1. Consolidated worksheet adjusting entries

Eliminating parent’s investment against equity acquired in subsidiary

- Dr Subsidiary’s total equity balance at acquisition date
- Cr Parent’s investment in subsidiary
  - E.g. if the subsidiary’s equity consists of share capital and retained earnings
    - Dr Share capital
    - Dr Retained earnings
  - Cr Investment in subsidiary

Understanding this
- In an M&A transaction, when a parent acquires a subsidiary (100% ownership), the parent records Dr Investment and Cr Cash
- However, if we treat them as one entity, we cannot recognise this investment in “yourself” or your own subsidiary as an asset
- Cr Investment in subsidiary
  - We need to eliminate this Investment in subsidiary asset account by creating an opposite journal entry to avoid double counting the net assets of a subsidiary’s pre-acquisition equity
  - Dr Share capital
    - From group’s perspective, we should present consolidated entity as parent’s equity + change in post-acquisition equity of subsidiary (changes in subsidiary equity after acquisition date)
    - Pre-acquisition entity of subsidiary has nothing to do with group’s equity

\[
\text{Consolidated Equity} = \text{Parents equity} + \Delta \text{post acquisition equity of subsidiary}
\]

Example

- Question
  - Parent paid $17,000 to acquire 100% of issued shares of the subsidiary when the subsidiary’s equity consisted of $9,000 issued capital and $8,000 retained earnings
  - At acquisition date, the assets and liabilities of the subsidiary were recorded at their fair values

- Answer
  1. Acquisition analysis
    a. Identify the parent and subsidiary, and determine if there is goodwill or not
    b. In this case, fair value of purchase consideration = fair value of identifiable net assets of subsidiary at the acquisition date
    c. $17,000 (Cost) = $9,000 (Share capital) + $8,000 (Retained earnings)

Fair value of purchase consideration

| Less fair value of identifiable net assets | 17000 |
| Share capital | 9000 |
| Retained earnings | 8000 |

Add/less fair value adjustments

| Add/less fair value adjustments | 0 |
| No Goodwill or Gain on bargain purchase | 0 |

2. Worksheet adjusting entries
• This is wrong → we haven’t eliminated the pre-acquisition equity of the subsidiary
• We need to eliminate the Retained earnings and Share capital to avoid double counting
• Create debit adjusting entry for both
• Also need to eliminate Shares in S to remove Investment in subsidiary

3. Journal entry
   a. Dr Retained earnings $8,000
   b. Dr Share capital $9,000
   c. Cr Investment in S ($17,000)

• Concluding points
  o All consolidation adjustment entries are made in the consolidated worksheet and not in the individual books of the parent or subsidiary
    ▪ Think: no permanent balance is kept
  o Hence, every time we calculate consolidated accounts over a number of years, we need to eliminate investment in subsidiary every time the consolidation worksheet is prepared

- Table

<table>
<thead>
<tr>
<th>Fin Stt (1)</th>
<th>Parent (2)</th>
<th>Subsid (3)</th>
<th>Adj Dr (4)</th>
<th>Adj Cr (5)</th>
<th>Ref (6)</th>
<th>Consid (7)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retained earnings</td>
<td>22000</td>
<td>8000</td>
<td>8000</td>
<td>(a)</td>
<td>22000</td>
<td></td>
</tr>
<tr>
<td>Share Capital</td>
<td>30000</td>
<td>9000</td>
<td>9000</td>
<td>(a)</td>
<td>30000</td>
<td></td>
</tr>
<tr>
<td>Shares in S</td>
<td>17000</td>
<td>-</td>
<td>17000</td>
<td>(a)</td>
<td>-</td>
<td></td>
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<tr>
<td>Other assets</td>
<td>35000</td>
<td>17000</td>
<td>52000</td>
<td>52000</td>
<td>52000</td>
<td></td>
</tr>
</tbody>
</table>
As the consolidation worksheet adjustments must be done at the date of every consolidation refresh

This example does not cover goodwill

**Elimination of dividend paid**

- Elimination of dividend paid
  - Dr Dividend revenue
  - Cr Dividend paid

- E.g. in 2012, subsidiary paid $5,000 dividend to parent
  - In 2013, elimination is as follows:
    - Dr Dividend revenue $5,000
    - Cr Dividend paid $5,000

- **Logic behind this**
  - Parent
    - Dr Cash at bank
    - Cr Dividend revenue
  - Subsidiary
    - Dr Dividend paid
    - Cr Cash at bank

- What if you are required to prepare adjusting entries in 2015?
  - No dividend adjusting entry is needed, because the effect of Dividend revenue of the parent and the Dividend paid by the subsidiary are both included in the opening retained earnings
  - Dr Opening retained earnings
  - Cr Opening retained earnings
  - Since these journal entries are the same account and by the same amount, no entry is required

**Elimination of dividend declared**

- This occurs when a subsidiary declares a dividend to the parent and the ownership of its shares changes before date of payment
- If **ex-dividend**, ignore dividend payable adjustment
- If **cum-dividend**, need to adjust

- Elimination of dividend declared and dividend payable
  - Dr Dividend revenue
  - Cr Dividend declared
  - Dr Dividend payable
  - Cr Dividend receivable

- These are not valid assets/liabilities of the group as they are not with external parties
  - The dividend receivable is from the subsidiary to the parent, and hence shouldn’t be in the consolidated records

- From 2009, all dividends paid/payable from subsidiary’s equity are considered dividend revenue by the parent

2. **Accounting for goodwill and impairment testing**

- **Goodwill**: Future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised
- Goodwill is not an intangible asset
• It is not identifiable, meaning it cannot be sold individually, and it doesn’t arise from contractual or other legal rights
• AASB 3: the acquirer is required to measure goodwill as the excess of the sum of consideration transferred (fair value at acquisition date) and the non-controlling interest in the acquire over the identifiable assets acquired and liabilities assumed
  o Identification of goodwill / gain on bargain purchase requires a comparison between cost of the parent’s investment asset and the fair value of the subsidiary’s net identifiable assets
• Costs directly attributable to the business combination such as legal costs, consultancy expenses, stamp duty are now normally expensed and not included in goodwill calculation/valuation of subsidiary

Example

• Question
  o Parent paid $18,000 to acquire 100% of the issued shares of the subsidiary when the subsidiary’s equity consisted of issued capital of $9,000 and retained earnings of $8,000
  o At acquisition date, the assets and liabilities of the subsidiary were recorded at their fair values

• Answer
  o Acquisition analysis

<table>
<thead>
<tr>
<th>Fair value of purchase consideration</th>
<th>18000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less fair value of identifiable net assets</td>
<td></td>
</tr>
<tr>
<td>Share capital</td>
<td>9000</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>8000</td>
</tr>
<tr>
<td>Add/less fair value adjustments</td>
<td>0</td>
</tr>
<tr>
<td>Goodwill on acquisition</td>
<td>1000</td>
</tr>
</tbody>
</table>

Goodwill is a residual

• Goodwill calculated here is for a wholly owned subsidiary refers to the controlling interests (parent) purchase of goodwill
• The parent is the only shareholder in the subsidiary

Impairment loss

• There should be sufficient disclosure to allow users to evaluate the effect of business combinations and changes in carrying value of goodwill
• AASB 136: Goodwill is tested at least once a year for impairment
  o Compare asset’s carrying amount to its recoverable amount (Fair value – cost to sell OR Value in use)
  o Goodwill emerges during consolidation elimination entry, so impairment loss is done on consolidation adjustment entry

• Journal entry
  o Dr Impairment loss
  o Cr Goodwill

• Journal entry (impairment losses that are in prior periods)
  o Dr Retained earnings (opening balance)
  o Cr Goodwill
• Impairment loss is allocated across assets of cash-generating units. Whilst working out the recoverable amount, need to identify the cash-generating units

• **Cash generating unit**: An identifiable group of assets that generate cash inflows largely independent from other groups of assets

• **Issues in calculating the cash-generating units**
  o Identifying the levels of cash-generating units to be recognised
    ▪ Do you impair goodwill for subsidiary A or subsidiary B within the group?
  o Difficulty in valuation of cash-generating units
  o Scope of bias in valuations
  o Additional time spent and greater cost

• As such, impairment testing of goodwill requires professional judgement and is subjective

3. **Accounting for gain on bargain purchase**

• **Gain on bargain purchase**: shortfall of the consideration of the business combination and non-controlling interest over the acquirer’s interest in net fair values of identifiable assets/liabilities

• If gain on bargain purchase exists, recognise as consolidated profit in year of acquisition

• Consolidations after date of acquisition would use retained earnings account

**Example**

**Question**
- On 1 January 20X0, P ltd acquired 100% of S Ltd for $12m cash. At acquisition date, the net assets of S Ltd were represented by shareholders’ equity balances as follows
  - Issued capital $10m
  - Retained earnings at 1/1/20X0 $1m

**Answer**
- Acquisition analysis
  - Cost of acquisition $12m
  - Less fair value of identifiable net assets acquired
    - Issued capital $10m
    - Retained earnings $1m
  - Goodwill $1m
- Eliminate cost of P’s investment against the net assets of S with recognition of goodwill
  - Dr Issued capital $10m
  - Dr Retained earnings $1m
  - **Dr Goodwill $1m**
  - Cr Investment in S $12m
- Here goodwill has arisen from the acquisition of S
Goodwill comes up in the consolidation worksheet → not part of subsidiary nor parent’s general ledger
  o Can treat like an adjustment in the worksheet

4. Summary of the consolidation process

- Start consolidation worksheet every year with separate financial accounts of subsidiary and parent
- Note date of acquisition and date of consolidation
- Process consolidation adjusting entries in worksheet