, has a subsidiary, B. Entity A transfers its shares in entity B to a new entity, C, whose shareholders are the same as the *shareholders* of entity A. Entity C will typically issue equity shares to finance this reconstruction but to the shareholders of entity A rather than to the entity itself. The diagram below shows the change in the group structure.



It is clear that, as far as the ultimate shareholders are concerned, little has happened other than a wholly internal rearrangement of their shareholdings, perhaps to facilitate running companies A and B as separate economic entities. As far as the consolidated accounts of A are concerned, though, there has been a disposal of shares in B. The disposal has effectively been made to the *shareholders* of A so the reduction in net assets is treated as a distribution to the shareholders – known as a *dividend in specie*.

Example 7.J

A has two 100% subsidiaries, B and C, which it has owned since their incorporation. The statement of financial positions of the three companies on 31 December 20X0 are as follows:

	A $'m	*B* $'m	*C* $'m
Investment in B	50		
Investment in C	45		
Property, plant and equipment	60	65	70
Net current assets	30	32	25
	185	97	95
Share capital ($1 shares)	100	50	45
Reserves	85	47	50
	185	97	95

- On 31.12 . X0 A transfers its shares in C to a new entity, D. D issues 60 million $1 shares to the *shareholders* of A.
- The net assets of the A group will be reduced by $95 million as a result of this disposal. This will be reflected in the *consolidated* accounts as a distribution (a dividend in specie) of $95 million. The individual accounts of entity A will show a dividend in specie of $45 million (the cost of the investment). The consolidated statement of financial position of the A group will no longer include any net assets of C and the individual statement of financial positions will be as follows:

	A $'m	*B* $'m	*Consolidated* $'m
Investment in B	50		
Investment in C	Nil		
Tangible fixed assets	60	65	125
Net current assets	30	32	62
	140	97	187

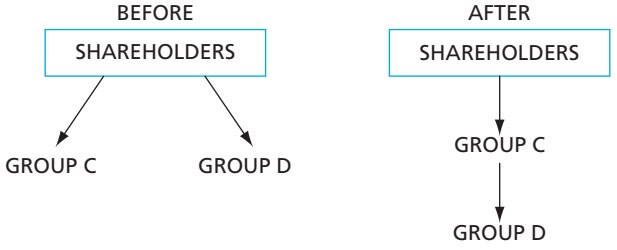
Share capital ($1 shares)	100	50	100
Reserves (reserves of A reduced by $45 m)	40	47	87
	140	97	187

The combination into a group of two or more entities that before the combination had the same shareholders

This is essentially the reverse of the scenario in the previous example, perhaps where controlling shareholders wish to manage their interests within a single structure. It might be achieved by one of the entities becoming a subsidiary of the other and the new parent issuing further equity shares to the former shareholders of its new subsidiary (who, of course, are also existing shareholders of the new parent).

Example 7.K

Two groups, groups C and D, have the same shareholders. The two groups combine so that D becomes a subsidiary of C. C issues more equity shares to the shareholders of D and the structure changes as follows:



7.7 Summary

This module has looked at various aspects of changes in group structures. Firstly we covered acquisitions in the accounting period, taking account of FV adjustments required at the date of acquisition. We also looked at piecemeal acquisitions where the shareholding had been built up in stages.

The module covered disposals of investments in depth, looking at complete disposals and partial disposals where an investment is retained either as a trade investment or an associate. In all three cases the gain/loss on disposal was included in the group income statement. Where a disposal in the period had resulted in a controlling interest being retained, no gain or loss was recognised. Instead an adjustment was made to equity, representing the amount of the consideration received less the increase in the value of the net assets held by the non-controlling interest.

Business reorganisations were also covered, looking briefly at the different forms the reorganisation can take.

Revision Questions 7

The list below provides details of what each question covers, to help with your revision of this area.

Acquisitions

Question 1 Preparation of a statement of financial position (SOFP), including detailed fair value adjustments. **(25 marks)**

Question 2 Calculation and explanation of fair value adjustments. **(10 marks)**

Question 3 Preparation of SOFP with a piecemeal acquisition and a FV adjustment. **(15 marks)**

Disposals

Question 4 Calculation of profit/loss on disposal (sub to trade investment). **(5 marks)**

Question 5 Calculation of profit/loss on disposal (controlling interest retained. **(5 marks)**

Question 6 Preparation of income statement with disposal (sub to associate). **(10 marks)**

Question 7 Preparation of SOFP with disposal (sub to associate). **(25 marks)**

Reorganisations

Question 8 Preparation of SOFP after reorganisation **(15 marks)**

Question 1

The statements of financial position of George and its subsidiary entities Zippy and Bungle at 30 June 20X3 (the accounting date for all three entities) are given below:

	George		*Zippy*		*Bungle*	
	$'000	$'000	$'000	$'000	$'000	$'000
ASSETS						
Non-current assets:						
Property, plant and equipment (*Note 3*)	45,000		25,000		20,000	
Financial assets (*Notes 1* and *2*)	20,000		Nil		Nil	
		65,000		25,000		20,000
Current assets:						
Inventories (*Notes 3* and *4*)	18,000		12,000		11,000	
Trade and other receivables (*Notes 3* and *4*)	15,000		10,000		9,000	
		33,000		22,000		20,000
Total assets		98,000		47,000		40,000

EQUITY AND LIABILITIES						
Equity:						
Issued ordinary share capital ($1 shares)	25,000		20,000		10,000	
Share premium account	10,000		Nil		4,000	
Retained earnings	24,000		8,000		9,300	
		59,000		28,000		23,300
Non-current liabilities						
Deferred tax (*Note 3*)	2,000		1,000		1,500	
		22,000		6,000		1,500
Current liabilities						
Trade payables (*Note 4*)	10,000		7,500		8,000	
Tax payable	2,000		1,500		1,000	
Bank overdraft	5,000		4,000		5,000	
Provisions (*Note 3*)	Nil		Nil		1,200	
		17,000		13,000		15,200
Total equity and liabilities		98,000		47,000		40,000

Notes to the statements of financial position

1. On 1 July 20W0, the date of incorporation of Zippy, George subscribed for all the ordinary shares of Zippy at par.
2. On 30 June 20X3, George purchased eight million $1 shares in Bungle. The terms of the purchase consideration were as follows:
   (a) On 30 June 20X3, George issued three $1 ordinary shares for every four shares purchased in Bungle. The market value of the ordinary shares at 30 June 20X3 was $4 per share.
   (b) On 30 June 20X5, George will pay the former shareholders of Bungle $1 in cash for every share in Bungle they have purchased. This payment is contingent on the cumulative profits after tax of Bungle for the 2 years ending 30 June 20X5 being at least $3 million. At the date of carrying out the fair value exercise (see *Note 3* below), the directors of George considered it probable that this cash payment would be made.
   (c) No entries in respect of the purchase of shares in Bungle have been made in the statements of financial position of George.
3. Following the acquisition of Bungle, the directors of George carried out a fair value exercise as required by IFRS 3 – *Business Combinations*. The following matters are relevant and all potential fair value adjustments are material:
   (a) Property, plant and equipment comprise land and buildings and plant and machinery. At 30 June 20X3, the land and buildings had a carrying value of $12 million and a market value of $18 million. The plant and machinery had a carrying value of $8 million. All the plant and machinery was purchased on 30 June 20X0 and was being depreciated on a straight-line basis over eight years. No reliable estimate was available of the current market value of the plant and machinery, but at 30 June 20X3, the plant would have cost $22 million to replace with new plant.
   (b) The inventory at 30 June 20X3 comprised:
      - Finished goods which could be sold for $14.5 million. A reasonable profit allowance for the selling effort of the group would be $3 million.
      - Finished goods that had been damaged and could only be sold for $100,000, representing a significant loss on sale.

(c) Trade receivables includes an amount of $400,000 that the directors of George consider doubtful.

(d) The other provisions of Bungle comprise:
- $400,000 in respect of the closure of various retail outlets to which the directors of Bungle became committed prior to entering into acquisition negotiations with the directors of George.
- $800,000 in respect of the estimated cost of integrating Bungle into the George group. No detailed integration plans had been formulated by 30 June 20X3.

(e) The additional deferred tax that needs to be provided on the adjustments that are necessary as a result of the fair value exercise is a liability of $3 million.

4. George supplies a component to Zippy at cost plus a mark up of 20%. At 30 June 20X3, the inventories of Zippy included $1.5 million in respect of this component. At 30 June 20X3, the receivables of George showed an amount receivable from Zippy of $1.2 million, while the trade payables of Zippy showed an amount payable to George of $600,000. On 29 June 20X3, George sent a consignment of components to Zippy at an invoiced price of $600,000. The consignment was received and recorded by Zippy on 2 July 20X3.

Requirements

(a) Compute the goodwill on consolidation of Bungle that will be shown in the consolidated statement of financial position of George at 30 June 20X3. Provide justification for your figures where you consider this is needed. **(10 marks)**

(b) Prepare the consolidated statement of financial position of George at 30 June 20X3. **(15 marks)**

(Total marks = 25)

Question 2

ABC is currently expanding its portfolio of equity interests in other entities. On 1 January 20X5, it made a successful bid for a controlling interest in DEF, paying a combination of shares and cash in order to acquire 80% of DEF's 100,000 issued equity shares. The terms of the acquisition were as follows:

In exchange for each $1 ordinary share purchased, ABC issued one of its own $1 ordinary shares plus $1.50 in cash. In addition to the consideration paid, ABC agreed to pay a further $1 per share on 1 January 20X7, on condition that the profits of DEF for the year ended 31 May 20X6 will exceed $6,000,000. ABC's directors consider that it is more likely than not that the additional consideration will be paid. The market value of a $1 share in ABC at 1 January 2005 was $3.50, rising to $3.60 at ABC's 31 May 20X5 year end.

Legal costs were $40,000 and share issue costs associated with the deal were $20,000.

The carrying value of DEF's net assets at 1 January 20X5 was $594,000. Carrying value was regarded as a close approximation to fair value, except in respect of the following:

1. The carrying value of DEF's property, plant and equipment at 1 January 20X5 was $460,000. Market value at that date was estimated at $530,000.
2. DEF had a contingent liability in respect of a major product warranty claim with a fair value of $100,000.
3. The cost of reorganising DEF's activities following acquisition was estimated at $75,000.

4. DEF's inventories included goods at an advanced stage of work-in-progress with a carrying value of $30,000. The sales value of these goods was estimated at $42,000 and further costs to completion at $6,000.

Requirement

Calculate goodwill on the acquisition of DEF, in accordance with the requirements of IFRS 3 *Business Combinations*, explaining your treatment of the legal costs, share issue costs and reorganisation costs. **(10 marks)**

Question 3

Extracts from the statements of financial position as at 31 December 20X8 are presented below:

Statements of financial positions as at 31 December 20X8	*MC*	*JD*
ASSETS	$000	$000
Non-current assets	4,000	3,000
Available for sale investments	3,440	–
	7,440	3,000
Current assets	1,720	2,000
	9,160	5,000
EQUITY AND LIABILITIES		
Share capital ($1 shares)	1,000	1,000
Retained earnings	6,160	3,500
	7,160	4,500
LIABILITIES	2,000	500
	9,160	5,000

Additional information

1. The available for sale investments relate to two acquisitions in JD made by MC. The details of the acquisitions are as follows:
   31 October 20X7 100,000 equity shares purchased for $500,000.
   30 June 20X8 500,000 equity shares purchased for $2,800,000.
   The retained earnings of JD at 30 June 20X8 totalled $3,000,000.
   The available for sale investments are accounted for in accordance with IAS 39 and are held at fair value. The cumulative gains recognised in equity as at 30 June 20X8 totalled $100,000. A further $40,000 was recognised by 31 December 20X8.
2. The fair value of the net assets of JD was assessed at 30 June 20X8. The results showed an increase of $650,000 relating to plant and machinery. In line with group policy the related assets will be depreciated on a monthly basis over the remaining useful life, which is estimated at 5 years.
3. There has been no impairment of goodwill.

Requirement:

Prepare the consolidated statement of financial position as at 31 December 20X8 for the MC group.

Question 4

AMY, an entity with a 30 September year end, holds several investments in subsidiaries. On 1 April 20X6, it disposed of 35,000 of its 40,000 $1 shares in its subsidiary BNZ for $320,000. AMY had acquired the shares, which represented 80% of BNZ's ordinary share capital, on 1 April 20X4 for $250,000, when BNZ's reserves totalled $186,000. BNZ's net assets at the date of disposal were $275,000. Since acquisition, there has been no impairment to goodwill. The fair value of the investment retained if $33,000.

Calculate the consolidated profit or loss on disposal of the shares for inclusion in AMY's financial statements for the year ended 30 September 20X6. **(4 marks)**

Question 5

Several years ago DVS acquired 75% of the ordinary share capital of EWT at a cost of $1.7 million. The fair value of the total net assets of EWT at the data of acquisition was $1.8 million. Net assets of EWT at 31 January 20X7 totalled $4.7 million. The non-controlling interest is valued at fair value and the resulting goodwill at the date of acquisition on the NCI's interest is $80,000. There has been no impairment of goodwill since the acquisition of the shares in EWT.

On that date DVS disposed of 10% of the ordinary share capital of EWT, leaving it holding 65% of EWT's ordinary shares. The disposal proceeds were $900,000.

Calculate the adjustment ot parent's equity as a result of this disposal.

Question 6

RW holds 80% of the 1,000,000 ordinary shares of its subsidiary, SX. Summarised income statements of both entities for the year ended 31 December 20X4 are shown below:

	RW	*SX*
	$'000	$'000
Revenue	6,000	2,500
Operating costs	(4,500)	(1,700)
Profit before tax	1,500	800
Income tax	(300)	(250)
Profit for the period	1,200	550

RW purchased 800,000 of SX's $1 shares in 20X3 for $3.2 million, when SX's reserves were $2.4 million. Goodwill has been carried at cost since acquisition and there has been no subsequent impairment.

On 1 July 20X4, RW disposed of 500,000 shares in SX for $3 million. SX's reserves at 1 January 20X4 were $2.9 million, and its profits accrued evenly throughout the year. RW is liable to income tax at 30% on any accounting profits made on the disposal of investments. The fair value of the investment retained is $1.4 million.

The effects of the disposal are not reflected in the income statements shown above.

Requirement

Prepare the summarised consolidated income statement for RW for the year ended 31 December 20X4. **(10 marks)**

Question 7

The statement of financial positions of AZ and two entities in which it holds substantial investments as at 31 March 20X6 are shown below:

	AZ		*BY*		*CX*	
	$'000	$'000	$'000	$'000	$'000	$'000
Non-current assets:						
Property, plant and equipment	10,750		5,830		3,300	
Investments	7,650		–		–	
		18,400		5,830		3,300
Current assets:						
Inventories	2,030		1,210		1,180	
Trade receivables	2,380		1,300		1,320	
Cash	1,380		50		140	
		5,790		2,560		2,640
		24,190		8,390		5,940
Equity:						
Share capital ($1 shares)		8,000		2,300		2,600
Preference share capital		–		1,000		–
Retained earnings		10,750		3,370		2,140
		18,750		6,670		4,740
Current liabilities:						
Trade payables	3,520		1,550		1,080	
Income tax	420		170		120	
Suspense account	1,500		–		–	
		5,440		1,720		1,200
		24,190		8,390		5,940

Notes

1. *Investments by AZ in BY*

   Several years ago AZ purchased 80% of BY's ordinary share capital for $3,660,000 when the retained earnings of BY were $1,950,000. In accordance with the group's policy goodwill was recorded at cost, and there has been no subsequent impairment.

   At the same time as the purchase of the ordinary share capital, AZ purchased 40% of BY's preference share capital at par. The remainder of the preference shares are held by several private investors. The preference shares are classified as equity, in accordance with IAS 32 *Financial Instruments: Presentation,* because of the rights and conditions attaching to the shares.

2. *Investment by AZ in CX*

   Several years ago AZ purchased 60% of CX's ordinary share capital for $2,730,000 when the retained earnings of CX were $1,300,000. Goodwill was recorded at cost and there has been no subsequent impairment.

   On 1 October 20X5 AZ disposed of 520,000 ordinary shares in CX, thus losing control of CX's operations. However, AZ retains a significant influence over the entity's operations and policies. The proceeds of disposal, $1,500,000, were debited to cash and credited to a suspense account. No other accounting entries have been made in respect of the disposal. An investment gains tax of 30% of the profit on disposal will become payable by AZ within the twelve months following the statement of financial position date of 31 March 20X6, and this liability should be accrued. The investments made by AZ were in unlisted entities and were initially classified as available for sale in AZ's own

accounts. The fair value of these investments were unable to be measured reliably and so continue to be held at cost in AZ's accounts.

CX's reserves at 1 April 20X5 were $1,970,000. The entity's profits accrued evenly throughout the year.

3. *Additional information*
   No fair value adjustments were required in respect of assets or liabilities upon either of the acquisitions of ordinary shares. The called up share capital of both BY and CX has remained the same since the acquisitions were made. All gains and losses on investments held by AZ have been realised through profit or loss in AZ's own accounts.

4. *Intra-group trading*
   During the year ended 31 March 20X6, BY started production of a special line of goods for supply to AZ. BY charges a mark-up of 20% on the cost of such goods sold to AZ. At 31 March 20X6, AZ's inventories included goods at a cost of $180,000 that had been supplied by BY.

Requirements

(a) Calculate the profit or loss on disposal after tax of the investment in CX that will be disclosed in:
   (i) AZ's own financial statements
   (ii) the AZ group's consolidated financial statements **(6 marks)**

(b) Calculate the consolidated reserves of the AZ group at 31 March 20X6. **(5 marks)**

(c) Prepare the consolidated statement of financial position of the AZ group as at 31 March 20X6.

(14 marks)

(Total marks = 25)

Question 8

The following statements of financial position relate to P, Q, R and S as at 31 May 20X7 immediately before the transaction mentioned below:

	P	*Q*	*R*	*S*
	$'m	$'m	$'m	$'m
Property, plant and equipment	3,500	550	60	90
Investment in Q	900			
Investment in R		90		
Investment in S	50			
Net current assets	1,830	400	70	60
Long-term loans	(130)	(30)	(10)	(5)
	6,150	1,010	120	145
Issued capital ($1 shares)	1,350	100	30	20
Share premium account	1,550	100	10	2
Retained earnings	3,250	810	80	105
	6,150	1,010	120	145

The directors of P decided to reconstruct the group at 31 May 20X7. Under the scheme the existing group was split into two separate groups. This involved P disposing of its shareholding in Q to another company, E. In return, E issued 300 million shares to the shareholders of P.

The following information relates to the dates of acquisition of the investments in group companies:

Investor	*Company acquired*	*% acquired*	*Balance on share premium*	*Balance on accumulated profits*
			$'m	$'m
P	Q	100	100	250
P	S	60	20	90
Q	R	80	10	60

P's investment in Q was made before the other two investments. All goodwill on consolidation had been written off as impaired by 31 May 20X6.

Requirement

Prepare the consolidated statement of financial position of the P and E groups as at 31 May 20X7 immediately after the group reconstruction has been put into effect.

(15 marks)

Solutions to Revision Questions

7

Solution 1

(a)

Step 1: Fair value of net assets acquired

Description	*Fair value* $'000	*Comment*
Land and buildings	18,000	Market value
Plant and machinery	13,750	Depreciated replacement cost (5/8 × $22 m)
Inventory	11,600	Selling price less profit allowance ($11.5 m) + scrap value ($100,000)
Receivables	8,600	Reduced by provision for doubtful receivable
Current liabilities	(14,000)	Book value
Deferred tax	(4,500)	Book value plus $3 m
Other provisions	(400)	$800,000 a post-acquisition item
	33,050	

Step 2: Fair value of consideration given

Shares: 8,000 × 3/4 × $4	= $24,000
Deferred cash: 8,000 × 0.873	= $6,984
Total	$30,984

Step 3: Compute goodwill

$30,984 − (80% × FV of net assets acquired $33,050) = $4,544

(b)

Consolidated statement of financial position of George at 30 June 20X3

	$'000	$'000
ASSETS		
Non-current assets		
Property, plant and equipment (45,000 + 25,000 + 18,000 + 13,750)	101,750	
Goodwill (requirement a)	4,544	
		106,294
Current assets		
Inventories [18,000 + 12,000 + 11,600 − 250 (W1)]	41,350	
Inventory in transit [600 − 100 (W1)]	500	
Receivables (15,000 + 10,000 + 8,600 − 1,200)	32,400	
		74,250
Total assets		180,544

EQUITY AND LIABILITIES		
Equity		
Ordinary share capital (25,000 + 6,000)		31,000
Share premium account (10,000 + 6,000 × $3)		28,000
Retained earnings (W3)		31,650
		90,650
Non-controlling interest (W2)		6,610
		97,260
Non-current liabilities		
Long-term loan (20,000 + 5,000)	25,000	
Deferred consideration	6,984	
Deferred tax (2,000 + 4,500 + 1,000)	7,500	
Other	400	
		39,884
Current liabilities		
Trade payables (10,000 + 7,500 + 8,000 − 600)	24,000	
Tax payable (2,000 + 1,000 + 1,500)	4,500	
Bank overdraft (5,000 + 4,000 + 5,000)	14,000	
		43,400
Total equity and liabilities		180,544

Workings

1. *Unrealised profit (in* $'000*)*

On inventory in hand (1,500 × 20/120)	= $250
On inventory in transit (600 × 20/120)	= $100

2. *Non-controlling interest*

	$'000
In Bungle: 20% × $33.050 m [see requirement (a)]	6,610

3. *Consolidated retained earnings*

	$'000
George	24,000
Zippy	8,000
Unrealised profit [250 + 100 (see W1)]	(350)
	31,650

☑ Solution 2

Calculation of goodwill on the acquisition of 80% of the equity shares in DEF:

	$'000	$'000
Fair value of consideration:		
80,000 shares acquired for consideration of $5 each ($1.50 in cash + $3.50 in shares)		400
Contingent consideration: $1 per share		80
Total consideration		480

Fair value of net assets acquired:		
Net assets at carrying value	594	
Adjustments for fair value:		
Property, plant and equipment ($530,000 − $460,000)	70	
Contingent liability	(100)	
Inventories (fair value of $36,000 less carrying value of $30,000)	6	
	570	
80% acquired (80% × $570,000)		456
Goodwill on acquisition		24

According to IFRS 3 (revised), directly attributable costs of acquisition should be written off when incurred and so will be charged as an expense in the income statement. The costs of issuing equity instruments are to be accounted for in accordance with IAS 39 *Financial Instruments: recognition and measurement*.

Solution 3

Consolidated statement of financial position of MC Group at 31 December 20X8

	$'000
ASSETS	
Non-current assets	
Plant and equipment (4,000 + 3,000 + 585 (W1))	7,585
Goodwill (W2)	610
	8,195
Current assets (1,720 + 2,000)	3,720
Total assets	11,915
EQUITY AND LIABILITIES	
Equity	
Ordinary share capital	1,000
Retained earnings (W3)	6,381
	7,381
Non-controlling interest (W4)	2,034
	9,415
Current liabilities (2,000 + 500)	2,500
Total equity and liabilities	11,915

Workings

1. *Fair value adjustment*

	At acquisition date $000	Movement $000	At statement of financial position date $000
Plant & equipment	650	(65)	585

2. *Goodwill on acquisition (30 June 20X8)*

	$000	$000
Consideration transferred (50% paid for)		2,800
FV of the investment held previously (FV at the date control is gained, 30 June)		600
Net assets acquired:		
Share capital	1,000	
Retained earnings	3,000	

FV uplift on non-current assets	650	
	4,650	
Group share of NA (60%)		(2,790)
		610

3. *Retained earnings*

	MC	JD
	$'000	$'000
At statement of financial position date	6,160	3,500
Gains from derecognition of financial asset at 30 June (10% investment held – now fully consolidated)	100	
Pre-acquisition retained earnings		(3,000)
		500
60% share of BD's post acq'n earnings	300	
Less gains on AFS investments recognised in MC's own accounts	(140)	
Group share of FV movement 60% (650/5 yrs × 6/12 months)	(39)	
Group retained earnings	6,381	

4. *Non-controlling interest*

40% × net assets of JD at 31 December 20X8:

	$000
Share capital	1,000
Retained earnings	3,500
Net balance of FV uplift (650 -65)	585
	5,085
40%	2,034

Solution 4

AMY: consolidated profit or loss on disposal

	$
FV of consideration	320,000
FV of 10% investment retained	33,000
Less FV of the consolidated net assets at disposal (80% × $275,000)	(220,000)
Goodwill (W1)	(61,200)
Gain on disposal	71,800

Working 1

Goodwill on consolidation	
Investment at cost	250,000
Less: acquired: [$40,000 + (186,000 × 80%)]	(188,800)
Goodwill	61,200

Solution 5

Adjustment to parent's equity

	$
Consideration received	(900,000)
Increase in FV of NCI in net assets at disposal date (10% × $4.7m)	470,000
Increase in NCI in goodwill ($80,000 × 25/35) − $80,000	32,000
Adjustment to parent's equity	(398,000)

Solution 6

RW: Consolidated income statement for the year ended 31 December 20X4

	$'000
Revenue (6,000 (6/12 × $2,500))	7,250.0
Operating costs (4,500 + (6/12 × $1,700))	(5,350.0)
	1,900.0
Share of profit of associate (W3)	82.5
Profit on disposal of investment (W2)	420.0
Profit before tax	2402.5
Income tax [300 + (6/12 × $250)+ (W4) $540	(965.0)
Profit for the period	1,437.5
Attributable to:	
Equity holders of the parent	1382.5
Non-controlling interest (W5)	55
Profit for the period	1437.5

Workings

1. *Goodwill on acquisition*

	$000	$'000
FV of consolidation transferred		3,200
Less FV of consolidated net assets at acquisition:		
Share capital	800	
Retained earnings	2,400	
	3,200	
Group share of 80%		(2,560)
Gain on disposal		640

2. *Consolidated profit on disposal*

	$000	$'000
FV of consolidation received		3,000
FV of 30% retained		1,400
Less FV of consolidated net assets as disposal date:		
Share capital	10,000	
Retained earnings 1 Jan	2,900	
Profit for 6 months to 30 June (6/12 × $550)	275	
	4,175	
Group share of 80%		(3,340)
Goodwill		(640)
Gain on disposal		420

3. *Share of profit of associate*

$550,000 × 6/12 months × 30% = $82,500

4. *Tax on gain on disposal*

This is calculated on RW's own profit:

	$'000
Proceeds of sale	3,000
Less CV of investment sold (30/80 × $3.2m)	1,200
Gain in individual accounts	1,800
Tax on that gain at 30%	540

5. *Non-controlling interest*

	$'000
To 1 July 20X4: ($550 × 6/12) × 20%	55

☑ Solution 7

(a) AZ originally acquired 60% of 2,600,000 shares: 1,560,000. On 1 October 20X5, it disposed of 520,000 shares – that is one third of its holding. After the disposal, AZ retained ownership of 40% of the ordinary share capital of CX.

(i) Profit or loss on disposal in AZ's own financial statements:

	$'000
Proceeds of sale	1,500
Cost: 1/3 × $2,730,000	(910)
Profit before tax	590
Tax charge: $590,000 × 30%	(177)
Profit after tax	413

(ii) Profit on disposal in the AZ group's consolidated financial statements.

Workings

Consolidated gain on disposal	$'000
FV of consideration received	1,500
FV of 40% retained (40/60 × $2,730)	1,820
Less FV of the consolidated NA at disposal date (60% × $4,655 (W2))	(2,793)
Goodwill (W1)	(390)
Consolidated gain	137

1. *Goodwill on the acquisition of CX*

	$'000
Cost of investment	2,730
Less: Acquired (2,600 + 1,300 = 3,900 × 60%)	(2,340)
Goodwill on acquisition	390

2. *CX's net assets at the date of disposal*

	$'000
Share capital	2,600
Retained earnings on 1 April 20X5	1,970
1/2 × profit for the year (2,140 − 1,970)/2	85
	4,655

(b)

1. *Provision for unrealised profit*

Cost structure: cost + (20% × cost) =	selling price ($'000)
Unrealised profit = 20/120 × 180 =	30
Of this, 20% is attributable to the minority:	(6)
The remainder reduces consolidated reserves:	24

2. *Consolidated retained earnings*

	$'000
Reserves of AZ	10,750
Post-acquisition retained earnings of BY: ($3,370 − $1,950) × 80%	1,136
Profit on disposal [see part (a)(i)]	413
Post-acquisition retained earnings in associate entity CX ($2,140 − $1,300) × 40%	336
Provision for unrealised profit (W1)	(24)
	12,611

(c)

AZ: Consolidated statement of financial position as at 31 March 20X6

	$'000	$'000
Non-current assets:		
Property, plant and equipment (10,750 + 5,830)	16,580	
Goodwill (W1)	260	
Investment in associate (W2)	2,156	
Other investments (W3)	860	
		19,856
Current assets:		
Inventories (2,030 + 1,210 − 30 PURP)	3,210	
Trade receivables (2,380 + 1,300)	3,680	
Cash (1,380 + 50)	1,430	
		8,320
		28,176
Equity:		
Share capital	8,000	
Consolidated retained earnings [part (b)]	12,611	
		20,611
Non-controlling interest (W4)		1,728
Current liabilities:		
Trade payables (3,520 + 1,550)	5,070	
Income tax {420 + 170 + 177 [part a (i)]}	767	
		5,837
		28,176

Workings

1. *Goodwill on the acquisition of BY*

	$'000
Cost of investment	3,660
Less: acquired (1,950 + 2,300) × 80%	(3,400)
Goodwill on acquisition	260

2. *Investment in associate CX*

	$'000
Cost of nvestment – amount transferred to investment in associate on disposal (40/80 × 2,730)	1,820
Share of post-acquisition profits [(2,140 − 1,300) × 40%]	336
	2,156

3. *Investments*

	$'000
As stated in AZ's statement of financial position	7,650
Less: investment at cost in BY's ordinary shares	(3,660)
Less: investment at cost in BY's preference shares	(400)
Less: investment at cost in CX's ordinary shares	(2,730)
Balance = other investments	860

4. *Non-controlling interest*

	$'000
In BY's preference shares	600
In BY's other net assets (2,300 + 3,370) × 20%	1,134
Provision for unrealised profit (part b)	(6)
	1,728

Solution 8

After the reconstruction there will be two separate groups. P will have one subsidiary, S, and E two subsidiaries, Q and R.

The initial goodwill on consolidation is as follows:

Q − $900 m − 100%($100 m + $100 m + $250 m) = $450 m
R − $90 m − 80%($30 m + $10 m + $60 m) = $10 m
S − $50 m − 60%($20 m + $20 m + $90 m) = $28 m

Therefore the consolidated statement of financial position of the P group is as follows (unless otherwise indicated, the figures are a simple aggregation of P and S).

	$'m
Property, plant and equipment	3,590
Net current assets	1,890
Long-term loans	(135)
	5,345
Issued capital (P only)	1,350
Share premium (P only)	1,550
Retained earnings (see working)	2,387
Non-controlling interest (40% × net assets of S)	58
	5,345

Working

Retained earnings

	$'m
P's retained earnings	3,250
Investment in Q distributed to shareholders	(900)
S's retained earnings [60% ($105 m − $90 m)]	9
Negative goodwill	28
	2,387

The consolidated statement of financial position of the E group appears below (unless otherwise indicated, the figures are a simple aggregation of Q and R).

	$'m
Property, plant and equipment	610
Net current assets	470
Long-term loans	(40)
	1,040
Share capital (E only)	300
Other reserves (W1)	600
Consolidated retained earnings (W2)	116
Non-controlling interest (20% × net assets of R)	24
	1,040

Working

1. *Other reserves*

   E has issued 300 million shares of $1 to acquire an investment in Q that had a carrying value of $900 million. The issue of shares is recorded at par. Given the fact that the reconstruction has no overall effect on the ultimate shareholders or on the non-controlling interests, there should be no effect on the amounts that are included in the consolidated statement of financial position. The 'other reserve' is the difference between the nominal value of the shares issued and the original carrying value of the investment in Q that was previously in the statement of financial position of P.

2. *Consolidated retained earnings*

	$'m
Q ($810 m − $250 m)	560
R [80% ($80 m − $60 m)]	16
Goodwill written off as impaired:	
Q	(450)
R	(10)
	116