

ACC2100 / ACF2100 Financial Accounting

Topic 8 Consolidations: Wholly Owned Subsidiaries: Lecture Example

On 1 July 2016, Batman Ltd acquired all of the share capital of Superman Ltd for \$218 500.

At this date, Superman's equity comprised:

o Share Capital (100 000 shares)	\$100 000
o General reserve	\$50 000
o Retained earnings	\$36 000

All identifiable assets and liabilities of Superman Ltd were recorded at fair value as at 1 July 2016 except for the following:

	Carrying amount	Fair value
o Inventory	\$27 000	\$35 000
o Land	\$75 000	\$90 00
o Equipment (cost \$100 000)	\$50 000	\$60 000

We have assets not recorded at FV...so we need to prepare BCVR entries

The equipment is expected to have a further 10-year life. All of the inventory was sold by June 2017. The tax rate is 30%.

Depn and sales of assets will affect BCVR/pre-acq entries

On 30 June 2017, the directors of Superman Ltd decided to transfer \$25 000 from the general reserve to retained earnings.

Transfers of equity like this one will affect our pre-acq entry

Batman Ltd applies the partial goodwill method.

The partial goodwill method (to be covered in topic 9) means we show goodwill in our pre-acq entry, and not the BCVR entries

Required

Prepare the consolidation worksheet entries for the preparation of the consolidated financial statements for Batman Ltd and its subsidiary Superman Ltd as at:

- 1) 1 July 2016
- 2) 30 June 2017
- 3) 30 June 2018, assuming goodwill has been impaired by \$1 000

Always note dates...
Very important!

ACC2100 / ACF2100 Financial Accounting

Topic 8 Consolidations: Wholly Owned Subsidiaries: Lecture Example Solution

At 1 July 2016... Batman Ltd – 100% – Superman Ltd

1) Worksheet entries at 1 July 2016 (acquisition date)

STEP 1 Acquisition analysis:

FVINA of Superman Ltd	=	(\$100 000 + \$50 000 + \$36 000) (<u>equity</u>)
		+ \$8 000 (1 – 30%) (inventory)
		+ \$15 000 (1 – 30%) (land)
		+ \$10 000 (1 – 30%) (equipment)
	=	\$
Consideration transferred	=	\$
Goodwill	=	\$

We will revalue these assets in our BCVR entries. This will create a tax effect and the BCVR (equity).

STEP 2 BCVR entries (at acquisition date)

Inventory, land, equipment on hand. No sales of assets or depreciation adjustments.

Remember deferred tax...here we are increasing the CA for accounting, however there has been no change to tax. This creates a TTD so we need to record the DTL.

Inventory	Dr
DTL (30%)	Cr
Business combination valuation reserve (BCVR)	Cr
(Valuation adjustment for inventory)	

Land	Dr
DTL	Cr
BCVR	Cr
(Valuation adjustment for land)	

Accumulated depreciation - equipment	Dr
Equipment	Cr
DTL	Cr
BCVR	Cr
(Valuation adjustment for equipment)	

Net rev. effect only...no OCI!

STEP 3 Pre-acquisition entries

RE (op)	Dr
Share capital	Dr
General reserve	Dr
BCVR (5 600 + 10 500 + 7 000)	Dr
Goodwill	Dr
Shares in Superman Ltd	Cr

(Pre-acquisition entry required on consolidation)

2. Worksheet entries at 30 June 2017 (one year since acquisition)

STEP 2 BCVR entries (one year since acquisition)

Inventory sold in current year. Land and equipment on hand...but we need a depreciation adjustment for equipment for one year.

Cost of sales	Dr
Income tax expense	Cr
Transfer from BCVR (RE)	Cr

(Valuation adjustment on sale of inventory)

Land	Dr
DTL	Cr
BCVR	Cr

(Valuation adjustment for land)

Accumulated depreciation - equipment	Dr
Equipment	Cr
DTL	Cr
BCVR	Cr

(Valuation adjustment for equipment)

Depn recorded by subsidiary:	\$5 000 (\$50 000 / 10 yrs)
Depn recorded by group:	<u>\$6 000</u> (\$60 000 / 10 yrs)

Adjustment required:

OR you can use the following calculation...

CA increased by \$10 000 so depn increases by (\$10 000 / 10 yrs)

When inv is sold, subs. records COS of \$27000. But COS should be \$35000 for the group! Increasing COS then reduces both profit \$8000 & ITE \$2400.

We will use this method from now on

Depreciation expense	Dr
Accumulated depreciation	Cr
(Depreciation adjustment)	

CA (and taxable temporary difference) reduced by \$1 000, so DTL must be reduced by... (\$1 000 x 30%) \$300

DTL	Dr
Income tax expense	Cr
(Tax effect on depreciation adjustment)	

There is a **deferred tax effect** – we have reduced CA by \$1000 and reversed out some of our TTD, so we need to reduce DTL by \$300.

There is also a **current tax effect** – we have reduced profit by \$1000 through depn exp and so need to reduce ITE by \$300.

STEP 3 Pre-acquisition entries

There are two changes since acquisition that affect the pre-acquisition entry:

- transfer from general reserve \$25 000
- transfer from BCVR on sale of inventory \$5 600

RE (op)	Dr	36 000	
Share capital	Dr	100 000	
General reserve	Dr	50 000	
BCVR	Dr	23 100	
Goodwill	Dr	9 400	
Shares in Superman Ltd	Cr		218 500

Transfer from general reserve (RE)	Dr
General reserve	Cr

Transfer from BCVR (RE)	Dr
BCVR	Cr

(Pre-acquisition entries required on consolidation)

The transfer accounts will be closed to RE at year end

Don't get confused with DRs and CRs...remember these are elimination entries!

3. Worksheet entries at 30 June 2018 (two years since acquisition)

STEP 2 BCVR entries (one year since acquisition)

Inventory adjustment? No! Inventory was sold in the previous year...BUT remember this will still affect the pre-acquisition entry.

Land	Dr
DTL	Cr
BCVR	Cr

(Valuation adjustment for land)

Accumulated depreciation - equipment	Dr
Equipment	Cr
DTL	Cr
BCVR	Cr

(Valuation adjustment for equipment)

CA increased by \$10 000 so depn increases by (\$10 000 / 10 yrs) \$1 000 p.a. for 2 yrs

Depreciation expense	Dr
RE (op)	Dr
Accumulated depreciation	Cr

(Depreciation adjustment)

RE represents previous years' profits/losses... depn exp and ITE for 2017 has been closed off here

CA reduced by \$1 000 p.a. so DTL must be reduced by (\$1 000 x 30%) \$300 p.a. for 2 yrs

DTL	Dr
Income tax expense	Cr
RE (op)	Cr

(Tax effect on depreciation adjustment)

Remember we need to post these entries every time we prepare the reports for the group!

STEP 3 Pre-acquisition entries

The pre-acquisition entries are now affected by:

- transfer from general reserve \$25 000 in previous year
- transfer from BCVR (on sale of inventory) \$5 600 in previous year
- RE adjustment = 36 000 pre-acq + 25 000 GR transfer + 5 600 BCVR transfer = \$66600
- impairment of goodwill in current year \$1 000

RE (op)	Dr
Impairment expense	Dr
Share capital	Dr
General reserve (50 000 – 25 000)	Dr
BCVR (10 500 land + 7 000 equip)	Dr
Goodwill	Dr
Shares in Superman Ltd	Cr
Accumulated impairment	Cr

(Pre-acquisition entry required on consolidation)

Adding in impairment
exp for the group

Remember...inv sold
in the previous year