Unit 6

FURTHER ASPECTS OF CONSOLIDATED ACCOUNTS BALANCE SHEETS

CHAPTER 23

Learning Objectives:

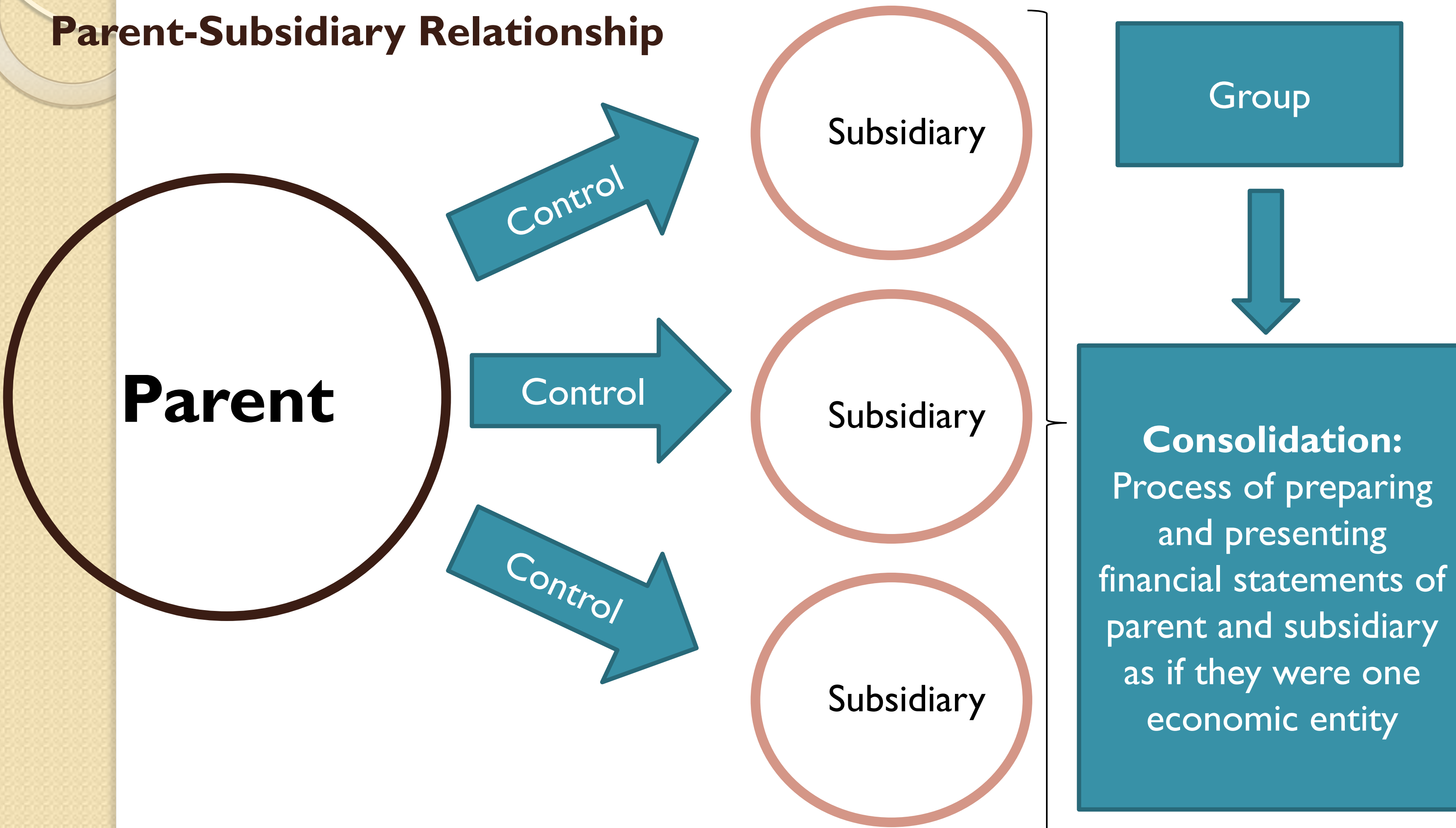
- **By the end of this lecture, you should be able to:**
- account for post –acquisition profits of a subsidiary
- eliminate inter-company balances and deal with reconciling items
- account for unrealized profits on inter-company transactions

Learning Objectives:

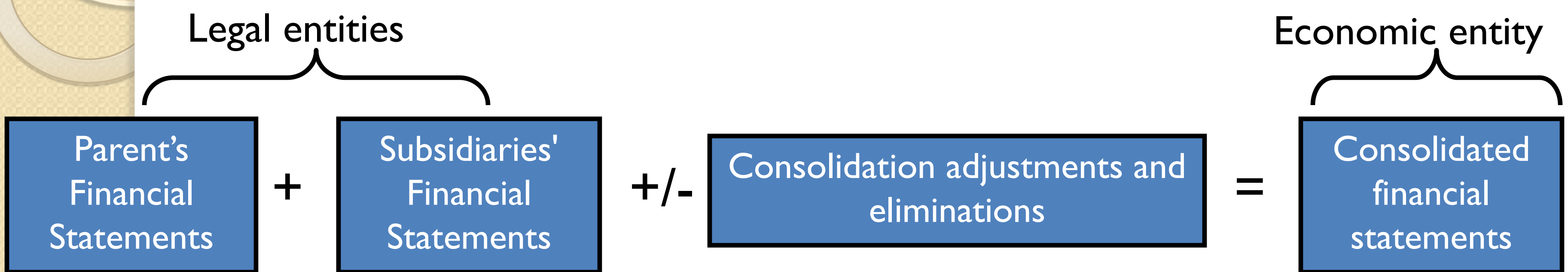
- understand how and why to eliminate intra-group dividends on consolidation;
- understand how to account for intra-group sales of inventory;
- understand how to account for intra-group sales of non-current assets

Introduction

Parent-Subsidiary Relationship



Consolidation Process



- Consolidation is the process of preparing and presenting the financial statements of a group as an economic entity
- No ledgers for group entity
- Consolidation worksheets are prepared to:
  - Combine parent and subsidiaries financial statements
  - Adjust or eliminate intra-group transactions and balances
  - Allocate profit to non-controlling interests

Introduction (contunied)

- The purpose of this topic is to extend your knowledge regarding **consolidations** by considering the effect of **inter-corporate transactions** on the consolidation process.
- Specifically, a range of inter-corporate transactions are considered including: sale of a non-current asset, dividends, as well as the sale and purchase of inventory.

What are inter-corporate transactions?

- During financial period, it is common for separate legal entities within an economic entity to **transact with each other;**
- The effects of all transactions between entities within the group are **eliminated in full;**

Pre acquisition profits

- Any profits or losses of a subsidiary made ***before*** the date of acquisition are referred to as **pre-acquisition profits** in the consolidated statements;
- These are represented by net assets that exist in the subsidiary on the date of acquisition.

- The fair values of these net assets will appear in **goodwill calculation.**
- They are **capitalized** at the date of acquisition by including them in the goodwill calculation.

Post-acquisition profits

- These are any profits or losses made after the date of acquisition;
- They will be included in the **group consolidated statement of comprehensive income;**
- They will appear in the **retained earnings** figure in the statement of financial position.

For example:

- On January 1, 2015 Red Company acquired Black Company when its:
- Reserves – 12,000$
- Retained Earnings – 15,000$
- Share capital – 20,000
- (1 share cost 1$)
- 18,000 shares were bought by a parent company for 50,000 $

By the end of the year:

- Reserves – 15,000$
- Retained Earnings – 17,000$
- Share capital – 20,000

Show the amount of Goodwill and capital and reserves' part

- First, we need to distinguish pre- and post acquisition profit of the Subsidiary;

	December	**January**	**Difference**
Reserves	15,000$	12,000$	3,000
Retained Earnings	17,000 $	15,000 $	2,000$

Calculation of Goodwill

- Investment in cost – 50,000$
- Less: 90% of NA
- Reserves – 12,000$
- Retained Earnings – 15,000$
- Share capital – 20,000 (42,300)
- Goodwill as on the day
- Of acquisition 7,700

Capital and Reserves' part

- Share capital of Parent – 60,000$
- Reserves – 25,000$
- Retained Earnings – 30,000$
- When consolidated with its Subsidiary:
- Share capital – 60,000$
- Reserves – 27,700
- 25,000 +(3,000 x0,9)
- Retained Earnings – 31,800
- 30,000 + (2,000x0,9)
- Non-controlling Interest 5,200
- (52,000 x 0,1)
- **124,700 $**

Fair Values

- Fair value of assets and liabilities is defined in IFRS 13
- *Fair value measurement as the price that would be received to sell an* asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (i.e. an exit price).

Fair value of net assets acquired

- IFRS 3 revised requires that the **subsidiary's assets and liabilities** are recorded **at their fair value** for the purposes of the **calculation of goodwill** and production of **consolidated accounts.**
- **Adjustments** will therefore be required where the **subsidiary's accounts** themselves **do not reflect fair value.**

For example

- NCA of the Subsidiary – 11,000$
- Yet, its fair value is at 11,600$
- The adjustment is made with regard to extra 600$ above book value;
- **The accounting entry is as follows:**
- Dr NCA 600$
- Cr Revaluation reserve 600$

Calculation of Goodwill

- Investment in cost – 50,000$
- Less: 90% of NA
- Reserves – 12,000$
- Retained Earnings – 15,000$
- Share capital – 20,000
- Revaluation Reserve – 600$ <u>(42,840)</u>
- Goodwill as on the day
- Of acquisition 7,160

Capital and Reserves' part

- Share capital of Parent – 60,000$
- Reserves – 25,000$
- Retained Earnings – 30,000$
- When consolidated with its Subsidiary:
- Share capital – 60,000$
- Reserves – 27,700
- 25,000 +(3,000 x0,9)
- Retained Earnings – 31,800
- 30,000 + (2,000x0,9)
- Non-controlling Interest 5,260
- (52,600 x 0,1)
- **124,760 $**

Some examples of Inter-entity Transactions

- preferred shares held by a parent in its subsidiary
- bonds held by a parent in its subsidiary
- payment of management fees to a group member
- inter-entity sales of inventory
- inter-entity sales of non-current assets
- inter-entity loans
- inter-entity dividends payable/receivable

Current accounts

- If P and S trade with each other then this will probably be done on credit leading to:
- receivables (current) account in one company's SFP
- payables (current) account in the other company's SFP.

- These are amounts owing within the group rather than outside the group and therefore they must not appear in the consolidated statement of financial position.
- They are therefore cancelled against each other on consolidation.

Cash/goods in transit

- At the year end, current accounts may not agree, owing to the existence of in transit items such as goods or cash.
- The usual rules are as follows:
- If the goods or cash are in transit between P and S, make the adjusting entry to the statement of financial position of the recipient:

Cash/goods in transit

- cash in transit adjusting entry is:
- Dr Cash in transit
- Cr Receivables current account
- goods in transit adjusting entry is:
- Dr Inventory
- Cr Payables current account

Unrealised profit

- Profits made by members of a group on transactions with other group members are:
- recognized in the accounts of the individual companies concerned, but
- in terms of the group as a whole, such profits are unrealised and
- Must be eliminated from the consolidated accounts.

- Unrealised profit may arise within a group scenario on:
- inventory where companies trade with each other
- Noncurrent assets where one group company has transferred an asset to another.

- Current accounts must be cancelled
- Where goods are still held by a group company, any unrealised profit
- must be cancelled.
- Inventory must be included at original cost to the group (i.e. cost to the
- company which then sold it).

If the seller is the parent company

- the profit element is included in the holding company's accounts and relates entirely to the group.
- **Adjustment required:**
- Dr Group retained earnings
- Cr Group inventory

If the seller is the subsidiary

- the profit element is included in the subsidiary company's accounts and relates partly to the group, partly to noncontrolling interests (if any).
- **Adjustment required:**
- Dr Subsidiary retained earnings
- Cr Group inventory

For example

- Many group – parent
- Few – subsidiary
- Many buys 1,000$ worth goods for resale and sells them to Few for 1,500
- Profit made – 500$
- Few has not sold the goods purchased;
- No profit is made by the group;
- 500$ is unrealized profit;
- It is removed from consolidated FS

IFRS 3 NCI

- IFRS 3 allows for 2 different methods of measuring the NCI in the statement of FP;
- **Method 1** proportionate share of the net assets of the subsidiary at the date of acquisition plus the relevant share of changes in the post-acquisition NA of the subsidiary
- Each reporting date the NCI is measured as the share of the NA of the subsidiary

Method 2

- NCI is measured at FV at the date of acquisition plus the relevant share of changes in the post-acquisition NA of the acquired subsidiary
- Each reporting date, the NCI is measured as the share of the NA of the subsidiary plus goodwill that has been apportioned to the NCI

IFRS 3 revision (2008)

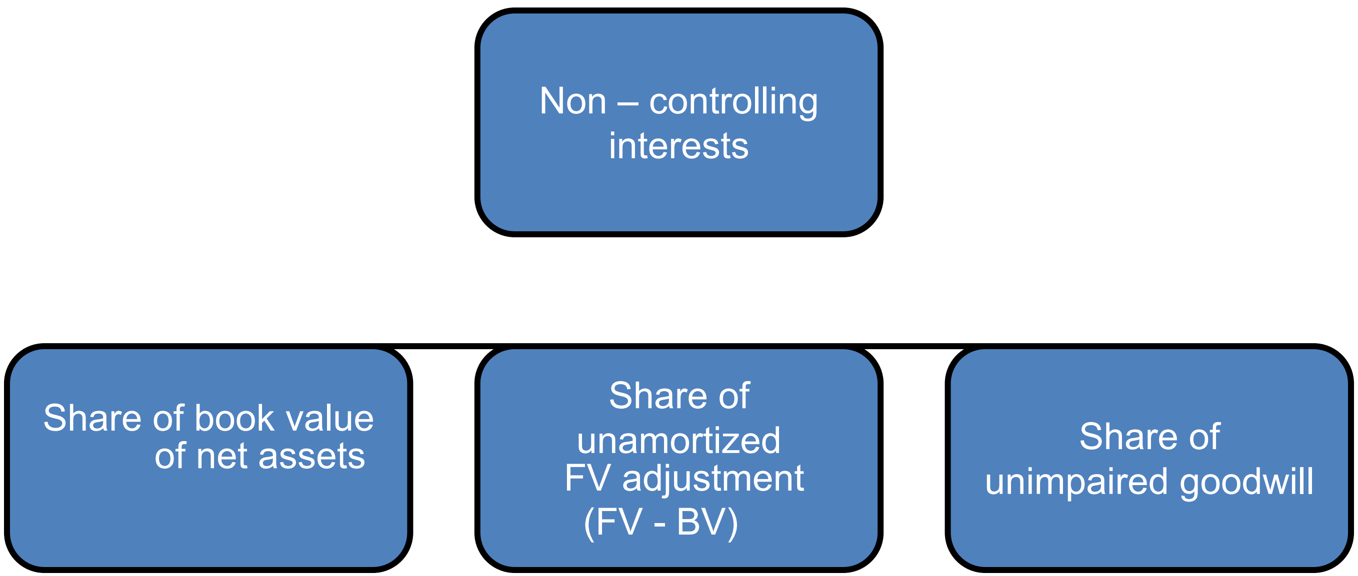
- IFRS 3 now introduces the option to value NCI at fair value. This affects the goodwill and NCI calculations.
- Three Options ;-

1. You are told what the fair value of NCI is
2. You may be given the share price at the date of acquisition
3. You may be given the goodwill attributable to NCI

Non-Controlling Interests' Share of Goodwill

Under the fair value option:

- FV is determined by either the active market prices of subsidiary's equity share at acquisition date or other valuation techniques
- FV per share of NCI may differ from parent due to control premium paid by parent
- NCI comprises of 3 items:



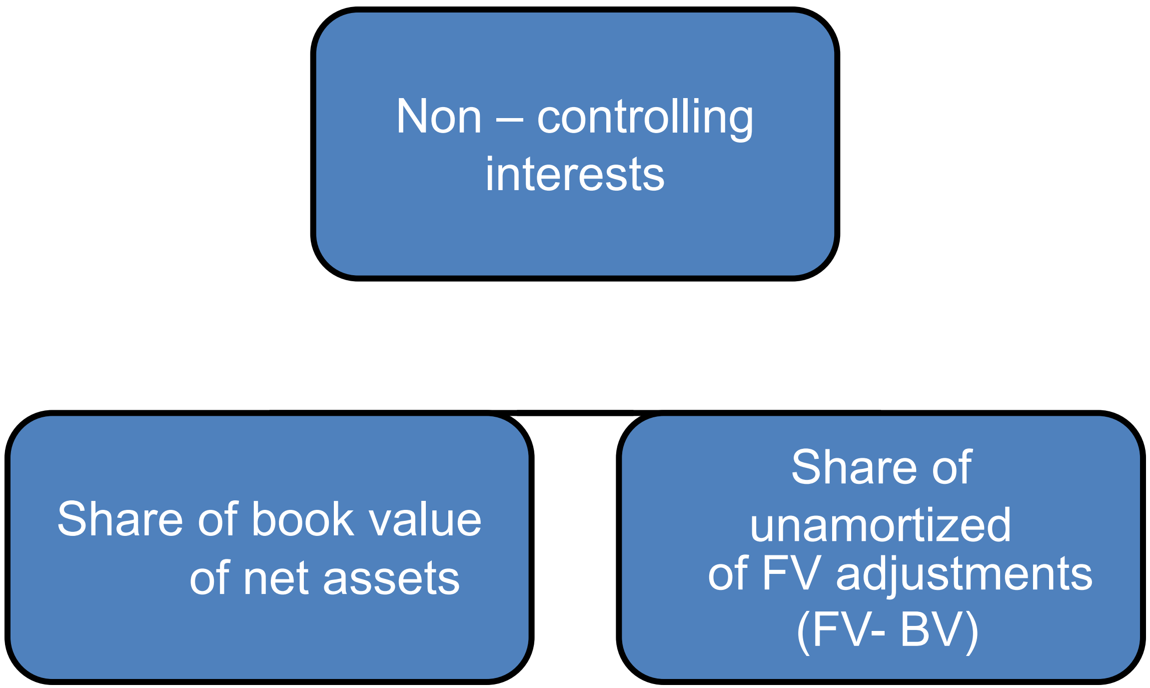
Non-Controlling Interests' Share of Goodwill

- Under the fair value option:
  - Journal entry to record NCI at fair value (re-enacted each year):

Dr	Share capital of subsidiary
Dr	Retained earnings at acquisition date
Dr	Other equity at acquisition date
Dr	FV differentials (FV- BV)
Dr	Goodwill (Parent & NCI)
Dr/Cr	Deferred tax asset/ (liability) on fair value adjustment
Cr	Investment in subsidiary
Cr	Non-controlling interests (At fair value)

Non-Controlling Interests' Share of Goodwill

- Under the 2nd option:
  - NCI is a proportion of the acquiree's identifiable net assets
  - NCI comprises of 2 items:



Non-Controlling Interests' Share of Goodwill

- Under the 2nd option:
  - Journal entry to record NCI (re-enacted each year):

Dr	Share capital of subsidiary
Dr	Retained earnings at acquisition date
Dr	Other equity at acquisition date
Dr	FV differentials
Dr	Goodwill (Parent only)
Dr/Cr	Deferred tax asset/ (liability) on FV adjustment
Cr	Investment in S subsidiary
Cr	Non-controlling interests (NCI % x FV of identifiable net assets)

example

- On January 2000, Bird plc acquired 80% of the 10,000 of 1$ ordinary shares in Flower plc for 1,50$
- The fair value is 2,900$
- To calculate attributable goodwill:
- FV of NCI – 2,900$
- 20% of NA (14,000x0,2) <u>(2,800)</u>
- Attributable goodwill 100

Goodwill in the balance sheet

- Goodwill
- Method 1 + attributable goodwill
- In our case, 800 + 100 = 900$
- NCI – 2,800+ 100= 2,900$

Preferred shares

- Parent's share of the preferred shares in the subsidiary's statement of Financial position will represent the part of the **net assets acquired;**
- and will be included in the calculation of **goodwill**.

Preferred shares

- On consolidation the preferred shares purchased by the **parent** and included in the **cost** of investment will be cancelled out against the liability of the subsidiary.

- Any preferred shares not held by the parent are part of the NCI;
- Parent company can buy **different proportions** of preferred shares even less than **50%**
- **They are cancelled at the purchase rate;**

Bonds

- Any bonds in the subsidiary's statement of Financial position that have been acquired by the parent will represent **the part of the net assets acquired**;
- and will be included in the calculation of **goodwill.**

Example

- On January 2015 Prose acquired
- 80% of the equity shares in Verse for 21,000$
- 20% of the preferred shares for 2,000$
- And 10% of the bonds for 900$
- RE – 4,000$
- FV of land in Verse was 1,000$ above its book value

Capital Structure and Liability of the Subsidiary

- Equity – 11,000
- Preferred shares – 8,000
- Retained Earnings – 4,000

- Long-term liability
- Bonds – 7,000

Calculation of Goodwill

The cost of investment –		**24,000$**
(21,100$+2,000$ + 900$)		
Less: FV of NA in Subsidiary		
Equity (11,000x0,8)	8,800	
RE (4,000x0,8)	3,200	
Fair Value adjustments		
(1,000x0,8)	800	
Preferred shares		
(8,000x0,2)	1,600	
Bonds (7,000x0,1)	700	**(15,100)**
Goodwill		**8,900**

Calculation of NCI

- Note that bonds are not included in the calculation of NCI
- The rate of preferred shares will go to the NCI **(100%-20%=80%)**
- So, **8,000x0,8 = 6,400$**
- The other acquired financial assets will be valued at **20%**

Inter-company balances arising from sales or other transactions

- **Eliminating Inter-company balances**
- **Reconciling inter-company balances**

Inter-company dividends payable/receivable

- it is necessary to eliminate all dividends paid/payable to other entities within the group;
- all dividends received/receivable from other entities within the group
- Only dividends paid externally should be shown in consolidated financial statements;
- On consolidation intra group balances, transactions, income and expenses shall be **eliminated in full.**

Dividends (continued)

- If the subsidiary company has declared a dividend before **the year-end**, this will appear **in the current liabilities** of the subsidiary company and **in the current assets** of the parent company
- It must be cancelled before preparing the consolidated statement of financial position
- If the subsidiary is wholly owned by the parent the whole amount will be cancelled.

Dividends (continued)

- If there is **a non-controlling interest** in the subsidiary, the non-cancelled amount of the dividend payable in the subsidiary's statement of financial position will be the **amount payable to the non-controlling interest** and will be reported as **a part of non-controlling interest in the consolidated statement of financial position**.
- Where a dividend has not been declared by the year-end date there is no liability under IAS 10
- For Events After the Balance Sheet Date there should, therefore, be no liability reported under International Accounting Standards.

Declared but not yet paid dividends with 100% of acquisition

- The subsidiary declares the payment of 1000$ dividends;
- It creates Dividends Payable
- The parent company after the notification creates an account as its Current asset – Dividends Receivable
- These are canceled when preparing consolidated statement of FP

Cancellation of Dividends Declared

- Original Entry:
- Dr Dividends Receivable (P) 1,000$
- Cr Dividends Payable (S) 1,000$

- To cancel:
- Dr Dividends Payable (S) 1,000$
- Cr Dividends Receivable (P) 1,000$

Cancellation of Dividends Declared if the rate of acquisition 80%

- Original Entry:
- Dr Dividends Receivable (P) 800$
- Cr Dividends Payable (S) 800$

- To cancel:
- Dr Dividends Payable (S) 800$
- Cr Dividends Receivable (P) 800$

- In that case, parent company will have only **800$** to be received
- The subsidiary – **1,000$** to be paid
- **200$** remains in the Consolidated FS

Dividends paid from post acquisition profits

- Only dividends paid **externally** should be shown in **the consolidated financial statements**

Dividends paid from pre - acquisition profits

- If an entity pays dividends out of profits earned before acquisition, it is effectively **returning part of the net assets** originally acquired (return of part of investment in subsidiary)
- not to be accounted for as revenue of investor if dividends are received from pre-acquisition reserves including from pre-acquisition retained earnings,
- So, the amount of **purchase consideration** is correspondingly reduced

Dividends or interest paid out of pre-acquisition profit

- In that case, dividends or interest paid will come out of the net asset acquired at the date of acquisition,
- It is not an income but a return of part of the purchase price

Example

- Bow plc acquired 75% of the shares in Tie plc on January 1, 2001 for 80,000$
- RE balance – 40,000$
- No goodwill
- On 10 January 2001, Bow received a dividend of 3,000$ from Tieout of profits for the year ended 31.12.2000

80,000 – 3,000 = 77,000

	Bow	**Tie**	**Consolidated**
GP	130,000	70,000	200,000
Expenses	50,000	40,000	90,000
Profit from operations	80,000	30,000	110,000
Dividends received from Tie	**3,000**	**x**	**x**
Profit before tax	83,000	30,000	110,000
Income tax expense	24,000	6,000	30,000
Profit for the period	59,000	24,000	80,000

Unrealised profit on inter-company sales

- Where sales have been made between two companies within the group, there may be an element of profit that has not been realized by the group
- If the goods have not, then sold on to a third been party before the year-end.
- This is called **a provision** for unrealised profit
- Inter-company profits and losses, sales, income and expenses, receivables and liabilities between companies have to be eliminated.

Intercompany sales

- From the group's perspective, revenue should not be recognised until inventory is sold to parties outside the group.
- There is a need to eliminate any unrealised profits from the consolidated accounts.
- Unrealised profits result from stock, which is sold within the group for a profit, remaining on hand within the group at the end of the period.

Interest (on intra group loans)

- Remove interest received and paid from finance costs and investment income
- Dr Interest incomes (Parent)
- Cr Interest expenses (subsidiary)

- Dr interest receivable (Parent)
- Cr interest payable (subsidiary)

Dividends

- **Paid out of pre-acquisition profit** (it is actually return on investment on purchase price)
-
- Dr Dividend income – Retained earnings

  (Parent's book)
- Cr investment in subsidiary
-
- Dr Dividend payable (Subsidiary's book)
- Cr Dividend expense – Retained earnings
-

Paid out of post-acquisition profit

- Dr dividend income
  parent's book
- Cr dividend receivable
-
- Dr dividend payable
  Subsidiary's book
- Cr dividend declared / expense

Intragroup Transactions

- Intragroup transactions are eliminated to:
  - Show the financial position, performance and cashflow of the economic (not legal) entity
  - Avoid double counting of transactions

<u>Example:</u>

- Parent sold inventory to subsidiary for $2M
- The original cost of inventory is $1M
- Subsidiary eventually sold the inventory to external parties for $3M

Q: What is the journal entry to eliminate intragroup sales transaction?

Consolidation adjustment			
Dr	Sale	2,000,000	
Cr	Cost of sale		2,000,000

Intragroup Transactions

Extract of consolidation worksheet

	Parent's Income Statement	Subsidiary's Income Statement	Consolidation elimination entries and adjustments Dr	Cr	Consol. Income Statement	Without elimination
Sales	$2,000,000	$3,000,000	2,000,000		$3,000,000	$5,000,000
Cost of sales	(1,000,000)	(2,000,000)		2,000,000	(1,000,000)	($3,000,000)
Gross profit	$1,000,000	$1,000,000			$2,000,000	$2,000,000

Note: Without elimination the consolidated sales and cost of sales figures will be overstated by $2 M.

Unrealised profit on inter-company sales

- Profits and losses resulting from intra group transactions that are recognised in assets such as **inventory and fixed assets** are eliminated in full.

Provision for unrealized profit affecting a non-controlling interest

- the non-controlling interest must be charged with their share of any provisions for unrealized profit.

Intra-group sales of non-current assets

- In their individual accounts, the companies concerned will treat the transfer just like a sale between unconnected parties;
- The selling company will record **a profit or loss on sale**
- The purchasing company will record the asset at the amount **paid to acquire** it
- Then, it will use this amount as a basis to **calculate depreciation**

The double entry:

- Sale by parent
- Dr Group RE
- Cr NCA
- With the profit on disposal, less the additional depreciation
- Sale by subsidiary
- Dr Group RE (P's share of S)
- Dr NCI (NCI's share of S)
- Cr NCA

example

- P Co owns 60% of S co and on 1January 2001 S co sells plant costing 10,000$ to P for 12,500
- The companies make up accounts to 31 December 2001
- Their balances:
- P Co after charging depreciation of 10% on plant - 27,000$
- S co including profit on sale of a plant – 18,000$

RE (extract)

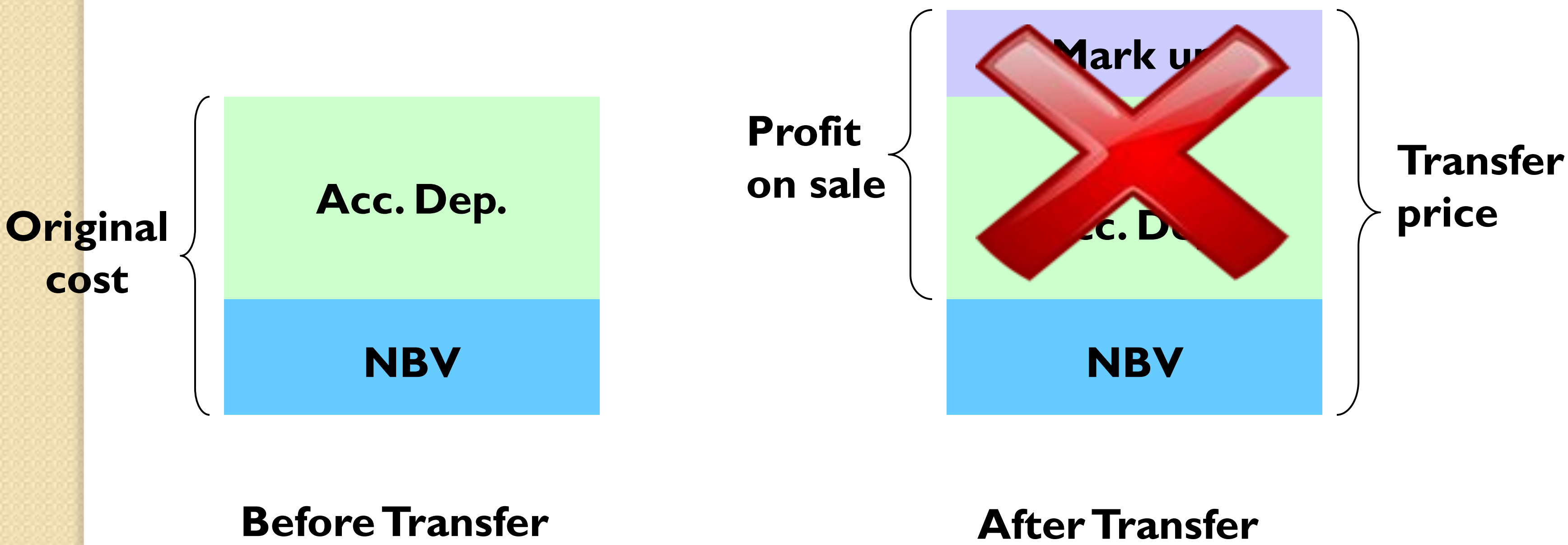
Per question	Parent	Subsidiary
	27,000	18,000
Disposal of plant		
Profit		(2,500)
Depreciation 10%x2,500		250
		15, 750
Share of S co 15,750 x60%	9,450	
	36,450	

notes

- The NCI in the RE of S is **40%**
- **40%x15,750 $= $ 6,300**
- The profit on the transfer less related depreciation of **$2,250 (2,500-250)**will be deducted from the CA of the plant to write it down to cost to the group

Transfers of Fixed Assets

- When fixed assets (FA) are transferred at a marked-up price
  - The unrealized profit must be eliminated from the carrying amount of FA
  - It is as though the transfer did not take place from the group's perspective



Adjustments of Transfers of Fixed Assets

1. Restate the FA carrying amount to the NBV at the point of transfer
2. Profit on sale of FA is adjusted out of:
   - ✔ Consolidated income statement if sale occurred in the same period
   - ✔ Opening RE if sale occurred in the previous period
3. Subsequent depreciation is based on original cost of asset & estimated useful life (including revision of estimate)
   - ✔ The difference between the old and new depreciation is adjusted to:
     - ✔ Consolidated income statement for current year
     - ✔ Opening RE for prior year accumulated depreciation

Adjustments of Transfers of Fixed Assets

4. The profit or loss on transfer of FA is realized through the higher or lower depreciation charge subsequently
5. Tax effect must be adjusted on the unrealized profit and subsequent corrections of depreciation

Impact on NCI When an Unrealized Profit Arises from an Intragroup Transfer of FA

- Downstream sales:
  - No impact on NCI
- Upstream sales:
  - NCI is adjusted for:
    - ✔ Unrealized profit on sale of FA
    - ✔ Correction of over/under-depreciation
    - ✔ Tax effect on unrealized profit
    - ✔ Tax effect on correction of over/under-depreciation

Illustration 3:
Downstream Transfer of Fixed Assets

- 1 Jan 20X2: P sold equipment to S for $360,000
- The original cost of the equipment was $400,000
- The remaining useful life was 10 years from the original purchase date
- The remaining useful life is 8 years from the date of transfer
- Assume a tax rate of 20%

	Status Quo	With sale	Amount to be restored/adjusted
Cost of asset	$400,000	$360,000	$40,000
Acc. Dep	$120,000	$45,000	$75,000
Current Dep	40,000	45,000	5,000
Profit on sale	-	$40,000	$40,000

Illustration 3:
Downstream Transfer of Fixed Assets

31 Dec 20X2

CJE 1: Adjustment of unrealized profit			
Dr	Equipment (S)	40,000	
Dr	Profit on Sale (P)	40,000	
Cr	Accumulated depreciation (S)		80,000

Reversal of these entries:

In P's Books			
Dr	Cash	360,000	
Dr	Acc. dep	80,000	
Cr	Equipment		400,000
Cr	Profit on sale		40,000

In S's Books			
Dr	Equipment	360,000	
Cr	Cash		360,000
Dr	Dep	45,000	
Cr	Acc. Dep		45,000

© 2009

Illustration 3:
Downstream Transfer of Fixed Assets

CJE 2: Reverse tax on profit on sale			
Dr	Deferred tax asset (group's BS)	8,000	
Cr	Tax expense (P)		8,000

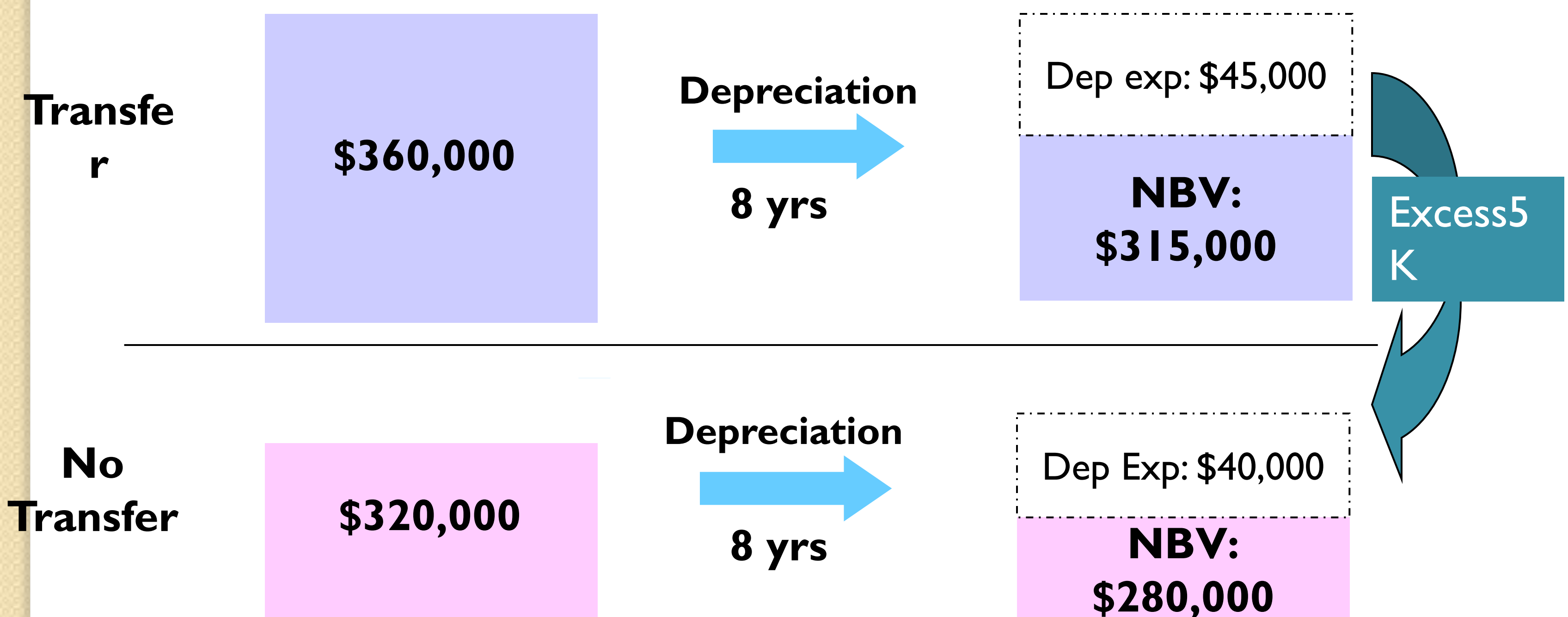


Illustration 3: Downstream Transfer of Fixed Assets

CJE 3: Correct the over-depreciation on unrealized profit included in equipment

Dr	Accumulated depreciation (S)	5,000	
Cr	Depreciation (S)		5,000

Old depreciation	40,000
New depreciation	45,000
Over-depreciation	5,000

CJE 4: Increase in tax arising from correction of over-depreciation

Dr	Tax expense (S)	1,000	
Cr	Deferred tax asset (group's BS)		1,000

Illustration 3:
Downstream Transfer of Fixed Assets

When the equipment is fully depreciated:

CJE 5: Reinstate to original cost, accumulated depreciation and reverse profit

Dr	Equipment (S)	40,000	
Dr	Opening RE (P)	40,000	
Cr	Accumulated depreciation (S)		80,000

CJE 6 : Correction of past excess depreciation

Dr	Accumulated depreciation (S)	40,000	
Cr	Opening RE (S)		40,000

Illustration 3: Downstream Transfer of Fixed Assets

CJE 7: Tax effects on unrealized profit on sale of fixed assets

Dr	Deferred tax asset	8,000	
Cr	Opening RE (P)		8,000

CJE 8: Tax effects on unrealized profit on sale of fixed assets

Dr	Opening RE (S)	8,000	
Cr	Deferred tax asset		8,000

Illustration 4:
Upstream Transfer of Fixed Assets

- Assume illustration 3, except that S transfers to P
- 1 Jan 20X2 S sold equipment to P for $360,000
- The original cost of equipment was $400,000
- The remaining useful life is 8 years from date of transfer
- Net profit after tax of S for YE 31 Dec 20X2 : 500,000
  YE 31 Dec 20X3 : 800,000
- Assume a tax rate of 20%

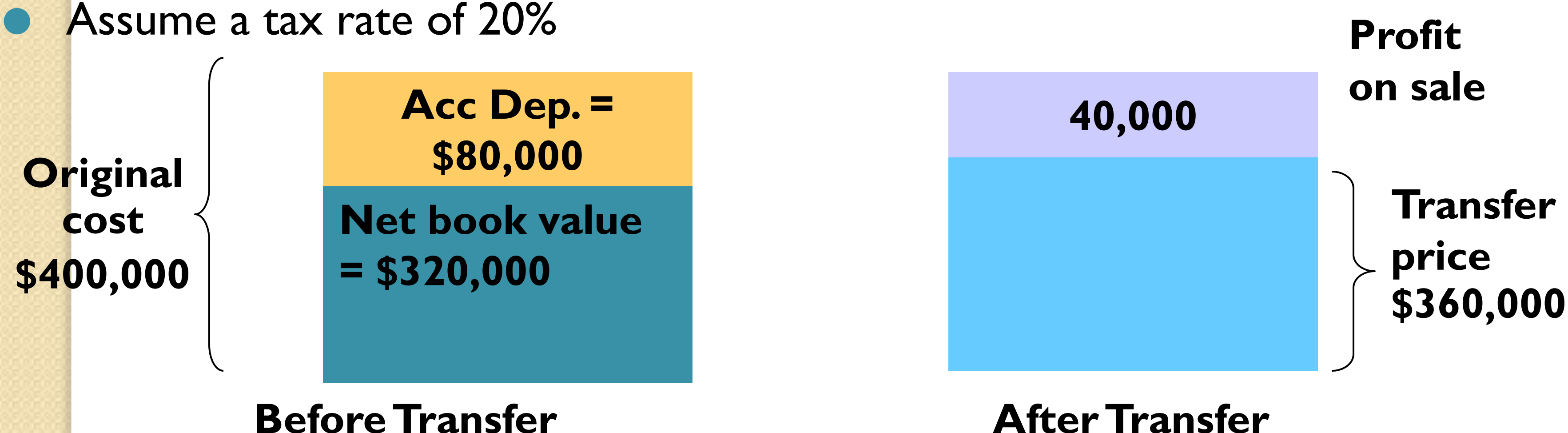


Illustration 4:
Upstream Transfer of Fixed Assets

31 Dec 20X2

CJE 1: Adjustment of unrealized profit

Dr	Equipment (S)	40,000	
Dr	Profit on Sale (P)	40,000	
Cr	Accumulated depreciation (S)		80,000

CJE 2: Reverse of tax on profit on sale

Dr	Deferred tax asset (group's BS)	8,000	
Cr	Tax expense (S)		8,000

Illustration 4:
Upstream Transfer of Fixed Assets

CJE 3: Correct the over-depreciation on unrealized profit included in equipment

Dr	Accumulated depreciation (P)	5,000	
Cr	Depreciation (P)		5,000

Old depreciation	40,000
New depreciation	45,000
Over-depreciation	5,000

CJE 4: Increase in tax arising from correction of over-depreciation

Dr	Tax expense (P)	1,000	
Cr	Deferred tax asset (group's BS)		1,000

Illustration 4: Upstream Transfer of Fixed Assets

CJE 5: Allocation of current year profit

Dr	Income to NCI	47,200	
Cr	NCI		47,200

Net profit after tax of S	500,000
Less: Unrealized profit on sale (after-tax)	(32,000)
Add: Over-depreciation (after-tax)	4,000
Adjusted net profit	472,000
NCI's share (10%)	47,200

* Note: Upstream sale of FA will affect NCI's share of profit as unrealized profit resides in S

Illustration 4: Upstream Transfer of Fixed Assets

31 Dec 20X3

CJE 1: Adjustment of unrealized profit in prior year			
Dr	Equipment (P)	40,000	
Dr	Opening RE (S)	36,000	
Dr	NCI	4,000	
Cr	Accumulated depreciation (P)		80,000

CJE 2: Reversal of tax on profit on sale in prior year			
Dr	Deferred tax asset (group's BS)	8,000	
Cr	Opening RE (S)		7,200
Cr	NCI		800

Illustration 4: Upstream Transfer of Fixed Assets

CJE 3: Correct the over-depreciation for prior and current year

Dr	Accumulated depreciation (P)	10,000	
Cr	Depreciation (P)		5,000
Cr	Opening RE (P)		4,500
Cr	NCI		500

CJE 4: Increase in tax arising from correction of over-depreciation in prior and current year

Dr	Tax expense (P)	1,000	
Cr	Opening RE (P)	900	
Cr	NCI	100	
Cr	Deferred tax asset (group's BS)		2,000

Illustration 4:
Upstream Transfer of Fixed Assets

CJE 5: Allocation of current year profit to NCI			
Dr	Income to NCI	80,400	
Cr	NCI		80,400

Net profit after tax of S	800,000
Add: Over-depreciation (after-tax)	4,000
Adjusted net profit	804,000
NCI's share (10%)	80,400

Content

1. Elimination of intragroup transactions and balances
2. Elimination of realized intragroup transactions
3. Elimination of intragroup balances
4. Adjustment of unrealized profit or loss arising from intercompany transfers
5. Impact on non-controlling interests arising from adjustments of unrealized profit or loss
6. Special considerations for intercompany transfers of fixed assets
7. Special accounting considerations when intragroup transfers are made at a loss

Transfers of Assets at a Loss

- Need to reassess whether the loss is indicative of impairment loss

- If it is indicative of impairment loss:
  - Unrealized loss is not adjusted out of the carrying amount of asset
  - Only reverse the sales and cost of sale (to the extent of the sales) for inventory
  - Only reverse the excess over cost and accumulated depreciation (to the extent of the sales) for FA

- If it is not indicative of impairment loss:
  - Same treatment as with unrealized profit
  - Unrealized loss is adjusted out of the carrying amount of asset
  - Realized only when the inventory is sold to 3rd party or under/over-depreciation of FA is corrected

Illustration 5:
Unrealized Loss Arising From Intragroup Transfers

- Parent transferred inventory to subsidiary during the year ended 31 Dec 20X6

Transfer price	$60,000
Original Cost	$80,000
Gross loss	($20,000)

- The loss on transfer indicated an impairment loss on the inventory

What is the consolidation journal entry?

Dr	Sales	60,000	
Cr	Cost of Sales		60,000

Eliminate the transfer of Inventory – no adjustment is made to remove the unrealized loss

Illustration 5:
Unrealized Loss Arising From Intragroup Transfers

- Parent transferred fixed asset to subsidiary during the year ended 31 Dec 20X6

Transfer price		$120,000	
Original Cost			$200,000
Acc. Dep	($ 50,000)		
NBV			$150,000
Loss on transfer			$ (30,000)

- The loss on transfer indicated an impairment loss on the fixed asset

What is the consolidation journal entry?

Dr	Fixed assets	80,000	
Cr	Accumulated depreciation		80,000

Eliminate the transfer of fixed asset – loss of $30,000 is not eliminated

Subsequent depreciation will take into account any revision in useful life of the impairment in value

Conclusions

- Only transactions with 3rd parties should be shown in consolidated financial statements
- Intra-group transactions and balances must be eliminated after reconciliation of balances
- Unrealized profit or loss in inventory or fixed assets must be adjusted
- Upstream transfers will impact NCI
- Tax effects on profit adjustments must be made
- Special considerations for transfers at a loss

Questions & Answers