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

$$\textit{Consolidated Equity} = \textit{Parents equity} + \Delta\ \textit{post acquisition equity of subsidiary}$$

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		17000
Less fair value of identifiable net assets		
Share capital	9000	
Retained earnings	8000	17000
Add/less fair value adjustments		0
No Goodwill or Gain on bargain purchase		0

    2. Worksheet adjusting entries

	Parent (2)	Subsid (3)	Adj Dr (4)	Adj Cr (5)	Ref (6)	Consld (7)
Retained earnings	22000	8000				30k
Share Capital	30000	9000				39k
	52000	17000				69k
Shares in S	17000	-				17k
Other assets	35000	17000				52k
	52000	17000				69k

- 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

Fin Stt (1)	Parent (2)	Subsid (3)	Adj Dr (4)	Adj Cr (5)	Ref (6)	Consld (7)
Retained earnings	22000	8000	8000		(a)	22000
Share Capital	30000	9000	9000		(a)	30000
	52000	17000				**52000**
Shares in S	17000	-		17000	(a)	-
Other assets	35000	17000				52000
	52000	17000				**52000**

- We can see that the balance is now equal to the parent's equity
- Immediately after the acquisition, nothing has happened to the subsidiary, so there is no change in the post-acquisition subsidiary equity account

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

- **Concluding points**
    - All consolidation adjustment entries are made in the consolidated worksheet and <u>not in the individual books of the parent or subsidiary</u>
        - Think: no permanent balance is kept
    - 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

    - 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
  - 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**
  - 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
  - At acquisition date, the assets and liabilities of the subsidiary were recorded at their fair values
- **Answer**
  - Acquisition analysis

Fair value of purchase consideration		18000
Less fair value of identifiable net assets		
Share capital	9000	
Retained earnings	8000	17000
Add/less fair value adjustments		0
Goodwill on acquisition		1000

› **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
  - Compare asset's carrying amount to its recoverable amount (Fair value – cost to sell OR Value in use)
  - Goodwill emerges during consolidation elimination entry, so impairment loss is done on consolidation adjustment entry
- **Journal entry**
  - Dr Impairment loss
  - Cr Goodwill
- **Journal entry (impairment losses that are in prior periods)**
  - Dr Retained earnings (opening balance)
  - 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**
  - Identifying the levels of cash-generating units to be recognised
    - Do you impair goodwill for subsidiary A or subsidiary B within the group?
  - Difficulty in valuation of cash-generating units
  - Scope of bias in valuations
  - 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 <u>consolidated profit in year of acquisition</u>
- 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

Consolidation worksheet—1 January 20X0

	Financial statements $000		Consolidated adjustments 1 January 20X0			Result $000
	P Ltd	S Ltd	Debit	Ref.	Credit	Group
Shareholders' equity						
Issued capital	35000	10000	10000	(a)		35000
Retained earnings	2000	1000	1000	(a)		2000
Total equity	37000	11000				37000
Liabilities						
Borrowings	12000	1000				13000
Total liabilities and equity	49000	12000				50000
Assets						
Other assets	37000	12000				49000
Investment in subsidiary	12000			(a)	12000	
Goodwill	-	-	1000	(a)	-	1000
Total assets	49000	12000	12000		12000	50000

- Goodwill comes up in the consolidation worksheet → not part of subsidiary nor parent's general ledger
  - 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