CHAPTER - 8

COMPLEX GROUP STRUCTURES

Two structures exist: -

- Vertical (sub-subsidiaries); and
- Mixed groups

The parent only controls its subsidiaries' holdings in other companies but does not control an associate's holdings in other companies.

INTRODUCTION: VERTICAL GROUPS

Consider the following groups structure:

P ULTIMATE PARENT COMPANY (Parent company of S

$\downarrow$ **60%**

S SUBSIDIARY (parent company of SS)

$\downarrow$ **70%**

SS SUB-SUBSIDIARY (indirect subsidiary of P)

Where SS is a subsidiary of S and S is a subsidiary of P, and then SS is a sub-subsidiary of P (P has indirect control over SS via S). For accounting purposes, we shall refer to SS as a sub-subsidiary. To show the group as a single economic entity, SS must be included in the consolidated accounts of P.

PREPARATION OF CONSOLIDATED STATEMENT OF FINANCIAL POSITION INCORPORATING SUB-SUBSIDIARY

Two methods available:

1. Two stage consolidation (indirect method)
   (Not recommended in examination)
2. One stage consolidation (direct method)
   (Recommended in examination)
   Under this method we need to take into account the EFFECTIVE INTERST (EI) in the sub-subsidiary company.

   Using the earlier group structure:

   - P owns 60% of S and S own 70% of SS.
   - So P has an effective group interest in SS of 60% × 70% = 42%
   - Non controlling interests own 58% of SS.

   The Non controlling interest can be analysed as follows.

	%
Owned by outside shareholders in SS	30
Owned by outside shareholders in S (40% × 70%)	<u>28</u>
Effective Non controlling interest	<u>58</u>

Use effective interest to ascertain ownership of net assets and profits. But note that the treatment of the investment is determined by the control relationship, not the effective interest. Despite the fact that P owns only 42% of SS, SS is treated as a subsidiary (not an associate) because S controls SS.

WHAT DIFFERENCE WOULD IT MAKE IF THE DATES OF ACQUISITION HAD NOT COINCIDED?

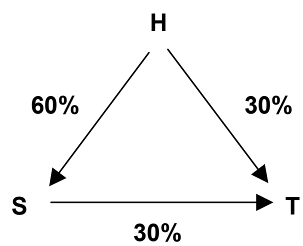
The critical date is the date when effective control is acquired by the ultimate parent company.

- For example, suppose S acquired SS on 31 December 20.X3 and P acquired S on 31 December 20.X4.
- This situation makes no difference because the critical date is 31 December 19.X4 when P acquires control over both S and SS.
- Now consider the other possible situation when SS is acquired after S. For example, suppose P acquired S on 31 December 20.X4 (as before) and acquired Ss on 31 December 20.X5. In this case there are two critical dates to consider. The dates when P acquired control over S and SS – 31 December 20.X4 and 31 December 20.X5

INTRODUCTION: COMPLEX GROUP

The group is structure in a manner where both the ultimate parent and a subsidiary have an interest in another entity.

For example



T is a subsidiary of H as H controls 30% directly and 30% indirectly via its interest in S. Thus 60% is controlled. Consolidation is performed in a single stage using the consolidation percentages.

S	Group share	60%	
	Non controlling interest		40%
T	Group share		
	Direct	30%	
	Indirect 60% of 30%	18%	48%
	Non controlling interest		52%

SUGGESTED APPROACH OF QUESTION

1: Ascertain group structure – part of workings
2. Establish the effective interests – part of workings
3. Establish the effective date of acquisition of sub-subsidiary – part of workings
4. Proceed with consolidation workings
5. Prepare Pro-forma CSOFP

Example – 1

The relevant details and summary of the individual statement of financial positions of P, S and SS at December 31,20 X1 are as follows: -

- S acquired the shares in SS on December 31, 19 X 4, when its accumulated profits were Rs. 700. On the same date P acquired the shares in S, when its accumulated profits were Rs. 2,750.
- Goodwill arising on acquisition is capitalized and tested annually for impairment. No impairment has been detected to date.

	P Rs.	S Rs.	SS Rs.
2,400 shares in S	5,100	--	--
180 shares in SS	--	750	--
Sundry net assets	11,900	5,500	1,200
	17,000	6,250	1,200
Share capital Rs. 1 ordinary shares	10,000	3,000	300
Accumulated profits	7,000	3,250	900
	17,000	6,250	1,200

Required: -
Prepare consolidated statement of financial position as at December 31, 20X1.

Example – 2

- P made a 75% investment of Rs. 20 million in H on December 31, W6 when the net assets of H were Rs. 24 million (issued capital Rs. 12 million plus reserves Rs. 12 Million).
- On December 31, W 7 H made a 60% investment of Rs. 10 million in S when the net assets of S were Rs. 15 million (issued capital Rs. 10 million plus reserves Rs. 5 million).
- The group has the policy of measuring NCI at fair value. The fair value of NCI in S is 7.5 million and in SS is 9.5 million.
- During the current year H sold goods to S of which Rs. 2 million goods are still stock of S. H charged Mark up of 25% on all goods it sell to group companies.
- In the post acquisition period P sold non-depreciable asset to H by recognizing Rs. 2 million gain on disposal. The asset still exists in H statement of financial position.
- The statement of financial positions of the three companies at December 31, X 0 were as under: -

	P Rs. (M)	H Rs. (M)	S Rs.(M)
Investment in subsidiaries	20	10	--
Non-current assets	30	20	20
Sundry current assets	10	6	5
	60	36	25
Equity-Ordinary share capital of Rs. 1 each	30	12	10
Retained profits	30	24	15
	60	36	25

None of the entities has issued new shares since 31-12-W6. There has been no impairment of goodwill since the acquisitions.
Required: -
Prepare consolidated statement of financial position as at December 31, X0.

Example – 3

P holds 90% of the ordinary shares of S and 20% of the ordinary shares of Q. S also hold 60% of the ordinary shares of Q.

P acquired its holding in S on December 31, 19X4 when the accumulated profits of that company were Rs. 201,000. On the same date both companies acquired their shares in Q when the balance of accumulated profits was Rs. 67,000. The group has the policy of measuring NCI at fair value. The fair value of NCI in S at the date of acquisition is Rs.65,000 and in Q 26% NCI has Rs.75,000. The following summarized statements of financial position have been prepared at December 31, 20X1.

	P	S	Q
	Rs.	Rs.	Rs.
Investment in subsidiaries			
S	600,000		
Q	40,000	120,000	
Sundry net assets	1,336,000	717,000	213,000
	1,976,000	837,000	213,000
Equity-Ordinary share capital of Rs. 1 each	500,000	400,000	100,000
Retained profits	1,476,000	437,000	113,000
	1,976,000	837,000	213,000

Note: Goodwill arising on consolidation is capitalized and tested annually for impairment. No impairment has been detected to date.

Required: Prepare consolidated statement of financial position for Group at December 31, 20X1.

Example – 4

P owns 75% of S and S own 90% of SS.

The condensed income statements of all three companies are given as under: -

	P	S	SS
	Rs.	Rs.	Rs.
Operating profit	100,000	80,000	20,000
Investment income			
Dividend from S	6,000		
Dividend from SS		1,800	
Profit before tax	106,000	81,800	20,000
Tax	(40,000)	(30,000)	(7,000)
Profit after tax	66,000	51,800	13,000
Dividend paid	(35,000)	(8,000)	(2,000)
Retained profit for the year	31,000	43,800	11,000

Required: - Consolidated income statement for the year then ended

COMPREHENSIVE ILLUSTRATION 1 (Complex Group)

On April 01, 20X1 H Limited bought 80% of the issued share capital of K Limited and on April 01, 20X3 H Limited was itself taken over by P Limited, which purchased 75% of the ordinary shares in H Limited.

The statement of financial position of three entities at October 31, 20X5 showed the following position.

	P	H	K
	Rs.	Rs.	Rs.
Property, plant and equipment			
Freehold land	89,000	30,000	65,000
Building	64,000	80,000	23,600

Plant	33,000	84,000	43,800
	186,000	194,000	132,400
Investments			
Shares in H at cost	135,000		
Shares in K at cost		130,000	
Current assets			
Inventory	108,500	75,500	68,400
Trade receivables	196,700	124,800	83,500
Cash at bank	25,200		25,400
	651,400	524,300	309,700
Capital and reserves			
Ordinary shares of Rs.1 each	200,000	120,000	100,000
10% Preference shares Rs. each			40,000
Reserves	154,000	119,000	74,000
	354,000	239,000	214,000
Current liabilities			
Bank overdraft		37,400	
Trade payables	160,000	152,700	59,200
Income tax	57,400	47,200	24,500
Dividend payable	80,000	48,000	12,000
	651,400	524,300	309,700

Additional information

a) The fair value of net assets of H and K on April 01, 20x1 were Rs. 150,000 and Rs. 165,000 and on April 01, 20x3 were Rs. 175,000 and Rs. 185,000. The whole of fair value gain related to free hold lands which are not depreciated. The group has the policy of measuring non-current assets under cost model.

b) At the date of acquisition P agreed to pay Rs. 30,000 to old shareholders of H if H earning per share exceed Rs. 2 per share within two years of acquisition. The earning target has not been satisfied by the end of two year. No accounting entries have been incorporated by P.

c) At the date of acquisition of K, by the group there was an internet domain name not recognized by K has a fair value of Rs. 5,000 and useful life of five years. At the date of acquisition of H by P, H was having an operating lease contract favorable from market term by Rs. 5,000 and remaining lease term was 5 years at the date of acquisition.

d) Dividend declared before the year-end by K is ordinary Rs. 10,000 and preference Rs. 2,000.

e) Dividend by P and H is included in receivables.

f) Items purchased by H from K and remaining in inventory at October 31, 20X5 are Rs. 25,000. K charges 20% profit element in the selling price.

g) Included in the plant and equipment of K is equipment purchased from the manufacturers, P on January 01, 20X4 for Rs. 10,000. P recorded a profit of Rs. 2,000 on sale of the machine. The group charges depreciation on plant and equipment @ 10 % on each year.

h) Intra group balances are included in receivables and payables respectively and are as follows: -

		Rs.
P	Payable to H	45,600
	Payables to K	28,900
H	Receivables from P	56,900
K	Receivables from P	28,900

i) A cheque drawn by P for Rs.11,300 on October 28, 20X5 was received by H on November 3, 20X5.

j) At April 01, 20X1 reserves in H were Rs. 28,000 and in K were Rs. 20,000 at April 01, 20X3 the figures were Rs. 40,000 and Rs. 60,000 respectively.

k) The group has the policy of measuring NCI at proportionate share of fair value of net assets at the date of acquisition.

l) Goodwill was completely written off some years ago following an impairment review.

Required: -

Prepare consolidated statement of financial position as at October 31, 20X5 for Sales and its subsidiaries.

COMPREHENSIVE ILLUSTRATION 2

The following statements of financial positions relate to Rodney, a public limited company, Del, a public limited company and Trigger a public limited company as at November 30, 2009.

	Rodney	**Del**	**Trigger**
	Rs. (m)	**Rs. (m)**	**Rs. (m)**
Non- current assets			
Tangible	1,230	505	256
Investment in Del	640	--	--
Investment in Trigger	160	100	--
	2,030	605	256
Current assets			
Inventory	300	135	65
Trade receivables	240	105	49
Cash and bank	90	50	80
	630	290	194
Total assets	2,660	895	450
Equity and liabilities			
Equity			
Share capital	1500	500	200
Share premium	300	100	50
Revaluation reserve	--	--	70
Retained earnings	625	200	60
	2425	800	380
Non-current liabilities	135	25	20
Current liabilities	100	70	50
	2,660	895	450

It is the group's policy to value the non-controlling interest at fair value.

The following information is relevant to the preparation of the group financial statements:

(i) Rodney had acquired 80% of the ordinary share capital of Del on 1 December three years ago, when the retained earnings of Del were Rs.100m. The fair value of the non-controlling interest was Rs.154m at acquisition. The fair value of the net assets of Del was Rs.710m at that date. Any fair value adjustments related to inventory and these had been realized by the current year end. There had been no new issues of shares in the group since the current group structure was created.

(ii) Rodney and Del had acquired their holdings in Trigger on the same date as part of an attempt to mask the true ownership of Trigger. Rodney acquired 40% and Del acquired 25% of the ordinary share capital of Trigger two years ago. The fair value of the non-controlling interest in Trigger was Rs.149m at acquisition. The retained earnings of Trigger on that date were Rs.50m and those of Del were Rs.150m. There was no revaluation reserve in the books of Trigger at acquisition. The fair values of the net assets of Trigger at acquisition were not materially different from their carrying values.

(iii) The group operates in the pharmaceutical industry and incurs a significant amount of expenditure on the development of products. These costs were formerly written off to the income statement as incurred but then reinstated when the related products were brought into commercial use. The reinstated costs are shown as 'Development Inventory'. The costs do not meet the development criteria in IAS 38, Intangible Assets for classification as intangibles and it is unlikely that the net cash inflows from these products will be in excess of the development costs. In the current year, Del has included Rs.20m of these costs in inventory.

(iv) Del had purchased a significant amount of new production equipment early in the year. The cost before trade discount of this equipment was Rs.50m. The trade discount of Rs.6m was taken to the income statement. Depreciation is charged on the straight-line basis over a six-year period.

(v) The policy of the group is now to state tangible non-current assets at depreciated historical cost. The group changed from the revaluation model to the cost model under IAS 16, Property, Plant and Equipment at the current year start and restated all of its tangible non-current assets to historical cost in that year except for the tangible non-current assets of Trigger. These had been revalued by the directors of Trigger on the first day of the current year. The values were incorporated in the financial records creating a revaluation reserve of Rs.70m. The tangible non-current assets of Trigger were originally purchased on 1 December two years before the current year end, at a cost of Rs.300 million. The assets are depreciated over six years on the straight-line basis. The group does not make an annual transfer from revaluation reserves to the retained earnings in respect of the excess depreciation charged on revalued tangible non-current assets. There were no additions or disposals of the tangible non-current assets of Trigger for the two years to the current year end.

(vi) The goodwill resultant from the Del acquisition was impairment tested at the first and second year end after acquisition and again at the current year end. The first and second impairment reviews revealed no impairment. However, the current review identified a recoverable value of Rs.809m for Del. There has been no impairment in Trigger's goodwill since acquisition.

Required: - Prepare a consolidated statement of financial position of the Rodney Group as at 30 November 2009?

SUB-ASSOCIATE

Question –1

The balance sheets of H, S and A at December 31, 20X0 are as follows: -

	H	S	A
	Rs. (000)	**Rs. (000)**	**Rs. (000)**
Investments	23,500	10,000	--
Property, plant and equipment	20,000	22,000	25,000
Net current assets	8,000	6,000	5,000
	51,500	38,000	30,000
Issued capital (1 Rs. each)	20,000	15,000	10,000
Accumulated profits	31,500	23,000	20,000
	51,500	38,000	30,000

Notes:

a) On December 31,20W5, when the accumulated profits of S showed a balance of Rs. 11 million, H purchased 12 million shares in S for Rs. 23.5 million. The fair value of NCI at the date of acquisition was Rs. 7.5 million.

b) On December 31, 20W6, when the accumulated profits of A showed a balance of Rs. 12 million, S purchased 4 million shares in A for Rs. 10 million.

c) There has been no impairment of goodwill yet.

Required: -

Prepare consolidated statement of financial position as at December 31, 20X0.

Question – 2

The balance sheets of P, S and A at December 31, 20X1 are as follows: -

	P	S	A
	Rs. (000)	**Rs. (000)**	**Rs. (000)**
Investments			
80,000 shares in S	130,000		--
3,000 shares in A		5,000	--
Net assets	120,000	225,000	25,000
	250,000	230,000	25,000
Issued capital (1 Rs. each)	100,000	100,000	10,000
Accumulated profits	150,000	130,000	15,000
	250,000	230,000	25,000

Notes:

a) P acquired the shares in S on December 31, 19X4, when its accumulated profits were Rs. 50,000. The fair value of NCI was Rs. 30,000. On the same day S acquired the shares in A, when its accumulated profits were Rs. 5,000.

b) Goodwill arising on acquisition has been impaired fully to date.

Required: -

Consolidated statement of financial position as at December 31, 20X1

Solution Q-1
P GROUP
CONSOLIDATED FINANCIAL STATEMENT OF FINANCIAL POSITION
AS AT OCTOBER 31, 20X5

	Rs.	Rs.
Non-current assets		
Tangible assets		
Freehold land (184,000+40,000)	224,000	
Building	167,600	
Plant (160,800-2000+367)	159,167	550,767
Intangible assets		
Internet domain (5,000-2,583)	2,417	
Operating lease contract (5,000-2,583)	2,417	4,834
		555,601
Current assets		
Inventory (252,400-5,000)	247,400	
Trade receivables (405,000-8,000-36,000-85,800)	275,200	
Cash and bank (50,600+11,300)	61,900	584,500
		1,140,101
Equity and liabilities		
Ordinary share capital	200,000	
Consolidated retained earnings	229,883	
	429,883	
NCI	124,318	554,201
Non- current liabilities		
10% preference share capital		40,000
Current liabilities		
Bank overdraft	37,400	
Trade payables (371,900+11,300-85,800)	297,400	
Income tax	129,100	
Dividend payable (140,000-8,000-36,000-14,000)	82,000	545,900
		1,140,101

W-1 Group structure

P
↓ 75%
H
↓ 80%
K

	H	K
	%	%
Group	75	60
NCI	25	40
	100	100

W-2 Cost of control account	H	K
Investment	135,000	97,500
Contingent consideration	30,000	--
Total cost of investment	165,000	97,500
Share capital	90,000	60,000
Retained earnings	45,000	54,000
Goodwill/ Bargain purchase gain	30,000	(16,500)

W-3 NCI		
Share capital (30,000+40,000)	70,000	
Dividend payable	14,000	
HRE-pre	15,000	
HRE-post	19,104	
KRE-pre	36,000	
KRE-post	2,714	
Investment	(32,500)	124,318

W-4 Consolidated retained earnings		
P company	154,000	
Contingent consideration	30,000	
HRE-post	57,313	
KRE-post	4,070	
Bargain purchase gain	16,500	
Depreciation	(2,000)	
Goodwill	(30,000)	229,883

W-5 Fair value gain	H	K
Fair value	175,000	185,000
Share capital	120,000	100,000
Pre acquisition reserves	40,000	60,000
	160,000	160,000
	15,000	25,000

W-7		
	HRE	KRE
As per question	119,000	74,000
Adjustments		
Depreciation	--	367
Fair value gain	5,000	5,000
Fair value gain	15,000	25,000
Stock	--	(5,000)
Amortization	(2,583)	(2,583)
	136,417	96,784
Allocation		
Cost of control account	45,000	54,000
Consolidated retained earnings	57,313	4,070
NCI	15,000	36,000
NCI	19,104	2,714
	136,417	96,784