

# Solutions manual

## Chapter 2

### Principles of consolidation

(Pages 104–16)

#### **Q2.1 Objectives of consolidated financial statements (Sections 2.1 and 2.2)**

The objective of consolidated financial statements is to show the operating results and financial position of a group of business entities under common control as if they are operating as a single entity controlled by the same management, the parent entity.

Consolidated financial statements comprise one set of financial statements covering the entire group: one consolidated statement of comprehensive income; one consolidated statement of changes in equity; one consolidated statement of financial position; and one consolidated statement of cash flows for the entire group.

The group consists of the parent entity and its subsidiaries, which are controlled by the parent. The parent entity has exposure or rights to variable returns from its involvement with its subsidiaries, and the parent has the ability to use its power over its subsidiaries to affect the amount of the variable returns it receives from subsidiaries (AASB 10 Appendix A). A parent entity has power over a subsidiary when the parent has existing rights that give it the current ability to direct activities of the subsidiary that significantly affect the subsidiary's returns (AASB 10.10). The management of the parent entity makes decisions relating to the finances and operations of its subsidiaries, which significantly affect the amount of returns the parent receives from its subsidiaries, and has the power to impose these decisions upon its subsidiaries (AASB 10.10 and B5–B6). Therefore, a group effectively operates as one economic entity.

The consolidated financial statements portray the group as if it is a single economic entity. The consolidated statement of financial position shows all the assets under the control of parent entity management, and how those assets are financed by liabilities and equity of the group. The consolidated statement of comprehensive income shows how well the parent entity management uses the assets of the group to generate profits for the group. Similarly, the consolidated statement of cash flows shows how well the parent entity management used the assets of the group to generate cash flows from operating activities.

The consolidated financial statements show only the effect of transactions between the group, and parties external to the group, and the effect of external events (e.g., changes in fair values of assets). The effects of all intragroup transactions between entities within the group are eliminated upon consolidation. Intragroup investments, intragroup transactions, intragroup unrealised profits and intragroup balances have no impact on the consolidated financial statements because they do not involve parties external to the group.

Investors in the parent entity, and creditors of the parent, have effectively invested in the group. The parent entity has reinvested funds received from investors and creditors into the subsidiaries it controls, via equity investments and loans. Often a large proportion of the parent's assets are invested into subsidiaries. The profit of the parent entity, and the cash flows from operating activities of the parent, are often largely dependent upon dividends/profit

distributions, and interest received from its subsidiaries. Therefore, investors in the parent, and creditors of the parent, require information about the group. Consolidated financial statements provide information about the group as a whole.

The separate financial statements of the parent entity have limited usefulness for investors and creditors of the parent. Where the parent has invested a major proportion of its assets in subsidiaries, it is difficult for investors and creditors to analyse the performance and financial position of the parent using the financial statements of the parent. In these circumstances:

- 1 The profit and operating cash flows of the parent entity is heavily dependent upon dividends/profit distributions, and interest revenue from its subsidiaries. The profit and cash flows reported by the parent could also be affected by unrealised profits resulting from intragroup transactions. The profit and the cash flows reported by the parent can easily be manipulated by the parent instructing subsidiaries to increase or decrease dividends, changing interest rates on intragroup loans, and unrealised intragroup profits. In contrast, the effects of all intragroup transactions are eliminated from the consolidated statement of comprehensive income, and the consolidated statement of cash flows.
- 2 The assets in the parent entity's statement of financial position will consist largely of investments in subsidiaries, and loans to subsidiaries. The parent may have guaranteed some or all debts of subsidiaries. Where the parent entity has not guaranteed the debts of its subsidiaries, the parent is usually equitably obliged to assist a subsidiary in financial difficulty, in order to avoid damage to the reputation/ borrowing capacity of the group. In contrast, the consolidated statement of financial position shows all the underlying assets of the parent and its subsidiaries (the underlying assets the parent has invested in) and all the liabilities of the group.

Providing consolidated financial statements to investors and creditors of the parent entity is a more understandable means of providing information about the group, compared to providing separate financial statements of each entity in the group, especially where the parent has a large number of subsidiaries. If the parent entity provided investors and creditors with separate financial statements of each entity in the group, it would be very difficult for investors and creditors to obtain an understanding of the performance and financial position of the group.

## ***Q2.2 Separate and consolidated financial statements (Section 2.2)***

### **Separate statement of financial position of the parent entity**

A separate financial report (including a separate statement of financial position) is prepared for each entity in the group (the parent entity and each of its subsidiaries) at reporting date, which is derived from the separate accounting records maintained by each entity in the group.

The parent entity's separate statement of financial position shows all the assets and liabilities of the parent. Often, a large proportion of the parent's assets consist of investments in subsidiaries and loans to subsidiaries.

### **Consolidated statement of financial position for the group**

A consolidated financial report (including a consolidated statement of financial position) is prepared for the group (comprising of the parent entity and all its subsidiaries) at reporting/consolidation date, as if the group is a single entity. The

consolidated financial report is derived from the consolidation worksheet at reporting/consolidation date, which consolidates the separate financial statements of each entity in the group, via consolidation worksheet adjusting entries.

The consolidated statement of financial position shows all the underlying assets of the parent and its subsidiaries (the underlying assets the parent has invested in) and all the liabilities of the group. The consolidated statement of financial position shows all the assets under the control of parent entity management, and how those assets are financed by liabilities and equity of the group.

### **Q2.3 Inputs, processes and outputs of consolidation accounting (Section 2.2)**

#### **Inputs, processes and outputs of consolidation accounting**

**Inputs** of consolidation accounting comprise of:

- 1 The separate financial statements of each entity in the group (the parent entity and each of its subsidiaries) at reporting/consolidation date, which is derived from the separate accounting records maintained by each entity in the group; and
- 2 Details of pre-acquisition equity of subsidiaries, including fair values and the carrying amounts of subsidiaries' identifiable net assets at acquisition date, and details of intragroup transactions and balances.

**Processes** of consolidation accounting, **using a consolidation worksheet**, comprise of:

- 1 Recording the financial data in the separate financial statements of each entity in the group into a consolidation worksheet;
- 2 Preparing **consolidation worksheet adjusting entries**, including:
  - (a) consolidation adjusting entries adjusting subsidiaries' identifiable net assets to fair value, based upon information about the fair values and the carrying amounts of subsidiaries' identifiable net assets at acquisition date;
  - (b) the investment elimination entry for each subsidiary, based upon information about pre-acquisition equity of each subsidiary; and
  - (c) consolidation adjusting entries eliminating intragroup transactions, intragroup unrealised profits and losses, and intragroup balances (based upon information about intragroup transactions, and intragroup balances) and posting these consolidation worksheet adjusting entries into the consolidation worksheet; and
- 3 Calculating the consolidated figures for the group by:
  - (a) adding across rows for each financial statement line item (income, expenses, profit appropriations, assets, liabilities and equity items) in the consolidation worksheet, applying the usual rules of debit and credit used in accounting—adding across rows for financial statement line items adjusts the balances recorded by individual group entities to obtain the consolidated figure for the group, so that the rows on the consolidation worksheet function as a ledger accounts for the group as a whole;
  - (b) adding and/or subtracting consolidated figures for the group in the consolidation worksheet, in the normal manner, to calculate consolidated subtotals and totals for the group (consolidated gross profit, consolidated profit for the period, consolidated closing retained earnings, consolidated

total equity, consolidated total liabilities and equity, and consolidated total assets).

### **Output**

The consolidated figures for the group, calculated in the consolidation worksheet are used to prepare the consolidated financial report, comprising of a consolidated statement of comprehensive income, consolidated statement of changes in equity, consolidated statement of financial position, consolidated statement of cash flows, and notes to the consolidated financial statements.

## **Q2.4 Nature of consolidation adjustments (Section 2.3)**

### **Repeating investment elimination entry when consolidating in every reporting period**

The investment elimination entry is repeated in consolidation worksheets in each successive reporting period because consolidation worksheet adjusting entries do not carry forward from one reporting period to the next, as they are not posted to the accounts of either the parent entity or its subsidiaries. At each reporting/consolidation date, the consolidation commences with the accounts of the parent entity, and its subsidiaries at that date (which do not include the consolidation adjusting entries of previous reporting periods). Where consolidation worksheet adjusting entries from the previous reporting period are still relevant in the current reporting period, such as the investment elimination entry, they are repeated in the current period consolidation.

During an accounting period between reporting dates, each entity in the group maintains its own separate accounting records by recording all transactions it engages in, including any transactions with other entities in the group. At the end of the reporting period, each entity in the group prepares its own financial statements. The completed financial statements of each entity in the group is the starting point for the preparation of consolidated financial statements.

The group as a whole has no separate accounting records, and in particular has no ledger. Consolidation worksheet adjusting entries are prepared at the end of each reporting period, and posted to the consolidation worksheet, which is used to prepare consolidated financial statements.

## **Q2.5 Pre-acquisition versus post-acquisition equities (Section 2.3)**

### **Pre-acquisition equity of a subsidiary**

Pre-acquisition equity of a subsidiary is the issued capital, reserves and retained earnings (or accumulated losses) of the subsidiary at acquisition date. Acquisition date of a subsidiary is the date the parent entity obtains control of the subsidiary.

The pre-acquisition equity of a subsidiary includes:

- 1 The equity recorded by the subsidiary in its separate accounting records on acquisition date; and
- 2 The equity of the subsidiary existing on acquisition date, but not recorded by the subsidiary in its accounting records. Unrecorded equity arises from:
  - (a) differences between the recorded values of assets and liabilities in the subsidiary's accounts at acquisition date, and their fair values at acquisition date; and
  - (b) the existence of identifiable assets and liabilities of the subsidiary, which

are not recorded in the subsidiary's accounts at acquisition date. Therefore, the pre-acquisition equity of the subsidiary is the equity which represents the fair value of the subsidiary's identifiable net assets at acquisition date.

### **Post-acquisition equity of a subsidiary**

The post-acquisition equity of a subsidiary is the change in the subsidiary's equity after acquisition date until consolidation date. The post-acquisition equity consists of:

- 1 The retained profits or accumulated losses of the subsidiary (i.e., profits and/or losses less dividends/profit distributions) from acquisition date to consolidation date; and
- 2 Movements in reserves (e.g., revaluations of property, plant and equipment recorded directly in the revaluation surplus), from acquisition date to consolidation date.

### **Significance of the distinction between pre-acquisition equity and post-acquisition equity to the consolidation process**

The pre-acquisition equity of the subsidiary is eliminated upon consolidation against the parent entity's investment in subsidiary asset, in the investment elimination entry. Any difference between the pre-acquisition equity and the cost of the investment in subsidiary is recognised as goodwill or gain on bargain purchase in the consolidated accounts. Therefore, the pre-acquisition equity of the subsidiary is not part of the consolidated equity reported in the consolidated financial statements.

The post-acquisition equity of the subsidiary, after any necessary consolidation adjustments to eliminate the effect of intragroup transactions, is included in the consolidated equity reported in the consolidated financial statements. These post-acquisition profit and losses are included in consolidated profit or loss, and consolidated equity, because these profits are earned and losses incurred by the subsidiary, while the subsidiary is part of the group. Similarly, post-acquisition movements in reserves are included in consolidated total comprehensive income and consolidated equity because these movements in reserves occurred while the subsidiary is part of the group.

## **Q2.6 Cost of investment in subsidiary (Section 2.4.1)**

### **Measuring the cost of investment in a subsidiary**

The cost of a parent entity's investment in a subsidiary is measured as the fair value at acquisition date of the consideration transferred by the parent to acquire the investment in subsidiary. The consideration is the sum of the acquisition date fair values of the assets transferred by the parent, the liabilities incurred by the parent to the former owners of the subsidiary, and the equity interests issued by the parent (AASB 3.37).

### **Treatment of each item**

The following items should be included in the cost of the acquirer company's investment in the target company.

*Item 1: The fair value of shares in the acquirer company issued to target company shareholders*

*Explanation:* The shares issued by the acquirer company form part of the

consideration paid by the acquirer for its investment in the target company. The shares issued by the acquirer are included in the cost of acquisition of the acquirer's investment in the target company by measuring the shares at their fair value at acquisition date. The best evidence of the fair value of the acquirer's shares is their quoted market price at acquisition date. If the acquirer is not listed on a stock exchange, or the quoted price is considered to be unreliable, other valuation techniques must be used to estimate the fair value of the acquirer's shares, such as prices in recent arm's length transactions, discounted cash flows and option pricing models.

*Item 2: The fair value of probable additional shares in the acquirer company—the acquirer is required to issue to target company shareholders two years after acquisition date, if the market value of the acquirer's shares is below \$5.50 on that date*

*Explanation:* The contingent consideration, the additional shares the acquirer may be required to issue two years after acquisition date, forms part of the consideration paid by the acquirer for its investment in the target company (AASB 3.39). The probable number of additional shares expected to be issued by the acquirer is included in the cost of acquisition of the acquirer's investment in the target company by measuring the additional shares at their fair value at acquisition date. The fair value of the probable additional shares is measured by discounting the expected market value of the additional shares two years after acquisition date to their present value at acquisition date. (The effect of discounting should be material as the probable additional shares will be issued two years after acquisition date).

*Item 3: The fair value of debt obligations of the target company assumed by the acquirer company—only if the debt obligations are owed by the target company to the former shareholders of the target company*

*Explanation:* The debt obligations of the target company owed to its former shareholders, which are assumed by the acquirer company, forms part of the consideration paid by the acquirer for its investment in the target company. The assumption by the acquirer of debt obligations of the target company owed to the former shareholders of the target company is part of the contract to purchase shares in the target company between the acquirer and the former shareholders of the target company. The debt obligations of the target company are included in the cost of acquisition of the acquirer's investment in the target company by measuring the debt obligations at their fair value at acquisition date. The fair value of the debt obligations is measured by discounting the future cash payments to present value at acquisition date.

*Item 9: The fair value of unsecured notes issued by the acquirer company to target company shareholders*

*Explanation:* The unsecured notes issued by the acquirer company forms part of the consideration paid by the acquirer for its investment in the target company. The unsecured notes issued by the acquirer are included in the cost of acquisition of the acquirer's investment in the target company by measuring the unsecured notes at their fair value at acquisition date. The fair value of the unsecured notes is measured by discounting the future cash payments to present value at acquisition date.

The following items should not be included in the cost of the acquirer company's investment in the target company:

*Item 3: The fair value of debt obligations of the target company assumed by the acquirer company—if the debt obligations of the target company are not owed to the former shareholders of the target company*

*Explanation:* The debt obligations of the target company, which are not owed to

its former shareholders, and is assumed by the acquirer company, does not form part of the consideration paid by the acquirer for its investment in the target company. The assumption by the acquirer of debt obligations of the target company owed to other entities does not involve the former shareholders of the target company, and therefore is not part of the contract to purchase shares in the target company between the acquirer and the former shareholders of the target company. The assumption by the acquirer of debt obligations of the target company owed to other entities is a transaction between the acquirer and the target company.

*Item 4: Stamp duty payable on acquisition of target company shares*

*Explanation:* The stamp duty payable on acquisition of target company shares does not form part of the consideration paid by the acquirer for its investment in the target company. The stamp duty payable is an acquisition-related cost, which AASB 3.53 requires to be expensed in the period incurred.

*Item 5: Accounting fees for a due diligence report on the target company*

*Explanation:* The accounting fees for a due diligence report on the target company do not form part of the consideration paid by the acquirer for its investment in the target company. The accounting fees are acquisition-related costs, which AASB 3.53 requires to be expensed in the period incurred.

*Item 6: Costs incurred by a department in the parent entity formed to facilitate the acquisition of the target company*

*Explanation:* The costs incurred by a department in the parent entity, formed to facilitate the acquisition of the target company, do not form part of the consideration paid by the acquirer for its investment in the target company. The costs incurred by the department are an acquisition-related cost, which AASB 3.53 requires to be expensed in the period incurred.

*Item 7: Borrowing costs incurred on debt used to finance the acquisition of the target company*

*Explanation:* The borrowing costs incurred on debt used to finance the acquisition of the target company do not form part of the consideration paid by the acquirer for its investment in the target company. The borrowing costs are a finance cost, which is required to be expensed in the period it is incurred.

*Item 8: Allocation of directors' fees for time spent on the acquisition of the target company*

*Explanation:* The portion of directors' fees attributable to the time spent by directors on the acquisition of the target company does not form part of the consideration paid by the acquirer for its investment in the target company. If additional directors' fees are incurred due to time spent on the acquisition of the target company, the additional directors' fees are an acquisition-related cost, which AASB 3.53 requires to be expensed in the period incurred. Alternatively, if no additional directors' fees are incurred due to the acquisition of the target company, the directors' fees are not an acquisition-related cost, but the directors' fees are still expensed in the period incurred.

*Item 10: Redundancy costs payable to employees of the target company as part of a planned restructuring of the target company*

*Explanation:* The redundancy costs payable to employees of the target company as part of a planned restructuring of the target company do not form part of the consideration paid by the acquirer for its investment in the target company. The redundancy costs payable to employees, do not involve the former shareholders of the target company, and therefore is not part of the contract to purchase shares in the target company between the acquirer and the former shareholders

of the target company.

The redundancy costs payable should not be recognised as part of the target company's net identifiable assets purchased by the acquirer at acquisition date, because the redundancy costs the acquirer expects to incur, but is not obliged to incur, are not liabilities at acquisition date (AASB 3.10 and 3.11). Subsequent to acquisition date, the acquirer must recognise a liability for redundancy costs payable in the consolidated financial statements, when the acquirer has detailed a formal plan for restructuring, and the acquirer has raised a valid expectation that it will implement the restructuring plan by commencing to implement the restructuring plan, or announcing its main features to those affected by it (AASB 137.72).

## **Q2.7 Goodwill (Section 2.4)**

### **Recognition and initial measurement of goodwill**

At acquisition date, goodwill is measured as the excess of the cost of a parent entity's investment in a subsidiary over the fair value of the subsidiary's net identifiable assets acquired by the parent.

In particular, AASB 3.32 requires goodwill to be initially measured as the excess of (a) over (b).

- (a) The aggregate of:
- (i) the fair value of the consideration transferred by the parent on acquisition date to obtain control of the subsidiary;
  - (ii) the value of any non-controlling interest in the subsidiary at acquisition date; and
  - (iii) the fair value at acquisition date of the parent's equity in the subsidiary purchased prior to acquisition date, where control of the subsidiary is achieved via several equity purchases on different dates.
- (b) The fair value at acquisition date of the net amount of assets acquired and liabilities assumed in the subsidiary.

AASB 3 requires goodwill to be initially recognised as an asset only in the consolidated statement of financial position. Goodwill is not recognised in the separate accounts of the parent entity, or the subsidiary.

### **Impairment and subsequent measurement of goodwill**

After recognition, goodwill must be tested annually for impairment, not necessarily at the end of the reporting period, and more frequently if impairment indicators are observed after initial impairment testing, but before the end of the reporting period (AASB 136.90 and 136.96). Where goodwill is acquired in a business combination in the current reporting period, the goodwill must be tested for impairment before the end of the reporting period (AASB 136.96).

Goodwill cannot be tested independently for impairment, because goodwill does not generate cash flows independently of other assets and it is not possible to measure either goodwill or a related impairment loss directly. Therefore, to test goodwill for impairment, goodwill must be allocated among the cash-generating units expected to benefit from the goodwill (AASB 136.80). A cash-generating unit "is the smallest identifiable group of assets that generates cash flows that are largely independent of the cash flows of other assets or groups of assets" (AASB 136.6). The cash-generating unit to which goodwill is allocated shall be the lowest level within the group at which

goodwill is monitored for internal management purposes, and should not be larger than an operating segment as defined in AASB 8 *Operating Segments* (AASB 136.80).

Impairment testing is conducted for cash-generating units in the same manner as individual assets are tested for impairment. Where the carrying amount of the assets allocated to a cash-generating unit exceeds the recoverable amount of the cash-generating unit, the cash-generating unit is impaired, and must be written down to its recoverable amount by recognising an impairment loss (AASB 136.90). The impairment loss attributable to a particular cash-generating unit must be allocated among the assets comprising the cash-generating unit. Where the cash-generating unit includes goodwill, any impairment loss is first applied to goodwill (AASB 136.104). An impairment loss to goodwill is recorded in the consolidated accounts.

After initial recognition, goodwill is measured at cost less (any) accumulated impairment losses.

## **Q2.8 Gain on bargain purchase of an investment (Section 2.4)**

### **Accounting treatment of goodwill required by AASB accounting standards**

The statement provided in the question correctly describes the accounting treatment of goodwill required by accounting standards (although the description provided is incomplete). Where the cost of a parent entity's investment in a subsidiary exceeds the fair value of the subsidiary's net identifiable assets acquired by the parent, goodwill is recognised. AASB 3 requires goodwill to be initially recognised as an asset in the consolidated statement of financial position. After recognition, goodwill must be tested annually for impairment, and more frequently if impairment indicators are observed after initial impairment testing, but before the end of the reporting period, in accordance with AASB 136. Where the carrying amount of goodwill exceeds its expected recoverable amount, goodwill is impaired, and must be written down to its recoverable amount, by recognising an impairment loss.

### **Accounting treatment of gain on bargain purchase required by AASB 3**

The statement provided in the question correctly describes the accounting treatment of gain on bargain purchase required by AASB 3, although the description provided is incomplete. Where the fair value of the subsidiary's net identifiable assets acquired by the parent exceeds the cost of a parent entity's investment in a subsidiary, a gain on bargain purchase is identified. Where a gain on bargain purchase is identified, AASB 3.36 requires the parent entity to review whether:

- 1 All the identifiable assets acquired and liabilities assumed were identified and recognised;
- 2 The identifiable assets and liabilities were correctly measured at their fair value at acquisition date;
- 3 The cost of investment in subsidiary has been correctly valued;
- 4 Any non-controlling interest in the subsidiary has been correctly valued; and
- 5 Where control of the subsidiary is achieved via several equity purchases on different dates, the parent's equity in the subsidiary purchased prior to acquisition date has been correctly measured at fair value at acquisition date.

If a gain on bargain purchase remains after conducting the review required by AASB 3.36, AASB 3.34 requires the gain on bargain purchase to be recognised as a gain on acquisition date, in the consolidated statement of comprehensive

income.

### **Rationale for the accounting treatment of gain on bargain purchase required by AASB 3**

The requirement of AASB 3 to review the calculation of a gain on bargain purchase, where a gain on bargain purchase is identified, is most likely attributable to the very low probability of the fair value of the subsidiary's net identifiable assets acquired by the parent exceeding the cost of a parent entity's investment in a subsidiary. No other AASB accounting standard requires calculations to be reassessed.

Where the parent entity has been able to acquire its investment in the subsidiary for a cost less than the fair value of the subsidiary's net identifiable assets acquired, the parent has obtained an immediate gain, which should be recognised in consolidated profit or loss.

### **Q2.9 Investment elimination entry (Section 2.3)**

#### **Investment elimination entry**

The investment elimination entry refers to the consolidation worksheet adjusting entry which eliminates the parent entity's investment in subsidiary asset against the pre-acquisition equity of the subsidiary acquired by the parent on acquisition date. Any difference between the cost of the parent's investment in subsidiary and the fair value of the subsidiary's equity acquired by the parent on acquisition date is recognised as either goodwill or gain on bargain purchase.

#### **Repeating investment elimination entry in successive reporting periods**

The investment elimination entry is repeated in consolidation worksheets in each successive reporting period because consolidation worksheet adjusting entries do not carry forward from one reporting period to the next, as they are not posted to the accounts of either the parent entity or its subsidiaries. At each reporting/consolidation date, the consolidation commences with the accounts of the parent entity and its subsidiaries at that date, which do not include the consolidation adjusting entries of previous reporting periods. Where consolidation worksheet adjusting entries from the previous reporting period are still relevant in the current reporting period, they are repeated in the current period consolidation.

The group as a whole has no separate accounting records, and in particular has no ledger. Consolidation worksheet adjusting entries are prepared at the end of each reporting period and posted to the consolidation worksheet, which is used to prepare consolidated financial statements.

#### **Events which cause the investment elimination entry to alter from one reporting period to the next**

The investment elimination entry in the current reporting period will differ from the investment elimination entry in the preceding reporting period, where pre-acquisition retained earnings has been transferred to a reserve, or where a bonus share issue has capitalised part of pre-acquisition equity.

The transfer of pre-acquisition retained profits to a reserve, and a bonus share issue funded from pre-acquisition equity, have the effect of transferring part of pre-acquisition equity from one equity account of the subsidiary to another equity account of the subsidiary. The transfer of part of pre-acquisition equity from one equity account to another equity account will require corresponding changes in the amounts debited (or credited) to these equity accounts in the investment

elimination entry. The investment elimination entry must reflect the classification of pre-acquisition equity at reporting/consolidation date, rather than the classification in the preceding reporting period (or at acquisition date).

### **Q2.10 Dividends (Section 2.3.3)**

#### **Cum-dividend**

If shares in a new subsidiary are acquired *cum-dividend*, the right to receive the dividend declared but not paid by the subsidiary at acquisition date accrues to the new shareholder of the subsidiary, the parent entity. The dividend declared but not yet paid by the subsidiary at acquisition date forms part of what is purchased by the new parent entity.

#### **Ex-dividend**

Alternatively, if shares in a new subsidiary are acquired *ex-dividend*, right to receive the dividend declared but not paid by the subsidiary at acquisition date remains with the former shareholders of the subsidiary. The dividend declared but not yet paid by the subsidiary at acquisition date, is not purchased by the new parent entity.

### **Q2.11 Accounting periods and accounting policies (Section 2.2.4)**

- 1 Different reporting dates of Gisela Ltd and Joao Ltd  
The *Corporations Act 2011* s. 323D(3) requires a parent entity that must prepare consolidated financial statements to do whatever is necessary to ensure that the financial years of all subsidiaries have the same financial year period as the parent entity. Synchronisation of financial years must occur within 12 months of acquiring a subsidiary. To assist with synchronisation, the financial year of a newly acquired subsidiary may be extended or shortened, but cannot be longer than 18 months (s. 323D(4)). Therefore, the *Corporations Act* requires that the reporting date of Joao Ltd be changed to 30 June so that the reporting date and financial year of Joao Ltd coincides with the reporting date and financial year of its new parent entity, Gisela Ltd.
- 2 Differences accounting policies of Gisela Ltd and Joao Ltd for valuation of land  
AASB 10.19 requires consolidated financial statements to be prepared using uniform accounting policies for similar transactions and other events in similar circumstances. Groups are required to apply consistent accounting policies for similar transactions and events, except where permitted by AASB standards (AASB 108.13). An entity may apply different accounting policies provided that the differences are justified by dissimilar circumstances and events. Therefore, the accounting policy of Joao Ltd relating to the valuation of land must be changed to historic cost valuation, so that its accounting policy is consistent with Gisela Ltd, and any other subsidiaries in the Gisela Ltd Group.

The management of the parent entity will normally act to ensure that consistent accounting policies are used in the separate accounting records of the entities in the group whenever this is possible. However, it may not be possible for the parent entity to impose consistent accounting policies on a subsidiary (e.g., a foreign subsidiary that must report in another country) using an accounting policy required by local accounting standards that is not permitted in Australia.

Where a subsidiary adopts different accounting policies from those used in the consolidated financial report for similar transactions or events, and the impact

on the consolidated financial statements is material, then appropriate consolidation adjustments must be made to achieve uniformity when preparing the consolidated financial report (AASB 10B.87). If Joao Ltd continues to value land at fair value, consolidation adjustments are required to restate Joao Ltd's land from fair value to historic cost valuation, and eliminate the associated revaluation surplus, deferred tax liability and deferred tax expense, to achieve uniformity in the accounting method used to value land in the consolidated financial statements of Gisela Ltd Group. Alternatively, Joao Ltd must prepare a second financial report for consolidation purposes, which uses historic cost valuation of land.

## **Q2.12 Intragroup transactions (Sections 2.4 and 2.5)**

### **Consolidation eliminations and adjustments required for the year ending 31 December 20X5**

- 1 Elimination of Paredes Ltd's investment in Carlos Ltd against the pre-acquisition equity of Carlos Ltd acquired on 1 January 20X5 and recognition of goodwill  
*Explanation:* It is necessary to eliminate the parent entity's investment in subsidiary asset and the portion of the subsidiary's pre-acquisition equity acquired by the parent because a group cannot recognise an investment in itself as an asset, nor can a group recognise equity in itself as equity, because this is inconsistent with presenting the group as a single entity in the consolidated financial report. The elimination of the parent entity's investment in subsidiary asset also avoids double counting of the subsidiary's net assets on acquisition date: first, as the assets and liabilities of the subsidiary on acquisition date; and second, as the investment in subsidiary asset. The elimination of the subsidiary's pre-acquisition equity is necessary because a group can only earn profits from an investment, after the investment occurs.
- 2 Elimination of intragroup dividend revenue and intragroup dividend declared  
*Explanation:* It is necessary to eliminate the effect of intragroup dividends upon consolidation, since a group cannot pay dividends to itself. The dividend revenue is not a valid revenue of the group because no revenue is derived by the group from an external party. Similarly, dividend declared is not a valid profit distribution of the group because no dividend was distributed by the group to shareholders external to the group.
- 3 Elimination of intragroup dividend receivable and intragroup dividend payable  
*Explanation:* It is necessary to eliminate the intragroup balances owing upon consolidation, since a group cannot owe dividends to itself. The dividend receivable is not a valid asset of the group because no asset is receivable by the group from an external party. Similarly, dividend payable is not a valid liability of the group because no dividend is payable by the group to an external party.

## Q2.13 Goodwill or gain on bargain purchase (Section 2.4)

### Goodwill or gain on bargain purchase as at 1 July 20X7

#### Acquisition analysis

<i>Cost of acquisition of investment in Fate Ltd</i>	<b>\$</b>
Fair value of purchase consideration for 100% of Fate Ltd's equity <sup>1</sup>	3 200 000
Less Fair value of identifiable net assets of Fate Ltd	
Recorded value of equity (equals carrying amount of identifiable net assets)	<u>3 500 000</u>
Add (subtract) Fair value adjustments to identifiable net assets	=
Fair value of identifiable net assets of Fate Ltd acquired	<u>3 500 000</u>
<b>Gain on bargain purchase:</b> cost of acquisition < fair value of identifiable net assets	(300 000)
	=====

#### Note:

- 1** The cost of acquisition of Destiny Ltd's investment in Fate Ltd does not include acquisition-related costs incurred by Destiny Ltd: legal costs (\$90 000).

### Goodwill or gain on bargain purchase as at 5 July 20X7

#### Acquisition analysis

<i>Cost of acquisition of investment in Fate Ltd</i>	<b>\$</b>	<b>\$</b>
Fair value of purchase consideration for 100% of Fate Ltd's equity		3 200 000
Less Fair value of identifiable net assets of Fate Ltd		
Recorded value of equity (equals carrying amount of identifiable net assets)		<u>3 500 000</u>
Add (subtract) Fair value adjustments to identifiable net assets		=
Understatement of liability for employee entitlements	(120 000)	
Overstatement of fair value of inventory (\$420 000 - \$600 000)	(180 000)	<u>(300 000)</u>
Adjusted Fair value of identifiable net assets of Fate Ltd acquired		<u>3 200 000</u>
<b>No goodwill nor Gain on bargain purchase:</b> cost of acquisition = fair value of identifiable net assets		0
		=====

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*Extracts from Financial Statements for the year ended 30 June 20X5*

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*Misia Ltd*

*\$000*

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*Statement of Financial Position as at 30 June 20X5*

*Shareholders' equity*

Issued capital	7,000
Retained earnings	<u>13,000</u>
Total equity	<u><u>20,000</u></u>

*Statement of Changes in Equity for the year ended 30 June 20X5*

Profit for the year	1,800
Dividends paid	1,000

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***Ruas Ltd***  
***\$000***

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3,500  

---

5,800  

---

**9,300**

700  
400

---







### **Additional information**

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- (a) In 20X2, Misia Ltd acquired all the issued shares of Ruas Ltd for \$9,000,000.
- (b) At acquisition date, Ruas Ltd's equity consisted of issued capital of \$3,500,000 \$4,200,000.
- (c) At acquisition date, the assets and liabilities of Ruas Ltd were recorded at their

### **Acquisition analysis:**

---

*Cost of acquisition of investment in Ruas Ltd*

Fair value of purchase consideration for 100% of Ruas Ltd's equity

*Less fair value of identifiable net assets of Ruas Ltd*

Recorded value of equity (equals carrying amount of identifiable net assets)

    Issued capital

    Retained earnings

Add/subtract fair value adjustments to identifiable net assets

Fair value of identifiable net assets of Ruas Ltd acquired

Goodwill: cost of acquisition > fair value of identifiable net assets

---

and retained earnings of

fair values.

	<u>\$</u>	<u>\$</u>
		9,000,000
	3,500,000	
	<u>4,200,000</u>	7,700,000
		<u>-</u>
		<u>7,700,000</u>
		<u><u>1,300,000</u></u>

---

**Consolidation worksheet journal entries for consolidation at 30 June 20X5**

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	<b>Dr.</b>
	<b>\$000</b>
<i>(a) Elimination of Misia Ltd's investment in subsidiary asset against the pre-acquisition equity of Ruas Ltd acquired at acquisition date, and recognition of goodwill</i>	
Dr Issued capital	3,500
Dr Retained earnings 1 July 20X4	4,200
Dr Goodwill	1,300
Cr Investment in Ruas Ltd	
 <i>(b) Elimination of intragroup dividend paid by Ruas Ltd to Misia Ltd</i>	
Dr Dividend revenue	400
Cr Dividend paid	

---

---

Cr.  
*\$000*

---

9,000

400

---



**Misia Ltd Group****Consolidated Profit for the year ended 30 June 20X5**

	<u>\$000</u>	<u>\$000</u>
<i>Misia Ltd's contribution to group profit</i>		
Misia Ltd's profit for the year	1,800	
Less Intragroup dividend revenue*	<u>(400)</u>	
		1,400
<i>Ruas Ltd's contribution to group profit</i>		
Ruas Ltd's profit for the year	<u>700</u>	
		700
Consolidated profit for the year		<u><u>2,100</u></u>

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\*The profit of Misia Ltd includes dividend revenue of \$400,000 received from Ruas Ltd. The intragroup dividend revenue is eliminated upon consolidation.



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*Statements of Financial Position as at 1 April 20X8*

	<i>Guerreiro Ltd</i>	<i>Katia Ltd</i>
	<i>\$000</i>	<i>\$000</i>
<i>Assets</i>		
Other assets	2,000	1,700
Investment in Katia Ltd	1,450	-
Total assets	<u>3,450</u>	<u>1,700</u>
<i>Liabilities</i>		
Debenture payable	550	-
Other liabilities	1,000	580
Net assets	<u>1,900</u>	<u>1,120</u>
<i>Shareholders' equity</i>		
Issued capital	1,300	700
Retained earnings	600	420
Total equity	<u>1,900</u>	<u>1,120</u>

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### **Additional information**

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- (a) On 1 April 20X8, Guerreiro Ltd acquired all the issued shares in Katia Ltd for a cash issue \$550,000 in 8% debentures.
- (b) On 1 April 20X8, the carrying amount of the assets and liabilities of Katia Ltd is as follows:

### **Acquisition analysis:**

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*Cost of acquisition of investment in Katia Ltd*

Fair value of purchase consideration for 100% of Katia Ltd's equity

*Less fair value of identifiable net assets of Katia Ltd*

Recorded value of equity (equals carrying amount of identifiable net assets)

Issued capital

Retained earnings

Add/subtract fair value adjustments to identifiable net assets

Fair value of identifiable net assets of Katia Ltd acquired

Goodwill: cost of acquisition > fair value of identifiable net assets

---

a cash payment of \$900,000 and the reflected their fair values.

<u>\$</u>	<u>\$</u>
	1,450,000
700,000	
<u>420,000</u>	1,120,000
	<u>-</u>
	<u>1,120,000</u>
	<u>330,000</u>

**Guerreiro Ltd Group Consolidation Worksheet at 1 April 20X8**

	<i>Financial statements</i>		<i>Consolidation adj</i>	
	<i>Guerreiro Ltd</i>	<i>Katia Ltd</i>	<i>Debit</i>	<i>Ref</i>
	<i>\$000</i>	<i>\$000</i>	<i>\$000</i>	
<i>Shareholders' equity</i>				
Issued capital	1,300	700	700	<b>a</b>
Retained earnings 1 April 20X8	600	420	420	<b>a</b>
Total equity	1,900	1,120		
<i>Liabilities</i>				
Debentures payable	550	-		
Other liabilities	1,000	580		
Total liabilities and equity	3,450	1,700		
<i>Assets</i>				
Other assets	2,000	1,700		
Investment in Katia Ltd	1,450	-		<b>a</b>
Goodwill	-	-	330	<b>a</b>
Total assets	3,450	1,700		

<i>adjustments</i>	<i>Group</i>	
<i>Credit</i>	<i>Consolidated</i>	
<i>\$000</i>	<i>\$000</i>	
	1,300	
	600	
	<u>1,900</u>	
	550	
	1,580	
	<u>4,030</u>	
	3,700	
1,450	-	
	330	
	<u>4,030</u>	





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**Consolidation worksheet journal entries for consolidation at 1 April 20X8**

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	<b>Dr.</b>
	<b>\$000</b>
<i>(a) Elimination of Guerreiro Ltd's investment in subsidiary asset against the pre-acquisition equity of Katia Ltd acquired at acquisition date, 1 April 20X8, and recognition of goodwill</i>	
Dr Issued capital	700
Dr Retained earnings 1 April 20X8	420
Dr Goodwill	330
Cr Investment in Katia Ltd	

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---

Cr.  
*\$000*

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1,450

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***Guerreiro Ltd Group***

***Consolidated Statement of Financial Position as at 1 April 20X8***

	<u><i>\$000</i></u>
<i>Assets</i>	
Other assets	3,700
Goodwill	<u>330</u>
Total assets	<u><u>4,030</u></u>
 <i>Liabilities</i>	
Debenture payable	550
Other liabilities	<u>1,580</u>
Net assets	<u><u>1,900</u></u>
 <i>Shareholders' equity</i>	
Issued capital	1,300
Retained earnings	<u>600</u>
Total equity	<u><u>1,900</u></u>







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*Statements of Financial Position as at 30 June 20X9*

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	<i>Dulce Ltd</i>
	<u><i>\$000</i></u>
<i>Shareholders' equity</i>	
Issued capital	7,800
General reserve	3,500
Retained earnings	<u>2,000</u>
Total equity	13,300
<i>Liabilities</i>	
Loans	<u>5,200</u>
Total liabilities and equity	<u><u>18,500</u></u>
 <i>Assets</i>	
Cash	6,300
Inventory	4,300
Property, plant and equipment (net)	<u>7,900</u>
Total assets	<u><u>18,500</u></u>

---

---

*Pontes Ltd*  
*\$000*

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2,400  
1,900  

---

1,100  

---

5,400

2,800  

---

8,200

---

---

300  
3,100  

---

4,800  

---

8,200

---

---

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## **Additional information**

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- (a) On 1 July 20X9, Dulce Ltd acquired all the issued shares of Pontes Ltd for \$5,7  
*Assume that on 1 July 20X9, the carrying amount of the assets and liabilities of values.*

## **Acquisition analysis:**

---

*Cost of acquisition of investment in Pontes Ltd*

Fair value of purchase consideration for 100% of Pontes Ltd's equity

*Less fair value of identifiable net assets of Pontes Ltd*

Recorded value of equity (equals carrying amount of identifiable net assets)

Issued capital

General reserve

Retained earnings

Add/subtract fair value adjustments to identifiable net assets

Fair value of identifiable net assets of Pontes Ltd acquired

Goodwill: cost of acquisition > fair value of identifiable net assets

---

700,000 cash.

£ Pontes Ltd reflected their fair

	\$	\$
		5,700,000
	2,400,000	
	1,900,000	
	<u>1,100,000</u>	5,400,000
		-
		<u>5,400,000</u>
		<u>300,000</u>

***Dulce Ltd Group Consolidation Worksheet at 1 July 20X9***

	<i>Financial statements</i>		<i>Consolida</i>
	<i>Dulce Ltd</i>	<i>Pontes Ltd</i>	<i>Debit</i>
	<i>\$000</i>	<i>\$000</i>	<i>\$000</i>
<i>Shareholders' equity</i>			
Issued capital	7,800	2,400	2,400
General reserve	3,500	1,900	1,900
Retained earnings 1 July 20X9	2,000	1,100	1,100
Total equity	13,300	5,400	
<i>Liabilities</i>			
Loans	5,200	2,800	
Total liabilities and equity	18,500	8,200	
<i>Assets</i>			
Cash*	600	300	
Inventory	4,300	3,100	
Property, plant and equipment (net)	7,900	4,800	
Investment in Pontes Ltd	5,700	-	
Goodwill	-	-	300
Total assets	18,500	8,200	

\*Cash = 6,300,000 (balance at 30 June 20X9) – 5,700,000 (cash paid for shares in Pontes Ltd) = 600,000

<i>tion adjustments</i>		<i>Group</i>
<i>Ref</i>	<i>Credit</i>	<i>Consolidated</i>
	<i>\$000</i>	<i>\$000</i>
<b>a</b>		7,800
<b>a</b>		3,500
<b>a</b>		2,000
		<u>13,300</u>
		8,000
		<u>21,300</u>
		<u><u>21,300</u></u>
		900
		7,400
		12,700
<b>a</b>	5,700	-
<b>a</b>		300
		<u>21,300</u>
		<u><u>21,300</u></u>

10,000





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**Consolidation worksheet journal entries for consolidation at 1 July 20X9**

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	<b>Dr.</b>
	<b>\$000</b>
<i>(a) Elimination of Dulce Ltd's investment in subsidiary asset against the pre-acquisition equity of Pontes Ltd acquired at acquisition date, 1 July 20X9, and recognition of goodwill</i>	
Dr Issued capital	2,400
Dr General reserve	1,900
Dr Retained earnings 1 July 20X9	1,100
Dr Goodwill	300
Cr Investment in Pontes Ltd	

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---

**Cr.**  
***\$000***

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5,700

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## **Additional information**

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- (b) On 1 July 20X9, Dulce Ltd acquired all the issued shares of Pontes Ltd for \$5,2  
*Assume that on 1 July 20X9, the carrying amount of the assets and liabilities of values.*

### **Acquisition analysis:**

---

*Cost of acquisition of investment in Pontes Ltd*

Fair value of purchase consideration for 100% of Pontes Ltd's equity

*Less fair value of identifiable net assets of Pontes Ltd*

Recorded value of equity (equals carrying amount of identifiable net assets)

    Issued capital

    General reserve

    Retained earnings 1 July 20X9

Add/subtract fair value adjustments to identifiable net assets

Fair value of identifiable net assets of Pontes Ltd acquired

Gain on bargain purchase: cost of acquisition < fair value of identifiable net assets

---

200,000 cash.

£ Pontes Ltd reflected their fair

	<u>\$</u>	<u>\$</u>
		5,200,000
	2,400,000	
	1,900,000	
	<u>1,100,000</u>	5,400,000
		<u>-</u>
		<u>5,400,000</u>
ets		<u><u>(200,000)</u></u>

**Dulce Ltd Group Consolidation Worksheet at 1 July 20X9**

	<i>Financial statements</i>		<i>Consolida</i>
	<i>Dulce Ltd</i>	<i>Pontes Ltd</i>	<i>Debit</i>
	<i>\$000</i>	<i>\$000</i>	<i>\$000</i>
Profit for the year#	-	-	
Retained earnings - opening	2,000	1,100	1,100
<i>Shareholders' equity</i>			
Retained earnings - closing	2,000	1,100	
Issued capital	7,800	2,400	2,400
General reserve	3,500	1,900	1,900
Total equity	13,300	5,400	
<i>Liabilities</i>			
Loans	5,200	2,800	
Total liabilities and equity	18,500	8,200	
<i>Assets</i>			
Cash*	1,100	300	
Inventory	4,300	3,100	
Property, plant and equipment (net)	7,900	4,800	
Investment in Pontes Ltd	5,200	-	
Total assets	18,500	8,200	

\*Cash = 6,300,000 (balance at 30 June 20X9) – 5,200,000 (cash paid for shares in Pontes Ltd) = 1,100,000

# This consolidation worksheet adjusting entry allows the gain on bargain purchase arising from the gain recognised in profit for the period in the year of acquisition, (as required by AASB3.34), in the consolidated financial statements of Dulce Ltd Group.

In subsequent reporting periods following acquisition, the gain on bargain purchase must be included in the earnings of the group because the gain occurred in a prior period.

<i>tion adjustments</i>		<i>Group</i>
<i>Ref</i>	<i>Credit</i>	<i>Consolidated</i>
	<i>\$000</i>	<i>\$000</i>
<b>a</b>	200	200
<b>a</b>		2,000
		2,200
<b>a</b>		7,800
<b>a</b>		3,500
		13,500
		8,000
		21,500
		1,400
		7,400
		12,700
<b>a</b>	5,200	-
		21,500

100,000

e acquisition of Pontes Ltd to be  
 consolidated financial statements of the Dulce

ed in the opening balance of retained





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**Consolidation worksheet journal entries for consolidation at 1 July 20X9**

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	<b>Dr.</b>
	<b>\$000</b>
<i>(a) Elimination of Dulce Ltd's investment in subsidiary asset against the pre-acquisition equity of Pontes Ltd acquired at acquisition date, 1 July 20X9, and recognition of gain on bargain purchase</i>	
Dr Issued capital	2,400
Dr General reserve	1,900
Dr Retained earnings- opening	1,100
Cr Gain on bargain purchase	
Cr Investment in Pontes Ltd	

---

---

**Cr.**  
***\$000***

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200  
5,200

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