Task IM-8.8: Group Accounting (based on CPUT materials, W. Lotter)

The example below covers a reporting period ended 30 September 20X4. KULIS Ltd. and LANGERG Ltd. publish the financial statements below. KULIS obtaines the shares in LANGERG Ltd. at 1.08.20W9 when the retained earnings of LANGERG Ltd. are R 10.00. KULIS Ltd. holds 240 shares at R1 of LANGERG Ltd.

Required: The consolidated financial statements of KULIS Ltd. and its subsidiary LANGERG Ltd.
<u>The rate of income tax equals to 28%. It is assumed that no tax on capital returns applies.</u>

Statement of financial performance	**K Ltd**	**L Ltd**
Profit from operations	700	400
Dividends received from L Ltd	80	-
Profit before tax	780	400
Taxation	(196)	(112)
Profit for the year	584	288
Statement of change in equity	**Ret. earnings**	**Ret. earnings**
Opening balance	120	60
Profit	584	288
Dividends	(500)	(100)
Closing balance	204	248
Statement of financial position		
Property, plant and equipment	470	555
Investment in L Ltd at cost (240 shares)	250	-
Current assets	132	65
	852	620
Ordinary share capital (400 / 300 shares)	400	300
Retained income	204	248
Non-current liabilities	130	50
Current liabilities	118	22
	852	620
<u>Other information</u>	-	-
K Ltd obtained the shares in L Ltd at **1 August 2009** when the retained earnings of.		
A Ltd was R10.		
Required		
The consolidated financial statements of K Ltd and its subsidiary L Ltd.		

Solution:
For consolidation, we firstly determine the value of the equity acquired. It amounts to the share capital and the retained earnings and is amounting to: 240 + 80% × 10 = **R 248.00**. Although a portion of the retained earnings is allocated to the subsidiary, the other 20% of the retained earnings and the 20% of the issued capital is to be assigned to non-controlling interest holders. The amounts are: 300 × 20% = **R 60.00** and 10 × 20% = **R 2.00**.
The cost of acquisition for the subsidiary do not mix with the book value of the shares. Hence, a goodwill of: 250 – 246 = **R 4.00** must be disclosed.

	PARENT	SUBSIDIARY	AGGR.	CAP. CONS			CONS. F/S
N-cur Assets							
P,P,E	470	555	1,025				1,025
Int. assets			0				0
Investments	250		250	(250)			0
Goodwill			0	**2**			**2**
cur Assets	132	65					
Inventory			0				0
Receivables			0				0
Prepaid exp.			0				0
Cash			0				0
	852	*620*	*1,472*	*(248)*	*0*	*0*	*1,224*
SH's capital							
Issued capital	(400)	(300)	(700)	240	60		(400)
Reserves			0				0
Reval. Reserves			0				0
Retained ear.	(204)	(248)	(452)	10			(442)
Non-ctrl. int			0	(2)	**(60)**		**(62)**
Liabilities							
Int. bear. liab.	(130)	(50)	(180)				(180)
Payables	(118)	(22)	(140)				(140)
Provisions			0				0
Def. income			0				0
Tax liabilities			0				0
	(852)	*(620)*	*(1,472)*	*248*	*0*	*0*	*(1,224)*

Exhibit 2: Initial consolidation of capital

In order to keep the initial consolidation short, we record one consolidation bookkeeping entry and keep it up:

```
DR Goodwill ........................        2.00 ZAR
DR Issued Capital ..................      300.00 ZAR
DR Retained Earnings ...............       10.00 ZAR
CR Non-ctrl Interest ...............       62.00 ZAR
CR Investment ......................      250.00 ZAR
```

With regard to the profit consolidation, no profit is earned intra-group-wise. As a result, the profits can be added. The consolidated income statement is disclosed below:
The calculation of the taxes is based on operating profits: (400 + 700) × 28% = **R 308.00**. The profit of the group increases based on the dividend received (tax-free!) from the subsidiary. Hence the profit is (400 + 700) × (1 - 28%) = **R 792.00**. The profit is split between the parent and subsidiary. The subsidiary's non-controlling interest share is: 288 × 20% = **R 57.60**. The share of the controlling interest holders equals to: 792 – 57.60 = **R 734.40**. The profit is not added to the consolidation chart as it is included in the Retained Earnings account of the balance sheet already. However, the transfer from the R/E account to non-ctrl interest is to be recorded.

DR Non-ctrl Interest .... 57.60 ZAR

CR Retained Earnings .... 57.60 ZAR

For the consolidated income statement, the profit comprises of the operating activities only as shown in the single entity income statements. The dividend received by KULIS Ltd. is tax free (task). The dividend received is an intra-group thing and does not affect the consolidated financial statements. However, the dividend payment to non-ctrl interest holders does (see below).

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

	[EUR]
Revenue	
Other income	
	0.00
Materials	
Labour	
Depreciation	
Other expenses	
Earnings before int. & taxes (EBIT)	1,100.00
Interest	
Earnings before taxes (EBT)	1,100.00
Income tax expenses	(308.00)
Dividends received	
Earnings after taxes (EAT)	792.00
ctrl interst holders	734.40
non-ctrl interest holders	57.60

Exhibit 3: consolidated income statement

We next prepare the consolidated statement of changes in equity for the group. For the consolidated statement of changes in equity the previous profits need to be considered.

The consolidated statement of changes in equity discloses in the upper part the shares of the parent. Shares of the subsidiary are cancelled out by consolidation to an extent of 80 %, the remaining portion is shown as non-controlling interest: 20% × 300 = **R 60.00**. With regard to retained earnings, the amount of R 2.00 represents the situation at the time of acquisition. The acquisition contains besides of the shares an amount of retained earnings of R 10.00. Again, 80 % thereof are cancelled out due to capital consolidation: 80% × 10 = **R 8.00**. The other portion is disclosed as non-controlling interest: 20% × 10 = **R 2.00**. At the beginning of the Accounting period, the retained earnings of the parent equal to R 120.00. At the same time the opening amount of the subsidiary equals to R 60.00. The opening amount at the time of acquisition is to be deducted as considered/consolidated already. Hence, the amount of retained earnings from 20W9 – 20X3 is 60 – 10 = **R 50.00**. The amount is subject to retained earnings increases, but is split up at a 20 : 80 ratio. Hence, 80% × 50 = **R 40.00** is added to the retained earnings of the controlling interest holders and: 20% × 50 = **R 10.00** is added to non-controlling interest holders.
The profit is (with exception of the intra group dividend) taken straight from the consolidated income statement. It is added to non-controlling interest and controlling interest column. The dividend is to be considered in the consolidated SCE as it is only derived from opening amounts and profit. Hence the dividend of the parent is deducted to an extent of R 500.00 and the dividend of the subsidiary is reduced by the intra group dividend and gives: 100 – 80 = **R 20.00**.

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

	Share capital c	Non-ctrl int	Retained earnings c	total
	[R]	[R]	[R]	[R]
as at 1.10.20X3	400.00			400.00
shares of subsidiary	cons	60.00		60.00
retained earnings		2.00	120.00	122.00
	400.00	62.00	120.00	582.00
Profit between		10.00	40.00	50.00
Profit 20X4		57.60	734.40	792.00
Dividend 20X4			(500.00)	(500.00)
Dividend 20X4		(20.00)		(20.00)
Additions to reserves				0.00
as at 30.09.20X4	400.00	109.60	394.40	904.00

Exhibit 4: Consolidated statement of changes in equity

For the preparation of the consolidated balance sheet, we study the consolidation chart below. Caution, the consolidated chart is aggregated in order to fit on the page. The first column to the right of the aggregated figures contains the consolidation bookkeeping entry as explained above. The next column is linked to the period between 20W9 ... 20X3. We only care about the subsidiary, as this is the only one to be split. The increase in retained earnings is considered as the single-entity financial statements are based on actual amounts of LANGERG Ltd. Hence, there is no reason to add an amount. However, the retained earnings belong to an extent of 20% to the non-controlling interest holders. This is why the consolidation bookkeeping entry reads:

```
DR R/E Ctrl Interest ...............        10.00 ZAR
CR Non-ctrl Interest ...............        10.00 ZAR
```

The profit for the actual period is considered by the retained earnings figure. However, there is a correction required for non-controlling interest holders. The profit share that belongs to the non-controlling interest holders is R 57.40, see the consolidated income statement. At the same time, the dividend paid to non-controlling interest holders reduces their retained earnings on the consolidated balance sheet. Hence, the allocation equals to: 57.40 – 20 = **R 37.40**.

```
DR Non-ctrl Interest ...............        37.40 ZAR
CR R/E Ctrl Interest ...............        37.40 ZAR
```

We add up the 3 columns for the consolidation and arrive at the consolidated financial statements which means the consolidated balance sheet. Observe below:

	PARENT	SUBSIDIARY	AGGR.	CAP. CONS	interim profit	actual profit	CONS. F/S
N-cur Assets							
P,P,E	470	555	1,025				1,025
Int. assets			0				0
Investments	250		250	(250)			0
Goodwill			0	**2**			**2**
cur Assets	132	65	197				197
Inventory			0				0
Receivables			0				0
Prepaid exp.			0				0
Cash			0				0
	852	*620*	*1,472*	*(248)*	*0*	*0*	*1,224*
SH's capital							
Issued capital	(400)	(300)	(700)	300			(400)
Reserves			0				0
Reval. Reserves			0				0
Retained ear.	(204)	(248)	(452)	10	10	38	(394.40)
M.I.			0	(62)	**(10)**	**(38)**	**(109.60)**
Liabilities							
Int. bear. liab.	(130)	(50)	(180)				(180)
Payables	(118)	(22)	(140)				(140)
Provisions			0				0
Def. income			0				0
Tax liabilities			0				0
	(852)	*(620)*	*(1,472)*	*248*	*0*	*0*	*(1,224)*

Exhibit 5: Consolidation chart

The balance sheet below shows the amounts on the group's balance sheet.

Kulis Group's
consolidated **STATEMENT of FINANCIAL POSITION**
as at 30.09.20X4

A		C, L	
Non-current assets	[R]	*Equity*	[R]
P, P, E	1,025.00	Share capital	400.00
Intangibles		Reserves	
Financial assets		Retained earnings	394.40
Goodwill	2.00	non-ctrl Interest	109.60
Current assets	197.00	*Liabilities*	
Inventory		Interest bear liab	180.00
Accounts receivables		Accounts payables	140.00
Prepaid expenses		Provisions	
Cash/Bank		Tax liabilities	
Total assets	1,224.00	***Total equity and liab.***	1,224.00

Exhibit 6: consolidated balance sheet

We cross check our balance sheet with the statement of consolidated changes in equity. The amounts mix.