Task IM-8.12: Consolidated Financial Statements (based on CPUT materials, W. Lotter)

DEVON Ltd. holds 150 shares of ELISBURG Ltd. and 330 shares of FRANSHOOK Ltd. See the case as depicted in below.

The example below covers a reporting period ended 30 September 2014			
Statement of profit or loss	**D Ltd**	**E Ltd**	**F Ltd**
Profit from operations	800	700	600
Dividends received from E Ltd	220		
Dividends received from F Ltd	90	-	-
Profit before tax	1 110	700	600
Taxation	(240)	(210)	(180)
Profit for the year	870	490	420
Statement of change in equity (only retained earnings)			
	D Ltd	**E Ltd**	**F Ltd**
Opening balance	200	160	120
Profit	870	490	420
Dividends	(500)	(400)	(300)
Closing balance	570	250	240
Statement of financial position	**D Ltd**	**E Ltd**	**F Ltd**
Property, plant and equipment	600	500	400
Investment in F Ltd at cost (150 shares)	180	-	-
Investment in E Ltd at cost (330 shares)	380		
Current assets	240	390	384
	1 400	890	784
Ordinary share capital (R1 shares)	700	600	500
Retained income	570	250	240
Non-current liabilities	90	30	30
Current liabilities	40	10	14
	1 400	890	784
	-	-	-

Exhibit 1: Case

Other information given is: D Ltd obtained the shares in E Ltd and F Ltd at 30 September 2011 when the retained income of E Ltd and F Ltd were R80 and R50 respectably. E Ltd sold inventory (cost R30) to D Ltd for R70. The inventory is included in the current assets of D Ltd. The tax rate is 30%. The deferred tax balance is a credit.

Required: Prepare the consolidated financial statements of DEVON Ltd. and its subsidiary ELISBURG Ltd. The investment in the associate should be valued using the equity method.

Solution:

(1) We determine the percentages of ownership. They depend on the amount of ordinary shares held. DEVON Ltd. holds 150 out of 500 shares of FRANSHOOK Ltd. This is a portion of 30 % and indicates an investment in an associate. DEVON Ltd. holds 330 out of 600 shares of ELISBURG Ltd. This gives 55 % of ownership and indicates an interest in a subsidiary.

(2) We discuss the associate which is calculated based on the equity method. The 150 shares are held at cost of R 180.00. The amount is based on the acquisition when the equity was: R 50.00. 30% x 50 = R 15.00. Hence, the book value at the time of acquisition was: 150 + 15 = R 165.00. At the time of acquisition, DEVON Ltd. recorded a goodwill of: 180 – 165 = **R 15.00**.

At the time of 30.09.20X4, the equity of the associate discloses a retained income of R 120 and issued capital of R 500. The value added to the investment in the associate has changed by: (120 – 50) + 420 – 300 = **R 190.00**. This is an increase of DEVON Ltd.'s investment by: 30% × 190 = **R 57.00**. The new value of the investment equals to: 180 + 57 = **R 237.00**. This is the amount we disclose on the single-entity balance sheet for DEVON Ltd. with regard to the investment in FRANSHOOK Ltd, see below.

Hence, DEVON Ltd. increases the value by: 237 – 180 = **R 57.00**. The contra entry is made in the Retained Earnings account. The change portion thereof which falls under the actual Accounting period equals to profit less dividend: 30% × (420 – 300) = **R 36.00**. After deduction of goodwill, a net increase of: 36 – 15 = **R 21.00** stays, see the statement of changes in equity! Be aware the amount disclosed before was R 180.00 and includes the goodwill.

Devon Ltd.'s
STATEMENT of FINANCIAL POSITION
as at 30.09.20X4

A		C, L	
Non-current assets	[R]	*Equity*	[R]
P, P, E	600.00	Share capital	700.00
Intangibles		Reserves	
Investment in E	380.00	Retained earnings	627.00
Investment in F	237.00		
Current assets	240.00	*Liabilities*	
Inventory		Interest bear liab	90.00
Accounts receivables		Accounts payables	40.00
Prepaid expenses		Provisions	
Cash/Bank		Tax liabilities	
Total assets	1,457.00	***Total equity and liab.***	1,457.00

Exhibit 2: Devon Ltd.'s balance sheet after revaluation of investment

(3) We prepare the consolidation chart for DEVON Ltd and ELISBURG Ltd. below. We only enter the figures of the balance sheet in the consolidation chart.

In the column CapCons we record the capital consolidation for the investment in ELISBURG Ltd. The investment was bought at R 380 when its book value was: 55% x (600 + 80) = **R 374.00**. Hence, DEVON Ltd. discloses a goodwill to the extent of: 380 – 374 = **R 6.00**.

At the time of acquisition, the remaining shares are allocated to the non-controlling interest. This is 600 – 330 = **R 270.00**. At the same time, the amount for the retained income of the subsidiary ELISBURG Ltd. is allocated to the non-controlling interest holders: 45% × 80 = **R 36.00**.

	PARENT	SUBSIDIARY	AGGR.	CAP. CONS					CONS. F/S
N-cur Assets									
P,P,E	600	500	1,100						1,100
Int. assets			0						0
Investments	617		617	(380)					237
Goodwill	0		0	**6**					**6**
cur Assets	240	390							
Inventory			0						0
Receivables			0						0
Prepaid exp.			0						0
Cash			0						0
	1,457	*890*	*2,347*	*(374)*	*0*	*0*	*0*	*0*	*1,973*
SH's capital									
Issued capital	(700)	(600)	(1,300)	330	270				(700)
Reserves			0						0
Reval. Reserves			0						0
Retained ear.	(627)	(250)	(877)	44		36			(797)
Non-ctrl. int			0		**(270)**	**(36)**			**(306)**
Liabilities									
Int. bear. liab.	(90)	(30)	(120)						(120)
Payables	(40)	(10)	(50)						(50)
Provisions			0						0
Def. income			0						0
Tax liabilities			0						0
	(1,457)	*(890)*	*(2,347)*	*374*	*0*	*0*	*0*	*0*	*(1,973)*

Exhibit 3: Consolidation chart

In order to keep the consolidation chart slim we add the bookkeeping entries and write them as a whole:

```
DR Goodwill ........................        6.00 ZAR
DR Issued Capital ..................      600.00 ZAR
DR Retained Earnings  ..............       80.00 ZAR
CR Investment ......................      380.00 ZAR
CR Non-ctrl Interest ...............      306.00 ZAR
```

(4) The consolidation bookkeeping entry is entered in the consolidation chart as one bookkeeping entry every Accounting period as the consolidation is based on derived financial statements.

(5) We now consider the time between the financial statements and the acquisition. The subsidiary earned a retained earnings of closing balance less amount at time of acquisition: 160 – 80 = **R 80.00**. The amount of 45% × 80 = **R 36.00** is allocated to the non-controlling interest holders as it is not included by the initial capital consolidation.

(6) Next we study the consolidated income statement. Besides of the proft aggregation, it is relevant that ELISBURG Ltd. recorded an unrealised profit by selling inventory to DEVON Ltd. at R 70.00 which costs R 30.00. This gives an unrealised profit of: 70 – 30 = **R 40.00**. The amount is deducted from the income statement's pretax profit. The pre-tax profit is then: 800 + 700 – 40 = **R 1,460.00**. Taxes are calculated by our MS Excel spreadsheet automatially. It gives R 1,022.00. Additionally, we have to consider the profit of

the subsidiary, being 30% × 420 = R 126.00. No dividend is deducted for the income statement. Hence, the profit is 1,022 + 126 = **R 1,148.00**. See below.
(7) We calculate the profit after taxation for the subsidiary: The amount is: 700 – 40 × (1 – 30%) = **R 462.00**. The portion of 45 % is transferred to the non-controlling interest holders: 45% × 462 = **R 207.90**. Hence, the profit portion for controlling interest holders increases by: 1,148 – 207.90 = **R 940.10**.

Devon Group's
STATEMENT of PROFIT & LOSS
and OTHER COMPREHENSIVE INCOME
for the year ended 30.09.20X4

	[R]
Revenue	
Other income	
	0.00
Materials	
Labour	
Depreciation	
__ Other expenses	
Earnings before int. & taxes (EBIT)	1,460.00
__ Interest	
Earnings before taxes (EBT)	1,460.00
Income tax expenses	(438.00)
__ Profit share of associate	126.00
Earnings after taxes (EAT)	1,148.00
to non-controlling interest holders:	207.90
to controlling interest holders	940.10

Exhibit 4: Consolidated income statement

(8) Due to the changes in profit for the inventory sale, the inventories on the asset section of DEVON Ltd. are to be revalued. They are to be carried at the costs as they entered the group but not at the costs they were bought intra group. The reduction in value is: 70 – 30 = **R 40.00**. Therein is a tax portion of: 30% × 40 = **R 12.00**.
The bookkeeping entry for the adjustment is:

```
DR Retained earnings ................          28.00 ZAR
DR Tax Liabilities ..................          12.00 ZAR
CR Inventories (current assets) .....          40.00 ZAR
```

We consider tax liabilities as long-term liabilities here.

(9) We prepare the statement of changes in equity for the group.
It contains the initial issued capital for the parent and the non-controlling interest holders of R 700 and 45% × 600 = **R 270.00** respectively. Furthermore, the amount of retained earnings as at the time of acquisition

of R 80.00 is split: 45% × 80 = **R 36.00**. Hence, the non-controlling interest holders disclose 270 + 36 = **R 306.00**.
The retained earnings of the parent at the beginning of the Accounting period are R 200.00.
The increase in value of the associate under consideration of profit and dividend is R 21.00, see above. Note, the goodwill is not disclosed.
The profit increase of the subsidiary ELISBURG Ltd. is split at a 45 : 55 ratio between the parent and the subsidary and gives R 36.00 and R 44.00 respectively. The increase of profit for non-controlling interest holders equals to R 207.90 as shown on the consolidated income statement. The profit of the parent is R 940.10.
The dividends are only considered ex-group. Hence, the dividend of the subsidiary ELISBURG Ltd. is disclosed on the statement of changes in equity as: 400 × 45% = **R 180.00**.

Devon Group's
STATEMENT of CHANGES in EQUITY
as at 30.09.20X4

	Share capital	non-ctrl int	R/E ctrl int	total
	[EUR]	[EUR]	[EUR]	[EUR]
as at 30.09.20X3	700.00		200.00	900.00
MI before		306.00		306.00
Associate			21.00	21.00
between		36.00	44.00	80.00
Profit of the parent				0.00
Profit 20X4		207.90	940.10	1,148.00
Dividend 20X4			(500.00)	(500.00)
Dividend 20X4		(180.00)		(180.00)
as at 30.09.20X4	700.00	369.90	705.10	1,775.00

Exhibit 5: Consolidated statement of changes in equity

	PARENT	SUBSIDIARY	AGGR.	CAP. CONS	profit between	profit	Inv valuation	Div Subs	CONS. F/S
N-cur Assets									
P,P,E	600	500	1,100						1,100
Int. assets			0						0
Investments	617		617	(380)					237
Goodwill	0		0	**6**					**6**
cur Assets	240	390	630				(40)		590
Inventory			0						0
Receivables			0						0
Prepaid exp.			0						0
Cash			0						0
	1,457	*890*	*2,347*	*(374)*	*0*	*0*	*(40)*	*0*	*1,933*
SH's capital									
Issued capital	(700)	(600)	(1,300)	600					(700)
Reserves			0						0
Reval. Reserves			0						0
Retained ear.	(627)	(250)	(877)	80	36	208	28	(180)	(705.10)
non-ctrl int			0	(306)	**(36)**	**(208)**		**180**	**(369.90)**
Liabilities									
Int. bear. liab.	(90)	(30)	(120)				12		(108)
Payables	(40)	(10)	(50)						(50)
Provisions			0						0
Def. income			0						0
Tax liabilities			0						0
	(1,457)	*(890)*	*(2,347)*	*374*	*0*	*0*	*40*	*0*	*(1,933)*

Exhibit 6: Consolidation chart

Devon Group's
consolilidated **STATEMENT of FINANCIAL POSITION**
as at 30.09.20X4

A		C, L	
Non-current assets	[R]	*Equity*	[R]
P, P, E	1,100.00	Share capital	700.00
Intangibles		Reserves	
Goodwill	6.00	Retained earnings	705.10
Investment in F	237.00	Non-ctrl. int	369.90
Current assets	590.00	*Liabilities*	
Inventory		Interest bear liab	108.00
Accounts receivables		Accounts payables	50.00
Prepaid expenses		Provisions	
Cash/Bank		Tax liabilities	
Total assets	1,933.00	***Total equity and liab.***	1,933.00

Exhibit 7: Consolidated balance sheet