Complex Group

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Learning Outcome:

- Introduction of Group accounts
- Complexities in Group Accounts
- Understanding of complex groups
- Accounting of vertical group
- Accounting of D shaped group

Group accounts: the statement of financial position

IFRS 3 Business Combinations looks into the working of a group (the parent company, its subsidiaries and associates) and provides guidelines towards the working of the fair values and goodwill.

Goodwill is the residual amount paid at the time of the acquisition of the company after valuing the net assets of the company at their fair values. It is an intangible asset which is created due to reputation, strong customer base or the technical skills that the entity possesses.

Structure of the consolidated SOFP

A consolidated Statement of Financial Position shows:

- Goodwill;
- The net assets of the whole group;
- the share capital of the group (which always equals the share capital of the parent only);
- the retained profits which consists of the profits made by the group (i.e. the parent's historical profits plus post acquisition profits of the subsidiary).

Complexities

In reality, consolidation is not as straightforward. It involves further complexities that impact the creation of the consolidated SOFP, such as:

- Accounting for intra-group transactions;
- Accounting for adjustments to fair values of assets and liabilities at the acquisition date;
- Accounting for partly owned subsidiaries;
- Accounting for acquisitions done part way through the year.

The chapter will progress from a straightforward consolidation to handling of the more complex scenarios.

Pre and post-acquisition reserves

Subsidiary pre-acquisition reserves

The subsidiary's pre-acquisition reserves are not consolidated in the group reserves as they are included as part of the cost of investment. This is then replaced by assets and liabilities on consolidation. If a premium is paid for the subsidiary's net assets then this is capitalized as goodwill.

Component	Reflected in...
Premium	Goodwill asset
Equity	Assets and liabilities
Cost of Investment	
Retained Earnings	Assets
(Pre-acq'n)	

Subsidiary post-acquisition reserves

After the initial acquisition, earnings will be made in the subsidiary and it is these earnings the group will be entitled to. The group share of post-acquisition earnings will form part of the total of consolidated retained earnings, balanced by increases in net assets on the other side of the statement of financial position in the future.

Component	Reflected in...
Premium	Goodwill asset
Shares &	
Retained Earnings (Pre-acq'n)	Assets and liabilities (At acq'n)
Cost of Investment	
Retained Earnings (Post-acq'n)	Increases in net assets Group reserves

Non-controlling interest

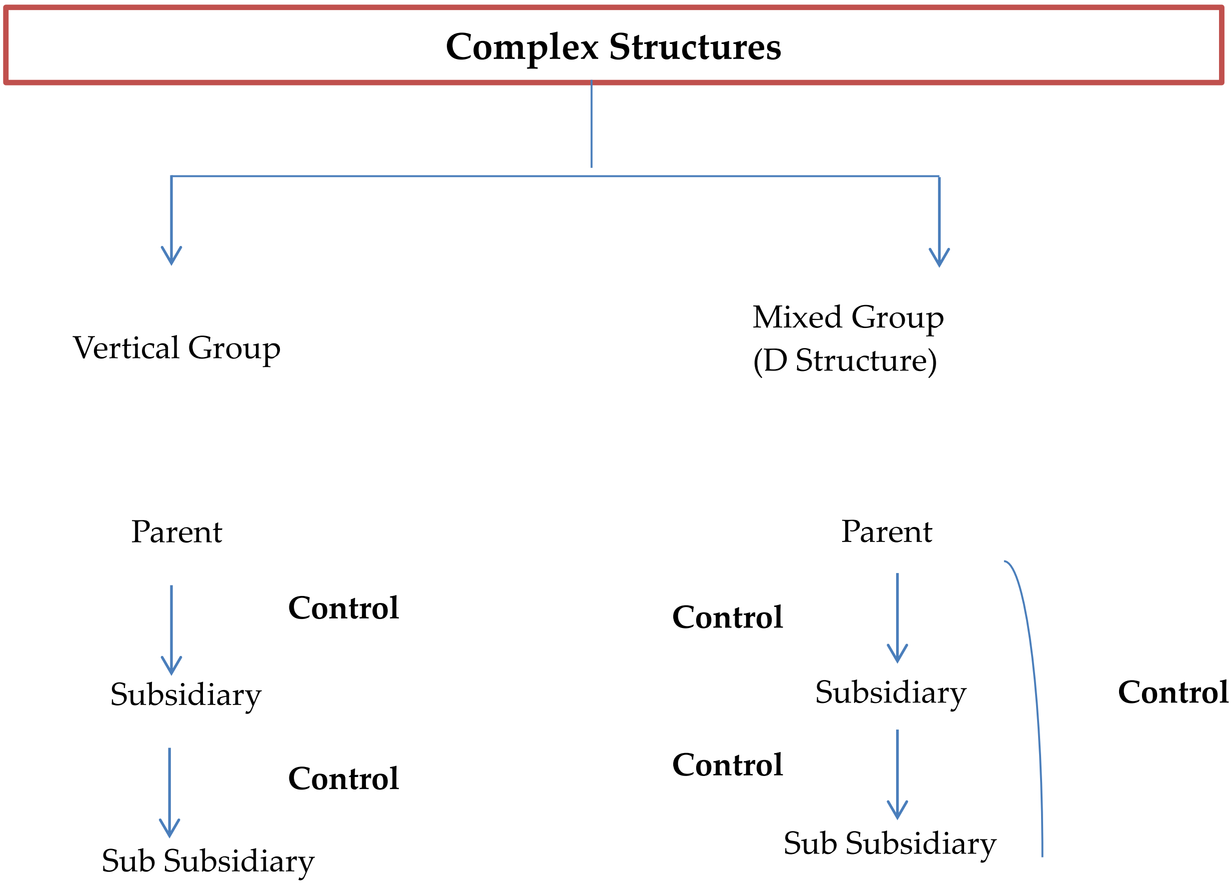
It refers to that stake of the subsidiary which is owned by other shareholders and not by the parent company. Since, the subsidiary is a part of the group of the parent company; the NCI shareholders are also considered a part of the group. Therefore, their interests are also reported in the consolidated financial statements of the parent company.

As already learnt, the two methods of valuing the NCI are:

a. Fair Value

b. Proportion of Net Assets

Complex Group



COMPLEX GROUP ACCOUNTING

In order to establish a group structure, it is important to consider the control of the parent company (direct or indirect control), the stake of ownership in the subsidiaries and the date of acquisition of each company.

Vertical Groups

A vertical group exists when the parent company indirectly controls a subsidiary company via another subsidiary company. The subsidiary controlled indirectly by the parent company is referred to as the sub-subsidiary.

- If the sub-subsidiary is acquired by the Subsidiary prior to the Subsidiary being acquired by the Parent, the date of acquisition of both the subsidiary and the sub-subsidiary is the same as the date of acquisition of the subsidiary.

  Example1: P (Parent company) acquires S (subsidiary company) on 12.05.2015.

  S acquires Q (sub-subsidiary) on 13.06.2014.

  So, S is consolidated from 12.05.2015

  Q is consolidated from 12.05.2015

  But if the sub-subsidiary is acquired by the subsidiary after the subsidiary has been acquired by the parent company, then the date for consolidation for the sub-subsidiary will be the date of its acquisition by the subsidiary.

  Example 2: P (Parent company) acquires S (subsidiary company) on 12.05.2015.

  S acquires Q (sub-subsidiary) on 13.06.2015.

  So, S is consolidated from 12.05.2015

  Q is consolidated from 13.06.2015

- Parent's effective interest in a sub-subsidiary= Parent's interest in the subsidiary * subsidiary's interest in its sub-subsidiary

  Example: P owns 80% of the ordinary shares in S. S owns 70% of the ordinary shares in Q.

  Therefore, P owns (80%*70%) 56% in Q.

Indirect Holding Adjustments (IHA): Affects the NCI & Goodwill calculation.

- Goodwill
  - Goodwill for sub-subsidiary
    - Group's cost of investment in sub-subsidiary(i.e. group's share of Subsidiary's cost of investment in sub-subsidiary, e.g. 80% of Subsidiary's cost of investment in sub-subsidiary)
    - – Group's share (using effective interest) of net assets of Sub-Subsidiary

Example 3:

	A	B	C
Investments	$000	$000	$000
In B	800		
In C		500	

A owns 90% of B. B owns 80% of C. Calculate the goodwill of C.

Solution: A owns 90% of B and 10% of B is acquired by the NCI. Therefore, the cost of acquiring C is incurred by A and the NCI in 90:10 proportion, which is, A's cost (90%*500) & NCI's cost (10%*500)

Goodwill of C

	$000
Investment (incurred by B)	500
Less: IHA (10%*500)	(50)
Investment by A (90%*500)	**450**
Value of NCI at acquisition	X
Less: Fair Value of Net assets of C at acquisition	(X)
Goodwill at Acquisition	**X**

  - Calculate Goodwill for Subsidiary as per normal, add both Goodwill's together.
- NCI
  - Calculate NCI for Subsidiary as per normal
  - Calculate NCI for Sub-Subsidiary as per normal, but subtract the NCI's share of Subsidiary's cost of investment in Sub-Subsidiary (e.g. Parent owns 80% of Subsidiary, so subtract 20% * Subsidiary's cost of investment in Sub-Subsidiary). This is because in the Goodwill computation, the cost excludes the NCI's share of Subsidiary's cost of investment in Sub-Subsidiary, so this

amount needs to be correspondingly removed in the NCI for the Sub-Subsidiary.

Example 3 (continued):

	A	B	C
Investments	$000	$000	$000
In B	800		
In C		500	

A owns 90% of B. B owns 80% of C. Calculate the NCI of B.

Solution:

	$000
Value of B's NCI at acquisition	X
Less: IHA (in goodwill calculation)	(50)
NCI% of B's post-acquisition reserves	X
	X

- Add the two NCI answers together.

- NCI (for sub-subsidiary)'s effective interest
  - = 1 – Parent's effective interest, OR
  - = (1 – Subsidiary's interest) + (Subsidiary's interest * (1 – Parent's interest in Subsidiary)), i.e. the direct NCI of the sub-subsidiary+ the indirect NCI within the portion owned by the Subsidiary
- Reserves
  - Parent's reserves + Parent's share of Subsidiary's post-acquisition reserves + Parent's share of Sub-Subsidiary's post-acquisition reserves – Parent's share of Goodwill impairment

Example 4 (integrated question): The following are the statements of financial position at 31 December 2014 for X group companies:

	X	Y	Z
	$000	$000	$000
Investment in Subsidiaries	70	50	
Sundry Assets	290	130	100
	345	**188**	**100**
Equity Share Capital	100	80	50
Retained Earnings	55	30	25
Liabilities	150	70	25
	345	**188**	**100**

On 1st January 2005, X acquired 60,000 equity shares of Y for $65,000 in cash when the retained earnings of Y were $15,000.

On the same date, Y acquired 35,000 of the $1 equity shares of Z for $55,000 in cash. The retained earnings of Z at this date were $5,000.

It is group policy to measure NCI at fair value at the date of acquisition. At 1 January 2005, the fair value of the NCI in Y was $30,000 and the fair value of the NCI in Z, reflecting X's effective holding was $50,000.

Required:

Prepare the consolidated statement of financial position of the X group as at 31 December 2014.

Solution: Consolidated statement of financial position as at 31 December 2014

	$
Goodwill (5000+70,000) (W3)	75,000
Other net assets (290,000+130,000+100,000)	520,000
	595,000
Capital & Reserves	
Equity Share Capital	100,000
Retained Earnings (W5)	76,750
NCI (W4)	80,750
Liabilities (150,000+70,000+117,500)	337,500
	595,000

Workings:

(W1) Group Structure

X

| 60/80= 75% on 1.1.2005

Y

| 35/50= 70% on 1.1.2005

Z

Effective consolidated percentages:

	Y	Z
Group Interest	75%	52.5% (75%*70%)
Non-Controlling Interest	25%	47.5%
	100%	**100%**

(W2) Net Assets

	Y		Z	
	Acq'n Date (1.1.2005	Rep. Date (31.12.2015)	Acq'n Date (1.1.2005	Rep. Date (31.12.2015)
	$	$	$	$
Share Capital	80,000	80,000	50,000	50,000
Retained Earnings	15,000	30,000	5,000	25,000
	95,000	110,000	55,000	75,000

(W3) Goodwill

	Y	Z
	$	$
Y's investment in Z		50,000
IHA (25%*50,000)		(12,500)
Fair Value of X's Investment	70,000	37,500
NCI at fair value	30,000	50,000
Fair Value of Y's & Z's Net assets at acquisition (W2)	(95,000)	(55,000)
	5000	70,000

(W4) Non-Controlling Interest

	$
Y:	
NCI at acquisition (W3)	30,000
NCI%*post acquisition reserves [25%*(110,000-95000)] (W2)	3750
IHA (W3)	(12,500)
Z:	
NCI at acquisition (W3)	50,000
NCI%* post acquisition reserves [47.5%*(75,000-55,000)] (W2)	9500

	80,750

(W5) Consolidated Retained Earnings

	$
Retained earnings of X	55,000
Group share of post-acquisition profits	
Y:75%*(110,000-95,000) (W2)	11,250
Z:52.5%*(75,000-55,000) (W2)	10,500
	76,750

Consolidated Statement of Comprehensive Income for Vertical Group

The SOCI with the sub-subsidiary is prepared in the same way as for the subsidiary. The effective percentages of control are used in order to distribute the expenses and income between the parent, subsidiary and the sub-subsidiary.

Vertical Group with Subsidiary invested in an Associate

- Think of it as preparing the Subsidiary's separate financial statements, which would include its share of the Associate's profits, then consolidating the Subsidiary's statements into the Parent's.
- Consolidated Balance Sheet
    - Includes the "Investment in Associates" based on Subsidiary's share in Associate.
    - NCI includes share of Associate's post-acquisition reserves, share being (1 – Parent's share in Subsidiary) * (Subsidiary's share in Associate).
    - Parent's reserves includes share of Associate's post-acquisition reserves, share being (Parent's share in Subsidiary) * (Subsidiary's share in Associate).
- Consolidated Income Statement
    - Includes the "Share of profit after tax of Associate", with the share being the interest of the Associate owned by the Subsidiary.
    - Profit attributable to
        - NCI includes the share of profit after tax of the Associate, with the share being (1 – Parent's share in Subsidiary) * (Subsidiary's share in Associate).
        - Owners of Parent includes the share of profit after tax of the Associate with the share being (Parent's share in Subsidiary) * (Subsidiary's share in Associate)

Sub Associates

Parent

↓ **Control (Acquisition Method)**

Subsidiary

↓ **Significant Influence (Equity Accounting)**

Associate

In S books, Investment in Associate would be made up of Cost of Investment & S's share in post-acquisition profit. In P's book, the asset of S will be fully consolidated as it is under control of P

In context to S's share in Post-Acquisition Profit of A, P only own the profit equivalent to P's share in S. & rest by NCI i.e. if P own S 75% & S own A 40%, P own in A 30% (i.e. 75X40) & rest 10 by NCI.

Hence post acquisition profit will be split in 40:10 ratio.

Mixed Group (D Structure)

Parent

Control ↓

Subsidiary — **Control**

Control ↓

Sub Subsidiary

First it needs to be decided whether control (direct or indirect) is there or not on first date of acquisition of interest. If there is control (direct or indirect) and later on additional interest is acquired (indirectly or directly), apply the **control to control approach**.

If there is no control (direct or indirect) on first date of acquisition of interest and later on control (indirectly or directly) is acquired, apply the **non-control to control approach**.

Secondly, if the first transaction of interest acquisition is through indirect way, than use the approach of **Indirect Holding Adjustment** also.

D-shaped Groups

- Same as Vertical Groups, just that Parent has a direct holding in the Sub-Subsidiary as well.
- The computation for Goodwill in the Sub-Subsidiary will need to include the cost of direct and in-direct investments.

Chapter Summary

This chapter deals with the complexities in a group structure. There can be vertical and D structure groups. Also, it is important to consider the control of the parent company over the other companies in the group, the percentage of the ownership and the date of acquisition. These 3 factors bring about the change in the structure of the group.