Chapter 16
Consolidation: Wholly owned subsidiaries
Prepared by
Emma Holmes

The consolidation process

Before consolidating, it may be necessary to adjust subsidiary’s financial statements where:

1. The subsidiary’s balance date is different to the parent’s. In such cases the subsidiary is required to prepare adjusted financial statements as at the parent’s reporting date. 
   Eg: 30 June vs. 31 December

2. The subsidiary’s accounting policies are different to the parent’s. In such cases the subsidiary is required to prepare adjusted accounts to ensure accounting policies consistent with the parent.
   Eg: cost vs. revaluation methods of accounting for non-current assets

The consolidation process

Consolidation involves adding together the financial statements of the parent and subsidiaries and making a number of adjustments:

- Business combination valuation entries – required to adjust the carrying amounts of the subsidiary’s assets and liabilities to fair value
- Pre-acquisitions entries – required to eliminate the carrying amount of the parents investment in each subsidiary against the pre-acquisition equity of that subsidiary
- Transactions between entities within the group subsequent to acquisition date (chapter 17)
Consolidation journals are posted into the consolidation worksheet in “adjustment” columns as follows:

<table>
<thead>
<tr>
<th>Parent</th>
<th>Subsidiary</th>
<th>Adjustments</th>
<th>Cons Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>400</td>
<td>150</td>
<td>XX</td>
<td>XX</td>
</tr>
<tr>
<td>200</td>
<td>100</td>
<td>XX</td>
<td>XX</td>
</tr>
<tr>
<td>100</td>
<td>50</td>
<td>XX</td>
<td>XX</td>
</tr>
<tr>
<td>500</td>
<td>150</td>
<td>XX</td>
<td>XX</td>
</tr>
<tr>
<td>100</td>
<td>50</td>
<td>XX</td>
<td>XX</td>
</tr>
<tr>
<td>700</td>
<td>150</td>
<td>XX</td>
<td>XX</td>
</tr>
</tbody>
</table>

- All consol. journals recorded in these DR/CR columns
- Purpose: to remove the parent’s investment in the subsidiary and the effect of all interentity transactions so that the final column shows an “external view”

Consolidation journal adjustments are ONLY prepared for the purpose of consolidation

- They are posted onto the consolidation worksheet only—they are NOT recorded in the books of the parent or the subsidiary
- As a result, some consolidation adjustments are repeated every time consolidated accounts are prepared

Acquisition analysis

- An acquisition analysis compares the cost of acquisition with the fair value of the identifiable net assets and contingent liabilities (FVINA) that exist at acquisition to determine whether there is:
  - Goodwill on acquisition (where cost > FVINA)
  - Bargain purchase (where cost < FVINA)
- Recall that goodwill is an unidentifiable intangible asset that is calculated as a residual value
- Also recall that net assets = assets – liabilities = shareholders equity
Acquisition analysis

- The FVINA include all identifiable asset and liabilities of the subsidiary as well as the fair value of any contingent liabilities the acquiree may have.
- Recall that contingent liabilities are not recognised in subsidiaries balance sheet—rather they are recorded by way of note disclosure only. AASB3 requires them to be recognised on the acquisition of another business.
- We commonly determine the FVINA with reference to the equity balances of the subsidiary, rather than the individual asset and liability balances.

Example – background information

Hitech Ltd acquired all of the issued share capital of Lotech Ltd on 30 June 2011 for a cash consideration of $400,000. At that time the net assets of Lotech Ltd were represented as follows:

<table>
<thead>
<tr>
<th></th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share capital</td>
<td>300,000</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>50,000</td>
</tr>
<tr>
<td>Net assets</td>
<td>350,000</td>
</tr>
</tbody>
</table>

The book value of identifiable net assets (BVINA) is $350,000.

Example – background information

When Hitech acquired its investment in Lotech the following information applied:

- Land held by Lotech was undervalued by $10,000.
- A building held by Lotech was undervalued by $45,000. The building had originally cost $100,000 2 years ago and was being depreciated at 10% per year.
- A contingent liability relating to an unsettled legal claim with a fair value of $3,000 was recorded in the notes to Lotech’s financial statements.

The tax rate is 30%.
Acquisition analysis - no previously held equity interest

- Cost of acquisition: $400,000
- Book value of net assets:
  - Share capital: $300,000
  - Retained earnings: $50,000
- Total book value of net assets: $350,000
- Fair value adjustments:
  - After tax increase in land: $7,000
  - After tax increase in building: $31,500
  - After tax recognition of provision for legal claim: $(2,100)
- Total fair value adjustments: $36,400
- FVINA: $386,400
- %age acquired: 100%
- Goodwill/bargain purchase on acquisition: $13,600

Parent has previously held equity interest

- Where control is achieved in stages the previously held equity instruments in the acquiree must be adjusted to fair value prior to performing the acquisition analysis.
- This will require additional entries to be made in the parent’s books.
- Consolidation entries will remain unchanged.
- Example: Hitech acquired 85% of Lotech on 30 June 2005 and the remaining 15% on 30 June 2011.

Worksheet entries at acquisition date - Business combination valuation entries

- If the BV of subsidiary assets and liabilities ≠ FV, or if a contingent liability exists, it is necessary to make “business combination valuation” adjustments. These adjustments:
  - increase or decrease subsidiary’s recorded assets and liabilities book values to fair value;
  - recognise previously unrecognised assets (eg internally generated intangibles); or
  - recognise subsidiary’s contingent liabilities as liabilities at fair values
- Business Combination Valuation Reserve (BCVR) account is used to record these adjustments. The BCVR is similar to the Asset Revaluation Surplus (ARS) account
While it is possible for these adjustments to be made directly in the books of the subsidiary, it is likely and common for these adjustments to be made on consolidation.

In some cases, other accounting standards prevent the adjustment from being made in the subsidiaries books.

- AASB 102 requires all inventory to be recorded at the lower of cost or NRV therefore where the FV of inventory is higher than the cost, such an adjustment may not be made in the subsidiaries books.

- AASB 138 does not allow the subsidiary to recognise internally generated goodwill.

Worksheet entries at acquisition date - Business combination valuation entries

Where the BCVR entry is done in the ARS account in the subsidiary’s books it is recorded in the G/L and therefore automatically carries forward to future periods once entered.

BUT

Where the entry is done in the BCVR on consolidation (ie on the worksheet) it must be manually carried forward to future periods.

Land

- Land is undervalued by $10,000

Accordingly, the business combination valuation adjustment required on consolidation at 30 June 2011 (the date of acquisition) is:

<table>
<thead>
<tr>
<th>DR</th>
<th>Land</th>
<th>10,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>CR</td>
<td>DTL</td>
<td>3,000</td>
</tr>
<tr>
<td></td>
<td>BCVR</td>
<td>7,000</td>
</tr>
</tbody>
</table>

This entry will be posted onto the consolidation worksheet - refer slide 20 (Ref 1).
Buildings
• Buildings must be increased by $45,000.
• The buildings in the statement of financial position need to change as follows

<table>
<thead>
<tr>
<th>Buildings at cost (100,000)</th>
<th>Acc. Depreciation (20,000)</th>
<th>Book value 80,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>AT PRESENT</td>
<td>REQUIRED</td>
<td></td>
</tr>
<tr>
<td></td>
<td>125,000</td>
<td>0</td>
</tr>
<tr>
<td>10% depreciation p.a for 2 years</td>
<td>125,000</td>
<td></td>
</tr>
</tbody>
</table>

The FV of the asset is considered to be the cost of the asset to the group

The business combination valuation adjustments required (on consolidation) at 30 June 2011 (the date of acquisition) are:
DR Accum Depreciation 20,000
CR Buildings 20,000
DR Buildings 45,000
CR DTL 13,500
CR BCVR 31,500

A single journal can be prepared as follows:
DR Buildings 25,000
DR Accum Depreciation 20,000
CR DTL 13,500
CR BCVR 31,500

Both of these journals will be posted onto the consolidation worksheet—refer slide 20 (Ref 2)

Contingent Liability
• Recognising a contingent liability for the first time will result in a liability that has a carrying amount but no tax base. Such adjustments result in a Deferred Tax Asset (DTA)
• The business combination valuation adjustment required on consolidation at 30 June 2011 (the date of acquisition) in relation to the contingent liability is:
DR BCVR 2,100
DR DTA 900
CR Provision for legal claim 3,000

This entry will also be posted onto the consolidation worksheet—refer slide 20 (Ref 3)
BCVR adjustments at acquisition date

**Goodwill**
- Goodwill arising on the acquisition is $13,600.
- The business combination valuation adjustment required on consolidation at 30 June 2011 (the date of acquisition) in relation to the goodwill is as follows:

  | DR Goodwill | 13,600 |
  | CR BCVR     | 13,600 |

- There is not tax effect arising on the recognition of goodwill as goodwill gives rise to an excluded temporary difference.

This entry will also be posted onto the consolidation worksheet—refer slide 20 (Ref 4).

**Notes**
- Goodwill, provision and BCVR exist on consolidation only (nil balance in parent & sub’s books).

BCVR adjustments at acquisition date

The consolidation journals will be posted onto the consolidation worksheet at 30 June 2011 (the date of acquisition) as follows:

<table>
<thead>
<tr>
<th>March</th>
<th>June</th>
<th>Adjustments</th>
<th>Group</th>
</tr>
</thead>
<tbody>
<tr>
<td>$000</td>
<td>$000</td>
<td>$000</td>
<td>$000</td>
</tr>
<tr>
<td>Cash in bank</td>
<td>400</td>
<td>200</td>
<td></td>
</tr>
<tr>
<td>Deferred Tax Asset</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land</td>
<td>-</td>
<td>200</td>
<td></td>
</tr>
<tr>
<td>Building</td>
<td>-</td>
<td>200</td>
<td></td>
</tr>
<tr>
<td>Accumulated Depreciation</td>
<td>-</td>
<td>200</td>
<td></td>
</tr>
<tr>
<td>Goodwill</td>
<td>400</td>
<td>-</td>
<td>13,600</td>
</tr>
<tr>
<td>Creditors</td>
<td></td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Provisions for legal claims</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share capital</td>
<td>500</td>
<td>200</td>
<td></td>
</tr>
<tr>
<td>Retained earnings</td>
<td>300</td>
<td>90</td>
<td></td>
</tr>
<tr>
<td>BCVR</td>
<td></td>
<td>200</td>
<td></td>
</tr>
</tbody>
</table>

Pre-acquisition entry at acquisition date

- Equity balances that existed in the subsidiary prior to acquisition date are referred to as pre-acquisition equity.
- All movements after the date of acquisition are referred to as post-acquisition.
- You cannot have an investment in yourself, nor can you have equity in yourself. From a consolidated viewpoint, these items should not exist i.e. they must be eliminated to avoid double counting.
- By acquiring 100% of the share capital of Lotech, Hitech effectively gained control of all of the individual assets and liabilities of Lotech. It is these balances that should be reflected in the consolidated statement of financial position.
Pre-acquisition entry at acquisition date

- The pre-acquisition entry eliminates the asset “Investment in subsidiary” (in the parent’s books) against the pre-acquisition equity (in the subsidiary’s books)
- The pre-acquisition entry required in our example is:
  
  **Debit** Share capital 300,000  
  **Debit** Retained earnings 50,000  
  **Debit** BCVR 50,000  
  **Credit** Investment in Lotech 400,000

These figures are taken from the acquisition analysis (refer back to slide 10)

Pre-acquisition entry at acquisition date

<table>
<thead>
<tr>
<th>Block</th>
<th>Land</th>
<th>Building</th>
<th>Accumulated Depreciation</th>
<th>Deferred in cost</th>
<th>Goodwill</th>
<th>Investment in Lotech Ltd</th>
<th>Cash in bank</th>
<th>Totals</th>
</tr>
</thead>
<tbody>
<tr>
<td>S’/00</td>
<td>-200</td>
<td>20</td>
<td>20</td>
<td>0</td>
<td>13.6</td>
<td>400</td>
<td>400</td>
<td>1,200</td>
</tr>
<tr>
<td>S’/’00</td>
<td>500</td>
<td>300</td>
<td>300</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>1,200</td>
</tr>
</tbody>
</table>

In the equity section of the statement of financial position the subsidiary’s balances have been eliminated in full – group balances = parent’s balances

Acquisition analysis – other issues

- Note also the impact of the following on the acquisition analysis (covered in textbook but not lecture notes):
  
  - Where subsidiary has recorded goodwill at acquisition date (p. 770)
  - Where subsidiary has recorded dividends at acquisition date (p. 771) [Referred to as cum. divs]
Gain on bargain purchase

- A gain on bargain purchase is rare and AASB 10 recommends re-assessment and confirmation of net asset fair values before such a gain is recognised
- Assume Hitech paid $360,000 for Lotech. (Acquisition analysis on following page)
- Pre-acquisition entry at 30 June 2011 is:

<table>
<thead>
<tr>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share capital</td>
<td>300,000</td>
<td></td>
</tr>
<tr>
<td>Retained earnings</td>
<td>50,000</td>
<td></td>
</tr>
<tr>
<td>BCVR</td>
<td>36,400</td>
<td></td>
</tr>
<tr>
<td>Investment</td>
<td>360,000</td>
<td></td>
</tr>
<tr>
<td>Gain on bargain purchase (P&amp;L)</td>
<td>26,400</td>
<td></td>
</tr>
</tbody>
</table>

Cost of acquisition      360,000
Book value of net assets
- Share capital 300,000
- Retained earnings 50,000
Total book value of net assets 350,000
Fair value (BCVR) adjustments
- After tax increase in land 7,000
- After tax increase in building 31,500
- After tax recognition of provision for legal claim (2,100)
Total fair value adjustments 36,400
FVINA 386,400
%age acquired 100% 386,400
Gain on bargain purchase on acquisition (26,400)

Worksheet entries subsequent to acquisition date

- So far, we have considered the consolidation journals required if a consolidation was being prepared on the acquisition date
- How do these journals change if a consolidation is being prepared on a later date?
- The business combination valuation adjustment entries may differ due to transactions and events occurring since acquisition
- The pre-acquisition entry may also be affected by a number of events
Worksheet entries subsequent to acquisition date – BCVR - land

- **What if**, during the year ended 30 June 2013 the land was sold for $250,000?

- **On sale**, Lotech Ltd recognised the following journal:
  - **DR Cash** 250,000
  - **CR Gain on Sale** 50,000
  - **CR Land** 200,000

- From a group viewpoint, the **Gain on sale** was $40,000 (not $50,000) as the carrying value of the land on consolidation was $210,000

<table>
<thead>
<tr>
<th>Proceeds</th>
<th>Lotech</th>
<th>Consolidated</th>
<th>Therefore need to decrease gain on sale on consolidation by $10,000. Requires DR to debit to gain in sale account.</th>
</tr>
</thead>
<tbody>
<tr>
<td>$250</td>
<td>$250</td>
<td>$210</td>
<td></td>
</tr>
</tbody>
</table>

Worksheet entries subsequent to acquisition date – BCVR - land

**Until land is sold (30 June 2011 & 30 June 2012)**
- **DR Land** 10,000
- **CR DTL** 3,000
- **CR BCVR** 7,000

**In the year the land is sold (30 June 2013)**
- **DR Gain on sale** 10,000
- **CR ITE** 3,000
- **CR Transfer from BCVR (R/E)** 7,000

**In future years (2014 >)**
- No BCVR entry required (no effect on retained earnings)
- However, an adjustment is required to the pre-acquisition entry (refer slide 39)

Worksheet entries subsequent to acquisition date – BCVR - buildings

- A consequential depreciation adjustment is required in relation to depreciable assets that are revalued to fair value on acquisition of a subsidiary

- Required as the subsidiary is continuing to depreciate the asset based on its cost, which is lower than the fair value

- From a consolidated perspective, the depreciation charge is understated

- In relation to the buildings, the adjustment is calculated as shown on the following slide
Worksheet entries subsequent to acquisition date – BCVR - buildings

<table>
<thead>
<tr>
<th>Lotech</th>
<th>Group</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>80,000</td>
<td>125,000</td>
<td>45,000</td>
</tr>
</tbody>
</table>

Remaining useful life: 8 years, 8 years, 8 years
Annual depreciation: 10,000, 15,625, 5,625

5,625pa additional depreciation expense required on consolidation

Worksheet entries subsequent to acquisition date – BCVR - buildings

- On 30 June 2012 (1 year after acquisition) the original entry on slide 17 PLUS the following entries are required:
  - DR Depreciation expense 5,625
  - CR Accum depreciation 5,625
- Over the next eight years we are also required to progressively reverse the DTL created with the original valuation adjustment. The following journal must also be processed on consolidation
  - DR DTL 1,687.5
  - CR ITE 1,687.5

Worksheet entries subsequent to acquisition date – BCVR - buildings

- On 30 June 2013 (two years after acquisition) the original entry on slide 17 PLUS the following entries are required:
  - DR Depreciation expense 5,625
  - DR Retained earnings 5,625
  - CR Accum depreciation 11,250
  - DR DTL 3,375
  - CR ITE 1,687.5
  - CR Retained earnings 1,687.5
Worksheet entries subsequent to acquisition date – BCVR - contingent liability

- On 1 January 2012 the legal claim was settled for $2,000.
- On settlement, Lotech Ltd will recognise the following journal
  
  DR Expense - legal fees 2,000
  CR Cash 2,000
  
- As the liability no longer exists, it should not continue to be carried forward on consolidation. The business combination valuation adjustment must recognise the settlement and any gain/(loss) on settlement.

Worksheet entries subsequent to acquisition date – BCVR - contingent liability

**Until settlement (30 June 2011)**

<table>
<thead>
<tr>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>DR BCVR</td>
<td>2,100</td>
<td></td>
</tr>
<tr>
<td>DR DTA</td>
<td>900</td>
<td></td>
</tr>
<tr>
<td>CR Provision for legal claim</td>
<td>3,000</td>
<td></td>
</tr>
</tbody>
</table>

**In the year the liability is settled (30 June 2012)**

<table>
<thead>
<tr>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>DR Transfer from BCVR</td>
<td>2,100</td>
<td></td>
</tr>
<tr>
<td>DR ITE (PL)</td>
<td>900</td>
<td></td>
</tr>
<tr>
<td>CR Expense – legal fees (PL)</td>
<td>2,000</td>
<td></td>
</tr>
<tr>
<td>CR Gain on settlement (PL)</td>
<td>1,000</td>
<td></td>
</tr>
</tbody>
</table>

**In future years (2013 >)**

- No BCVR entry required (no effect on retained earnings)
- However, an adjustment is required to the pre-acquisition entry (refer slide 39)

Worksheet entries subsequent to acquisition date – BCVR – goodwill impairment

- On acquisition the balance of goodwill was $13,600
- On 30 June 2012, goodwill is assessed to have a recoverable value of $13,000. The goodwill is considered to be impaired. It is therefore necessary to reduce the value of goodwill
- This would be done by preparing the journal on slide 19 PLUS the following journal at 30 June 2012:
  
  DR Impairment expense 600 (PL)
  CR Goodwill – accum impairment losses 600 (BS)
  
- In future years the following entry would be required:
  
  DR Retained earnings 600
  CR Goodwill – accum. Impairment losses 600
Changes to pre-acquisition entry

- The pre-acquisition entry is required every time a consolidation is completed and does not change, except under the following circumstances:
- When a bonus share dividend is paid from pre-acquisition equity;
- Transfers between pre-acquisition retained earnings and reserves (including BCVR, general reserve)

Changes to pre-acquisition entry – transfers of pre-acquisition reserves

- When a transfer of pre-acquisition reserves is made subsequent to acquisition a change is required to the pre-acquisition elimination entry
- Consider the sale of the land in the example which was subject to a fair value adjustment
- The journals on the following slide show how the sale of the land would have affected the pre-acquisition entry
- Note that other types of reserve transfers (e.g., general reserves) are dealt with in the same way as BCVR transfers

Changes to pre-acquisition entry – transfers of pre-acquisition reserves

**In the year the land is sold (30 June 2013)**

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share capital</td>
<td>300,000</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>50,000</td>
</tr>
<tr>
<td>BCVR</td>
<td>50,000</td>
</tr>
<tr>
<td>Investment</td>
<td>400,000</td>
</tr>
<tr>
<td>Transfer from BCVR(R/E)</td>
<td>7,000</td>
</tr>
<tr>
<td>BCVR</td>
<td>7,000</td>
</tr>
</tbody>
</table>

**In future years (2014 onwards)**

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share capital</td>
<td>300,000[50,000 + 7,000]</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>57,000 [50,000 – 7,000]</td>
</tr>
<tr>
<td>BCVR</td>
<td>43,000</td>
</tr>
<tr>
<td>Investment</td>
<td>400,000</td>
</tr>
</tbody>
</table>
Other issues

- Also covered in chapter 16
  - 16.6 Revaluations in the records of the subsidiary at acquisition date
  - 16.7 Disclosures
  - 16.8 Reverse acquisitions