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CL-25-1 | Corporate Financial Reporting

Corporate Level (2025 – Curriculum)

- Consolidated Financial Statements – Part 6

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Change in a Group Structure

ACQUISITION OF A SUBSIDIARY

There are two acquisition scenarios that need to be considered in more detail:

- Mid-year acquisitions
- Step acquisitions

MID-YEAR ACQUISITIONS

A parent entity initiates the consolidation process for a subsidiary from the moment it attains control. In cases where this acquisition occurs midway through the reporting period, it becomes essential to proportionately allocate the subsidiary's financial results, ensuring that only the post-acquisition revenues and expenses are incorporated into the group statement of profit or loss.

STEP ACQUISITIONS

A step acquisition occurs when the parent company acquires control over the subsidiary in stages. This is achieved by buying blocks of shares at different times. Acquisition accounting is only applied at the date when control is achieved. Business combinations achieved in stages may also be known as 'piecemeal acquisitions'.

There are main two step-acquisitions.

- (1) Business combinations in which **control is achieved** (No control To control).
 - a. A previously held interest, say 10%, with no significant influence accounted for under SLFRS 9) is increased to a controlling interest of 50% or more.
 - b. A previously held equity interest, say 35%, accounted for as an associate under LKAS 28, is increased to a controlling interest of 50% or more.
 - c. A previously held equity interest, say 45%, accounted for as a joint venture under LKAS 28, is increased to a controlling interest of 50% or more.
- (2) Business combinations in which **control is maintained** (Control To control).
 - a. A controlling interest in a subsidiary is increased, say from 60% to 80%

Please note that purchasing further shares in a subsidiary after control has been acquired (for example taking the group interest from 60% to 75%) is regarded as a transaction between equity holders. When such transaction happens, Goodwill is not recalculated.

How to account when there is a business combination in which control is achieved?

Under SLFRS 3 a business combination occurs only when one entity obtains control over another, which is generally when 50% or more has been acquired. This has been referred to as 'crossing an accounting boundary'.

When this happens, the original investment – whether an investment in equity instruments with no significant influence, or an associate – is treated as if it were disposed of at fair value and re-acquired at fair value. This previously held interest at fair value, together with any consideration transferred, is the 'cost' of the combination used in calculating the goodwill.

Therefore, at the date when the equity interest is increased and control is achieved:

- (1) re-measure the previously held equity interest to fair value
- (2) recognize any resulting gain or loss in profit or loss for the year
- (3) calculate goodwill and the non-controlling interest on either a partial or full basis

The following proforma can be used.

Fair value of previously held interest	X
Fair value of consideration for additional interest	X
NCI at acquisition	X
Less: FV of net assets at acquisition	(X)
Goodwill at acquisition	X

If there has been re-measurement of any previously held equity interest that was recognized in other comprehensive income, any changes in value recognized in earlier years are now reclassified to retained earnings.

Test Your Understanding 31

Negombo, whose year-end is 30 June 2019 has a subsidiary, Amanwella, which it acquired in stages. The details of the acquisition are as follows.

Date of acquisition	Holding acquired (%)	Retained earnings at acquisition (Rs. Mn)	Purchase Consideration (Rs. Mn)
01.07.2017	20	270	120
01.07.2018	60	450	480

The share capital of Amanwella has remained unchanged since its incorporation at Rs. 300m. The fair values of the net assets of Amanwella were the same as their carrying amounts at the date of the acquisition. Negombo did not have significant influence over Amanwella at any time before gaining control of it. The group policy is to measure the non-controlling interest at its proportionate share of the fair value of the subsidiary's identifiable net assets.

You are required to:

- (1) **Calculate** the goodwill on the acquisition of Amanwella that will appear in the consolidated statement of financial position at 30 June 2019.

- (2) **Calculate** the profit on the derecognition of any previously held investment in Amanwella to be reported in group profit or loss for the year ended 30 June 2019.
- (3) **Provide** the journal entries required to record recognition of goodwill on consolidation.

Test Your Understanding 32

Pinnawala acquired a controlling interest in Arattana in 2 stages:

- (a) It acquired 30% for cash consideration of Rs. 80m in 2015. On the date of acquisition the fair value of the net assets of Arattana was Rs. 250m.
- (b) It acquired a further 40% in 2017 for cash consideration of Rs. 122m. On this date fair value of the net assets of Arattana was Rs. 284m and the previously held interest had a fair value of Rs. 88m.

Between 2015 and 2017, Arattana retained profits of Rs. 20m and recognized a revaluation surplus of Rs. 5m.

It is group policy to measure the non-controlling interest as a proportion of net assets.

You are required to:

- (a) **Calculate** the profit on derecognition of any previously held investment in Arattana to be reported in group profit or loss for the year ended 31 December 20X7.
- (b) **Provide** the journal entries required to record recognition of goodwill on consolidation.

How to present in Consolidated Financial Statements?

	Equity investment becomes a subsidiary	Associate/JV becomes a subsidiary
In Consolidated SoFP	- Investment is consolidated based on the year-end shareholding. - Goodwill is calculated as shown	- Investment is consolidated based on the year-end shareholding. - Goodwill is calculated as shown
In Consolidated SoCI	- Dividend income is recognized until the date on which control was achieved. - After acquisition date inter-company dividend will be eliminated	- Investment's results are equity accounted (Share of profit or loss) until the date on which control was achieved. - After acquisition date inter-company dividend will be eliminated

Test Your Understanding 33

Anne has owned 90% of the ordinary shares of Fara for many years. Anne also has a 10% investment in the shares of Brayan, which was held in the consolidated statement of financial position as at 31 December 2022 at Rs. 24,000 in accordance with SLFRS 9. On 30 June 2023, Anne acquired a further 50% of Brayan's equity shares at a cost of Rs. 160,000.

The draft statements of profit or loss for the three companies for the year ended 31 December 2023 are presented below:

Statements of profit or loss for the year ended 31 December 2023

	Anne	Fara	Brayan
Revenue	500	300	200
Cost of sales	-300	-70	-120
Gross profit	200	230	80
Operating costs	-60	-80	-60
Profit from operations	140	150	20
Income tax	-28	-30	-4
Profit for the period	112	120	16

The non-controlling interest is calculated using the fair value method. On 30 June 2023, fair values were as follows:

- Brayan's identifiable net assets – Rs. 200,000
- The non-controlling interest in Brayan – Rs.100,000
- The original 10% investment in Brayan – Rs. 26,000

You are required to:

Prepare the consolidated statement of profit or loss for the Anne Group for the year ended 31 December 2023 and calculate the goodwill arising on the acquisition of Brayan.

DISPOSALS

A parent company may dispose of a full or partial shareholding. In some cases, control is retained. The accounting treatment depends on the level of disposal.

There can be main two types of disposals.

- 1) Disposals where **control is lost**.
 - a. Full disposal: all the shareholding is sold (say, 80% to nil)
 - b. Subsidiary to associate (say, 80% to 30%)
 - c. Subsidiary to equity investment (say, 80% to 10%)

In these cases, a gain or loss on disposal is calculated and recognized in the financial statements

- 2) Disposals where **control is retained**.
 - a. In a subsidiary-to-subsidary disposal, control is retained, however the controlling shareholding is reduced. This type of disposal is accounted for differently from those where control is lost.

How to account when there is a disposal in which control is lost?

When an investor sells shares of a subsidiary investments, the disposal gain or loss is impacting to both individual financial statements of the investor and the consolidated financial statements of the entire group. The disposal gain or loss can be calculated as follows in both the situations.

Disposals in the individual financial statements

In all of the above scenarios, the profit on disposal in the investing entity's individual financial statements is calculated as follows:

Sales proceeds	X
Carrying amount (usually cost) of shares sold	(X)
Profit/(loss) on disposal	<u>X/(X)</u>

The profit or loss may need to be reported as an exceptional item. If so, it must be disclosed separately on the face of the parent's statement of profit or loss for the year.

There may be tax to pay on this gain, depending on the tax laws in place in the parent's jurisdiction. This would result in an increase to the parent company's tax expense in the statement of profit or loss.

Disposals in the consolidated financial statements

If the sale of shares causes control over a subsidiary to be lost, then the treatment in the consolidated financial statements is as follows:

- Consolidate the incomes and expenses of the subsidiary up until the disposal date.
- On disposal of the subsidiary, derecognize its assets, liabilities, goodwill and non- controlling interest and calculate a profit or loss on disposal.
- Recognize any remaining investment in the shares of the former subsidiary at fair value and subsequently account for this under the relevant accounting standard.
 - A holding of 20–50% of the shares would probably mean that the remaining investment is an associate, which should be accounted for using the equity method.
 - A holding of less than 20% of the shares would probably mean that the remaining investment should be accounted for under SLFRS 9 Financial Instruments.

Where control of a subsidiary has been lost, the following template should be used for the calculation of the profit or loss on disposal:

Disposal proceeds	X
Fair value of retained interest	X
	X
<u>(-) Interest in subsidiary disposed of:</u>	
Net assets of subsidiary at disposal date	X
Goodwill at disposal date	X
Less: Carrying amount of NCI at disposal date	(X)
	(X)
Profit/(loss) to the group	X/(X)

Full disposal: all the shareholding is sold

Test Your Understanding 34

Columbo Carpets PLC owns 75% of the ordinary shares in Floor Décor Ltd. The shares cost Rs. 230m in 2014, when the fair value of the net assets of Floor Décor was Rs. 280m and the fair value of the NCI was Rs. 73m. On 30 September 2019, Columbo Carpets PLC disposed of its shareholding in Floor Décor for Rs. 370m, on which date Floor Décor had net assets of Rs. 380m and the NCI had a carrying amount of Rs. 98m.

You are required to calculate gain on disposal in the view of parent and consolidated financial statements.

Preparation of consolidated financial statements – Full Disposals	
Consolidated statement of financial position	• The subsidiary's assets and liabilities are not recognized. • There is no non-controlling interest. • Retained earnings include either: ○ The group share of the reserves movement in the subsidiary between the

	○ acquisition and disposal date plus the group gain (or loss) on disposal, or the parent company gain or loss on disposal.
Consolidated statement of profit or loss and other comprehensive income	• The results of the subsidiary are consolidated until the date on which control is lost. • The NCI is allocated its share of results until the date on which control is lost. • The group gain or loss on disposal is recognized.

Partial disposal: subsidiary to associate

Test Your Understanding 35

Minneriya Ltd acquired 90% of Wilpattu Ltd in 2011 and held the investment until 30 September 2014 when it sold 2/3 of its holding to various parties for Rs. 420m. The remaining 30% investment was classified as an associate holding.

At the disposal date the net assets of Wilpattu were Rs. 580m, goodwill was fully impaired and the fair value of a 30% interest in the company was Rs. 220m.

The non-controlling interest is measured using the proportion of net assets method.

You are required to:

Calculate the gain on disposal in the consolidated accounts? How much of this is a gain on disposal of the 60% holding and how much is a gain on remeasurement of the 30% holding?

Preparation of consolidated financial statements – Subsidiary to Associate	
Consolidated statement of financial position	• The interest in the associate is equity accounted based on the year end shareholding. • The cost of the investment is taken to be the fair value of the interest retained at the disposal date and this is subsequently increased by the group share of post-acquisition retained total comprehensive income.
Consolidated statement of profit or loss and other comprehensive income	• The results of the subsidiary are consolidated until the date on which control is lost. • Thereafter the results of the associate investment are equity accounted. • The group gain or loss on disposal is recognized.

Partial disposal: subsidiary to equity investment

When there is a partial disposal where subsidiary becomes an equity investment by losing the control gain loss calculation will be same as previous and the FV of the retained interest will be recognized as a financial asset under SLFRS 9.

CONTROL TO CONTROL SCENARIOS

When there is a business combination where the controlling power remained unchanged or when there is a business disposal where the controlling power remains without losing,

such situations are identified as control to control scenarios. Following two situations can be identified accordingly as examples.

- 1) Increasing a shareholding in a subsidiary (e.g., 80% to 85%)
- 2) Sale of shares without losing control (e.g., 80% to 75%)

Increasing a shareholding in a subsidiary

When a parent company increases its shareholding in a subsidiary, this is not treated as an acquisition in the group financial statements. For example, if the parent holds 80% of the shares in a subsidiary and buys 5% more than the relationship remains one of a parent and subsidiary. However, the NCI holding has decreased from 20% to 15%.

The accounting treatment of the above situation is as follows:

- Goodwill is not recalculated.
- The previously held interest is not remeasured.
- The acquisition is accounted for as a transaction between shareholders and **no profit or loss arises on the purchase of the additional shares.**
- The NCI within equity decreases.
- The difference between the consideration paid for the extra shares and the decrease in the NCI is accounted for within equity (normally, in 'other components of equity').

The following proforma will help to calculate the adjustments required to NCI and other components of equity.

Cash paid (FV of the consideration)	X Cr
Decrease in NCI	(X) Dr
Decrease/(increase) to other components of equity	X/(X) Dr/Cr (bal. entry)

Test Your Understanding 36

Gordon has owned 80% of Mandy for many years.

Gordon is considering acquiring more shares in Mandy. The NCI of Mandy currently has a carrying amount of Rs.20,000, with the net assets and goodwill having a carrying amount of Rs.125,000 and Rs.25,000 respectively.

Gordon is considering the following two scenarios:

- (i) Gordon could buy 20% of the Mandy shares leaving no NCI for Rs.25,000, or
- (ii) Gordon could buy 5% of the Mandy shares for Rs.4,000 leaving a 15% NCI.

Required:

Calculate the adjustments required to NCI and other components of equity.

Test Your Understanding 37

P acquired 80% of S in 2015 for Rs. 300m. On that date the fair value of the identifiable net assets of S was Rs. 310m and the fair value of the non-controlling interest was Rs70m. Between the acquisition date in 2015 and 30 June 2017, S made total comprehensive income of Rs. 34m. On 30 June 2017, P increased its shareholding in S to 90%. Rs. 36m was paid as consideration for the additional 10% shareholding. The NCI on the acquisition was measured at fair value.

Required:

What journal entry is required to recognize the increased shareholding in the consolidated financial statements of P on 30 June 2017?

Sale of shares without losing control

Where a controlling shareholding is retained, SLFRS 3 and SLFRS 10 do not consider that a disposal has taken place. Therefore, in the consolidated financial statements, a gain or loss on disposal is not recognized and instead the disposal is recognized as a transaction between shareholders.

From the perspective of the group accounts, a sale of shares which results in the parent retaining control over the subsidiary is simply a transaction between shareholders. If the parent company holds 80% of the shares of a subsidiary but then sells a 5% holding, a relationship of control still exists. As such, the subsidiary will still be consolidated in the group financial statements. However, the NCI has risen from 20% to 25%.

The accounting treatment of the above situation is as follows:

- Goodwill is not recalculated.
- The previously held interest is not remeasured.
- The disposal is accounted for as a transaction between shareholders and **no profit or loss arises on the disposal of the shares.**
- The NCI within equity increases.
- The difference between the consideration received for the disposed shares and the increase in the NCI is accounted for within equity (normally, in 'other components of equity').

The following proforma will help to calculate the adjustments required to NCI and other components of equity:

Cash proceeds received	X Dr
Increase in NCI	(X) Cr
Increase/(Decrease) to other components of	X/(X) Cr/Dr (bal. entry) equity

The increase in the NCI will be the share of the net assets (always) and goodwill (fair value method only) of the subsidiary at the date of disposal which the parent has effectively sold to the NCI.

For example, if the NCI shareholding increases from 20% to 30%, then the carrying amount of the NCI must be increased by 10% of the subsidiary's net assets and, if using the fair value method, goodwill.

Test Your Understanding 38

Until 30 September 2017, Juno held 90% of Hera. On that date it sold a 10% interest in the equity capital for Rs.15,000. At the date of the share disposal, the carrying amount of net assets and goodwill of Hera were Rs.100,000 and Rs.20,000 respectively. At acquisition, the NCI was valued at fair value.

Required:

Discuss the treatment of the above in the Juno Group's financial statements?

Test Your Understanding 39

David has owned 90% of Goliath's ordinary shares for many years. On the last day of the reporting period, David sold 5% of Goliath's ordinary shares for Rs.5,000 (leaving it with a holding of 85%). At the date of the sale, net assets and goodwill of Goliath were carried in the consolidated financial statements at Rs.70,000 and Rs.20,000 respectively. The NCI of Goliath at acquisition was valued at fair value.

Required:

Discuss how the share sale should be accounted for in the consolidated financial statements of the David group?

Test Your Understanding 40

Statements of financial position for three entities at the reporting date are as follows:

Statements of Financial Position

Non-Current Assets

Property, plant & equipment
Investments in Sprite
Investments in Tango

Total Assets

Stated Ordinary Share Capital (Rs.1 Shares)
Retained Earnings
liabilities

Total Equity and Liabilities

	Pepsi	Sprite	Rs'000 Tango
Property, plant & equipment	1,000	800	500
Investments in Sprite	326	-	-
Investments in Tango	165	-	-
Total Assets	1,491	800	500
Stated Ordinary Share Capital (Rs.1 Shares)	500	200	100
Retained Earnings	391	100	200
liabilities	600	500	200
Total Equity and Liabilities	1,491	800	500

Investment in Sprite

Pepsi acquired 80% of Sprite when Sprite's retained earnings were Rs.25,000, paying cash consideration of Rs.300,000. It is group policy to measure NCI at fair value at the date of acquisition. The fair value of the NCI holding in Sprite at acquisition was Rs.65,000.

At the reporting date, Pepsi purchased an additional 8% of Sprite's equity shares for cash consideration of Rs.26,000. This amount has been debited to Pepsi's investment in Sprite.

Investment in Tango

Pepsi acquired 75% of Tango when Tango's retained earnings were Rs.60,000, paying cash consideration of Rs.200,000. The fair value of the NCI holding in Tango at the date of acquisition was Rs.50,000.

At the reporting date, Pepsi sold 10% of the equity shares of Tango for Rs.35,000. The cash proceeds have been credited to Pepsi's investment in Tango.

Required:

Discuss how to account for the purchase of the additional 8% holding in Sprite's equity shares and the sale of the 10% holding in Tango's equity shares.

SUBSIDIARIES ACQUIRED EXCLUSIVELY WITH A VIEW TO RESALE

A subsidiary acquired exclusively with a view to resale is not exempt from consolidation. However, if it meets the 'held for sale' criteria in SLFRS 5:

- it is presented in the financial statements as a disposal group classified as held for sale. This is achieved by amalgamating all its assets into one-line item and all its liabilities into another.
- it is measured, both on acquisition and at subsequent reporting dates, at fair value less costs to sell. (SLFRS 5 sets down a special rule for such subsidiaries, requiring the deduction of costs to sell. Normally, it requires acquired assets and liabilities to be measured at fair value).

The '**held for sale**' criteria include the requirements that:

- the subsidiary is available for immediate sale.
- the sale is highly probable.
- it is likely to be disposed of within one year of the date of its acquisition.

A newly acquired subsidiary which meets these held for sale criteria automatically meets the criteria for being presented as a discontinued operation.

Test Your Understanding 41

Daisy acquires Renold on 1 March 2023. Renold is a holding entity with two wholly owned subsidiaries, Mary and John. John is acquired exclusively with a view to resale and meets the criteria for classification as held for sale. Daisy's year end is 30 September.

On 1 March 2023 the following information is relevant:

- the identifiable liabilities of John have a fair value of Rs. 40m

- the acquired assets of John have a fair value of Rs. 180m
- the expected costs of selling John are Rs. 5m.

On 30 September 2023, the assets of John have a fair value of Rs. 170m. The liabilities have a fair value of Rs.35m and the selling costs remain at Rs. 5m.

You are required to:

Discuss how John will be treated in the Daisy Group financial statements on acquisition and at 30 September 2023.

UNMC