A-1
Preparation question: Simple consolidation

BOO GROUP

CONSOLIDATED INCOME STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 20X8

	Rs.000
Revenue (5,000 + 1,000 – 100)	5,900
Cost of sales (2,900 + 600 – 80)	(3,420)
Gross profit	2,480
Other expenses (1,700 + 320)	(2,020)
Profit before tax	460
Tax (130 + 25)	(155)
Profit for the year	305
Profit attributable to	
Owners of the parent	294
Non-controling interest (20% × 55)	11
	305

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (retained earnings only)

	Rs.000
Opening retained earnings (230 + (185 × 80%))	378
Total comprehensive income for the year	294
Closing retained earnings	672

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20X8

	Rs.000	Rs.000
Assets		
Non-current assets (2,000 + 200 – 80)		2,120
Current assets		
Inventory (500 + 120 + 80)	700	
Trade receivables (650 – 100 + 40)	590	
Bank and cash (390 + 35)	425	
		1,715
Total assets		3,825
Equity and liabilities		
Equity attributable to owners of the parent		
Share capital (Boo only)		2,000
Retained earnings (W4)		672
		2,672
Non-controlling interest (W3)		68
Total equity		2,740
Current liabilities		
Trade payables (910 + 30)	940	
Tax (130 + 25)	155	
		1,095

Total equity and liabilities	3,835

Workings

1 Group structure

Boo

↓ 80% since incorporation

Gross

2 Inter- company issues

Step 1 Record Goose's purchase		
DEBIT Purchases	Rs.100,000	
CREDIT Payables		Rs.100,000
DEBIT Closing inventory (B/S)	Rs.100,000	
CREDIT Closing inventory I/S (COS)		Rs.100,000
Step 2 Record Goose's purchase		
DEBIT COS (and retained earnings) in BOO	Rs.20,000	
CREDIT Inventory (B/S)		Rs.20,000
Step 3: Cancel intra-group transaction		
DEBIT Revenue	Rs.100,000	
CREDIT Cost of sales		Rs.100,000
Step 4: Cancel intragroup balances		
DEBIT Receivables	Rs.100,000	
CREDIT Payables		Rs.100,000

3 Non-controlling interest

	Rs.000
Share capital	100
Retained earnings	240
	340
Non-controlling interest 20%	68

4 Retained earnings

	Boo	Goose
	Rs.000	**Rs.000**
Per question	500	240
Unrealised profit (W1)	20	
Less pre acquisition		-
	480	240
Goose: 80% × 240	192	
Total, as per Statement of Changes in Equity	672	

A-2
Hideaway

IAS 24 Related Parties

(a) Importance of related party disclosures

Investors invest in a business on the assumption that it aims to maximize its own profits for the benefit of its own shareholders. This means that all transactions have been negotiated at arm's length between willing and informed parties. The existence of related parties may encourage directors to make decisions for the benefit of another entity at the expense of their own shareholders. This can be done actively by selling goods and services cheaply to related parties, or by buying in goods and services at an above market price. It can also happen when directors chose not to compete with a related party, or offer guarantees or collateral for other party's loans.

Disclosure is particularly important when a business is being sold. It may receive a lot of custom, supplies, services or general help and advice from family or group companies. When the company is sold these benefits may be withdrawn.

Related party transactions are not illegal, nor are they necessarily a bad thing. However shareholders and potential investors need to be informed of material related party transactions in order to make informed investment and stewardship decisions.

(b) Hideaway, Benedict and Depret

The directors and shareholders of Hideaway, the parent, will maximize their wealth by diverting profitable trade into wholly owned subsidiaries. They have done this by instructing Depret (a 55% subsidiary) to sell goods to Benedict (a 100% subsidiary) at Rs.5m below fair value. As a result the non-controlling shareholders of Depret have been deprived of their 45% interest in those lost profits, amounting to Rs.2.25m. The non- group directors of Depret will also lose out if their pay is linked to Depret's profits.

Because Depret's profits have been reduced, the non-controlling shareholders might be persuaded to sell their shares to Hideaway for less than their true value. Certainly potential shareholders will not be willing to pay as much for Depret's shares as they would have if Depret's profits had been maximised.

The opposite possibility is that the Directors of Hideaway are boosting Benedict's reported performance with the intention of selling it off for an inflated price.

Depret's non-controlling shareholders might be able to get legal redress because the majority shareholders appear to be using their power to oppress the non-controlling shareholders. This, however, will depend on local law. The tax authorities might also suspect Depret of trying to avoid tax, especially if Benedict is in a different tax jurisdiction.

A-3
Highveldt

(i) Goodwill in Samson

	Rs.000	Rs.000
Consideration transferred		210
80m shares ° 75% ° Rs.3.50		100

Deferred consideration; Rs.108m ° 1/1.08		310
Share of the net assets acquired at fair value		
Carrying value of net assets at 1.4.20X4:		
Ordinary shares	80	
Share premium	40	
Retained earnings	134	
	254	
Fair value adjustments (W)	42	
Fair value of the net assets at acquisition	296	
75% Group share		(222)
Cost of Goodwill		88
Impairment charge given in question		(22)
Carrying value at 31 March 20X5		66

Goodwill: alternative working

	Rs.000
Consideration transferred	310
Non-controlling interest at acquisition (296 x 25%)	74
Net assets at acquisition	(296)
	88
Impairment	(22)
	66

Notes (not required in the exam)

Goodwill is based on the present value of the deferred consideration. During the year the Rs.8m discount will be charged to Highveldt's income statement as a finance cost. (In (a)(iii) retained earnings will be adjusted for this accrued interest.)

Only the Rs.20m fair valuation is relevant at the date of acquisition. The Rs.4m arising post acquisition will be treated as a normal revaluation and credited to the revaluation surplus. (See (a)(iii) below.) Samson was right not to capitalise an internally developed brand name because, without an active market, its value cannot be measured reliably. However the fair value of a brand name can be measured as part of a business combination. Therefore the Rs.40m fair value will be recognised at acquisition and an additional Rs.4m amortisation will be charged in the consolidated income statement. At acquisition Samson had capitalised Rs.18m of development expenditure. Highveldt does not recognise this as an asset, so the net assets at acquisition are reduced by Rs.18m. A further Rs.32m is capitalised by Samson post acquisition; this will be written off in the consolidated income statement (net of the Rs.10m amortisation already charged).

(ii) Non-controlling interest in Samson's net assets

Rs.m

Samson's net assets from the question	330
Fair value adjustment (W)	42
Post-acquisition revaluation of land	4
Amortization of brand	(4)
Capitalised development expenditure – carrying value (32-10)	(22)
Unrealised profit (Rs.6m/3)	(2)
	348
Non-controlling interest 25%	87

(iii) Consolidated Reserves

Share premium

The share premium of a group, like the share capital, is the share premium of the parent only (Rs.80m)

Revaluation surplus

	Rs.m
Parent's own revaluation surplus	45
Group share of Samson's post acquisition revaluation; Rs.4m ° 75%	3
	48

Retained earnings

Retained earnings attributable to owners of the parent

	Highyeldt	Samson
	Rs.m	**Rs.m**
Per question	350	76
Accrued interest from Samson (Rs.60m × 10%)	6	-
Unwinding of discount on deferred consideration	(8)	-
Amortisation of brand (Rs.40m/10 years)	-	(4)
Write off development expenditure as incurred (Rs.50m – Rs.18m)	-	32
Write back amortisation of development expenditure	-	10
Unrealised profit	-	(2)
	348	48
Group share (75%)	36	
Impairment of goodwill in Samson	(22)	
	362	

Working	**Rs.m**
Fair value adjustment:	
Revaluation of land	20

Recognition of fair value of brands	40
De-recognition of capitalized development expenditure	(18)
	42

(b) Usefulness of consolidated financial statements

The main reason for preparing consolidated accounts is that groups operate as a single economic unit, and it is not possible to understand the affairs of the parent company without taking into account the financial position and performance of all the companies that it controls. The directors of the parent company should be held fully accountable for all the money they have invested on their shareholders behalf, whether that has been done directly by the parent or via a subsidiary.

There are also practical reasons why parent company accounts cannot show the full picture. The parent company's own financial statements only show the original cost of the investment and the dividends received from the subsidiary. As explained below, this hides the true value and nature of the investment in the subsidiary, and, without consolidation, could be used to manipulate the reported results of the parent.

- The cost of the investment will include a premium for goodwill, but this is only quantified and reported if consolidated accounts are prepared.
- A controlling interest in a subsidiary can be achieved with a 51% interest. The full value of the assets controlled by the group is only shown through consolidation when the non-controlling interest is taken into account.

- Without consolidation, the assets and liabilities of the subsidiary are disguised.
  - A subsidiary could be very highly geared, making its liquidity and profitability volatile.
  - A subsidiary's assets might consist of intangible assets, or other assets with highly subjective values.
- The parent company controls the dividend policy of the subsidiary, enabling it to smooth out profit fluctuations with a steady dividend. Consolidation reveals the underlying profits of the group.
- Over time the net assets of the subsidiary should increase, but the cost of the investment will stay fixed and will soon bear no relation to the true value of the subsidiary.

A-4
Hample

Top tips. The main difficulties in this question relate to the fair value adjustments on the non-current assets. There are lots of easy marks to be gained for straightforward adjustments, such as those for intragroup transactions.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 MARCH 20X9

	Rs.000	**Rs.000**
Assets		
Non-current assets		
Property, plant and equipment (W7)	4,020	
Goodwill (W2)	480	

Software (W8)	1,440	
Investments (65 + 210)	275	
Current assets		
Inventory (719 + 560 – 5 (W5))	1,274	
Trade receivables (524 + 328)	852	
Cash and bank (20 + 55 cash in transit)	75	
Total assets		8,416
Equity and liabilities		
Equity attributable to owners of the parent		
Share capital	2,000	
Share premium	2,000	
Retained earnings (W4)	2,420	
		6,420
Non-controlling interest (W3)		350
Non current liabilities		
Government grants (230+40)		270
Current liabilities		
Trade payables (475 + 472)	947	
Overdraft	27	
	402	1,376
Total equity & liability		8,416

Workings

1 Group structure

Hample

↓ 90% 1.4.X8

Sopel

2. Goodwill

	Rs.000		Rs.000
Consideration transferred			4,110
Less share of net assets acquired			
Equity shares	1,500		
Share premium	500		
Retained earnings at 1 April X8 (2,200 – 300 (W6))	1,900		
	3,900	- 90%	(3,150)
			600
Impairment			(120)

Carrying value	480

Goodwill: alternative working

	Rs.000
Consideration transferred	4,110
Non-controlling interest at acquisition (3,900 x 10%)	390
Net assets at acquisition	(3,900)
	600
Impairment	(120)
Carrying value	480

3 Non-controlling interest

	Rs.000
Net assets per question	3,955
Less unrealised profit (W5)	(5)
Fair value adj (W6)	(450)
	3,500
	x 10%
	350

Non-controlling interest: Rs.3,500,000 × 10% = Rs.350,000

4 Retained earnings

	Hample	Sopel
	Rs.000	Rs.000
Per question	2,900	1,955
Fair value adj (W6)		(150)
Unrealised profit (W5)		(5)
Pre-acquisition		(2,200)
		(400)
Share of post acquisition		
Sopel: (400) × 90%	(360)	
Less goodwill impairment (W2)	(120)	
	2,42 0	

5 Unrealized profit

Sopel's sales to Hample: Rs.25,000

Marked up at 25%, so unrealised profit is Rs.25,000 × 25/125 = Rs.5,000

Dr Retained earnings (Sopel) Rs.5,000

Cr Group inventories Rs.5,000

6 Fair value adjustments

	1.4.X8	In year	31.3.X9
	Rs.000	Rs.000	Rs.000
Leasehold (4 yr life)	(120)	30	(90)

Software (W8)	(180)	(180)	(360)
	(300)	(150)	(450)

7 Property, plant and equipment

	Rs.000
Hample	2,120
Sopel	1,990
Fair value adjustment (Note (i))	(120)
Reduced depreciation arising from fair value adjustment (Note (ii))	30
	4,020

Notes

(i) The leasehold carrying value would be based upon present value of future rentals (receivable in advance):

	Rs.000
80 + (80 × 2.5*)	280
Book value	400
Reduction	120

*2.5 is the annuity factor for years 1-3 at 10%.

(ii) Depreciation is based upon 280/4 = 70
Depreciation in Sopel books = 100
Reduction: 100 – 70 = 30

8 Software

	Sopel accounts Rs.000	Consol-edated Rs.000
Capitalized	2400	2,400
Depreciation to 31 March 20X8 (8 yrs/5 yrs)	(300)	(480)
NBV at acquisition	2100	1,920
Depreciation to 31 March 20X9	(300)	(480)
NBV 31 March 20X9	1,800	1,440

Note. There is a fair value adjustment of 180 plus extra depreciation of 180

9 Elimination of current account

	Rs.000
Sopel in Hample accounts	75
Less cash in transit	(15)
Hample in Sopel accounts	60

10 Intragroup loan

	Rs.000
Investment in Hample accounts	200
Repayment in transit	(40)
Liability in Sopel accounts	160

A-5
Parentis

PARENTIS GROUP: CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 MARCH 20X7

	Rs.m
Assets	
Non-current assets	
Property, plant and equipment (640 + 340 + 38 (W4))	1,018
Goodwill (W6)	108
	1,126
Current assets	
Inventory (76 + 22 – 2 (W2))	96
Trade receivables (84 + 44 – 4 (W3) – 7 intragroup)	117
Government compensation receivable	10
Cash (4 + 4)	8
	231
Total assets	1,357
Equity and liabilities	
Equity attributable to owners of the parent	
Equity shares 25c (300 + 75 (W5))	375
Share premium	150
Retained earnings (W8)	264
	789
Non-controlling interest (W7)	89
	878
Non-current liabilities	
10% loan notes (120 + 20)	140
Current liabilities	
Trade payables (130 + 57 – 7 intragroup)	180
Deferred consideration (discount unwound)	66
Tax payable (45 + 23)	68
Overdraft	25
	339
Total equity and liabilities	1,357

Workings

1 Group structure

Parentis

75% Offspring

2 Unrealised profit

Rs.6m × 5/15 = Rs.2m

DR retained earnings/CR Group inventories

3 Cash in transit

DR Cash Rs.4m/CR Receivables Rs.4m

4 Fair value adjustment

	Acquisition 1.4.X6	Movement (1 year)	B/S date 31.3.X7
Properties	40	(2)	38

5 Investment in Offspring

Parentis shares (600/2 × 0.75) (sc 75/premium 150)	225
Loan note	120
Deferred consideration	66
Discount on deferred consideration (66/1.1 × 0.1)	(6)
	405

6 Goodwill

Consideration transferred		
Acquired:		405
Share capital	200	
Retained earnings	120	
Fair value adjustment (W4)	40	
	360	
x 75%		(270)
Goodwill on acquisition		135
Impairment		(27)
		108

Goodwill: alternative working

Consideration transferred	405
Non-controlling interest at acquisition (360 x 25%)	90
Net assets at acquisition	(360)
	135
Impairment	(27)
Carrying value	108

7 Non-controlling interest

Offspring net assets	340
Unrealised profit (W2)	(2)

Loss on intellectual property (30 – 10)	(20)	
Fair value adjustment (W4)	38	
	356	
Non controlling share 25%	89	

8 Retained earnings

Opening balance	300	20
Loss on intellectual property (30 – 10)		(20)
Unrealised profit		2
Additional depreciation (W4)		(2)
		4
Group share 75%	(3)	
Goodwill impairment	(27)	
Unwinding of discount (as per W5)	(6)	
	264	

A-6
Preparation question: Acquisition during the year

(a) PORT GROUP: CONSOLIDATED INCOME STATEMENT FOR THE YEAR ENDING 31 DECEMBER 20X4

	Port	Alfred 2/12	Adjustment	Group
	Rs.'000	**Rs.'000**		**Rs.'000**
Revenue	100	166		266
Cost of sales	(36)	(43)		(79)
Gross profit				187
Interest on loan to Alfred	276		(46)	230
Other investment income	158			158
Finance costs	(56)	(55)		(111)
Operating expenses	-	(46)	46	-
Profit before tax				464
Taxation	(112)	(6)		(118)
Profit for the year				346
Profit attributable to:				
Owners of the parent				342
Non-controlling interest (W4)				4
				346

PORT GROUP STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20X4

	Adjustment	Group
		Rs.'000
Assets		

Non-current assets			
Goodwill	(W2)		275
Property, plant and equipment	100+3,000		3,100
Investments			
Loan to Alfred	2,300+0	(2,300)	-
Other investments	600+0		600
			3,975
Current assets		800+139	939
Total assets			4,914
Equity and liabilities			
Equity attributable to owners of the parent			
Rs.1 equity shares	(W3)		235
Share premium	(W3)		1,115
Retained earnings	(W5)		2,912
			4,262
Non-controlling interest	(W4)		129
Total equity			4,391
Non-current liabilities			
Loan from Port	0+2,300	2,300	-
Current liabilities			
Sundry	200+323		523
Total equity and liabilities			4,914

		Share capital		Share premium	Retained earnings		Non-controlling interest		Total
		Rs.'000		**Rs.'000**	**Rs.'000**		**Rs.'000**		**Rs.'000**
Opening		200		500	2640				3,340
Share issue	W3	35	W3	615	-		-	W3	650
New subsidiary		-		-	-	W4	125		125
Dividends for the year		-		-	70				(70)
Total comprehensive income for the year		-		-	342		4		346
Closing		235		1,115	2,912		129		4,391

Workings

1 Group structure

Port	
	75% subsidiary Two months only
Alfred	

2 Calculation of the cost of investment and goodwill

	Rs.'000	Rs.'000	Rs.'000
Consideration transferred (shares)			650
Net assets at date of acquisition (Note)			
Shares		100	
Share Premium		85	
Retained earnings			
Opening	235		
Add: accrued profit for the year: Rs.96,000 × 10/12	80		
Pre-acquisition retained earnings		315	
Net assets		500	
Group share: 75%			(375)
Goodwill			275

Goodwill: alternative working

	Rs.'000
Consideration transferred	650
Non-controlling interest at acquisition (500 x 25%)	125
Net assets at acquisition	(500)
	275

Note. The net assets at the date of acquisition are also calculated by time-apportioning profits. The share capital and retained earnings brought forward obviously all arose before acquisition. The profit for the year is assumed to have arisen evenly over time.

3 Issue of shares

	Draft	New issue	Revised
	Rs.'000	Rs.'000	Rs.'000
Share Capital	200	35	235
Share Premium	500	615	1,115
Fair value of proceeds		650	

4 Non-controlling interests

Income statement and statement of changes in equity

The rule here is to time apportion the non-controlling interest in the subsidiary acquired during the year. After all, you can only take out in respect of the non-controlling interest what was put in in the first place. So, if two months were consolidated then two months of non-controlling interest will be deducted. (The same rule applies when a subsidiary is disposed of.)

Rs.96,000 ? 2/12 ? 25% = Rs.4,000.

At acquisition in the statement of changes in equity

The net assets at acquisition were Rs.500,000, so the non-controlling interest will be 25% of that =

Rs.125,000.

Statement of financial position

Alfred's equity is Rs.516,000. The non-controlling interest is 25% of that = Rs.129,000.

5 Group retained earnings

	Draft Port **Rs.'000**	New issue Alfred **Rs.'000**
Pre acquisition	2,900	331
Less pre acquisition (W2)		(315)
		16
Share of Alfred (16 – 75%)	12	
	2,912	

A-7 Hillusion

(a) THE HILLUSION GROUP

CONSOLIDATED INCOME STATEMENT FOR THE YEAR ENDED 31 MARCH 20X3

Sales revenues (60,000 + (9/12 24,000) – 12,000 (W3))	66,000
Cost of sales (42,000 + (9/12 20,000) – 12,000 + 500 (W3) + 600 (W4))	(46,100)
Gross profit	19,900
Operating expenses (6,000 + (200 × 9/12) + 300 (W5))	(6,450)
Finance costs (200 × 9/12 less 75 income)	(75)
Profit before tax	13,375
Income tax expense (3,000 + (600 ×9/12))	(3,450)
Profit for the year	9,925
Profit attributable to:	
Owners of the parent	9,595

Non-controlling interest (3,000 × 9/12) – 600 (W4)) × 20%	330
	9,925

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 MARCH 20X3

	Rs.000
Asset	
Non-current asset	29,920
Property, plant and equipment (19,320 + 8,000 + 2,600 fair valuation (W4))	1,130
Goodwill (W5)	-
Investments (11,280 – 10,280 (W5) – 1,000 loan notes)	31,050
Current assets (15,000 + 8,000 – 500 unrealised profit (W3) – 750 inter-company)	21,750
Total assets	52,800
Equity and liabilities	
Equity attributable to owners of the parent	
- Share capital (Parent only)	10,000
- Retained earnings (W6)	26,180
	36,180
Non-controlling interest ((10,400 + 2,600 (W4)) × 20%) + 170 goodwill (W5))	2,770
Non-current liabilities (0 + 2,000 – 1,000 loan notes)	1,000
Current liabilities (10,000 + 3,600 – 750 inter-company)	52,800

Workings

1. Group Structure as at 31 March 20X3

Hillusion	
	80% purchased for Rs.10.28m on 1 July 20X2 Skeptik is Hillusion's subsidiary for 9/12 of the year
Skeptik	

2 Timeline

3 Intra group trade and the provision for unrealized profit

Group revenues and cost of sales are reduced by the Rs.12m of intra-group sales at invoiced value. This adjustment dos not affect profits.

An adjustment is made for the unrealized profit on goods sold by Hillusion to Skeptic but still unsold at the year end. This increases the cost of sales in the income statement and reduced the value of the inventories in the statement of financial position. The gross profirt margin was 25% (Rs.3m/Rs.12m).

	Rs.'000
Goods unsold at the year-end; Rs.12m - Rs.10m	2,000

	Unrealized profit : Rs.2m – 25%	500

4 Fair valued plant

	Rs.'000
Fair value at acquisition	3,200
Depreciation over four years for nine months: Rs.3.2m – ¼ - 9/12 IS	(600)
Carrying value of licence 31 March 20X3	2,600

The extra Rs.600,000 depreciation is taken into account when apportioning the profit for the year between the parent and the non-controlling interest. It also affects the group's retained earnings in the statement of financial statement.

The non-controlling interest in the statement of financial position is adjusted for the Rs.2,600 closing carrying value

5 Goodwill in Skeptic

	Rs.'000	Rs.'000
Consideration transferred		10,280
Share of the net assets acquired at fair value		
Share capital	2,000	
Opening retained earnings	5,400	
Time apportioned profit for the year: Rs.3m – 3/12	750	
Fair value increase for the plant	3,200	
Fair value of the net assets at acquisition	11,350	
80% Group share		(9,080)
Cost of goodwill		1,200
Impairment (300 x 80%)		(240)
		960

Goodwill attributable to non-controlling interest	Rs.'000
Non-controlling interest at fair value	2,500
Non-controlling interest at share of net assets (11,350 x 20%)	2,270
	230
Impairment (300 x 20%)	(60)
	170
Total goodwill (960 6+ 170)	1,130

Goodwill: alternate working

	Rs.'000
Consideration transferred	10,280
Non-controlling interest at fair value	2,500
Fair value of net assets	(11,350)
	1,430
Impairment	(300)
	1,130

6 Retained earnings attributable to owners of the parent

	Hillusion	Skeptic
	Rs.'000	**Rs.'000**
Per question	25,600	8,400
Pre-acquisition reserves	-	(6,150)
Provision for unrealized profit (W3)	(500)	-
Depreciation on fair valuation (W4)	-	(600)
	25,100	1,650
Group share (80%)	1,320	
Impairment of goodwill (W5)	(240)	
	26,180	

(b) Unrealised profits

Unrealised profits arise when group companies trade with each other. In their own individual company accounts profits and losses will be claimed on these transactions, and goods bought from a fellow group company will be recorded at their invoiced cost by the purchaser.

However, consolidated accounts are drawn up on the principle that a group is a single economic entity. From a group point of view, no transaction occurs when goods are traded between group companies, and no profits or losses arise. Revenue and profits will only be claimed when the goods are sold onto a third party from outside of the group.

In this example, Hillusion sold Rs.12m of goods to Skeptik making a profit of Rs.3m. The sale by Hillusion and the purchase by Skeptik must be eliminated from the group income statement. This adjustment will not affect profits because both the sales and the purchases have been reduced by the same amount.

By the year-end Skeptik had sold Rs.10m of these items making a profit of Rs.5m. From a group point of view, the profit on these items, including their share of the profit claimed by Hillusion, has now been realized. However, Skeptik still has Rs.2m of goods bought from Hillusion. This valuation includes an element of profit
(Rs.500,000) that has not yet been realized and needs to be eliminated. This will reduce the carrying value of the inventory to the amount originally paid for them by Hillusion. If unrealised profits were not eliminated, then groups could boost their profits and asset values by selling goods to each other at inflated prices.

A future purchaser of Skeptik would obviously review Skeptik's own financial statements. These show a Rs.3.6m profit before tax, which gives a very healthy 15% net profit on revenues. However, over 60% of Skeptik's revenue comes from selling goods supplied by Hillusion. The gross profit earned on these items is Rs.5m, which is more than the Rs.4m gross profit for the company as a whole. A new owner might not get such favourable terms from Hillusion, leaving them with the loss making products. Nobody would be interested in buying such a business, but this information cannot be gleaned from the entity's own financial statements.

A-8
Hydan

(a) HYDAN CONSOLIDATED INCOME STATEMENT YEAR ENDED 31 MARCH 20X6

	Rs.'000
Revenue (98,000 + 35,200 – 30,000 intra group)	103,200
Cost of sales (76,000 + 31,000 – 30,000 intra group + 200 (W6) + 300 (W7)	(77,500)
Gross profit	25,700
Operating expenses (11,800 + 8,000 + 375 (W2)	(20,175)
Interest receivable (350 – 200 intra group (4,000 x 10% x 6/12))	150
Finance costs	(420)
Profit before tax	5,255
Income tax expense (4,200 – 1,000)	(3,200)
Profit for the year	2,055
Profit attributable to:	
Owners of the parent	3,455
Non-controlling interest (W3)	(1,400)
	2,055

Hydan CONSOLIDATED STATEMENT OF FINANCIAL POSITION AT 31 MARCH 20X6

	Rs.'000
Non-current assets	
Property, plan and equipment (18,400 + 9,500 + 1,200 – 300 (W7))	28,800
Goodwill (W2)	3,025
Investments (16,000 + 10,800 (W2) – 4,000)	1,200
Current assets (18,000 + 7,000 – 200 (W6) – 1,000 intra group	24,000
	57,025
Equity and liabilities	
Equity attributable to owners of the parent	
Ordinary shares of Rs.1 each	10,000
Share premium	5,000
Retained earning (W5)	17,675
	32,675
Non-controlling interest (W4)	4,050
	36,725
Non-current liabilities	
7% bank loan	6,000
Current liabilities (11,400 + 3,900 – 1,000 intra group)	14,300
Total equity and liabilities	57,025

1 Group structure

Hydan

↓ 60% 1.10.X5

Systan

2 Goodwill in Systan

	Rs.'000	**Rs.'000**
Consideration transferred (1,200 - Rs.9)		10,800
Share of net assets acquired:		

Ordinary shares	2,000	
Share premium	500	
Pre-acquisition reserves (6,300 + 3,000)	9,300	
Fair value adjustment	1,200	
	13,000	
Group share 60%		(7,800)
Goodwill		3,000
Impairment (375 x 60%)		(225)
Carrying value		2,775
Goodwill attributable to non-controlling interest (see below)		250
Total goodwill		3,025

Goodwill attributable to non-controlling interest

	Rs.'000
Non-controlling interest at fair value (800 shares Rs.7)	5,600
Share of net assets at acquisition (13,000 x 40%)	(5,200)
Goodwill at acquisition	400
Impairment (375 x 40%)	(150)
	250

Goodwill: alternative working

	Rs.'000
Consideration transferred	10,800
Non-controlling interest at fair value	5,600
Net assets at acquisition	(13,000)
	3,400
Impairment	(375)
	3,025

3 Non-controlling interest: income statement

	Rs.'000
Post acquisition loss	3,000
Unrealized profit in inventory (W6)	200
Additional depreciation (W7)	300
Adjusted loss	3,500
Non-controlling shares 40%	1,400

4 Non-controlling interest: statement of financial position

	Rs.'000
Ordinary shares	2,000
Share premium	500
Retained earnings	6,300
Unrealized profit in inventory	(200)
Fair value adjustment (W7)	900
	9,500

	Non-controlling shares 40%		3,800
	Goodwill attributable to non-controlling interest (W2)		250
			4,050
5	Group retained earnings		
		Hydan	Systan
		Rs.'000	**Rs.'000**
	Per question	20,000	6,300
	Pre acquisition		(9,300)
	Unrealized profit in inventory (W6)		(200)
	Additional depreciation (W67)		(300)
	Goodwill impairment (375 x 60%)	(225)	
		19,775	(3,500)
	Group share of Systan ((3,500) – 60%)	17,675	
6	Unrealized profit		
			Rs.'000
	Goods sold by Systan to Hydan and still in inventory		4,000
	Unrealized profit – 5% of selling price to Hydan		200
	Dr Retained earnings (Systan)	200	
	Cr Group inventory	200	
7	Fair value adjustment		

	At acquisition date	Movement	At 31.3.X6
	Rs.'000	**Rs.'000**	**Rs.'000**
Property, plant and equipment (Note (i))	1,200		1,200
Additional depreciation		(300)	(300)
	1,200	(300)	900
	Goodwill	Retained earnings	PPE/NCI

(b) If we look at Systan's pre-acquisition operating performance, we can see a gross profit margin of 25% and a net profit margin of 15%. During the post-acquisition 6-month period revenue is up by 46% but the gross profit margin is only 12% and the company has made a net loss of 8.5%. Clearly this requires some explanation.

Hydan obtained a controlling interest in Systan in order to secure its supplies of components. In the post- acquisition period Rs.30m of Systan's Rs.35m sales were to Hydan and realised 5% gross profit. In order to compensate for this, Systan has substantially increased the price charged to its other customers to give a 50% gross profit margin on those sales. The eventual result of this may be that it will no longer have any other customers.

Systan's results for the second half-year have also suffered from a large rise in operating expenses – from Rs.1.2m in the pre-acquisition half year to Rs.8m in the post-acquisition half year. It looks as though Systan has been charged a large share of group operating expenses. Hydan itself has operating expenses for the year of Rs.11.8m on a revenue of Rs.98m, while Systan has expenses of Rs.8m on 6 months revenue of Rs.35m. As there are no current account balances outstanding, Systan has obviously had to pay the intra-group portion of this Rs.8m, facilitated by a loan from Hydan at 10%. At the same time, Hydan owes Systan Rs.1m on which no interest is being paid.

The overall conclusion must be that Systan's position has been adversely affected by the acquisition and by the resulting related party transactions. Hydan has used transfer pricing and inter-company charges to transfer profits from the subsidiary to the parent company, thus benefiting its own shareholders at the expense of the non-controlling shareholders.

A-9
Hydrate

(a) THE HYDRATE GROUP

CONSOLIDATED INCOME STATEMENT FOR THE YEAR ENDED 30 SEPTEMBER 20X2

	Rs.'000
Sales revenue (24,000 + 6/12 ¯ 20,000)	34,000
Cost of sales (16,600 + 6/12 ¯ 11,800)	(22,500)
Gross profit	11,500
Operating expenses (1,600 + (6/12 × 1,000) + 3,000 impairment)	(5,100)
Profit before tax	6,400
Income tax expense (2,000 + 2,000 + (6/12 × 3,000))	(3,500)
Profit for the year	2,900

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 30 SEPTEMBER 20X2

	Rs.'000	**Rs.'000**
Assets		
Non-current assets		
Property, plant and equipment (64,000 + 35,000)		99,000
Goodwill (W2)		27,000
Available for sale investments (0 + 12,800 + 5,000 fair valuation)		17,800
		143,800
Current assets		
Inventory (22,800 + 23,600)	46,400	
Trade receivables(16,400 + 24,200)	40,600	
Bank and cash (500 + 200)	700	
		87,700
Total assets		231,500

EQUITY AND LIABILITIES

Equity attributable to owners of the parent		
Share capital (Parent only) SOCIE		35,000
Share premium (Parent only) SOCIE		79,000
Retained earnings (W3)		56,300
		170,300
Non-current liabilities		
8% Loan Notes (5,000 + 18,000)		23,000
Current liabilities		
Trade payables (15,300 + 17,700)	33,000	
Income tax (2,200 + 3,000)	5,200	38,200
Total equity and liabilities		231,500

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEAR

	Share capital	Share premium	Retained earning	Total
	Rs.'000	**Rs.'000**	**Rs.'000**	**Rs.'000**
Opening	20,000	4,000	53,400	77,400
Share issue (W2)	15,000	75,000	-	99,000
Total comprehensive income for the year	-	-	2,900	2,900
	35,000	79,000	56,300	170,300

Workings

1 Group Structure as at 30 September 20X

Hydrate
The Parent

100%

1 April 20X2

Sulphate
The Subsidiary

Consolidate in full for six months

2 Consideration transferred and goodwill in Sulphate

Number of shares issued: 12m ¯ 5/4 = 15 million

		Rs.'000
Nominal value	Rs.1	15,000
Share premium (balancing figure)	Rs.5	75,000

Fair value of shares and cost of the business combination	Rs.6	90,000
Fair value of the net assets acquired		
Share Capital		12,000
Share premium		2,400
Retained earnings at 30 September 2002	42,700	
Less post acquisition profits (6/12 ˉ Rs.4.2m)	(2,100)	
		40,600
Fair value increase in the value of the investments		5,000
Fair value of the net assets at acquisition		45,600
		60,000
Goodwill at cost		30,000
Impairment		(3,000)
Carrying value		27,000

3 Group retained earnings

	Rs.'000	Rs.'000
Parent's retained earnings		57,200
100% share of subsidiary's post acquisition profits ((Rs.4.2m ˉ 6/12)		2,100
Impairment of goodwill		(3,000)
		56,300

A-10
Preparation question: Laurel

Laurel Group - Consolidated statement of financial position as at 31 December 20X9

	Rs.'000
Property, plant and equipment (220 + 160 + (W3) 3)	383
Goodwill (W4)	9
Investment in associate (W5)	96.8
	488.8
Current assets	
Inventories (384 + 234 – (W2) 10)	608
Trade receivables (275 + 166)	441
Cash (42 + 10)	52
	1,101
	1,589.8
Equity attributable to owners of the parent	
Share capital – Rs.1 ordinary shares	400
Share premium	16
Retained earnings (W7)	326.8

	742.8
Non-controlling interests (W6)	47
	789.8
Current liabilities	
Trade payables (457 + 343)	800
	1589.8

Workings

1 Group structure

Laurel

80% 1.1.X7 → Hardy Rs.64,000

40% 1.1.X7 → Comic (associate) Rs.24,000 pre acquired earnings

2 Unrealized profit

Laurel's sales to Hardy: Rs.32,000 – Rs.22,000 = Rs.10,000

DR Retained earnings (Laurel)Rs.10,000

CR Group inventories Rs.10,000

Laurel's sales to Comic (associate) (Rs.22,000 – Rs.10,000) × ½ × 40% share = Rs.2,400. DR Retained earnings (Laurel) Rs.2,400

CR Investment in associate Rs.2,400

3 Fair value adjustments

	At acquisition date	Movement	At year end
	Rs.'000	**Rs.'000**	**Rs.'000**
PPE (57 – 45)	+12	(9)	+3
*Extra depreciation Rs.12,000 × ¾	↓	↓	↓
	Goodwill	Ret'd earnings	PPE.NCI

4 Goodwill

	Groups		NCI
	Rs.'000	**Rs.'000**	**Rs.'000**
Consideration transferred		160	39
Share of net assets acquired:			
Share capital	96		
Share premium	3		
Retained earnings	64		
Fair value adjustment (W3)	12		
	175		

Group/NCI share (80%/20%)	(140)	(35)
	20	4
Impairment losses (15 × 80%/20%)	(12)	(3)
	8	1
	$\underbrace{\qquad\qquad}_{9}$	

5 Investment in associate

	Rs.'000
Cost of associate	70
Share of post acquisition retained reserves ((97,000 – 24,000) -40%)	29.2
Unrealised profit (W2)	(2.4)
Impairment losses	(0)
Cost of associate	96.8

6 Non-controlling interests

	Rs.'000		Rs.'000
Net assets per question	227		
Fair value adjustment (W3)	3		
	230	-20%	46
Non-controlling interest in goodwill (W4)			1
			47

7 Consolidated retained earnings

	Laurel	Hardy	Comic
	Rs.'000	**Rs.'000**	**Rs.'000**
Ret'd earnings per question	278	128	97
Less: PUP re Hardy (W2)	(10)		
PUP re Comic (W2)	(2.4)		
Fair value adjustment movement (W3)		(9)	
	265.6	119	97
Less: pre-acquisition ret'd earnings		(64)	(24)
		55	73
Hardy (55 × 80%)	44		
Comic (73 × 40%)	29.2		
Less: impairment losses (W4)	(12.0)		
	326.8		

A-11
Preparation question: Tyson

STATEMENT OF COMPREHENSIVE INCOME

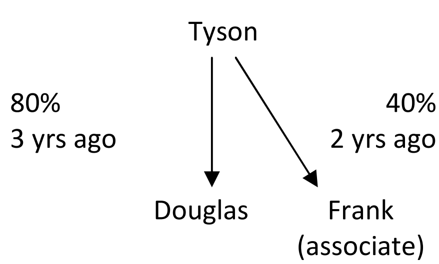
Tyson Group – Consolidated statement of comprehensive income for the year ended 31 December 20X9

Revenue (500 + 150 – 66)	584
Cost of sales (270 + 80 – 66 + (W2) 18)	(302)
Gross profit	282
Other expenses (150 + 20 + (W3) 15))	(185)
Finance income (15 + 10)	25
Finance costs	(20)
Share of profit of associate [(10 × 40%) – 2.4*]	1.6
Profit before tax	103.6
Income tax expense (25 + 15)	(40)
PROFIT FOR THE YEAR	63.6
Other comprehensive income:	
Gains on property revaluation, net of tax (20 + 10)	30
Share of other comprehensive income of associate (5 × 40%)	2
Other comprehensive income for the year, net of tax	32
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	95.6
Profit attributable to:	
Owners of the parent (63.6 – 2.4)	61.2
Non-controlling interests [(45 – (W2) 18) × 20% – (W3) 3]	2.4
	63.6
Total comprehensive income attributable to:	
Owners of the parent (95.6 – 4.4)	91.2
Non-controlling interests [(55 – (W2) 18) × 20% – (W3) 3]	4.4
	95.6

* Impairment losses could either be included in expenses or deducted from the share of profit of associates figure. IAS 28 is not prescriptive.

Workings

1 Group structure



Rs.40,000 Rs.20,000
pre acquired
earnings

	Rs.'000
Selling price	66
Cost	(48)
PUP	18

		Group	NCI
	Rs.'000	**Rs.'000**	**Rs.'000**
Consideration transferred		188	40
Net asset required			
Share capital	100		
Reserves	40		
	140		
Group/NCI share (80%/20%)		(112)	(28)
		76	12
Impairment loss (15 - 80%/20%)		(12)	(3)
		64	9

73

A-12
Hepburn

(a) HEPBURN
CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 31 MARCH 20X1

	Rs.'000
Sales revenue (1,200 + (1,000 × 6/12) – 100 (W5))	1,600
Cost of sales (650 + (660 × 6/12) – 100 (W5) + 10 (W5))	(890)
Gross profit	710
Operating expenses (120 + (88 × 6/12) + 20 (W2))	(184)
Debenture interest (12 - 6/12)	(6)
Profit before tax	520
Taxation (100 + 40 × 6/12)	(120)
Profit for the year	400
Profit attributable to:	
Owners of the parent	380
Non-controlling interest (200 × 6/12 × 20%)	20

		400

HEPBURN

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 MARCH 20X1

	Rs.'000	Rs.'000
Assets		
Non-current assets		
Intangible: goodwill (W2)		180
Tangible		
Property (400 + 150 + 125)		675
Plant and equipment (220 + 510)		730
Investments (20 + 10)		30
		1,615
Current assets		
Inventories (240 + 280 − 10 (W5))	510	
Accounts receivable (170 + 210 − 56)	324	
Bank (20 + 40 + 20)	80	
		914
Total assets		2,529
Equity and liabilities		
Equity attributable to owners of the parent		
Equity shares Rs.1 each (400 + 300 (W2))		700
Share premium account (900 – 300 (W2))		600
Retained earnings (W4)		500
		1800
Non-controlling interest (W3)		195
Total equity		1995
Non-current liabilities		
8% debentures		150
Current liabilities		
Accounts payable (170 + 155 – 36)	289	
Taxation (50 + 45)	95	
		384
Total equity and liability		2,529

Workings

1 Group structure

Hepburn

↓ 80% 1.10.X0

Salter

2 Goodwill

	Rs.'000	Rs.'000
Consideration transferred (150 - 80% - 5/2 (= 300) - Rs.3)		900
Fair value of net assets acquired		
Equity shares	150	
Retained earnings:		
At 1 April 20X0 (700 – 200)	500	
Profit to 1 Oct 20X0 (200 - 6/12)	100	
Fair value adjustment	125	
	875	
Group share (80%)		700
Goodwill at cost		200
Closing impaired value from question		180
Impairment loss (balancing figure)		20

Goodwill: alternative working

	Rs.'000
Consideration transferred	900
Non-controlling interest at acquisition (875 x 20%)	175
Net assets at acquisition	(875)
	200
Impairment loss (balancing figure)	(20)
Carrying value	180

3. Non-controlling interest at reporting date

	Rs.'000
Equity shares: 20% - 150	30
Retained earnings: 20% - 700	140
Fair value adjustment of land: 20% - 125	25
	195

4. Retained earnings

	Hepburn	Salter
	Rs.'000	Rs.'000
Per question	450	700
Unrealised profit in inventory	(10)	
Pre-acquisition profit		(600)
		100
Salter 100 x 80%	80	
Goodwill impairment charge (W2)	20	
	500	

5. Unrealized profit

	Rs.'000
Hepburn sales to Salter (remove from revenue and cost of sales)	100
At 25% mark-up, profit = 100 × 25/125 = 20 × 50%	10

(b) In voting rights, Hepburn's interest in Woodbridge is 60%; however it is correct that it is only entitled to 6,000/24,000 = 25% of any dividends paid.

The approach taken by Hepburn to its investment in Woodbridge seems to be based on the view that, with a 25% equity holding, the investment would normally be treated as an associate and equity accounting applied. However, Hepburn does not exert any significant influence over Woodbridge and hence under IAS 28 Investments in associates it can rebut the presumption of associate status.

This overlooks the fact that IAS 27 Consolidated and separate financial statements bases the treatment of an investment in another entity on the notion of control rather than ownership. Hepburn can control Woodbridge by virtue of its holding the majority of the voting rights in the company.

Woodbridge is thus a subsidiary and should be consolidated in full in Hepburn's group accounts, from the date of acquisition.

Hepburn's directors may wish to avoid consolidation because of Woodbridge's losses. But these losses may indicate that the value of the investment in Woodbridge in Hepburn's own individual accounts may be overstated. A test for impairment, as required by IAS 36 Impairment of assets, may reveal that the recoverable amount of the investment has fallen below Rs.20,000, thus requiring a write down in Hepburn's own accounts and a write down of Woodbridge's assets in the consolidated accounts.

A-13
Holdrite

(a) Goodwill

Goodwill in Staybrite

	Rs.'000	Rs.'000
Consideration transferred		
Share exchange: (2/3 - 75% - 10m shares) - Rs.6		30,000
Loan Note: (100/250 - 75% - 10m shares) - Rs.1		3,000
		33,000
Share of the net assets acquired at fair value		
Share Capital	10,000	
Share premium	4,000	
Opening retained earnings	7,500	
Time apportioned profits for the year; Rs.9m ° 6/12	4,500	
Fair value adjustment (W5)	8,000	
Fair value of the net assets at acquisition	34,000	
75% Group share		(25,500)
Goodwill		7,500

The fair value of the share exchange is the market price of the shares issued by the acquirer. The fair value of the loan note is its nominal value.

Goodwill: alternative working

Consideration transferred	33,000
Non-controlling interest at acquisition (34,000 x 25%)	8,500
Net assets at acquisition	(34,000)
Goodwill	7,500

Carrying value of Allbrite

Cost of investment:	
Share exchange: (3/4 - 40% - 5m shares) - Rs.6	9,000
Cash: (Rs.1 - 40% - 5m shares)	2,000
	11,000
Share of post-acquisition profit (4,000 - 6/12 - 40%)	800
	11,800

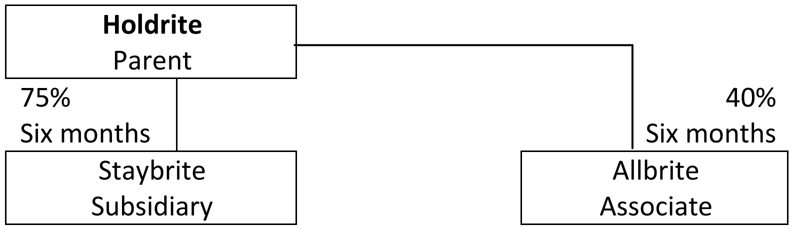
(b) THE HOLDRITE GROUP

CONSOLIDATED INCOME STATEMENT FOR THE YEAR ENDED 30 SEPTEMBER 20X4

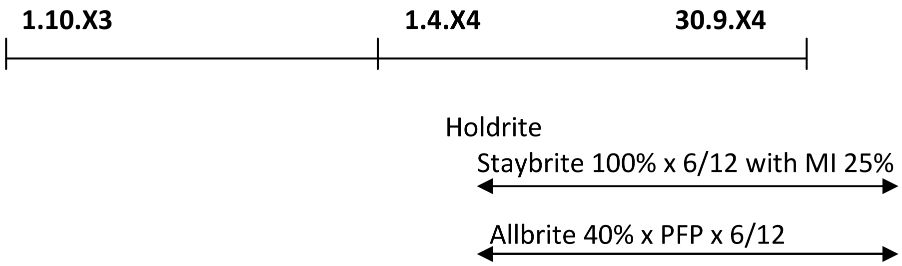
Sales revenue (75,000 + (40,700 × 6/12) – 10,000 (W3))	85,350
Cost of sales (47,400 + (19,700 × 6/12) – 10,000 + 1,000 (W4) + 500 (W5))	(48,750)
Gross profit	36,600
Operating expenses (10,480 + (9,000 × 6/12) + 750 goodwill impairment)	15,730
Finance costs	(170)
Share of profit of associate (4,000 × 6/12 × 40%)	800
Profit before tax	21,500
Income tax expense (4,800 + (6/12 ° 3,000))	(6,300)
Profit for the year	15,200
Profit attributable to:	14,200
Owners of the parent	1,000
Non-controlling interest ((9,000 × 6/12) – 500) × 25%)	15,200

Workings

1 Group Structure as at 30 September 20X4



2 Timeline



3 Intragroup trading

Dr	Revenue	10,000	
Cr	Cost of sales		10,000

4 unrealized profit

Dr	Cost of sales (4,000 × 3)	1,000	
Cr	Inventories		1,000

5 Fair value adjustments

	At consideration 1.4.X4	Movement -	At 30.9.X4
Land (23,000 – 20,000)	3,000	-	3,000
Plant (30,000 – 25,000)	5,000	(500)	4,500
	8,000	(500)	7,500
	↓ Goodwill	↓ I/S and non-controlling interest (I/S)	↓ Non-controlling interest

(c) Movement of consolidated retained earnings

	Rs.'000
Opening (parent only, as there were no subsidiaries or associates)	18,000
Profit for the year attributable to parent company shareholders	14,200
Equity dividends paid	(5,000)

27,200

A-14
Hapsburg

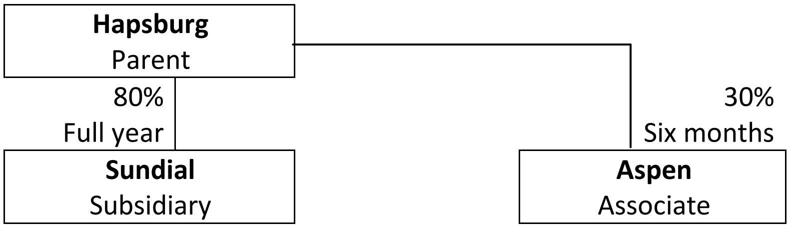
(a) THE HAPSBURG GROUP

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 MARCH 20X4

	Rs.'000
Assets	
Non current assets	
Property, plant and equipment (41,000 + 34,800 + 3,750 (W3)	79,550
Goodwill (W2)	12,800
Investments (at fair value)	4,500
Investment in associate (W6)	15,150
	112,000
Current assets	
Inventories (9,900 + 4,800 + 300 W5)	14,40
Trade and other receivables (13,600 + 8,600)	22,200
Cash and cash equivalents (1,200 + 3,800)	5,000
	41,600
	153,600
Equity and liabilities	
Equity attributable to owners of the parent	
Share capital (Parent only)	36,000
Share premium (Parent only)	24,000
Retained earnings (W8)	8,050
	68,500
Non-controlling interest (W7)	9,150
Total equity	77,200
Non-current liabilities	
Loans	20,200
Deferred consideration (W4)	19,800
	40,000
Current liabilities	
Trade and other payables (16,500 + 6,900)	23,400
Taxation (9,600 + 3,400)	13,000
	36,400
Total equity and liabilities	153,600

Workings

1 Group Structure as at 31 March 20X4



2 Goodwill in Sundial

	Rs.'000	Rs.'000
24m shares – 2/3 - Rs.2 (share exchange)		32,000
24m shares – 0.75(deferred consideration of Rs.1 in 3 years time)		18,000
		50,000
Share of the net assets acquired at fair value		
Net assets at 31 March 20X4	40,500	
Less retained profit for the year	(4,500)	
Fair value increase for the plant (15,000 – 10,000)	5,000	
Fair value increase for the investments (4,500 – 3,000)	1,500	
Fair value of the net assets at acquisition	42,500	
80% Group share		(34,000)
Cost of Goodwill		16,000
Impairment		(3,200)
Carrying value at 31 March 20X4		12,800

Goodwill: alternative working

	Rs.'000
Consideration transferred	50,000
Non-controlling interest at acquisition (42,500 x 20%)	8,500
Net assets at acquisition	(42,500)
	16,000
Impairment	3,200
Carrying value	12,800

A-15
Hedra

HEDRA

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 30 SEPTEMBER 20X5

	Rs.'000	Rs.'000
Assets		
Non current assets		

Property, plant and equipment (W5)		650
Investment in associate (W6)		220
Investment in Salvador: Equity (195 taken to cost of control)		-
Loan Notes (50 inter-company)		-
Investments		45
Goodwill (W3)		90
		1,005
Current assets		
Inventories (130 + 80)	210	
Trade receivables (142 + 97)	239	
Cash at bank	4	453
Total assets		1,458
Equity and liabilities		
Equity attributable to owners of parent		
Share capital (Parent only; 400 + 80 (W6))		480
Share premium (Parent only; 40 + 120 (W6))		160
Revaluation surplus (15 + (5 ° 60%) + 12)		30
Retained earnings (W8)		269
		939
Non-controlling interest (W7)		114
Total equity		1,053
Non current liability		
8% Loan Notes (50 inter-company)	-	
Deferred tax (45 – 10 (tax losses))	35	
		35
Current liabilities		
Trade payables (118 + 141)	259	
Bank overdraft	12	
Current tax payable	50	
Deferred consideration now due (W3)	49	
		370
Total equity and liabilities		1,458

Workings

1 Group Structure

Group Structure as at 30 September 20X5

Hydra
Parent — 40% 1.4.X5 — Aragon Associate

60% 1.10.X4

Salvador
Subsidiary

2 Fair value adjustments

	Acquisition 1.10.X4	Movement	Reporting date 30.9.X5
Land	20	–	20
Plant	20	(5)	15
Deferred tax asset (Rs.40m × 25%)	10	10	10
	50	(5)	45

3 Goodwill in Salvador

Consideration transferred		
		Rs.'000
Cash		195
Deferred consideration		49
		244
Share of the net assets acquired at fair value		
Carrying value of net assets at 1.10. X4:		
Ordinary shares	120	
Share premium	50	
Retained earnings	20	
Fair value adjustments (W2)	50	
Fair value of the net assets at acquisition	240	
60% Group share		(144)
Cost of Goodwill		100
Impairment loss given in question (20 x 60%)		(12)
Carrying value at 30 September 20X5		88
Goodwill attributable to NCI (W4)		2
		90

Goodwill: alternative working

Consideration transferred	244

Non-controlling interest ((240 x 40%) + 10 (goodwill per question))	106
Net assets at acquisition	(240)
	110
Impairment	20
Total goodwill	

Salvador's profits have exceeded the agreed amount and the Rs.49m deferred consideration is now payable. It will be accrued for as a current liability.

The Rs.5m increase in the fair value of Salvador's land post acquisition is treated as a revaluation. This will be shared between the parent (60% = Rs.3m) and the non-controlling interest (40% = Rs.2m)

4 Goodwill attributable to NCI

	Rs.m
Goodwill per question	10
Impairment (20m x 40%)	(8)
	2

5 Non-current assets

	Rs.m	Rs.m
Hedra		358
Revaluation		12
		370
Salvador	240	
Fair valuation increase of land	20	
Revaluation of land	5	
Fair valuation increase of plant	20	
25% Depreciation on fair valuation	(5)	
		280
		650

6 40% Investment in associate

Cost of acquisition	
2 shares in Hedra issued for each of 40m shares acquired in Aragon	
Fair value = 80m shares ° Rs.2.50	200
Hedra's share of post acquisition profits	
40% ° ½ (300 – 200)	20
Carrying value of associate	220

Nominal value and premium on shares issued

Rs.m

Nominal value of shares issued (Rs.1)	80
Share premium (balancing figure)	120
Fair value (Rs.2.50)	200

7 Non-controlling interest in Salvador's net assets

	Rs.m
Salvador's net assets from the question	230
Fair value adjustments (W2)	45
Revaluation of land post acquisition	5
Consolidated value of Salvador's net assets	280
Non-controlling 40% interest	112
Goodwill attributable to NCI (W4)	2
	114

8 Retained earnings attributable to the equity holders of the parent

	Hedra	Salvador	Aragon
	Rs.m	**Rs.m**	**Rs.m**
Per question	240	60	300
Additional depreciation (25% ? Rs.20m)	-	(5)	-
Pre-acquisition profits – Salvador	-	(20)	-
– Aragon (200 + ½ (300 – 200))	-	-	(250)
	240	35	50
Group share of subsidiary (60%)	21		
Group share of associate (40%)	20		
Impairment of goodwill in Salvador (20 × 60%)	(12)		
	269		

A-16
Hosterling

(a) Goodwill in Sunlee

	Rs.'000	Rs.'000
Consideration transferred (16,000 - 5 - 3/5)		48,000
Shares	20,000	
Pre-acquisition reserves	18,000	
Fair value adjustment (W)	12,000	
	50,000	
Group share 80%		(40,000)
Goodwill		8,000

Working

Total fair value adjustment = 4,000 + 3,000 + 5,000 = Rs.12m.

Goodwill: alternative working

	Rs.'000
Consideration transferred	48,000
Non-controlling interest (50m x 20%)	10,000
Net assets at acquisition	(50,000)
	8,000

(b) **Investment in Amber**

	Rs.'000
Cost of investment (6m × Rs.4) (Rs.3 cash + Rs.1 loan note)	24,000
Share of post-acquisition loss (20m × 3/12 × 40%)	(2,000)
Carrying value prior to impairment	22,000

Per note (v) the investment was valued at Rs.21.5m at 30 Sept 20X6. The impairment loss was therefore Rs.500,000.

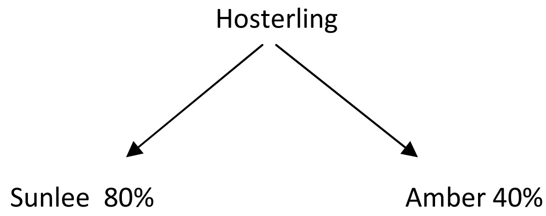
(c) HOSTERLING GROUP

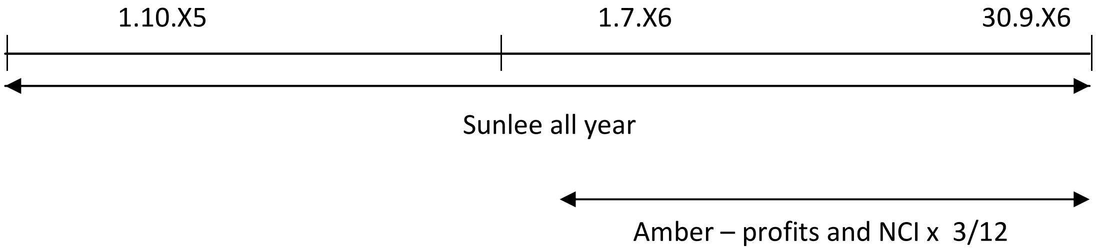
CONSOLIDATED INCOME STATEMENT FOR THE YEAR ENDED 30 SEPTEMBER 20X6

	Rs.'000
Revenue (105,000 + 62,000 – 18,000)	149,000
Cost of sales (W4)	(89,000)
Gross profit	60,000
Distribution costs (4,000 + 2,000)	(6,000)
Administrative expenses (7,500 + 7,000 + 1,600 (note (v))	(16,100)
	37,900
Share of loss of associate (W5)	(2,500)
Finance costs (1,200 + 900)	(2,100)
Profit before tax	33,300
Income tax expense (8,700 + 2,600)	(11,300)
Profit for the year	22,000
Profit attributable to:	
Owners of the parent	19,600
Non-controlling interest ((13,000 – 1,000 (W4)) × 20%)	2,400
	22,000

Workings

1 Group structure





3. Provision for unrealised profit

	Rs.'000
Goods held in inventory by Sunlee	7,500
Unrealised profit at cost plus 25% (7,500 × 25/125)	1,500

4. Cost of sales

	Rs.'000
Hosterling	68,000
Sunlee	36,500
Intra-group	(18,000)
Unrealised profit in inventory (W3)	1,500
Depreciation on fair value adjustment (5,000/5)	1,000
	89,000

5. Share of loss of associate

	Rs.'000
Share of loss after tax (20,000 × 3/12 × 40%)	2,000
Impairment ((b) above)	500
	2,500

A-17
Pumice

(a) The acquisition of an 80% holding in Silverton can be assumed to give Pumice control. Silverton should therefore be treated as a subsidiary from the date of acquisition and its results consolidated from that date. As Silverton is being treated as a subsidiary, the investment in loan notes is effectively an intra-group loan. This should be cancelled on consolidation, leaving the remaining Rs.1m of Silverton's loan notes as a non- current liability in the consolidated statement of financial position.

The shares in Amok represent a 40% holding, which can be presumed to give Pumice 'significant influence', but not control. Amok should therefore be treated as an associate and its results brought into the consolidated financial statements using the equity method.

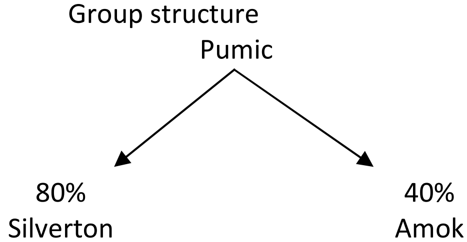
(b) PUMICE GROUP

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AT 31 MARCH 20X6

	Rs.'000
Non-current assets	
Property, plant and equipment (20,000 + 8,500 + 1,800 (W3))	30,300
Goodwill (W4)	4,200
Investment in associate (W6)	11,400
Investments – other (W9)	1,400
	47,300
Current assets (15,000 + 8,000 – 1,000 (W2) – 1,500 (intragroup))	20,500
Total assets	67,800
Equity and liabilities	
Equity attributable to owners of the parent	
Share capital (parent)	10,000
Retained earnings (W8)	37,720
	47,720
Non-controlling interest (W7)	3,080
	50,800
Non-current liabilities	
8% loan note	4,000
10% loan note (2,000 – 1,000 (W8))	1,000
Current liabilities (10,000 + 3,500 – 1,500 (intragroup))	12,000
Total equity and liabilities	67,800

Workings

1 Group structure



2. Unrealized profit

	Rs.'000
Sale of goods to Silverton	6,000

Cost to Pumice		(4,000)
Profit		2,000
50% still in inventory		1,000

DR Retained earnings/CR Inventories

3 Fair value adjustments

	Acquisition date	Movement	Reporting date
	Rs.'000	**Rs.'000**	**Rs.'000**
Land	400	-	400
Plant	1,600	(200)	1,400
	2,000	(200)	1,800

4 Goodwill

	Rs.'000	Rs.'000
Consideration transferred		13,600
Less: fair value of net assets acquired:		
Share capital	3,000	
Pre-acquisition retained earnings (8,000 – 1,000)	7,000	
Fair value adjustments: land	400	
plant	1,600	
	12,000	
Group share 80%		(9,600)
Goodwill		4,000
Impairment to date (400 × 80%)		(320)
Carrying value		3,680
Goodwill attributable to NCI (W5)		520
		4,200

Goodwill: alternative working

	Rs.'000
Consideration transferred	13,600
Non-controlling interest at fair value (per question)	3,000
Net assets at acquisition	(12,000)
	4,600
Impairment	(400)
	4,200

5 Goodwill attributable to NCI

	Rs.'000
NCI at fair value (per question)	3,000
NCI at share of net assets (12m x 20%)	2,400
Goodwill attributable to NCI	600

Impairment (400 × 20%)	(80)
Carrying value	520

6 Associate

	Rs.'000
Cost of investment (Rs.6.25 - 1.6m)	10,000
Share of post-acquisition profit (8,000 (note (iii) - 6/12) - 40%)	1,600
	11,600
Less impairment	(200)
Carrying value	11,400

7 Non-controlling interest

	Rs.'000
Silverton – net assets	11,000
Fair value adjustments (W3)	2,000
Depreciation adjustment (Rs.1.6m/4 - 6/12) (W3)	(200)
	12,800
Non-controlling share 20%	2,560
Goodwill (W5)	520
	3,080

8 Group retained earnings

	Pumic	Silverton	Amok
	Rs.'000	**Rs.'000**	**Rs.'000**
Per statement of financial position	37,000	8,000	20,000
Additional depreciation (W3)		(200)	
Unrealised profit ((6,000 – 4,000) /2)	(1,000)		
Pre-acquisition retained earnings (W4)	-	(7,000)	(16,000)
	36,000	800	4,000
Group share: 800 - 80%	640		
4,000 - 40%	1,600		
	38,240		
Impairment: Silverton	(320)		
Amok	(200)		
	37,720		

* (20,000 – (8,000 - 6/12))

9. Investment

	Rs.'000
Pumice – per statement of financial position	26,000
Investment in Silverton	(13,600)
Investment in Amok	(10,000)
Intra-group loan note	(1,000)

Other investments	1,400

A-18

(a) HORSEFIELD GROUP

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 31 MARCH 20X2

	Rs.'000	**Rs.'000**
Assets		
Non-current assets		
Property, plant and equipment (8,050 + 3,600 + 120 fair valuation)		11,770
Goodwill (W3)		1,170
Waste disposal licence (W2)		120
Investment in associate (W4)		717
Other financial assets (4,000 + 910 – 3,240 Sandfly – 630 Anthill)		1,040
		14,817
Current assets		
Inventory (830 + 340)	1,170	
Trade receivables (520 + 290 – 40 inter-company)	770	
Bank and cash (240 + nil + 40 cash in transit)	280	
		2,220
		17,037
Equity and liabilities		
Equity attributable to owners of the parent		
Share capital (Parent only)		5,000
Retained earnings (W6)		8,883
Shareholders' funds		13,883
Non-controlling interest (W5)		374
		14,257
Non-current liabilities		
10% Loan Notes (500 + 240)		740
Current liabilities		
Trade payables (420 + 960)	1,380	
Bank overdraft (Nil + 190)	190	
Income tax (220 + 250)	470	
		2,040
		17,037

Workings:

1 Group structure as at 31 March 20X2

Horsefield The Parent	30% 1 October 20X1	Anthill The Associate

90%

Recognize as an

1 April 20X0	investment using the equity method	

Sandfly The Subsidiary

Consolidate in full

2 Waste disposal licence

	Rs.'000
Fair value at acquisition	180
Amortisation for a full two years 2/6 × Rs.180,000	(60)
Carrying value of licence 31 March 20X2	120

Top tips. An intangible asset can be recognised if its value can be determined:

(i) By reference to an active market, or

(ii) On a basis that reflects what the entity would have paid for the asset in an arm's length transaction. However, if this basis is used it must not give rise to negative goodwill.

In this question it has been assumed (in the absence of information to the contrary) that the Rs.180,000 valuation meets these criteria.

3 Goodwill in Sandfly, the Subsidiary

	Rs.'000	Rs.'000
Consideration: 90% of 1.2m shares @ Rs.3 each		3,240
Fair value of the net assets acquired		
Share capital	1,200	
Retained earnings at 1 April 20X0	800	
Fair value increase for the investment property	120	
Fair value of the waste disposal licence	180	
Fair value of the net assets at acquisition	2,300	
90% Group share		(2,070)
Cost and carrying value of goodwill		1,170

Goodwill: alternative working

	Rs.'000
Consideration transferred	3,240
Non-controlling interest (2,300 x 10%)	230
Net assets at acquisition	2,300
Carrying value of investment	1,170

	Rs.'000
Cost of investment (180 × Rs.3.5)	630
Share of post-acquisition retained earnings ((600 × 6/12) × 30%)	90
Share of provision for unrealised profit ((65 × 2/3 × 30/130) × 30%)	(3)
Carrying value of investment	717

Top tips. The provision for unrealised profit relates to items sold to and held by the associate. Therefore, the provision reduces the value of these items that in turn reduces the book value of the associate. When the group's retained earnings are calculated the parent will suffer its 30% share of this loss because it was the parent that made the sale and claimed the profit in the first place.

5 Non-controlling interest in Sandfly, the subsidiary

	Rs.'000
Sandfly's equity at 31 March 20X2	3,500
Add fair value increase on the investment property	120
Add carrying value of the fair value of the licence (W2)	120
	3,740
Non-controlling 10% interest	374

6 Retained earnings

	Horsfield	Sandfly	Anthill
	Rs.'000	**Rs.'000**	**Rs.'000**
Per question	7,500	2,300	1,400
Less unrealised profit: 30% × Rs.10,000	(3)		
	7,497		
Additional amortisation on licence (W2)		(60)	
		2,240	
Pre-acquisition per question		(800)	
800 + (600 - 6/12)			(1,100)
		1,440	300
Share of Sandfly: 1,440 × 90%	1,296		
Share of Anthill: 300 × 30%	90		
	8,883		

(b) Associate status

IAS 28 states that an associate is an entity in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor.

The key idea is that the investor has significant influence over the investee company. This is the power to participate in the financial and operating policy decisions of the investee, but not the ability to control them. (Control would make the investee company a subsidiary of the investor.)

Identifying significant influence will obviously be subjective, but the standard cites the following situations as evidence that significant influence exists:

(i) Representation on the board of directors

(ii) Participation in policy making decisions

(iii) Material transactions between the investor and the investee

(iv) Interchange of management personnel

(v) Provision of essential technical information

A typical example would be where the investor is able to nominate a minority of the Board of Directors. These directors would participate in Board Level discussions on the company's operating and financial policies, and so it would be able to influence the Board's decisions. However, because the investor's nominees would form a minority on the Board they would not be able to control the outcome of any vote. IAS 28 contains a rebuttable presumption that deems an investment to be an associate if the investor's equity shareholding is between 20% and 50%.

A-19

(a) HANFORD GROUP

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 30 SEPTEMBER 20X1

	Rs.'000	Rs.'000
Assets		
Non current assets		
Goodwill (W4)		5,355
Property, plant and equipment		
(78,540 + 27,180 + 4,000) (W3) – 360 (W2)		109,360
		114,715
Current assets		
Inventory (7,450 + 4,310)	11,760	
Accounts receivable (12,960 + 4,330 – 820 (W7))	16,470	
Insurance claim (W3)	800	
Bank (520 + 300 dividend)	820	
Total assets		29,850
		144,565
Equity and liabilities		
Equity attributable to owners of the parent		
Ordinary shares of Rs.1 each (W9)		30,000
Share premium (W9)		20,000
Retained earnings (W8)		66,805
		116,805
Non-controlling interest (W5)		7,350
Total equity		124,155
Non-current liabilities		
8% loan notes 20X4		6,000
Current liabilities		
Trade accounts payable (5,920 + 4,160 – 620 (W7))	9,460	
Bank overdraft	1,700	

Provision for taxation (1,870 + 1,380)	3,250	
		14,410
		144,565

Working

1 Group structure

Hanford

$\frac{6,000}{8,000}$ - 75%

Stopple

Note. Stopple was acquired half way through the year, so the retained profit will need to be time apportioned.

2 Unrealised profit

	Rs.'000
Profit on sale of plant to Stopple (2.4m – 2m)	400
Less corresponding depreciation (240 – 200 (note b))	(40)
	360

3 Fair value adjustment

	Rs.'000
Land (per question)	4,000
Insurance claim	800
	4,800

Following IAS 37 Provisions, contingent liabilities and contingent assets, the contingent asset would not be recognised in the individual financial statements of Stopple. However, at the date of acquisition the receipt of the claim is 'highly likely' and so IFRS 3 requires the asset to be recognised for consolidation purposes.

4 Goodwill

	Rs.'000	**Rs.'000**
Consideration transferred		25,000
Less pre-acquisition dividend (W6)		150
		25,150
Net assets acquired		
Share capital	8,000	
Share premium	2,000	

Retained earnings (6,000 + (8,800 × 6/12)	10,400	
Fair value adjustment (W3)	4,800	
	25,200	
Group share: 75%		18,900
Goodwill		5,950
Goodwill impairment		(595)
		5,355

Goodwill: alternative working

Consideration transferred	24,850
Non-controlling interest at acquisition (25,200 x 25%)	6,300
Net assets at acquisition	(25,200)
	5,950
Impairment	(595)
	5,355

5 Non-controlling interest

	Rs.'000	Rs.'000
Share capital		8,000
Share premium		2,000
Retained earnings per question: Rs.6m + Rs.8.8m	14,800	
Less central admin costs	(200)	
		14,600
Fair value adjustment		4800
		29,400

Non-controlling interest: 25% × Rs.29,400,000 =
Rs.7,350,000

6 Pre-acquisition dividend
Total dividend: Rs.400,000
Group share (post acquisition): Rs.400,000 × 6/12 × 75% = Rs.150,000
∴ Pre-acquisition group share of dividend = Rs.150,000

7 Elimination of current accounts

	Dr Rs.'000	Cr Rs.'000
Intragroup charge	200	
Accounts payable	620	
Accounts receivable		820

8 Retained earnings

	Handord	Stopple
	Rs.'000	**Rs.'000**
Per question	64,460	14,800
Central admin costs		(200)
		14,600
Less pre-acquisition (6,000 + 4,400)		(10,400)
		4,200
Unrealised profit on plant sold (W2)	(360)	
Dividend from Stopple (W6)	150	
Goodwill impairment losses	(595)	
Stopple: 4,200 × 75%	3,150	
	66,805	

9 Ordinary shares

No of shares Hanford acquired in Stopple = 6m

∴ No. of shares issued =6m – 5 / 3 = 10m

	Rs.m
Proceeds of issue:	
Total consideration	25
Cash consideration	(5)
∴Proceeds for shares	20

∴ Share capital and share premium both increase by Rs.10m.

(b) There are a number of reasons why a subsidiary may prefer not to consolidate a subsidiary. Most of these arise where the subsidiary is performing badly and incorporation of its results would reflect badly on the group. Such circumstances include the following.

(i) The subsidiary has a poor liquidity position.

(ii) The subsidiary is highly geared. If a subsidiary which carries a large amount of debt can be excluded, then the gearing of the group as a whole will be improved.

(iii) The subsidiary may simply be unprofitable. Substantial operating losses might leave the parent company wishing to exclude the subsidiary's results from consolidation.

Clearly, then, excluding subsidiaries from consolidation is a possible way to manipulate an entity's results. In the revision of December 2003, IAS 27 Consolidated and separate financial statements only allowed exclusion if control was intended to be temporary. There had to be evidence that the subsidiary was acquired with the intention to dispose of it within twelve months and the management must be actively seeking a buyer. However, IFRS 5, issued in March 2004, has changed the accounting treatment again. IFRS 5 treats such subsidiaries as held for sale and they are consolidated.

Before the 2003 revision, exclusion was allowed if the subsidiary was operating under severe long term restrictions. This exclusion is no longer allowed. Control must be lost before exclusion is allowed.

Many years ago exclusion was allowed on the basis of dissimilar activities, the argument being that the activities of the subsidiary are so different to the activities of the other companies within the group that to include its results in the consolidation would be misleading. However, IAS 27 states that exclusion on these grounds is not justified; instead, their results should be consolidated and the 'dissimilar activity' problem resolved by giving segment information.

A-20

(a) PLATEAU

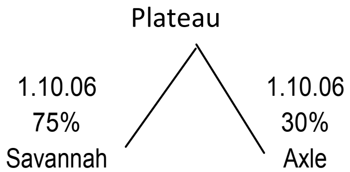
CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 30 SEPTEMBER 2007

	Rs.'000
Non-current assets	
Property, plant and equipment	
(18,400 + 10,400 – (W2) 400)	28,400
Goodwill (W6)	5,000
Intangible asset - customer contract	1,000
Investment in associate (W8)	10,500
Available-for-sale investment (note v to question)	9,000
	53,900
Current assets	
Inventories (6,900 + 6,200 – (W2) 300)	12,800
Trade receivables (3,200 + 1,500)	4,700
	17,500
Total assets	71,400
Equity and liabilities	
Equity attributable to owners of the parent	
Share capital (10,000 + (W5) 1,500)	11,500
Share premium (W5)	7,500
Retained earnings (W10)	30,300
	49,300
Non-controlling interest (W9)	3,900
	53,200
Non-current liabilities	
7% loan notes (5,000 + 1,000)	6,000
Current liabilities (8,000 + 4,200)	12,200

Total equity and liabilities	71,400

Workings

1 Group structure



2 Intragroup trading

Unrealised profit on sale of inventories:

Rs.2.7m - 50/150 - 1/3	Rs.0.3m

DR Cost of sales/CR Inventories in books of Savannah (affects NCI) Unrealised profit on transfer of plant:

	Rs.
Unrealised profit (Rs.2.5m – Rs.2m)	0.5m
Less realised by use (depreciation) 1/5	(0.1)m
	0.4m

DEBIT Retained earnings/CREDIT Property, plant and equipment in books of Plateau

3 Fair value adjustment – land

Acquisition date		End of reporting period
1.10.06	Movement	30.9.07
(500)	500	–

4 Available-for-sale investments

	Rs.'000
Fair value at 1 October 2006	6,500
Fair value at 30 September 2007	9,000
Increase in fair value	2,500

DEBIT Available-for-sale investments/CREDIT Retained earnings

5 Purchase of Savannah

DEBIT Cost of Savannah (3m/2 × Rs.6) + (3m - Rs.1.25)	12.75m	
CREDIT Share capital (3m/2 × Rs.1)		1.5m
CREDIT Share premium (3m/2 × Rs.5)		7.5m
CREDIT Cash		3.75m

6 Goodwill – Savannah

	Rs.'000	Rs.'000
Consideration transferred (W5)		12,750
Less: net fair value of assets and liabilities acquired:		
Share capital	4,000	
Retained earnings	6,000	
Customer based contract	1,000	
	11,000	
Group share 75%		(8,250)
		4,500
Goodwill attributable to NCI (W7)		500
		5,000

Goodwill: alternative working

	Rs.'000
Consideration transferred	12,750
Non-controlling at acquisition (1,000 shares @ Rs.3,25)	3,250
Net assets at acquisition	(11,000)
	5,000

7 Goodwill attributable to NCI

	Rs.'000
NCI at fair value (W6)	3,250
NCI at share of net assets (11,000 x 25%)	(2,750)
Goodwill attributable to NCI	500

8 Investment in Axle

	Rs.'000
Cost : (4,000 - 30% - Rs.7.50)	9,000
Share of post-acquisition retained earnings (5,000 – 30%)	1,500
	10,500

9 Non-controlling interest – Savannah

	Rs.'000
Net assets per question	12,900
Intangible asset – customer contract	1,000
Unrealised profit (W2)	(300)
	13,600
Non-controlling share 25%	3,400
Goodwill (W7)	500
	3,900

10 Group retained earnings

	Plateau	Savannah	Axle
	Rs.'000	Rs.'000	Rs.'000
Per statement of financial position	25,250	2,900	5,000
Unrealised profit (W2)	(400)	(300)	-
	24,850	2,600	5,000
Group share: 2,600 x 75%	1,950		
5,000 x 30%	1,500		

Gain on available-for-sale investment	
(9,000 – 6,500)	2,500
Professional costs of acquisition	(500)
Group retained earnings	30,300

(b) IFRS 3 requires the consideration for a business combination to be allocated to the fair values of the assets, liabilities and contingent liabilities acquired.

Although this is usually not the same as the original cost of the asset when acquired by the subsidiary, it is taken to be the cost of the asset to the group. If assets are not valued at fair value, this leads to an incorrect goodwill valuation and incorrect depreciation and goodwill impairment charges in subsequent years.

The financial assistant is confusing two different issues. The assets of the subsidiary are assumed to be acquired at their fair value at the date of acquisition by the parent. After acquisition they will be carried at depreciated amount, rather than subjected to regular revaluations. So they will be treated in the same way as other assets owned by the parent. The parent may decide to revalue all the assets of a class, including those acquired as part of a business combination, in which case they would all be carried at revalued amount.

A-21

(a) Pedantic

Consolidated income statement for the year ended 30 September 2008

	Rs.'000
Revenue (85,000 + (42,000 x 6/12) – 8,000 intra-group sales)	98,000
Cost of sales (w (i))	(72,000)
Gross profit	26,000
Distribution costs (2,000 + (2,000 x 6/12))	(3,000)
Administrative expenses (6,000 + (3,200 x 6/12))	(7,600)
Finance costs (300 + (400 x 6/12))	(500)
Profit before tax	14,900
Income tax expense (4,700 + (1,400 x 6/12))	(5,400)
Profit for the year	9,500
Attributable to:	
Equity holders of the parent	9,300
Non-controlling interest (((3,000 x 6/12) – (800 URP + 200 depreciation)) x 40%)	200

(b) Consolidated statement of financial position as at 30 September 2008

	Rs.'000
Assets	
Non-current assets	
Property, plant and equipment (40,600 + 12,600 + 2,000 – 200 depreciation adjustment (w (i)))	55,000
Goodwill (w (ii))	4,500
	59,500
Current assets (w (iii))	21,400
Total assets	80,900

Equity and liabilities	
Equity attributable to owners of the parent	
Equity shares of Rs.1 each ((10, 000 + 1,600) w (ii))	11,600
Share premium (w (ii))	8000
Retained earnings (w (iv))	35,700
	55,300
Non-controlling interest (w (v))	6,100
Total equity	61,400
Non-current liabilities	
10% loan notes (4,000 + 3,000)	7,000
Current liabilities (8,200 + 4,700 – 400 intra-group balance)	12,500
Total equity and liabilities	80,900

Workings (figures in brackets in **Rs.'000**)

(i) Cost of sales

	Rs.'000
Pedantic	63,000
Sophistic (32,000 x 6/12)	16,000
Intra-group sales	(8,000)
URP in inventory	800
Additional depreciation (2,000/5 years x 6/12)	200
	72,000

(ii) Goodwill in Sophistic

	Rs.'000	**Rs.'000**
Investment at cost		
Shares (4,000 x 60% x 2/3 x Rs.6)		9600
Less - Equity shares of Sophistic (4,000 x 60%)	(2400)	
- pre-acquisition reserves (5,000 x 60% see below)	(3000)	
- fair value adjustment (2,000 x 60%)	(1200)	6,600
Parent's goodwill		3,000
Non-controlling interest's goodwill (per question)		1,500
Total goodwill		4,500

The pre-acquisition reserves are:

At 30 September 2008	6,500
Earned in the post acquisition period (3,000 x 6/12)	(1500)
	5,000

Alternative calculation for goodwill in Sophistic

Investment at cost (as above)	9,600
Fair value of non-controlling interest (see below)	5,900
Cost of the controlling interest	15,500
Less fair value of net assets at acquisition (4,000 + 5,000 + 2,000)	(11,000)
Total goodwill	4,500

Fair value of non-controlling interest (at acquisition)		
Share of fair value of net assets (11,000 x 40%)		4,400
Attributable goodwill per question		1,500
		5,900

The 1·6 million shares (4,000 x 60% x 2/3) issued by Pedantic would be recorded as share capital of Rs.1·6 million and share premium of Rs.8 million (1,600 x Rs.5).

(iii) Current assets

	Rs.'000	**Rs.'000**
Pedantic	16000	
Sophistic	6,600	
URP in inventory	(800)	
Cash in transit	200	
Intra-group balance	(600)	
	21,400	

(iv) Retained earnings

Retained earnings		
Pedantic per statement of financial position	35,400	
Sophistic's post acquisition profit		
(((3,000 x 6/12) – (800 URP + 200 depreciation)) x 60%)	300	
	35,700	

(v) Non-controlling interest (in statement of financial position)

Net assets per statement of financial position	10,500	
URP in inventory		
(800) Net fair value adjustment (2,000 – 200)	1800	
	11,500	x 40% =
	4600	
Share of goodwill (per question)		1,500
		6,100

A-22

Answer

Consolidated statement of financial position of Pacemaker as at 31 March 2009:

	Rs.'million	**Rs.'million**
Non-current assets		
Tangible		
Property, plant and equipment (w (i))		818
Intangible		
Goodwill (w (ii))		23
Brand (25 – 5 (25/10 x 2 years post acq amortisation))		20
Investments		
Investment in associate (w (iii))		144
Other available-for-sale investments (82 + 37)		119
		1,124

Current assets

Inventory (142 + 160 – 16 URP (w (iv)))	286	
Trade receivables (95 + 88)	183	
Cash and bank (8 + 22)	30	499
Total assets		1,623
Equity and liabilities		
Equity attributable to the parent		
Equity shares (500 + 75 (w (iii)))		575
Share premium (100 + 45 (w (iii))	145	
Retained earnings (w (iv))	247	392
		967
Non-controlling interest (w (v))		91
Total equity		1,058
Non-current liabilities		
10% loan notes (180 + 20)		200
Current liabilities (200 + 165)		365
Total equity and liabilities		1,623

Workings (all figures in **Rs.'million**)
The investment in Syclop represents 80% (116/145) of its equity and is likely to give Pacemaker control thus Syclop should be consolidated as a subsidiary. The investment in Vardine represents 30% (30/100) of its equity and is normally treated as an associate that should be equity accounted.

(i)	Property, plant and equipment			
	Pacemaker			520
	Syclop			280
	Fair value property (82 – 62)			20
	Post-acquisition depreciation (2 years) (20 x 2/20 years)			(2)
				818
(ii)	Goodwill in Syclop:			
	Investment at cost	- cash		210
		- loan note (116/200 x Rs.100)		58
	Cost of the controlling interest			268
	Fair value of non-controlling interest (from question)			65
	Equity shares		145	
	Pre-acquisition profit		120	
	Fair value adjustments	- property (w (i))	20	
		- brand	25	
	Fair value of net assets at acquisition			(310)
	Goodwill			23

(iii)	Investment in associate	
		Rs.'million
	Investment at cost (75 x Rs.1·60)	120
	Share of post-acquisition profit (100 – 20) x 30%	24
		144

The purchase consideration by way of a share exchange (75 million shares in Pacemaker for 30 million shares in Vardine) would be recorded as an increase in share capital of Rs.75 million (Rs.1 nominal value) and an increase in share premium of Rs.45 million (75 million x Rs.0·60).

(iv) Consolidated retained earnings:

Pacemaker's retained earnings	130
Syclop's post-acquisition profits (130 x 80% see below)	104
Gain on investments – Pacemaker (see below)	5
Vardine's post-acquisition profits (w (iii))	24
URP in Inventories (56 x 40/140)	(16)
	247
Syclop's retained earnings:	
Post-acquisition (260 – 120)	140
Additional depreciation/amortisation (2 + 5)	(7)
Loss on available-for-sale investments (40 – 37)	(3)
Adjusted post-acquisition profits	130
Gain on the value of Pacemaker's available-for-sale investments:	77
Carrying amount at 31 March 2008 (345 – 210 cash – 58 loan note)	82
Carrying amount at 31 March 2009	5

(v) Non-controlling interest

Fair value on acquisition (from question)	65
Share of adjusted post acquisition profit (130 x 20% (w (iv)))	26
	91

A-23

(a)

(i) Goodwill in Salva at 1 April

	Rs.'000	Rs.'000
Controlling interest		
Shares issued (120 million x 80% x 3/5 x Rs.6)		345,600
Non-controlling interest (120 million x 20% x Rs.3·20)		76,800
Equity shares	120,000	
Pre-acquisition reserves:		
At 1 October 2008	152,000	
To date of acquisition (see below)	11,000	
Fair value adjustments (5,000 + 20,000)	25,000	308,500
Goodwill arising on acquisition		113,900

The interest on the 8% loan note is Rs.2 million (Rs.50 million x 8% x 6/12). This is included in Salva's income statement in the post-acquisition period. Thus Salva's profit for the year of Rs.21 million has a split of Rs.11·5 million pre-acquisition ((21 million + 2 million interest) x 6/12) and

Rs.9·5 million post-acquisition.

(ii) Carrying amount of investment in Ambra at 30 September 2009

	Rs.'000
Cost (40 million x 40% x Rs.2)	32,000
Share of post-acquisition losses (5,000 x 40% x 6/12)	(1,000)
Impairment charge	(3,000)
	28,000

(b) Pandar Group

	Rs.'000	Rs.'000
Consolidated income statement for the year ended 30 September 2009		
Revenue (210,000 + (150,000 x 6/12) – 15,000 intra-group sales)		27,0000
Cost of sales (w (i))		(162,500)
Gross profit		107,500
Distribution costs (11,200 + (7,000 x 6/12))		(14,700)
Administrative expenses (18,300 + (9,000 x 6/12))		(22,800)
Investment income (w (ii))		1,100
Finance costs (w (iii))		(2,300)
Share of loss from associate (5,000 x 40% x 6/12)	(1,000)	
Impairment of investment in associate	(3,000)	(4,000)
Profit before tax		64,800
Income tax expense (15,000 + (10,000 x 6/12))		(20,000)
Profit for the year		44,800
Owners of the parent		43,000
Non-controlling interest (w (iv))		1,800
		44,800

Workings (figures in brackets in **Rs.'000**)

		Rs.'000
(i)	Cost of sales	
	Pandar	126,000
	Salva (100,000 x 6/12)	50,000
	Intra-group purchases	(15,000)
	Additional depreciation: plant (5,000/5 years x 6/12)	500
	Unrealised profit in inventories (15,000/3 x 20%)	1000
		162,500

As the registration of the domain name is renewable indefinitely (at only a nominal cost) it will not be amortised.

(ii)	Investment income	
	Per income statement	9,500
	Intra-group interest (50,000 x 8% x 6/12)	2,000
	Intra-group dividend (8,000 x 80%)	6,400
		1,100

		Rs.'000	Rs.'000
(iii)	Finance costs		
	Pandar	1,800	
	Salva post-acquisition ((3,000 – 2,000) x 6/12 + 2,000)	2,500	
	Intra-group interest (w (ii))	(2,000)	

		2,300	
(iv)	Non-controlling interest		
	Salva's post-acquisition profit (see (i) above)	9,500	
	Less: post-acquisition additional depreciation (w (i))	(500)	
		9,000	
		X 20%	= 1,800

A-24

1 (a)

	Rs.'000	Rs.'000
Assets		
Non-current assets		
Property, plant and equipment (37,500 + 24,500 + 2,000 – 100)		63,900
Goodwill (16,000 – 3,800 (w (i)))		12,200
Investment in associate (w (ii))		13,200
Current assets		
Inventory (10,000 + 9,000 + 1,800 GIT – 600 URP (w (iii)))	20,200	
Trade receivables (6,500 + 1,500 – 3,400 intra-group (w (iii)))	4,600	24,800
Total assets		114,100
Equity and liabilities		
Equity attributable to owners of the parent		
Equity Shares of Rs.1 each		25,000
Share premium	19,800	
Retained earnings (w (iv))	27,500	47,300
		72,300
Non-controlling interest (w (v))		8,400
Total equity		80,700
Non-current liabilities		
7% loan notes (14,500 + 2,000)		16,500
Current liabilities		
Contingent consideration	27,000	
Other current liabilities (8,300 + 7,500 – 1,600 intra-group (w (iii)))	14,200	16,900
Total equity and liabilities		114,100

Workings (figures in brackets are in **Rs.'000**)

(i) Goodwill in Sander

	Rs.'000	Rs.'000
Controlling interest		
Share exchange (8,000 x 75% x 3/2 x Rs.3·20)		28,800
Contingent consideration		4,200
Non-controlling interest (8,000 x 25% x Rs.4·50)		9,000
		42,000

Equity shares		8000	
Pre-acquisition reserves:			
At 1 April 2009		16,500	
Fair value adjustments	– factory	2,000	
	– software (see below)	(500)	(26,000)
Goodwill arising on acquisition			16,000

Goodwill is impaired by Rs.3·8 million and therefore has a carrying amount at 31 March 2010 of Rs.12·2 million. The goodwill impairment is charged against Sander's retained earnings (see working (iv)), thus ensuring it is allocated between the controlling and non-controlling interests in proportion to their share ownership in Sander.

The effect of the software having no recoverable amount is that its write-off in the post-acquisition period should be treated as a fair value adjustment at the date of acquisition for consolidation purposes. The consequent effect is that this will increase the post-acquisition profit for consolidation purposes by Rs.500,000.

(ii) Carrying amount of Adler at 31 March 2010

	Rs.'000
Cash consideration (5	8,000
7% loan notes (5	4,000
Share of post-acquisition profits (6	1,200
	13,200

(iii) Goods in transit and unrealised profit (URP)

The intra-group current accounts differ by the goods-in-transit sales of Rs.1·8 million on which Picant made a profit of Rs.600,000 (1,800 x 50/150). Thus inventory must be increased by Rs.1·2 million (its cost), Rs.600,000 is eliminated from Picant's profit, Rs.3·4 million is deducted from trade receivables and Rs.1·6 million (3,400 – 1,800) is deducted from trade payables (other current liabilities).

(iv) Consolidated retained earnings

	Rs.'000
Picant's retained earnings	27,200
Sander's post-acquisition losses (2,400 x 75% see below)	(1,800)
Gain from reduction of contingent consideration (4,200 – 2,700 see below)	1,500
URP in inventory (w (iii))	(600)
Adler's post-acquisition profits (6,000 x 6/12 x 40%)	1,200
	275,00

The adjustment to the provision for contingent consideration due to events occurring after the acquisition is reported in income (goodwill is not recalculated).

Post-acquisition adjusted losses of Sander are:

	Rs.'000
Profit as reported	1,000
Add back write off software (treated as a pre-acquisition fair value adjustment)	500

Additional depreciation on factory	(100)
Goodwill written off (w (i))	(3,800)
	(2,400)

(v) Non-controlling interest

	Rs.'000
Fair value on acquisition (w (i))	9000
Post-acquisition losses (2,400 x 25% (w (iv)))	(600)
	8400

(b) Although the concept behind the preparation of consolidated financial statements is to treat all the members of the group as if they were a single economic entity, it must be understood that the legal position is that each member is a separate legal entity and therefore the group itself does not exist as a separate legal entity. This focuses on a criticism of group financial statements in that they aggregate the assets and liabilities of all the members of the group. This can give the impression that all of the group's assets would be available to discharge all of the group's liabilities. This is not the case.

Applying this to the situation in the question, it would mean that any liability of Trilby to Picant would not be a liability of any other member of the Tradhat group. Thus the fact that the consolidated statement of fi nancial position of Tradhat shows a strong position with healthy liquidity is not necessarily of any reassurance to Picant. Any decision on granting credit to Trilby must be based on Trilby's own (entity) financial statements (which Picant should obtain), not the group financial statements. The other possibility, which would take advantage of the strength of the group's statement of financial position, is that Picant could ask Tradhat if it would act as a guarantor to Trilby's (potential) liability to Picant. In this case Tradhat would be liable for the debt to Picant in the event of a default by Trilby.

A-25

Answer

(a)

Premier

Consolidated statement of comprehensive income for the year ended 30 September 2010

	Rs.'000
Revenue (92,500 + (45,000 x 4/12) – 4,000 intra-group sales)	103,500
Cost of sales (w (i))	(78,850)
Gross profit	24,650
Distribution costs (2,500 + (1,200 x 4/12))	2,900
Administrative expenses (5,500 + (2,400 x 4/12))	6,300
Finance costs	100
Profit before tax	15,350
Income tax expense (3,900 + (1,500 x 4/12))	(4,400)
Profit for the year	10,950
Other comprehensive income:	
Gain on available-for-sale investments	300
Gain on revaluation of property	500

Total other comprehensive income for the year	800
Total comprehensive income	11,750
Profit for year attributable to:	
Equity holders of the parent	10,760
Non-controlling interest ((1,300 see below – 400 URP + 50 reduced depreciation) x 20%)	190
	10,950
Total comprehensive income attributable to:	
Equity holders of the parent (10,760 + 300 + 500)	11,560
Non-controlling interest	190
	11,750

Sanford's profits for the year ended 30 September 2010 of Rs.3·9 million are Rs.2·6 million (3,900 x 8/12) pre-acquisition and Rs.1·3 million (3,900 x 4/12) post-acquisition.

(b) Consolidated statement of financial position as at 30 September 2010.

	Rs.'000
Assets	
Non-current assets	
Property, plant and equipment (w (ii))	38,250
Goodwill (w (iii))	9,300
Available-for-sale investments (1,800 – 800 consideration + 300 gain)	1,300
	48,850
Current assets (w (iv))	14,150
Total assets	63,000
Equity and liabilities	
Equity attributable to owners of the parent	
Equity shares of Rs.1 each ((12,000 + 2,400) w (iii))	14,400
Share premium (w (iii))	9,600
Land revaluation reserve	2,000
Other equity reserve (500 + 300)	800
Retained earnings (w (v))	13,060
	39,860
Non-controlling interest (w (vi))	3690
Total equity	43,550
Non-current liabilities	
6% loan notes	3,000
Current liabilities (10,000 + 6,800 – 350 intra group balance)	16,450
Total equity and liabilities	63,000

Workings in Rs. 000

		Rs.'000
(i)	Cost of sales	
	Premier	70,500

Sanford (36,000 x 4/12)	12,000
Intra-group purchases	(4,000)
URP in inventory	400
Reduction of depreciation charge	(50)
	78,850

The unrealised profit (URP) in inventory is calculated as Rs.2 million x 25/125 =

(ii) Non-current assets

Premier	25,500
Sanford	13,900
Fair value reduction at acquisition	(1,200)
Reduced depreciation	50
	38,250

(iii) Goodwill in Sanford

Investment at cost		
Shares (5,000 x 80% x 3/5 x Rs.5)		12,000
6% loan notes (5,000 x 80% x 100/500)		800
Non-controlling interest (5,000 x 20% x Rs.3·50)		3,500
		16,300
Net assets (equity) of Sanford at 30 September 2010	9,500	
Less: post-acquisition profits (see above)	1,300	
Less: fair value adjustment for property	1,200	
Net assets at date of acquisition		7,000
Goodwill		9,300

The 2·4 million shares (5,000 x 80% x 3/5) issued by Premier at Rs.5 each would be recorded as share capital of Rs.2·4 million and share premium of Rs.9·6 million.

(iv) Current assets

Premier	12,500
Sanford	2,400
URP in inventory	(400)
Intra-group balance	(350)
	14,150

(v) Retained earnings

Premier	12,300
Sanford's post-acquisition adjusted profit ((1,300 – 400 URP + 50 reduced depreciation) x 80%)	760
	13,060

(vi) Non-controlling interest in statement of financial position

At date of acquisition	3,500
Post-acquisition profit from income statement	190
	3,690

A-26

Answer

(a)

(i) Prodigal – Consolidated statement of comprehensive income for the year ended 31 March 2011

	Rs.'000
Revenue (450,000 + (240,000 x 6/12) – 40,000 intra-group sales)	530,000
Cost of sales (w (i))	(278,800)
Gross profit	251,200
Distribution costs (23,600 + (12,000 x 6/12))	(29,600)
Administrative expenses (27,000 + (23,000 x 6/12))	(38,500)
Finance costs (1,500 + (1,200 x 6/12))	(2,100)
Profit before tax	181,000
Income tax expense (48,000 + (27,800 x 6/12))	(61,900)
Profit for the year	119,100
Other comprehensive income	
Gain on revaluation of land (2,500 + 1,000)	3,500
Loss on fair value of equity financial asset investments (700 + (400 x 6/12))	(900)
	2,600
Total comprehensive income	121,700
Profit attributable to:	
Owners of the parent	111,600
Non-controlling interest (w (ii))	7,500
	119,100
Profit attributable to:	
Owners of the parent	114,000
Non-controlling interest (w (ii))	7,700
	121,700

(ii) Prodigal – Equity section of the consolidated statement of financial position as at 31 March 2011

	Rs.'000
Equity attributable to owners of the parent	
Share capital (250,000 + 80,000) see below	330,000
Share premium (100,000 + 240,000) see below	340,000
Revaluation reserve (land) (8,400 + 2,500 + (1,000 x 75%))	11,650
Other equity reserve (3,200 – 700 – (400 x 6/12 x 75%))	2,350
Retained earnings (w (iii))	201,600
	885,600
Non-controlling interest (w (iv))	107,700
Total equity	993,300

The share exchange would result in Prodigal issuing 80 million shares (160,000 x 75% x 2/3) at a value of Rs.4 each (capital 80,000; premium 240,000).

(b) IFRS 3 allows (as an option) a non-controlling interest to be valued at its proportionate share of the acquired subsidiary's identifiable net assets; this carries forward the only allowed method in the previous version of this Standard. Its effect on the statement of financial position is that the resulting carrying value of purchased goodwill only relates to the parent's element of such goodwill and as a consequence the non-controlling interest does not reflect its share of the subsidiary's goodwill. Some commentators feel this is an anomaly as the principle of a consolidated statement of financial position is that it should disclose the whole of the subsidiary's assets that are under the control of the parent (not just the parent's share). This principle is applied to all of a subsidiary's other identifiable assets, so why not goodwill?

Any impairment of goodwill under this method would only be charged against the parent's interest, as the non-controlling interest's share of goodwill is not included in the consolidated financial statements.

The second (new) method of valuing the non-controlling interest at its fair value would (normally) increase the value of the goodwill calculated on acquisition. This increase reflects the non-controlling interest's ownership of the subsidiary's goodwill and has the effect of 'grossing up' the goodwill and the non-controlling interests in the statement of financial position (by the same amount). It is argued that this method reflects the whole of the subsidiary's goodwill/premium on acquisition and is thus consistent with the principles of consolidation.

Under this method any impairment of the subsidiary's goodwill is charged to both the controlling (parent's share) and non-controlling interests in proportion to their holding of shares in the subsidiary.

Workings (figures in brackets in **Rs.'000**)

		Rs.'000	**Rs.'000**
(i)	Cost of sales		
	Prodigal	260,000	
	Sentinel (110,000 x 6/12)	55,000	
	Intra-group purchases	(40,000)	
	Unrealised profit on sale of plant	1,000	
	Depreciation adjustment on sale of plant (1,000/2½ years x 6/12)		
	(200) Unrealised profit in inventory (12,000 x 10,000/40,000)	3,000	
		278,800	
(ii)	Non controlling interest in income statement profit:		
	Sentinel's post-acquisition profit (66,000 x 6/12)	33,000	
	Less: Unrealised profit in inventory (w (i))	(3,000)	
		30,000	
		x 25%	=7,500
	Non controlling interest in total comprehensive income		
	As above	7,500	
	Other comprehensive income (1,000 – (400 x 6/12) x 25%)	200	
		7,700	
(iii)	Retained earnings		
	Prodigal at 1 April 2010	90,000	

	Per statement of comprehensive income	111,600
		201,600
(iv)	Non-controlling interest in statement of financial position	
	At acquisition	100,000
	Per statement of comprehensive income	7,700
		107,700

A-27

Answer

Consolidated statement of financial position of Paladin as at 30 September 2011

	$'000	$'000
Assets		
Non-current assets:		
Property, plant and equipment (40,000 + 31,000 + 4,000 - 1,000)		74,000
Intangible assets (w (i))		
- goodwill		15,000
- other intangibles (7,500 + 3,000 - 500)		10,000
Investment in associate (w (ii))		7,700
		106,700
Current assets		
Inventory (11,200 + 8,400 -600 URP (w (iii)))	19,000	
Trade receivables (7,400 + 5,300 - 1,300 intra-group (w (iii)))	11,400	
Bank	3,400	33,800
Total assets		140,500
Equity and liabilities		
Equity attributable to owners of the parent		
Equity shares of $1 each		50,000
Retained earnings (w (iv))		35,200
		85,200
Non-controlling interest (w (vi))		7,900
Total equity		93,100
Non-current liabilities		
Deferred tax (15,000 + 8,000)		23,000
Current liabilities		
Bank overdraft	2,500	
Deferred consideration	5,400	
Trade payables (11,600 + 6,200 - 1,300 intra-group (w (iii)))	16,500	24,400
Total equity and liabilities		140,500

Workings (figures in brackets are in $'000)

(i) Goodwill in Saracen

	$'000	$'000
Controlling interest (see below)		

Immediate cash		32,000
Deferred consideration (5,400 x 100/108)		5,000
Non-controlling interest (10,000 x 20% (see below) x $3.50)		7,000
		44,000
Equity shares	10,000	
Pre-acquisition reserves:		
At 1 October 2010	12,000	
Fair value adjustments - plant	4,000	
- intangible	3,000	(29,000)
Goodwill arising on acquisition		15,000

The cost of the majority shareholding in Saracen was $32 million. Paladin acquired eight million shares and Saracen has 10 million $1 shares, this gives a controlling interest of 80% and a non-controlling interest of 20%.
The customer relationship asset is recognised as an intangible asset in the consolidated financial statements under IFRS 3 *Business combinations*.

(ii) Carrying amount of Augusta at 30 September 2011

	$'000
Cash consideration	10,000
Share of post-acquisition profits (1,200 x 8/12 x 25%)	200
Impairment loss	(2,500)
	7,700

(iii) Unrealised profit (URP) in inventory/intra-group current accounts
The URP in Saracen's inventory (supplied by Paladin) of $2·6 million is $600,000 (2,600 x 30/130). The current account balances of Paladin and Saracen should be eliminated from trade receivables and payables at the agreed amount of $1·3 million.

(iv) Consolidated retained earnings:

	$'000
Paladin's retained earnings (25,700 + 9,200)	34,900
Saracen's post-acquisition profits (4,500 (w (v)) x 80%)	3,600
Augusta's post-acquisition profits (w (ii))	200
Augusta's impairment loss	(2,500)
URP in inventory (w (iii))	(600)
Finance cost of deferred consideration (5,000 x 8%)	(400)
	35,200

(v) Post-acquisition adjusted profit of Saracen is:

	$'000
Profit as reported	6,000
Additional depreciation of plant (4,000/4 years)	(1,000)
Additional amortisation of customer relationship asset (3,000/6 years)	(500)
	4,500

(vi) Non-controlling interest

$'000

Fair value on acquisition (w (i))	7,000
Post-acquisition profits (4,500 (w (v)) x 20%)	900
	7,900

A-28

Answer

(a) Pyramid - Consolidated statement of financial position as at 31 March 2012

	$'000	$'000
Assets		
Non-current assets:		
Property, plant and equipment (38,100 + 28,500 + 3,000 fair value - 600 depreciation)		69,000
Goodwill (w (i))		7,400
Investments - associate (w (ii))	6,600	
- fair value equity investments	2,800	9,400
		85,800
Current assets		
Inventory (13,900 + 10,400 + 1,500 GIT - 500 URP (w (iii)))	25,300	
Trade receivables (11,400 + 5,500 - 1,200 CIT - 3,200 intra group (w (iii)))	12,500	
Bank (900 + 600 + 1,200 CIT (w (iii)))	2,700	40,500
Total assets		126,300
Equity and liabilities		
Equity attributable to owners of the parent		25,000
Equity shares of $1 each		
Reserves:		
Share premium	17,600	
Retained earnings (w (iv))	36,380	53,980
		78,980
Non-controlling interest (w (v))		8,480
Total equity		87,460
Non-current liabilities		
11% loan notes (12,000 + 4,000 – 2,500 intra-group)	13,500	
Deferred tax (4,500 + 1,000)	5,500	19,000
Current liabilities		
Deferred consideration (6,400 + 640 unwinding of discount (w (iv)))	7,040	
Other current liabilities (9,500 + 5,000 + 1,500 GIT – 3,200 intra group (w (iii)))	12,800	19,840
Total equity and liabilities		126,300

Workings (figures in brackets are in $'000)

	$'000	$'000
(i) Goodwill in Square		
Controlling interest		
Share exchange		24,000

	Deferred consideration (10,000 x 80% x 0·88/1·1)		6,400
	Non-controlling interest (10,000 x 20% x $3·50)		7,000
			37,400
	Equity shares	10,000	
	Pre-acquisition reserves	18,000	
	Fair value adjustments – plant	3,000	
	– unrecorded deferred tax	(1,000)	(30,000)
	Goodwill arising on acquisition		7,400

(ii)	Carrying amount of Cube at 31 March 2012	
		$'000
	Cost	6,000
	Share post-acquisition profit (2,000 x 30%)	600
		6,600

		Pyramid	**Square**
		$'000	**$'000**
(ii)i	Reconciliation of current accounts		
	Current account balances per question to eliminate	4,400	1,700
	Goods-in-transit (GIT) (16,000 – 14,500)		1,500
	Cash-in-transit (CIT) (balance required to reconcile)	(1,200)	
		3,200	3,200

The goods-in-transit sale of $1·5 million includes unrealised profit (URP) of $500,000 (1,500 x 50/150)

(iv)	Consolidated retained earnings:	
	Pyramid's retained earnings (16,200 + 14,000)	30,200
	Square's post-acquisition profit (7,400 see below x 80%)	5,920
	Cube's post-acquisition profit (2,000 x 30%)	600
	Interest on deferred consideration (6,400 x 10%)	(640)
	URP in inventory (w (iii))	(500)
	Gain on equity investments (2,800 – 2,000)	800
		36,380
	The adjusted post-acquisition profits of Square are:	
	As reported	8,000
	Additional depreciation on plant (3,000/5 years)	(600)
		7,400

(v)	Non-controlling interest	
		$'000
	Fair value on acquisition (w (i))	7,000
	Post-acquisition profit (7,400 x 20% (w (iv)))	1,480
		8,480

A-29

Answer