CL-25-1 | Corporate Financial Reporting

Corporate Level (2025 – Curriculum)

- Consolidated Financial Statements – Part 3

Chandima Prabhath

B.Sc. Accounting (special) First Class (USJ) | ACA | CMA Passed Finalist | MAAT | ICAEW Finalist | ACCA Finalist | CA, CMA and AAT Merit and Subject Prize winner | Certification in Forensic Accounting (CASL) | ABR Prize Winner in CA Strategic Level

MECHANICS OF CONSOLIDATION

SLFRS 10 lays out the procedures for preparing consolidated financial statements. When preparing the consolidated statement of financial position, the statement of financial positions of the parent and its subsidiaries are combined on a line-by-line basis by adding together items of assets, liabilities and equity.

However, just adding the separate statements of financial positions will not provide the actual result and therefore, it is required to make several consolidation adjustments to show financial information about the group as if it was a single entity. However below simplified steps can be used as a guide to prepare consolidated statement of financial position.

1. The investment in the subsidiary (S) shown in the parent's (P's) statement of financial position is replaced by the net assets of the subsidiary.
2. The cost of the investment in the subsidiary is effectively cancelled with the ordinary share capital and reserves of the subsidiary, leaving goodwill as a balance.

This produces a consolidated statement of financial position showing:

- The net assets of the whole group (Parent + Subsidiary)
- The share capital of the group always equals the share capital of Parent.
- The retained earnings, comprising profits earned by the group (i.e. All of Parent's historical profits + post-acquisition profits made by Subsidiary).

Adjustments need to be made when consolidating:

1. Calculating and recognizing the goodwill and NCI on acquisition date
2. Allocation of the relevant share of post-acquisition profits to the non-controlling interest (NCI)
3. Adjustments to purchase consideration (*Discussed in part 2*)
4. Fair Value adjustments to the net assets of the subsidiary at the date on acquisition (*Discussed in part 2*)
5. Goodwill impairment
6. Elimination of the effects of intra-group trading
   6.1. Intercompany balance elimination
   6.2. Intercompany sales and unrealized profit adjustment
   6.3. Dividends adjustment
7. Adjustments for equity accounted investees.

Net Assets (equity) of the subsidiary

The net assets of the acquired subsidiary may consist of **Stated Capital** and the **Reserves** including **Retained Earnings**. When preparing the consolidated financial statements, it is vital to understand that these reserves can be identified as "Pre-Acquisition Reserves" and "Post Acquisition Reserves". Depending on whether the reserve portion is pre acquisition or post acquisition the treatment we need to do will differ.

Pre-acquisition reserves	The reserves which exist in a subsidiary at the date when it is acquired. They are capitalized at the date of acquisition by including them in the goodwill calculation.

Post-acquisition reserves	Profits made and included in the retained earnings or any other reserve of the subsidiary after the acquisition. They are apportioned between the group retained earnings and the NCI.

Hence, pre-acquisition reserves are the reserves as at the acquisition date and the post-acquisition reserves can be calculated as follows:

Net Assets of the subsidiary acquired	**As at date of acquisition**	**As at reporting date**	**Post-Acquisition**
	A	B	B-A
Ordinary Share Capital	XXX	XXX	-
Reserves:			
General Reserve	XXX	XXX	XXX
Revaluation Surplus	XXX	XXX	XXX
Retained Earnings	XXX	XXX	XXX

Therefore, as at the reporting date calculation of the group/consolidate reserves need to be done as follows.

Parent's Reserve balance as at the reporting date	XXX
(+) Subsidiary Post Acquisition Reserves attributable to Parent	XXX
Group/Consolidated Reserve balance as at the reporting date	XXX

Test Your Understanding 09 – Wholly owned subsidiary

Alpha PLC acquired 100% of the shares in Beta PLC on 31.03.2023 at a cost (consideration) of Rs. 50,000. The statements of financial positions as at 31.03.2023 are as follows.

Statements of Financial Position		**Rs.**
	Alpha	**Beta**
Non-Current Assets	60,000	40,000
Investment in Beta	50,000	-
Current Assets	40,000	40,000
Total Assets	**150,000**	**80,000**
Stated Ordinary Share Capital (Rs.1 Shares)	100,000	30,000
Retained Earnings	30,000	5,000
Current liabilities	20,000	45,000
Total Equity and Liabilities	**150,000**	**80,000**

The carrying amounts of the net assets of Beta PLC were equal to the fair values at the date of acquisition.

You are required to:

1. Calculate the Goodwill on acquisition.
2. Consolidated Retained Earnings
3. Consolidated Statement of Financial Position as at 31.03.2023
4. Consolidated Statement of Financial Position as at 31.03.2023 if Alpha acquired Beta on 01.04.2022 and at the date of acquisition Retained earnings was Rs. 3000.

Test Your Understanding 10 – Partially owned subsidiary

Alpha PLC acquired 80% of the shares in Beta PLC on 01.04.2022 at a cost (consideration) of Rs. 50,000. The statements of financial positions as at 31.03.2023 are as follows.

Statements of Financial Position		**Rs.**
	Alpha	**Beta**
Non-Current Assets	60,000	40,000
Investment in Beta	50,000	-
Current Assets	40,000	40,000
Total Assets	**150,000**	**80,000**
Stated Ordinary Share Capital (Rs.1 Shares)	100,000	30,000
Retained Earnings	30,000	5,000
Current liabilities	20,000	45,000
Total Equity and Liabilities	**150,000**	**80,000**

The carrying amounts of the net assets of Beta PLC were equal to the fair values at the date of acquisition and the NCI need to be measured using a proportionate share of net asset basis. Further, Retained Earnings of Beta as at the date of acquisition was Rs. 3000.

You are required to:

1. Calculate the Goodwill on acquisition.
2. Consolidated Retained Earnings as at 31.03.2023.
3. Non-Controlling Interest (NCI) as at 31.03.2023.
4. Consolidated Statement of Financial Position as at 31.03.2023.

FAIR VALUE ADJUSTMENTS TO CONSIDERATION

Test Your Understanding 11 – Consideration

Jack acquired 60% of Daniel on 01.04.2022 when the retained earnings of Daniel were Rs.5,800. Jack paid Rs. 5,000 in cash. Jack also issued 2 Rs.1 shares for every 5 shares acquired in Daniel and agreed to pay a further Rs.2,000 in 3 years' time. The market value of Jack's shares at 01.04.2022 was Rs.1.80. Jack has only recorded the cash paid in respect of the investment in Daniel. The current interest rate is 6%.

The Jack group uses the fair value method to value the non-controlling interest. At the date of acquisition, the fair value of the non-controlling interest was Rs. 5,750.

The statements of financial position of Jack and Daniel as at 31.03.2023 are given below.

Statements of Financial Position		**Rs.**
	Jack	**Daniel**
Property, plant & equipment	15,000	9,500
Investments	5,000	-
Current Assets	7,500	5,000
Total Assets	**27,500**	**14,500**
Stated Ordinary Share Capital (Rs.1 Shares)	8,000	5,000
Retained Earnings	12,500	7,200
Non-current liabilities	3,000	500
Current liabilities	4,000	1,800
Total Equity and Liabilities	**27,500**	**14,500**

You are required to:

1. Calculate the Goodwill on acquisition.
2. Consolidated Statement of Financial Position as at 31.03.2023.

FAIR VALUE ADJUSTMENTS TO THE NET ASSETS OF THE SUBSIDIARY AT THE DATE OF ACQUISITION AND ADJUSTMENTS AFTER ACQUISITION

Where an asset is subject to a fair value adjustment on acquisition, a subsequent adjustment may be required. You have already learnt how a fair value adjustment at the acquisition date is brought into a consolidation. Now we are going to look at which points a subsequent adjustment will require.

1. An adjustment may be necessary to the **value of inventory** at the acquisition date. The subsidiary will be carrying the inventory at the lower of cost and net realizable value, but its fair value will be considered when calculating the goodwill.

   If such an adjustment is necessary, take care to evaluate whether any adjustment is needed at the reporting date.

   If the entire inventory at the acquisition date is there at the reporting date then, only the fair value adjustment at the reporting date will be sufficient. But if the entire inventory at the acquisition date has been sold by the reporting date, then the already recorded cost of sales will not contain the increased fair value impact. Therefore, it is required to increase the cost of sales to charge the FV gain we recorded at the acquisition date.

2. Where a depreciable asset is subject to a fair value adjustment on acquisition for the purposes of consolidation, but this is not reflected in the subsidiary's individual accounts, then subsequent adjustments are required at each reporting date to account for the increase or decrease in depreciation:
   a. Where an asset is **fair valued upwards**, then more depreciation must be recognized in the consolidated financial statements – **Under Depreciation Adjustment**.
   b. Where an asset is **fair valued downwards**, then less depreciation must be recognized in the consolidated financial statements – **Over Depreciation Adjustment**.

3. When an unrecognized **Intangible Asset** in the subsidiary's individual financial statements is taken into account and recognized in the consolidated financial statements, if the said intangible asset has a definite useful lifetime, it needs to be amortized and such amortization relevant to the post-acquisition period needs to be recognized in the consolidated financial statements.

Test Your Understanding 12 – Under Depreciation

P Co acquired 80% of S Co on 1st April 2023. On the date of acquisition, the carrying amount of property in S Co's accounts was Rs. 760m. The fair value of the property, which had a remaining useful life of 40 years, was found to be Rs. 920m. No property has been acquired or sold since the acquisition date. On 31st March 2024 (reporting date), P Co's property had a carrying amount of Rs. 1,300m.

You are required to:

1. Determine the fair value adjustment required at the date of acquisition.
2. Calculate the under depreciation to be recognized during the post-acquisition period.
3. Calculate the Consolidated Property Amount that need to be shown in Consolidated Statement of Financial Position as at 31.03.2024.

Test Your Understanding 13 – Inventory FV Gain Realization

P Co acquired 80% of S Co on 01st April 2022 at a cost of Rs. 780m. At the acquisition date, the stated capital of S Co was Rs. 300m and retained earnings were Rs. 400m. In addition, inventory was found to have a fair value Rs. 1m in excess of its carrying amount.

At 31 December 20X5, the inventory had been sold outside the group. P Group Values NCI at the proportionate of net asset basis.

The abbreviated statements of financial position of the two companies at 31.03.2023 are as follows.

Statements of Financial Position		**Rs. Mn**
	P Co	**S Co**
Property, plant, and equipment	1,190	600
Investments	780	-
Current Assets	330	260
Total Assets	**2,300**	**860**
Stated Ordinary Share Capital	400	300
Retained Earnings	1,600	460
Liabilities	300	100
Total Equity and Liabilities	**2,300**	**860**

You are required to:

I. Prepare Consolidated Statement of Financial Position as at 31.03.2023.

Test Your Understanding 14

Peppermint acquired 80% of the share capital of Spearmint two years ago, when the reserves of Spearmint stood at Rs.125,000. Peppermint paid initial cash consideration of Rs.1 million. Additionally, Peppermint issued 200,000 shares with a nominal value of Rs.1 and a market value at the acquisition date of Rs.1.80. It was also agreed that Peppermint would pay a further Rs.500,000 in three years' time. Current interest rate is 10% p.a.

The shares issue and deferred consideration have not yet been recorded.

Below are the statements of financial position of Peppermint and Spearmint as at 31 March 2024:

Statements of Financial Position		**Rs. 000**
	Peppermint	**Spearmint**
Non-current assets		
Property, plant and equipment	5,500	1,500
Investment in Spearmint at cost	1,000	-
Current Assets		
Inventory	550	100
Receivables	400	200
Cash	200	50
Total Assets	**7,650**	**1,850**
Equity		
Stated Ordinary Share Capital	2,000	500
Retained Earnings	1,400	300
	3,400	800
Non-Current liabilities	3,000	400
Current liabilities	1,250	650
Total Equity and Liabilities	**7,650**	**1,850**

Further information:

I. At acquisition the fair values of Spearmint's plant exceeded its book value by Rs.200,000. The plant had a remaining useful life of five years at this date.

II. For many years Spearmint has been selling some of its products under the brand name of 'Mintfresh'. At the date of acquisition the directors of Peppermint valued this brand at Rs. 250,000 with a remaining life of 10 years. The brand is not included in Spearmint's statement of financial position.

III. The Peppermint Group values the non-controlling interest using the fair value method. At the date of acquisition the fair value of the 20% non-controlling interest was Rs.380,000.

You are required to:

I. Prepare Consolidated Statement of Financial Position for Peppermint Group as at 31.03.2024.

Post-Acquisition Revaluations

If there is a post-acquisition revaluation in the subsidiary's non-current assets, the full amount of the gain should be added to non-current assets. The parent's share of the gain is taken to the revaluation surplus, with the NCI share of the gain being taken to NCI.

Test Your Understanding 15 - Post-Acquisition Revaluations

P has owned 80% of S for many years. During the current year, P and S both revalue their properties for the first time. Both properties increase by Rs.100,000.

You are required to:

1. Explain how to recognize this revaluation in the Consolidated Statement of Financial Position.

GOODWILL IMPAIRMENT

If goodwill is considered to have been impaired during the post-acquisition period, this must be reflected within the group financial statements. Accounting for the impairment differs according to the policy followed to value the non-controlling interests, reflecting the ownership of the goodwill.

NCI measured at % of Subsidiaries Net Assets Basis	**NCI measured at Fair Value (FV)**
As the goodwill is a **partial goodwill** this will be owned only by parent. Hence, the impairment expense also needs to be borne only by the parent.	As the goodwill is a **full goodwill** this will be owned only by both parent and NCI. Hence, the impairment expense also needs to be borne only by both parent and NCI based on the holding percentages (%).
DR Consolidated Retained Earnings CR Goodwill	DR Consolidated Retained Earnings *(Total Impairment × P' %)* DR NCI *(Total Impairment × NCI%)* CR Goodwill *(Total Impairment)*

INTRA-GROUP TRANSACTIONS

The transactions within the group companies are known as Intra-group transactions. These transactions can be shown in the individual financial statements without an issue, but the effects of intra-group transactions must be eliminated from the consolidated financial statements in order to present the group as a single economic entity.

Such intra-group transactions may include:

- Inter-company sales
- Inter-company lending
- Inter-company transfers of PPE

As the purpose of consolidated financial statements is to present the group as a single entity, the effects of these transactions must be eliminated on consolidation so that the consolidated statement of financial position shows only amounts owing to and from third parties. Therefore, adjustments are made for:

- Intra-group balances along with cash or/and goods in transit
- Unrealized profits in inventory and PPE

INTRA-GROUP BALANCES WITH CASH/GOODS IN TRANSIT

Intra-group balances in SoFP may include:

- A receivable in one company and a payable in another
- A loan in one company and an investment in another

Note that these intra-group transactions are usually recorded within a single account in each entity, known as the **current account,** but these balances may be included in general receivables and payables also. Therefore, in the examination be vigilant on how the examiner has provided this information.

These are amounts owing within the group rather than outside the group and therefore they must not appear in the consolidated statement of financial position. They are therefore cancelled against each other on consolidation, by deducting from the relevant lines on the SoFP. It is known as inter-company balance elimination.

Unequal intra-group balances

At the year end, the inter-company balances may not agree, due to the existence of in-transit items such as goods or cash. For example, a payable balance in the parent's books may exceed the receivable balance in the subsidiary's books simply because the subsidiary has sent payment, but it has not yet been received by the parent.

Therefore, we must make an adjustment for such cash or goods in transit when preparing the CSoFP. **Please note that this in-transit adjustment is for the purpose of consolidation only**.

In such situation we need to adjust the statement of financial position as if the goods or cash had been received and then the balances will get tallied. Then same as previous the inter-company balances will be eliminated.

Cash in transit adjusting entry	DR Cash CR Receivables
Goods in transit adjusting entry	DR Inventory CR Payables

Test Your Understanding 16

Plant bought 80,000 shares in Shrub in 01.04.2024 when Shrub's retained earnings were 10,000.

The statements of financial position of Plant and Shrub as at 31.03.2025 are given below.

Statements of Financial Position		**Rs.**
	Plant	**Shrub**
Non-Current Assets		
Property, plant & equipment	100,000	140,000
Investments in S at cost	180,000	-
Current Assets		
Inventory	30,000	35,000
Trade receivables	20,000	10,000
Cash	10,000	5,000
Total Assets	**340,000**	**190,000**
Stated Ordinary Share Capital (Rs.1 Shares)	200,000	100,000
Retained Earnings	40,000	30,000
Non-current liabilities: 10% loan notes	75,000	-
Current liabilities	25,000	60,000
Total Equity and Liabilities	**340,000**	**190,000**

A. Plant's records show Rs.6,000 owing to Shrub, and Shrub's records show Rs.6,000 owed by Plant.
B. Further, Shurb's records show a payable to Plant amounting to Rs.2,500 and it was shown as receivable in Plant's records amounting to Rs.3,000. The difference is explained as cash in transit.
C. Impairment of goodwill has occurred as at reporting date is Rs.10,000.
D. Plant uses the proportion of net assets method to value the non-controlling interest.

You are required to:

1. Prepare Consolidated Statement of Financial Position as at 31.03.2025.

UNREALISED PROFITS

Profits made by entities within a group on transactions with other group entities are:

- recognized in the individual financial statements, but
- in terms of the group as a whole, such profits are unrealized and must be eliminated from the consolidated financial statements.

Unrealized profit may arise within a group on:

- inventory where entities trade with one another
- non-current assets where one group entity has transferred an asset to another.

Unrealized Profits on Inventory (URP on Inventory)

Where one group company sells goods to another group company in a reporting period, it is likely to record a profit on the sale. If the second group company has not sold those goods outside the group by the reporting date, the profit is unrealized. Until the goods are sold to an outside party there is no realized profit from the group perspective.

Remember, we are treating the group as a single entity – it is nonsense to say that the group has made a profit by selling something to itself!

Therefore, unrealized profits must be eliminated on consolidation.

Calculation of unrealized profits in inventory

As a markup on cost (Profit Markup)	Keeping profit as a percentage (%) of the cost of the inventory
As a margin of selling price (Profit Margin)	Keeping profit as a percentage (%) of the sales price of the inventory

Please note that, in examination questions it is vital to identify on which method the seller has kept profit on the sale of inventory.

Test Your Understanding 19 – URP on Inventory

HHL and HCL are group companies where HHL acts as the Parent. During the year ended 31.03.2025 below two inter-company sales transactions were occurred.

A) HHL(P’) has sold goods at a price of Rs. 400,000 based on a 25% mark up on cost.
B) HCL(S’) has sold goods of Rs. 400,000 based on a 25% profit margin.

All the goods remain in both company’s warehouse at 31.03.2025.

You are required to:

1. Calculate the URP on inventory in above two situations.

Elimination of unrealized profits in inventory

An unrealized profit must be:

- Removed from the selling company's profits.
- Removed from the carrying amount of inventory. (The company that bought the inventory will carry it at cost, ie the price that it paid in its own statement of financial position. In the consolidated statement of financial position, however, it must be carried at **cost to the group**.)

Test Your Understanding 20 – URP on Inventory

Polwatta Co owns 80% of Sita Co. It sold to Sita Co goods during the financial year 2024/25 for Rs. 100,000, keeping a profit margin of 10%. At the year end, half of these goods remain in stock.

You are required to:

1. Calculate the URP on inventory and determine the adjustment required to eliminate the unrealized profit from the consolidated financial statements.
2. Prepare the adjustment that would be required if Sita Co had sold the goods to Polwatta Co.

Unrealized Profits on PPE (URP on PPE)

Where one group company has sold an item of PPE to another group company, and that item of PPE remains within the group, the unrealized profit comprises two parts:

- The profit or loss on the sale of the item of PPE
- The increase or decrease in accumulated depreciation

Therefore, if one group entity sells non-current assets to another, adjustments must be made to recreate the situation that would have existed if the sale had not occurred:

- There would have been no profit on the sale.
- Depreciation would have been based on the original cost of the asset to the group

Test Your Understanding 21 – URP on PPE

P acquired 80% of S a number of years ago. P transferred an item of plant to S for Rs.6,000,000 on 01.04.2024. The plant originally cost P Rs.10,000,000 and had an original useful life of 5 years when purchased 3 years ago. The useful life of the asset has not changed as a result of the transfer.

You are required to:

1. Calculate the unrealized profit on the transaction.
2. Explain how this should be treated within the consolidated financial statements at 31.03.2025.
3. Explain how this should be treated within the consolidated financial statements at 31.03.2025 if the sale of PPE was made by P co.

INTER-COMPANY LOANS

One company within the group might have given a loan to another company within the group. As there cannot be any loans given to the it self in the perspective of the group, such loans need to eliminated from the lender's as well as buyer's SoFPs when preparing the consolidated statement of financial position.

Further, the loan interest also need to be eliminated accordingly based on the information provided.

Test Your Understanding 22

On 01.04.2021 Karl bought 60% of Susan paying Rs.76,000 cash when Susan's retained earnings were 45,000. The summarized statements of financial position for the two entities as at 31.03.2023 are given below.

Statements of Financial Position		Rs.
	Karl	**Susan**
Non-Current Assets		
Property, plant & equipment	138,000	115,000
Investments	98,000	-
Current Assets		
Inventory	15,000	17,000
Receivables	19,000	20,000
Cash	2,000	-
Total Assets	**272,000**	**152,000**
Stated Ordinary Share Capital	50,000	40,000
Retained Earnings	189,000	69,000
Non-current liabilities: 8% loan notes	-	20,000
Current liabilities	33,000	23,000
Total Equity and Liabilities	**272,000**	**152,000**

The following information is relevant:

A. The inventory of Karl includes Rs.8,000 of goods purchased for cash from Susan at cost plus 25%.
B. On 01.04.2022 Karl transferred an item of plant to Susan for Rs.15,000. Its carrying amount at that date was Rs.10,000, and its remaining useful life was 5 years.
C. Karl values the non-controlling interest using the fair value method and at the date of acquisition the fair value of the 40% non-controlling interest was Rs.50,000.
D. An impairment loss of Rs.1,000 is to be charged against goodwill at the reporting date.
E. The loan note in Susan's books represents monies borrowed from Karl on 01.07.2022.
F. Included in Karl's receivables is Rs.4,000 relating to inventory sold to Susan during the year. Susan raised a cheque for Rs. 2,500 and sent it to Karl on 29.02.2023 but Karl did not receive this cheque until the reporting date.

You are required to:

1. Prepare Consolidated Statement of Financial Position as at 31.03.2023.

DIVIDEND ASJUSTMENT

When accounting for the dividend adjustment, it is required to check whether the dividend declared by the subsidiary has already accounted by the subsidiary in their individual financial statements. If the declared dividend is not adjusted first it is required to adjust it and then need to eliminate the inter-company dividend receivable and payable. Further, the dividend portion attributable to NCI need to be credited to NCI.