CHAPTER 25

ACCOUNTING FOR INTRAGROUP TRANSACTIONS

LEARNING OBJECTIVES

Upon completing this chapter readers should be able to:

LO1 explain the nature of intragroup transactions;

LO2 describe how and why intragroup dividends from both post-acquisition and pre-acquisition earnings are eliminated on consolidation;

LO3 show how to account for intragroup sales of inventory inclusive of the related income tax expense effects; and

LO4 show how to account for intragroup sales of non-current assets inclusive of the related tax effects.

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

INTRODUCTION TO ACCOUNTING FOR INTRAGROUP TRANSACTIONS

During the financial period it is common for separate legal entities within an economic entity to transact with each other. In preparing consolidated financial statements, the effects of all transactions between entities within the economic entity—which are referred to as intragroup transactions—are eliminated in full, even where the parent entity only holds a fraction of the issued equity. Remember, in rare circumstances it might be necessary to consolidate an entity even when no equity is owned, if it is determined that there is a capacity to determine the financing and operating policies of the other organisation—the *power element*—and an entitlement to a significant level of current or future ownership benefits—the *benefit element*.

intragroup transaction Transaction undertaken between separate legal entities within an economic entity.

Intragroup transactions include:

- the payment of dividends to group members;
- the payment of management fees to a group member;
- the transfer of tax losses between entities with or without consideration;
- intragroup sales of inventory;
- intragroup sales of non-current assets; and
- intragroup loans.

When performing the consolidation adjustments for intragroup transactions these transactions would typically be eliminated by reversing the original accounting entries made to recognise the transactions in the separate legal entities. In the discussion that follows, the accounting for various intragroup transactions will be considered.

25.1 DIVIDEND PAYMENTS PRE-ACQUISITION AND POST-ACQUISITION

NZ IAS 27 considers when a parent entity should recognise a dividend received from a subsidiary. Paragraph 38A explains that

> *An entity shall recognise a dividend from a subsidiary, jointly controlled entity or associate in profit or loss in its separate financial statements when its right to receive the dividends is established.*

In the consolidation process it is however necessary to eliminate all dividends paid/payable to other entities within the group, and all intragroup dividends received/receivable from other entities within the group. Even though the separate legal entities in the group might be paying dividends to each other, it does not make sense for such dividends to be shown when the group is considered a single economic entity. That is, an entity cannot pay 'dividends' to itself. The only dividends that should be shown in the consolidated financial statements would be dividends paid to parties external to the economic entity or group, that is, to the shareholders of the parent entity and to the non-controlling interests. Non-controlling interests will be discussed in depth in the next chapter. The elimination of intragroup dividends is consistent with the requirements of NZ IAS 27 'Consolidated and Separate Financial Statements', paragraph 20, which requires all intragroup balances, transactions, income and expenses to be eliminated in full on consolidation.

DIVIDENDS OUT OF POST-ACQUISITION PROFITS

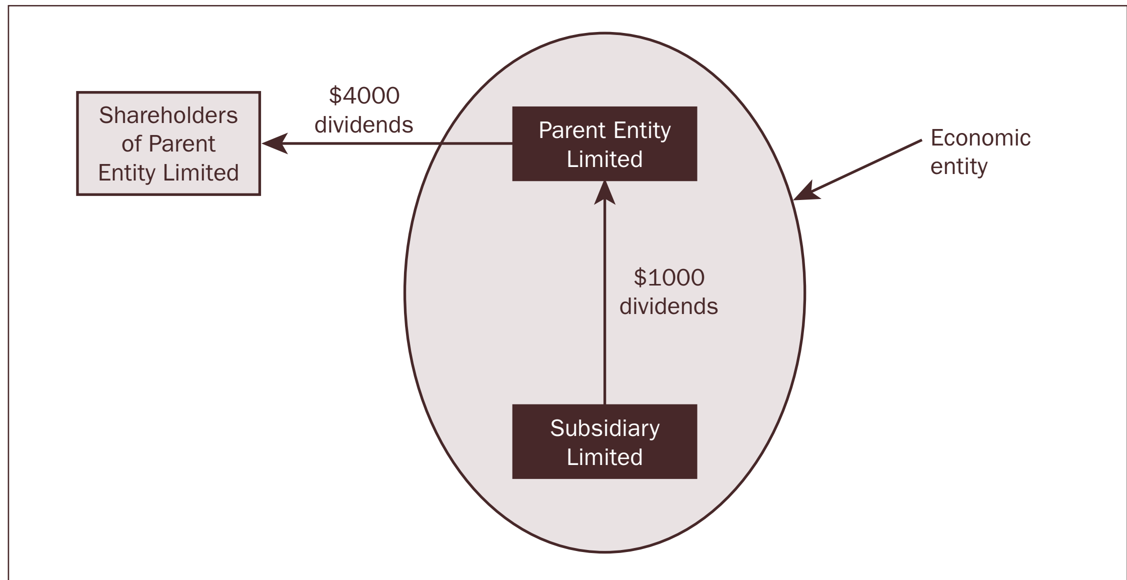
Only dividends paid externally should be shown in the consolidated financial statements. For example, in Figure 25.1, Subsidiary Limited is 100 per cent owned by Parent Entity Limited. Subsidiary Limited pays $1000 in dividends to Parent Entity Limited and Parent Entity Limited pays $4000 in dividends to its shareholders. The only dividends being paid externally, and hence the only dividends to be shown in the consolidated financial statements, will be the dividends paid to the shareholders of Parent Entity Limited, that is the $4000 in dividends. The dividends paid to the parent entity by the 100 per cent owned subsidiary will be eliminated on consolidation.

Worked Example 25.1 shows the consolidation of financial statements when a dividend has been paid by a subsidiary company after acquisition.

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

Figure 25.1

Dividends being paid by members of an economic entity



■ **WORKED EXAMPLE 25.1** DIVIDEND PAYMENTS BY A SUBSIDIARY OUT OF POST-ACQUISITION EARNINGS

Angela Limited owns all the contributed equity of Ballo Limited. Angela Limited acquired its 100 per cent interest in Ballo Limited on 1 April 2011 for a cost of $800 000 representing the fair value of the consideration transferred. The equity of Ballo Limited on the date of acquisition was:

	$
Contributed equity	500 000
Retained earnings	300 000
	800 000

It is considered that the assets of Ballo Limited are fairly stated at the date that Angela Limited acquires its shares. There is therefore no goodwill to be recognised on acquisition. On 31 March 2012 the directors of Ballo Limited proposed and communicated their decision to shareholders to pay a dividend of $50 000. Angela Limited recognises dividend income when it is declared by Ballo Limited. The financial statements of Angela Limited and Ballo Limited at 31 March 2012 are as follows:

	ANGELA LIMITED ($000)	*BALLO LIMITED ($000)*
RECONCILIATION OF OPENING AND CLOSING RETAINED EARNINGS		
Profit before tax	200	100
Income tax expense	50	40
Profit for the year	150	60
Retained earnings—1 April 2011	400	300
	550	360
less Dividends proposed	70	50
Retained earnings—31 March 2012	480	310
STATEMENT OF FINANCIAL POSITION		
Equity		
Contributed equity	500	500
Retained earnings	480	310
Liabilities		
Accounts payable	1 000	100
Dividends payable	70	50
	2 050	960

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

	ANGELA LIMITED ($000)	BALLO LIMITED ($000)
Assets		
Cash	100	70
Accounts receivable	50	130
Dividends receivable	50	–
Inventory	200	160
Plant and equipment	850	600
Investment in Ballo Limited	800	–
	2 050	960

Required •

(a) Prepare the journal entries that would have appeared in the accounting records of the separate legal entities, Angela Limited and Ballo Limited, to account for the dividends proposed by Ballo Limited.

(b) Prepare the consolidation worksheet for Angela Limited and its controlled entity.

Solution to Worked Example 25.1

(a) Journal entries that would have appeared in the accounting records of Angela Limited and Ballo Limited, to account for the dividends proposed by Ballo Limited.

Entry in records of Ballo Limited

			Dr	Cr
31 March 2012	Dr	Dividend proposed (statement of changes in equity)	50 000	
	Cr	Dividend payable (statement of financial position)		50 000
		Dividends proposed on 31 March 2012		

As Angela Limited accrues its dividend income, it would have the following entry in its own accounting records:

Entry in records of Angela Limited

			Dr	Cr
31 March 2012	Dr	Dividend receivable (statement of financial position)	50 000	
	Cr	Dividend income (statement of comprehensive income)		50 000
		Dividends receivable from Ballo Limited		

Since it does not make sense to retain the intragroup payables and receivables in the consolidated financial statements (one cannot owe money to oneself), these are eliminated on consolidation. Only dividends payable to shareholders of the holding company are shown in the consolidated financial statements.

(b) Consolidation worksheet for Angela Limited and its controlled entity
From the economic entity's perspective, Ballo Limited has paid no dividends to external parties. This means that any dividends paid by Ballo Limited must be eliminated for consolidation purposes. The elimination entries would be the reverse of those shown above, as follows:

(a) *Elimination entry for Ballo Limited*

			Dr	Cr
31 March 2012	Dr	Dividend payable	50 000	
	Cr	Dividend proposed		50 000
		Eliminating dividends proposed by Ballo Limited at 31 March 2012		

(b) *Elimination entry for Angela Limited*

			Dr	Cr
31 March 2012	Dr	Dividend income (part of profit before tax)	50 000	
	Cr	Dividend receivable		50 000
		Eliminating dividends receivable from Ballo Limited		

As was stressed in Chapter 24, consolidation journal entries are not made in the journals of either company but in a separate consolidation journal (or worksheet). Apart from the consolidation entries provided in (a) and (b) of this worked example, the investment in Ballo Limited also needs to be eliminated.

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

(c) *Eliminating investment in Ballo Limited*

The workings to eliminate the investment in Ballo Limited held by Angela Limited would be the following:

ELIMINATION OF INVESTMENT IN BALLO LIMITED	*BALLO LIMITED ($)*	*ELIMINATE PARENT 100% ($)*
Fair value of consideration transferred		800 000
less Fair value of identifiable assets acquired and liabilities assumed		
Contributed equity	500 000	500 000
Retained earnings—on acquisition	300 000	300 000
		800 000
Goodwill on acquisition date		–

This elimination entry would be:

31 March 2012	Dr	Contributed equity	500 000	
	Dr	Retained earnings	300 000	
		Cr Investment in Ballo Limited		800 000
	Eliminating investment in Ballo Limited			

The consolidation worksheet can now be prepared, as follows:

Angela Limited and its controlled entity
Consolidation worksheet for the period ending 31 March 2012

	ANGELA LIMITED ($000)	*BALLO LIMITED ($000)*	*ELIMINATIONS AND ADJUSTMENTS DR ($000)*	*CR ($000)*	*CONSOLIDATED STATEMENTS ($000)*
RECONCILIATION OF OPENING AND CLOSING RETAINED EARNINGS					
Profit before tax	200	100	50(b)		250
Income tax expense	50	40			90
Profit for the year	150	60			160
Retained earnings—1 April 2011	400	300	300(c)		400
	550	360			560
less Dividends proposed	70	50		50(a)	70
Retained earnings—31 March 2012	480	310			490
STATEMENT OF FINANCIAL POSITION					
Equity					
Contributed equity	500	500	500(c)		500
Retained earnings b/d	480	310			490
Liabilities					
Accounts payable	1 000	100			1 100
Dividends payable	70	50	50(a)		70
	2 050	960			2 160
Assets					
Cash	100	70			170
Accounts receivable	50	130			180
Dividends receivable	50	–		50(b)	–
Inventory	200	160			360
Plant and equipment	850	600			1 450
Investment in Ballo Limited	800	–		800(c)	–
	2 050	960	900	900	2 160

The retained earnings balance in the consolidated financial statements is $490 000 as at 31 March 2012. This balance represents the retained earnings of Angela Limited ($480 000) plus the increment in retained earnings of Ballo Limited ($10 000) since the date on which Ballo Limited was acquired (the post-acquisition increment).

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

DIVIDENDS OUT OF PRE-ACQUISITION PROFITS

In Worked Example 25.1, the dividends were paid out of post-acquisition profits. A dividend paid from pre-acquisition profits will occur when an investor acquires a controlling interest in a subsidiary, and the shares have been acquired 'cum div'—the term used to refer to shares being bought with a dividend entitlement. Dividends paid from profits earned prior to acquisition are, in effect, a return of part of the net assets originally acquired. These dividends represent a return of part of the investment in the subsidiary and, as such, are not accounted for as revenue of the investor. This means that any goodwill or gain on bargain purchase will not change as the payment of the dividends results in a decrease in the investor's share of the earnings of the subsidiary's net assets at the date of acquisition. Although not formally considered by either NZ IFRS 3 'Business Combinations' or NZ IAS 27, the accounting treatment for dividends paid from pre-acquisition profits was provided by NZ IFRS 3's predecessor, FRS-36 'Accounting for Acquisitions Resulting in Combinations of Entities or Operations', paragraph 5.45, which stated:

> *A distribution received from a subsidiary must be accounted for in the investor's own financial statements as a reduction in the cost of acquisition to the extent that the distribution is from pre-acquisition equity of the subsidiary.*

Dividends paid from pre-acquisition profits are considered in Worked Example 25.2.

■ **WORKED EXAMPLE 25.2** DIVIDENDS PAID OUT OF PRE-ACQUISITION EARNINGS

Sunshine Limited acquired all the issued capital of Sunrise Limited for a cash payment of $500 000 representing the fair value of the consideration transferred, on 31 March 2012. The statements of financial position of both entities immediately following the acquisition are:

	SUNSHINE LIMITED ($000)	*SUNRISE LIMITED ($000)*
Non-current assets		
Plant	1 480	600
Investment in Sunrise Limited	500	–
Current assets		
Cash	20	15
Accounts receivable	300	45
	2 300	660
Non-current liabilities		
Loans	800	180
Current liabilities		
Accounts payable	100	30
Equity		
Contributed equity	1 000	200
Retained earnings	400	250
	2 300	660

Immediately following the acquisition (that is, on the same day), a dividend of $200 000 was proposed by Sunrise Limited. The financial statements just provided do not reflect this dividend payment. The receivable will need to be treated as a reduction in the investment in Sunrise Limited account in the statement of financial position of Sunshine Limited.

Required • Provide the consolidated statement of financial position of Sunshine Limited and Sunrise Limited as at 31 March 2012.

Solution to Worked Example 25.2

Recognition of the dividend payable in the financial statements of Sunrise Limited

Sunrise Limited would have recorded the dividend payable to Sunshine Limited by means of the following journal entry:

31 March 2012	Dr Dividend paid	200 000	
	Cr Dividend payable		200 000
	Dividends payable by Sunrise Limited		

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

Recognition of the dividend receivable in the financial statements of Sunshine Limited

Sunshine Limited would have recorded the dividend receivable of pre-acquisition profits of Sunrise Limited in the following way:

31 March 2012	Dr	Dividend receivable	200 000	
		Cr Investment in Sunrise Limited		200 000
		Payment of dividends from pre-acquisition profits		

Dividends paid out of pre-acquisition profits should be accounted for by reducing the investment, rather than by the investor treating the receipt as income. Only dividends out of the investee's post-acquisition profits are treated as income in the books of the investor. It should be noted that the above entry (unlike the consolidation entries to follow) is made in the books of Sunshine Limited.

Consolidation journal entries

(a) *Elimination of investment in Sunrise Limited and recognising goodwill/gain on bargain purchase*

Given that the investment in Sunrise Limited account would have been reduced by $200 000 (as would the retained earnings shown in the financial statements of Sunrise Limited), the workings to eliminate the investment held by Sunshine Limited in Sunrise Limited are as follows:

ELIMINATION OF INVESTMENT IN SUNRISE LIMITED	*SUNRISE LIMITED ($)*	*ELIMINATE PARENT 100% ($)*
Fair value of consideration transferred		500 000
less Fair value of identifiable assets acquired and liabilities assumed		
Contributed equity	200 000	200 000
Retained earnings—on acquisition	250 000	250 000
		450 000
Goodwill on acquisition date		50 000

31 March 2012	Dr	Contributed equity	200 000	
	Dr	Retained earnings ($250 000 – $200 000 dividends from pre-acquisition profit)	50 000	
	Dr	Goodwill	50 000	
		Cr Investment in Sunrise Limited		300 000
		Eliminating investment in Sunrise Limited and recognising goodwill		

The intragroup payables and receivables will also need to be eliminated, since from the group perspective the group cannot owe itself any money.

(b) *Eliminating intragroup receivable and payable*

31 March 2012	Dr	Dividend payable	200 000	
		Cr Dividend receivable		200 000
		Eliminating dividends receivable and payable		

The consolidation worksheet can now be prepared, as follows:

Sunshine Limited and its controlled entity
Consolidation worksheet for the period ending 31 March 2012

	SUNSHINE LIMITED ($000)	*SUNRISE LIMITED ($000)*	*ELIMINATIONS AND ADJUSTMENTS DR ($000)*	*ELIMINATIONS AND ADJUSTMENTS CR ($000)*	*CONSOLIDATED STATEMENTS ($000)*
Non-current assets					
Plant	1 480	600			2 080
Investment in Sunrise Limited	300	–		300(a)	–
Goodwill	–	–	50(a)		50
Current assets					
Cash	20	15			35
Accounts receivable	300	45			345
Dividends receivable	200	–		200(b)	–
	2 300	660			2 510

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

	SUNSHINE LIMITED ($000)	SUNRISE LIMITED ($000)	ELIMINATIONS AND ADJUSTMENTS DR ($000)	CR ($000)	CONSOLIDATED STATEMENTS ($000)
Non-current liabilities					
Loans	800	180			980
Current liabilities					
Accounts payable	100	30			130
Dividend payable	–	200	200(b)		–
Equity					
Contributed equity	1 000	200	200(a)		1 000
Retained earnings	400	50	50(a)		400
	2 300	660			2 510

The consolidated statement of financial position would be as follows:

Sunshine Limited and its controlled entity
Consolidated statement of financial position at 31 March 2012

	GROUP ($000)	SUNSHINE LIMITED ($000)
Non-current assets		
Plant	2 080	1 480
Investment in Sunrise Limited	–	300
Goodwill	50	–
	2 130	1 780
Current assets		
Cash	35	20
Accounts receivable	345	300
Dividend receivable	–	200
	380	520
Total assets	2 510	2 300
Non-current liabilities		
Loans	980	800
Current liabilities		
Accounts payable	130	100
Total liabilities	1 110	900
Net assets	1 400	1 400
Equity		
Contributed equity	1 000	1 000
Retained earnings	400	400
	1 400	1 400

The dividend payment from pre-acquisition reserves will not affect the amount of goodwill recognised on consolidation. Had the pre-acquisition dividend not been paid by Sunrise Limited, the investment would have been recorded in Sunshine Limited's financial statements at $500 000 (not $300 000) and the retained earnings of Sunrise Limited would have been $250 000 (and not $50 000). In the absence of the pre-acquisition dividend, the entry to eliminate the investment in Sunrise Limited would have been:

31 March 2012	Dr	Contributed equity	200 000	
	Dr	Retained earnings—1 April 2011	250 000	
	Dr	Goodwill	50 000	
		Cr Investment in Sunrise Limited		500 000

Eliminating investment in Sunrise Limited and recognising goodwill on acquisition

Note: The entry to eliminate the intragroup dividend receivable and payable shown above would also have to be made.

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

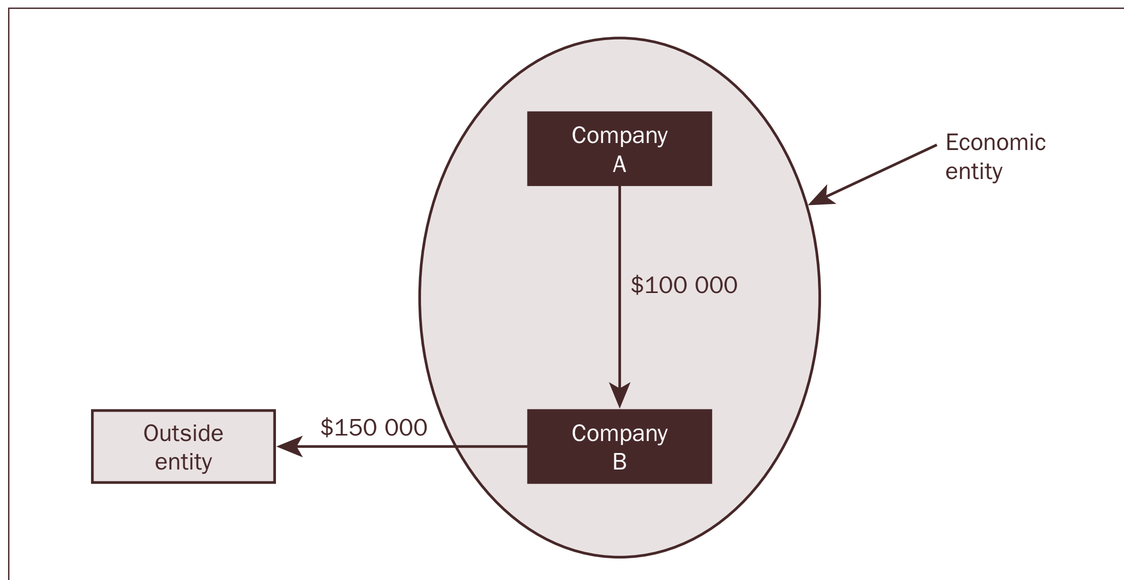
25.2 INTRAGROUP SALE OF INVENTORY

Entities that are related often sell inventory to one another in what is known as an intragroup sale of inventory. From the group's perspective, revenues should not be recognised until an external sale of inventory has taken place—that is, when inventory has been sold to parties outside the group. This is consistent with the NZ IAS 27, paragraph 20, requirement for intragroup balances, transactions, income and expenses to be eliminated in full on consolidation. Commentary paragraph 21 expands on this requirement by stating that any profits or losses that result from intragroup transactions that are recognised in assets such as inventory and fixed assets are to be eliminated in full on consolidation. The rationale for these adjustments is that the entity cannot transact with itself.

The following example will illustrate this requirement. Assume Company A sells $100 000 worth of inventory to Company B, which in turn sells it to a party outside of the economic entity for an amount of $150 000 (see Fig. 25.2). If the sales were simply aggregated in the consolidation process, it would appear that the economic entity's total sales were $250 000. From the economic entity's perspective this would be incorrect. The only sales that should appear in the consolidated financial statements are those made to parties external to the group, in this case $150 000.

Figure 25.2

Intragroup and external sales of inventory



Of course it might be possible at the end of the reporting period for some or all of the inventory sold within the group to still be on hand. Assume that half of the inventory sold by Company A to Company B is still on hand at the end of the reporting period and, further, that the total amount of inventory transferred from Company A to Company B at a sales price of $100 000 actually cost Company A $70 000 to manufacture. With half of the inventory still on hand, effectively this would mean that there is inventory on hand that appears in Company B's financial statements at a cost to Company B of $50 000, which only cost the group $35 000 to manufacture. As established in earlier chapters, an entity in New Zealand must record inventory at the lower of cost and net realisable value (see Chapter 6 for an explanation of how to value inventory). This means that inventory needs to be written down by $15 000 for the purposes of the consolidated financial statements (which have as their focus the economic entity). In the financial statements of Company B, as a separate legal entity, it is correct to leave the inventory at its cost to Company B, that is $50 000.

Remember that although unrealised profits are being eliminated from the consolidated financial statements from Company A's perspective, the profits have been earned, leading to a liability for tax. The economic entity does not pay tax on a collective basis as the individual legal entities pay tax on their own account. The Inland Revenue Department assesses income earned by the separate legal entities without any consideration of consolidation adjustments. From the group's perspective, an amount of profit related to the sale has not been realised and should not be included in the economic entity's profits. Therefore, if tax has been paid by one of the separate legal entities (for example, Company A), this represents from the group's perspective a pre-payment of tax (a deferred tax asset) as this income will not be earned by the economic entity until the inventory is sold outside the group. Worked Example 25.3 considers how to account for unrealised profit in closing inventory.

Due to copyright restrictions listed in
The Copyright Act 1968, this document
may not be reproduced or copied without
prior permission from McGraw-Hill

■ **WORKED EXAMPLE 25.3** UNREALISED PROFIT IN CLOSING INVENTORY

Big Limited owns 100 per cent of the contributed equity of Little Limited. These shares were acquired on 1 April 2011 for $1 million, representing the fair value of the consideration transferred, when the equity of Little Limited was:

	$
Contributed equity	500 000
Retained earnings on acquisition—1 April 2011	400 000
	900 000

All assets of Little Limited were fairly stated on acquisition date. The directors believe that during the year, the value of the goodwill has been impaired by an amount of $10 000.

During the 2012 reporting period Little Limited sold inventory to Big Limited at a sales price of $200 000. The inventory cost Little Limited $120 000 to produce. At 31 March 2012 half of the inventory is still on hand with Big Limited. The tax rate is 30 per cent.

The financial statements of Big Limited and Little Limited at 31 March 2012 are as follows:

	BIG LIMITED ($000)	*LITTLE LIMITED ($000)*
RECONCILIATION OF OPENING AND CLOSING RETAINED EARNINGS		
Revenue	1 200	400
Opening inventory	510	120
Purchases	590	320
less Closing inventory	600	300
Cost of goods sold	500	140
Gross profit	700	260
less Other expenses	60	30
Other income	70	25
Profit before tax	710	255
Income tax expense	200	100
Profit for the year	510	155
Retained earnings—1 April 2011	1 000	400
	1 510	555
Dividends paid	200	40
Retained earnings—31 March 2012	1 310	515
STATEMENT OF FINANCIAL POSITION		
Equity		
Contributed equity	4 000	500
Retained earnings	1 310	515
Current liabilities		
Accounts payable	100	85
Non-current liabilities		
Loans	600	250
	6 010	1 350
Current assets		
Cash	250	25
Accounts receivable	150	175
Inventory	600	300
Non-current assets		
Land	1 440	400
Plant	2 470	400
Investment in Little Limited	1 000	–
Deferred tax asset	100	50
	6 010	1 350

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

Required • Prepare the consolidation worksheet for Big Limited and its controlled entity for the reporting period ended 31 March 2012.

Solution to Worked Example 25.3

(a) *Eliminating investment in Little Limited and recognising goodwill*

Workings to eliminate investment in subsidiary

ELIMINATION OF INVESTMENT IN LITTLE LIMITED	*LITTLE LIMITED ($)*	*ELIMINATE PARENT 100% ($)*
Fair value of consideration transferred		1 000 000
less Fair value of identifiable assets acquired and liabilities assumed		
Contributed equity	500 000	500 000
Retained earnings—on acquisition	400 000	400 000
		900 000
Goodwill on acquisition date		100 000

Consolidating journal entries

			Dr	Cr
31 March 2012	Dr	Contributed equity	500 000	
	Dr	Retained earnings—1 April 2011	400 000	
	Dr	Goodwill	100 000	
	Cr	Investment in Little Limited		1 000 000
		Eliminating investment in Little Limited and recognising goodwill on acquisition		

(b) *Recognising the impairment of goodwill*

After initial recognition, any assets acquired, liabilities assumed or incurred and equity instruments issued in a business combination should be accounted for and measured in accordance with the appropriate NZ IFRSs for those items, depending on their nature. After its initial recognition, goodwill acquired in a business combination is measured at cost less any accumulated impairment losses. NZ IAS 36 'Impairment of Assets' requires goodwill to be tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. Extensive discussion on how impairment losses attributable to goodwill are calculated is provided in NZ IAS 36 'Impairment of Assets'.

			Dr	Cr
31 March 2012	Dr	Other Expenses—impairment of goodwill	10 000	
	Cr	Goodwill—accumulated impairment		10 000
		Recognising goodwill impairment expense		

In relation to the changes in the carrying amount of goodwill, which would be brought about by actions such as the recognition of impairment losses, NZ IFRS 3, paragraph 61 requires entities to disclose information that enables users of its financial statements 'to evaluate the financial effects of adjustments recognised in the current reporting period that relate to business combinations that occurred in the period or previous reporting periods'. In operationalising the requirements of paragraph 61, NZ IFRS 3, paragraph B67(d), provides the following detailed guidance:

(d) *a reconciliation of the carrying amount of goodwill at the beginning and end of the reporting period showing separately:*
- (i) *the gross amount and accumulated impairment losses at the beginning of the reporting period.*
- (ii) *additional goodwill recognised during the reporting period, except goodwill included in a disposal group that, on acquisition, meets the criteria to be classified as held for sale in accordance with NZ IFRS 5* Non-current Assets Held for Sale and Discontinued Operations*.*
- (iii) *adjustments resulting from the subsequent recognition of deferred tax assets during the reporting period in accordance with paragraph 67.*
- (iv) *goodwill included in a disposal group classified as held for sale in accordance with NZ IFRS 5 and goodwill derecognised during the reporting period without having previously been included in a disposal group classified as held for sale.*
- (v) *impairment losses recognised during the reporting period in accordance with NZ IAS 36. (NZ IAS 36 requires disclosure of information about the recoverable amount and impairment of goodwill in addition to this requirement.)*
- (vi) *net exchange rate differences arising during the reporting period in accordance with NZ IAS 21* The Effects of Changes in Foreign Exchange Rates*.*
- (vii) *any other changes in the carrying amount during the reporting period.*
- (viii) *the gross amount and accumulated impairment losses at the end of the reporting period.*

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

(c) *Eliminating intragroup sales*

The intragroup sales need to be eliminated because, from the perspective of the economic entity, no sales have occurred. This will ensure that the turnover of the economic entity is not overstated.

			Dr	Cr
31 March 2012	Dr	Revenue—sales Little Limited	200 000	
		Cr Purchases—Big Limited		200 000
	Eliminating intragroup sales			

If a perpetual inventory system was in use the above credit entry would be to cost of goods sold. (Cost of goods sold equals opening inventory plus purchases less closing inventory. So any reduction in purchases leads to a reduction in cost of goods sold.)

(d) *Eliminating unrealised profit in closing inventory*

The total profit earned by Little Limited on the sale of the inventory was $80 000. Since some of this inventory remains in the economic entity, this amount has not been fully earned. In this case, half of the inventory is still on hand. Therefore, the unrealised profit amounts to $40 000. In accordance with NZ IAS 2 'Inventories', the inventory must be valued at the *lower of cost and net realisable value*. This means that, on consolidation, the value of recorded inventory must be reduced, because the amount shown in the financial statements of Big Limited exceeds what the inventory cost the economic entity (that is, the profit element must be removed).

			Dr	Cr
31 March 2012	Dr	Closing inventory—profit and loss	40 000	
		Cr Inventory		40 000
	Eliminating unrealised profit in closing inventory			

If the perpetual inventory system were employed, the above debit entry would be to cost of goods sold. Cost of goods sold is increased by the unrealised profit in closing inventory because reducing closing inventory effectively increases cost of goods sold. (Remember, cost of goods sold equals opening inventory plus purchases, less closing inventory.) The effect of the above entries is to adjust the value of inventory so that it reflects the cost of the inventory to the group.

(e) *Consideration of the tax paid on the sale of inventory that is still held within the group*

From the group's perspective, $40 000 has not been earned. However, from Little Limited's perspective (as a separate legal entity) the full amount of the sale has been earned. This will attract a tax liability in Little Limited's financial statements of $24 000 (30 per cent of $80 000). However, from the group's perspective some of this, $12 000 ($40 000 × 30 per cent), will represent a prepayment of tax, as the full amount has not been earned by the group even if Little Limited is obliged to pay the tax. (Remember that tax is assessed on the separate legal entities, not on the consolidated profits.)

			Dr	Cr
31 March 2012	Dr	Deferred tax asset	12 000	
		Cr Income tax expense		12 000
	Recognising tax effect on unrealised profit in inventory			

(f) *Eliminating intragroup dividends*

Any intragroup dividends must also be eliminated on consolidation (as an entity cannot pay itself a dividend).

			Dr	Cr
31 March 2012	Dr	Other income—dividend revenue	40 000	
		Cr Dividends paid		40 000
	Eliminating intragroup dividends			

The consolidation worksheet can now be prepared, as follows:

Big Limited and its controlled entity
Consolidation worksheet for the period ending 31 March 2012

	SUNSHINE LIMITED ($000)	*SUNRISE LIMITED ($000)*	*ELIMINATIONS AND ADJUSTMENTS DR ($000)*	*ELIMINATIONS AND ADJUSTMENTS DR ($000)*	*CONSOLIDATED STATEMENTS ($000)*
RECONCILIATION OF OPENING AND CLOSING RETAINED EARNINGS					
Revenue	1 200	400	200(c)		1 400
Opening inventory	510	120			630
Purchases	590	320		200(c)	710
less Closing inventory	600	300	40(d)		860
Cost of goods sold	500	140			480
Gross profit	700	260			920
less Other expenses	60	30	10(b)		100
Other income	70	25	40(f)		55

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

	SUNSHINE LIMITED ($000)	SUNRISE LIMITED ($000)	ELIMINATIONS AND ADJUSTMENTS DR ($000)	CR ($000)	CONSOLIDATED STATEMENTS ($000)
Profit before tax	710	255			875
Income tax expense	200	100		12(e)	288
Profit for the year	510	155			587
Retained earnings—1 April 2011	1 000	400	400(a)		1 000
	1 510	555			1 587
Dividends paid	200	40		40(f)	200
Retained earnings—31 March 2012	1 310	515			1 387
STATEMENT OF FINANCIAL POSITION					
Equity					
Contributed equity	4 000	500	500(a)		4 000
Retained earnings b/d	1 310	515			1 387
Current liabilities					
Accounts payable	100	85			185
Non-current liabilities					
Loans	600	250			850
	6 010	1 350			6 422
Current assets					
Cash	250	25			275
Accounts receivable	150	175			325
Inventory	600	300		40(d)	860
Non-current assets					
Land	1 440	400			1 840
Plant	2 470	400			2 870
Investment in Little Limited	1 000	–		1 000(a)	–
Deferred tax asset	100	50	12(e)		162
Goodwill	–	–	100(a)		100
Goodwill—accum. Impairment	–	–		10(b)	(10)
	6 010	1 350	1 302	1 302	6 422

The consolidated financial statements can now be prepared, as follows:

Big Limited and its controlled entity
Consolidated statement of comprehensive income for the year ended 31 March 2012

	GROUP ($000)	BIG LIMITED ($000)
Revenue	1 400	1 200
Cost of goods sold	480	500
Gross profit	920	700
Other income	55	70
Other expenses	(100)	(60)
Profit before tax	875	710
Income tax expense	288	200
Profit for the year	587	510
Other comprehensive income	–	–
Total comprehensive income for the year	587	510

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

Big Limited and its controlled entity
Statement of changes in equity for the year ended 31 March 2012

	CONTRIBUTED EQUITY ($000)	GROUP RETAINED EARNINGS ($000)	TOTAL EQUITY ($000)
Balance at 1 April 2011	4 000	1 000	5 000
Total comprehensive income for the year		587	587
Distributions—Dividends		(200)	(200)
Balance at 31 March 2012	4 000	1 387	5 387

Big Limited
Statement of changes in equity for the year ended 31 March 2012

	CONTRIBUTED EQUITY ($000)	BIG LIMITED RETAINED EARNINGS ($000)	TOTAL ($000)
Balance at 1 April 2011	4 000	1 000	5 000
Total comprehensive income for the year		510	510
Distributions		(200)	(200)
Balance at 31 March 2012	4 000	1 310	5 310

Big Limited and its controlled entity
Consolidated statement of financial position at 31 March 2012

	GROUP ($000)	BIG LIMITED ($000)
Equity		
Contributed equity	4 000	4 000
Retained earnings	1 387	1 310
Current liabilities		
Accounts payable	185	100
Non-current liabilities		
Loans	850	600
	6 422	6 010
Current assets		
Cash	275	250
Accounts receivable	325	150
Inventory	860	600
Non-current assets		
Land	1 840	1 440
Plant	2 870	2 470
Investment in Little Limited	–	1 000
Deferred tax asset	162	100
Goodwill	90	–
	6 422	6 010

UNREALISED PROFIT IN OPENING INVENTORY

When it is time for Big Limited and its controlled entities of Worked Example 25.3 to prepare the consolidation adjustments at the end of the following reporting period, there will be unrealised profits in opening inventory. Remember that the consolidation journal entries do not affect the financial statements of the individual legal entities and, therefore, at the beginning

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

of the financial period, the cost of the opening inventory held by one of the entities within the group will be overstated from the group's perspective.

The closing retained earnings of Little Limited in the last year (opening retained earnings this year) will also be overstated from the group's perspective as it will include a gain on the intragroup sale of inventory. In the consolidation adjustments the income from the previous period, in which the inventory was still on hand, needs to be shifted to the period in which the inventory will ultimately be sold to parties external to the economic entity. The statement of comprehensive income consolidation entries at the end of the following year, that is, at 31 March 2013, would be:

Dr	Retained earnings—1 April 2012	40 000	
	Cr Opening inventory		40 000

Eliminating unrealised profit in opening inventory

Remember that reducing the value of opening inventory will reduce the cost of goods sold. This entry will effectively shift the income from 2012 to 2013 (the period in which the sale to an external party actually occurred). With higher profits this will lead to a higher tax expense that is based upon the accounting profit with the adoption of tax-effect accounting.

Dr	Income tax expense	12 000	
	Cr Retained earnings—1 April 2012		12 000

Income tax expense attributable to opening inventory

Any profits in opening inventory on 1 April 2012 will also need to be accounted for. Note in the above scenario that the balance of $12 000 in the deferred tax asset account raised in the previous year has not been reversed. Has a mistake been made? No! Remember that all consolidation adjustments are undertaken on a worksheet that is started 'fresh' each year. Prior adjustments do not accumulate in any ledger accounts. This means that in 2013, there is no amount residing in a deferred tax asset ledger account that needs to be reversed. The treatment of unrealised profit in opening inventory is shown in Worked Example 25.4.

■ WORKED EXAMPLE 25.4 UNREALISED PROFIT IN OPENING INVENTORY

During the 2013 reporting period, Little Limited sold a further $220 000 worth of inventory to Big Limited. The inventory cost Little Limited $160 000 to produce. At 31 March 2013, Big Limited had inventory worth $55 000 on hand that had been purchased from Little Limited. In addition, the directors believe that at 31 March 2013 goodwill had been impaired by a further $20 000.

The financial statements of Big Limited and Little Limited at 31 March 2013 are as follows:

	BIG LIMITED ($000)	*LITTLE LIMITED ($000)*
)RECONCILIATION OF OPENING AND CLOSING RETAINED EARNINGS		
Revenue	1 500	550
Opening inventory	600	300
Purchases	950	495
less Closing inventory	750	615
Cost of goods sold	800	180
Gross profit	700	370
less Other expenses	70	40
Other revenue	90	30
Profit before tax	720	360
Income tax expense	320	130
Profit for the year	400	230
Retained earnings—1 April 2012	1 310	515
	1 710	745
Dividends paid	200	50
Retained earnings—31 March 2013	1 510	695

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

	BIG LIMITED ($000)	LITTLE LIMITED ($000)
STATEMENT OF FINANCIAL POSITION		
Equity		
Contributed equity	4 000	500
Retained earnings	1 510	695
Current liabilities		
Accounts payable	140	90
Non-current liabilities		
Loans	590	240
	6 240	1 525
Current assets		
Cash	270	35
Accounts receivable	220	190
Inventory	750	455
Non-current assets		
Land	1 440	400
Plant	2 450	390
Investment in Little Limited	1 000	–
Deferred tax asset	110	55
	6 240	1 525

Required • Prepare the consolidation worksheet for Big Limited and its controlled entity for the reporting period ended 31 March 2013.

Solution to Worked Example 25.4

The first step is to do the workings that enable the consolidation journal entry to be prepared.

(a) *Eliminating investment in Little Limited and recognising goodwill*

ELIMINATION OF INVESTMENT IN LITTLE LIMITED	*LITTLE LIMITED ($)*	*ELIMINATE PARENT 100% ($)*
Fair value of consideration transferred		1 000 000
less Fair value of identifiable assets acquired and liabilities assumed		
Contributed equity	500 000	500 000
Retained earnings—on acquisition	400 000	400 000
		900 000
Goodwill on acquisition date		100 000

31 March 2013	Dr	Contributed equity	500 000	
	Dr	Retained earnings—1 April 2011	400 000	
	Dr	Goodwill	100 000	
		Cr Investment in Little Limited		1 000 000
		Eliminating investment in Little Limited and recognising goodwill on acquisition		

(b) *Recognising goodwill impairment expense*

This entry recognises the goodwill impairment loss for the period. Note that the cumulative effect of goodwill impairment loss in the previous period must also be taken into account. This is achieved by debiting opening retained earnings with the cumulative goodwill impairment loss to the beginning of the current period.

31 March 2013	Dr	Other expenses—impairment of goodwill	20 000	
	Dr	Retained earnings—1 April 2012	10 000	
		Cr Goodwill—accumulated impairment		30 000
		Recognising current and previous years' goodwill impairment loss		

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

(c) *Eliminating intragroup sales*

The *intragroup* sales need to be eliminated because, from the perspective of the economic entity, no sales have occurred. This will ensure that the turnover of the economic entity is not overstated.

31 March 2013	Dr	Revenue—sales Little Limited	220 000	
		Cr Purchases—Big Limited		220 000
	Eliminating intragroup sales			

(d) *Eliminating unrealised profit in opening inventory*

If unrealised profit in opening inventory is not eliminated, opening inventory will be overstated from the group perspective. At the beginning of the current reporting period the unrealised profit amounting to $40 000 needs to be shifted to the period in which the inventory will ultimately be sold to parties outside the group. As the perpetual inventory system is being employed in this example, the following entry must be made for consolidation purposes.

31 March 2013	Dr	Retained earnings—1 April 2012	40 000	
		Cr Opening inventory		40 000
	Eliminating unrealised profit in opening inventory			

(e) *Consideration of the tax paid on the sale of inventory held within the group at the beginning of the reporting period*

Reducing the value of opening inventory reduces the cost of goods sold. The entry made in (d) above effectively shifts the income from 2012 to 2013. Higher profits lead to a higher income tax expense. On the assumption that the whole of the unrealised profit in opening inventory has been realised in the current period, a corresponding increase in the income tax expense of $12 000 ($40 000 × 30 per cent) must be recognised.

31 March 2013	Dr	Income tax expense	12 000	
		Cr Retained earnings—1 April 2012		12 000
	Income tax expense attributable to opening inventory			

(f) *Eliminating unrealised profit in closing inventory*

The total profit earned by Little Limited on the sale to Big Limited of the $220 000 inventory in 2013 was $60 000. As 25 per cent of this inventory ($55 000 of $220 000)—or $55 000—remains in the economic entity, this amount has not been fully earned. In 2013, as 25 per cent of the inventory is still on hand, this means the unrealised profit amounts to $15 000. On consolidation, the value of recorded inventory must be reduced as the amount shown in the financial statements of Big Limited exceeds what the inventory cost the economic entity.

31 March 2013	Dr	Closing inventory—(statement of comprehensive income)	15 000	
		Cr Inventory—(statement of financial position)		15 000
	Eliminating unrealised profit in closing inventory			

Under a periodic inventory system, the above debit entry would be to closing inventory—profit and loss. The cost of goods sold is increased by the unrealised profit in closing inventory because reducing closing inventory effectively increases cost of goods sold. The effect of the above entries is to adjust the value of inventory so that it reflects the cost of the inventory to the group.

(g) *Consideration of the tax paid on the sale of inventory that is still held within the group*

From the group's perspective, $15 000 has not been earned. However, from Little's perspective (as a separate legal entity) the full amount of the sale has been earned. This will attract a tax liability in Little Limited's financial statements of $18 000 (30% of $60 000). From the group's perspective, some of this, $4500 ($15 000 × 30%), will represent a prepayment of tax, as the full amount has not been earned by the group even if Little Limited is obliged to pay the tax.

31 March 2013	Dr	Deferred tax asset	4 500	
		Cr Income tax expense		4 500
	Income tax expense attributable to unrealised profit in closing inventory			

(h) *Eliminating intragroup dividends*

Any intragroup dividends must also be eliminated on consolidation (as an entity cannot pay itself a dividend).

31 March 2013	Dr	Other income—dividend revenue	50 000	
		Cr Dividends paid		50 000
	Eliminating intragroup dividends			

The consolidation worksheet can now be prepared, as follows:

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

Big Limited and its controlled entity
Consolidation worksheet for the year ended 31 March 2013

	BIG LIMITED ($000)	LITTLE LIMITED ($000)	ELIMINATIONS AND ADJUSTMENTS DR ($000)	CR ($000)	CONSOLIDATED STATEMENTS ($000)
RECONCILIATION OF OPENING AND CLOSING RETAINED EARNINGS					
Revenue	1 500	550	220(c)		1 830.0
Opening inventory	600	300		40(d)	860.0
Purchases	950	495		220(c)	1225.0
less Closing inventory	750	615	15(f)		1350.0
Cost of goods sold	800	180			735.0
Gross profit	700	370			1095.0
less Other expenses	70	40	20(b)		130.0
Other income	90	30	50(h)		70.0
Profit before tax	720	360			1 035.0
Income tax expense	320	130	12(e)	4.5(g)	457.5
Profit for the year	400	230			577.5
Retained earnings—1 April 2012	1 310	515	400(a)	12(e)	
			10(b)		
			40(d)		1 387.0
	1 710	745			1 964.5
Dividends paid	200	50		50(h)	200.0
Retained earnings—31 March 2013	1 510	695			1 764.5
STATEMENT OF FINANCIAL POSITION					
Equity					
Contributed equity	4 000	500	500(a)		4 000.0
Retained earnings b/d	1 510	695			1 764.5
Current liabilities					
Accounts payable	140	90			230.0
Non-current liabilities					
Loans	590	240			830.0
	6 240	1 525			6 824.5
Current assets					
Cash	270	35			305.0
Accounts receivable	220	190			410.0
Inventory	750	455		15(f)	1 190.0
Non-current assets					
Land	1 440	400			1 840.0
Plant	2 450	390			2 840.0
Investment in Little Limited	1 000	–		1 000(a)	–
Deferred tax asset	110	55	4.5(g)		169.5
Goodwill	–	–	100 (a)		100.0
Accumulated impairment loss	–	–		30(b)	(30.0)
	6 240	1 525			6 824.5

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

25.3 SALE OF NON-CURRENT ASSETS WITHIN THE GROUP

Intragroup transactions are not limited to the sale of inventory. It is also common for non-current assets to be sold within a group. As with inventory, for the purposes of preparing the financial statements for the economic entity, the assets need to be valued as if the intragroup sale had not occurred. This means that the non-current asset must be restated to the original cost or revalued amount. Any unrealised profits on the sale will need to be eliminated.

Because the separate entity that acquired the asset would be depreciating the asset on the basis of the cost to itself, which might be more or less than the cost to the economic entity, there will also be a need for adjustments to depreciation (for depreciable assets) as a result of intragroup sales of non-current assets. Further, from the economic entity's perspective, no gain or loss on sale should be recorded in the financial statements—in the consolidated financial statements there should be no income tax expense related to any gain on the sale. However, there will be tax implications for the separate legal entity's financial statements. This means that timing differences might also arise as a result of intragroup sales of non-current assets. In Worked Example 25.5 the intragroup sales of a non-current asset, whose useful life remains unchanged, is examined.

■ **WORKED EXAMPLE 25.5** INTRAGROUP SALE OF A NON-CURRENT ASSET WHERE USEFUL LIFE REMAINS UNCHANGED

On 1 April 2011, Eddie Limited acquired a hundred per cent of Sandy Limited for $850 000 representing the fair value of the consideration transferred, when the equity of Sandy Limited was as follows:

	$
Contributed equity	500 000
Retained earnings	300 000
	800 000

All the assets of Sandy Limited were fairly stated on acquisition date. On 1 April 2011, Eddie Limited sells an item of plant to Sandy Limited for $780 000. This plant cost Eddie Limited $1 million, was four years old and had accumulated depreciation of $400 000 at the date of the sale. The remaining useful life of the plant is assessed as six years, and the tax rate is 30 per cent. At 31 March 2012, it was estimated that goodwill had been impaired by $5000. The financial statements of Eddie Limited and Sandy Limited at 31 March 2012 are as follows:

	EDDIE LIMITED ($000)	*SANDY LIMITED ($000)*
RECONCILIATION OF OPENING AND CLOSING RETAINED EARNINGS		
Revenue	2 000	900
Cost of sales	1 400	350
Gross profit	600	550
Other income		
Profit on sale of fixed asset	180	–
Total income	780	550
Expenses		
Depreciation	–	130
Other expenses	280	100
Profit before tax	500	320
Income tax expense	150	96
Profit for the year	350	224
Retained earnings—1 April 2011	400	300
Retained earnings—31 March 2012	750	524

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

	EDDIE LIMITED ($000)	SANDY LIMITED ($000)
STATEMENT OF FINANCIAL POSITION		
Equity		
Contributed equity	1 000	500
Retained earnings	750	524
Non-current liabilities		
Loans	400	250
Current liabilities		
Tax payable	150	96
	2 300	1 370
Non-current assets		
Land	730	320
Plant—cost	–	780
Plant—accumulated depreciation	–	130
	–	650
Investment in Sandy Limited	850	–
Current assets		
Inventory	420	220
Accounts receivable	300	180
	2 300	1 370

Required • Prepare the consolidated financial statement of Eddie Limited and its controlled entity for the reporting period ended 31 March 2012.

Solution to Worked Example 25.5

The first step is the workings that enable the consolidation journal entry to be prepared.

(a) *Eliminating investment in Sandy Limited and recognising goodwill*

ELIMINATION OF INVESTMENT IN SANDY LIMITED	*SANDY LIMITED ($)*	*ELIMINATE PARENT 100% ($)*
Fair value of consideration transferred		850 000
less Fair value of identifiable assets acquired and liabilities assumed		
Contributed equity	500 000	500 000
Retained earnings—on acquisition	300 000	300 000
		800 000
Goodwill on acquisition date		50 000

Consolidation journal adjustments for 2012

31 March 2012	Dr	Contributed equity	500 000	
	Dr	Retained earnings—1 April 2011	300 000	
	Dr	Goodwill	50 000	
		Cr Investment in Sandy Limited		850 000
		Eliminating investment in Sandy Limited and recognising goodwill on acquisition		

(b) *Reversal of gain recognised on sale of asset and reinstatement of cost and accumulated depreciation (statement of financial position)*

The result of the sale of the item of plant to Sandy Limited is that the gain of $180 000 will be shown in Eddie Limited's financial statements. As there has been no transaction with a party outside the economic entity, the following entry is necessary so that the financial statements will reflect the balances that would have been in place had the intragroup sale not occurred.

31 March 2012	Dr	Gain on sale of asset	180 000	
	Dr	Plant	220 000	
		Cr Accumulated depreciation		400 000
		Reversal of gain recorded in Eddie Limited's financial statements and reinstatement of accumulated depreciation		

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

The result of this entry is that the intragroup gain is removed and the asset and accumulated depreciation account is restated to that reported by Eddie Limited prior to the sale. The gain of $180 000 will be recognised progressively in the consolidated financial statements of the economic entity by adjustments to the amounts of depreciation charged by Sandy Limited in its financial statements. As the service potential or economic benefits embodied in the asset are consumed, the $180 000 profit will be progressively recognised from the economic entity's perspective. This is shown in journal entry (d).

(c) *Impact of tax on gain on sale of asset*

Eddie Limited would have recorded a related income tax expense of $180 000 × 30 per cent. From the economic entity's perspective no gain has been made, which means that the income tax expense must be reversed. A deferred tax asset is recognised because, from the group's perspective, the amount paid to the Inland Revenue Department represents a prepayment of tax.

31 March 2012	Dr	Deferred tax asset	54 000	
		Cr Income tax expense		54 000
	Reducing related income tax expense			

(d) *Restating statement of financial position accumulated depreciation*

Sandy Limited would be depreciating the asset by $780 000 ÷ 6 = $130 000. From the economic entity's perspective, the depreciation charge should be $600 000 ÷ 6 = $100 000 (originally $1 000 000 ÷ 10).

31 March 2012	Dr	Plant—accumulated depreciation	30 000	
		Cr Depreciation		30 000
	Reducing depreciation expense			

(e) *Consideration of tax effect of reduction of depreciation expense*

The increase in the income tax expense is due to the reduction in the depreciation expense. The additional income tax expense is $9000 ($30 000 × 30%). This entry represents a partial reversal of the deferred tax asset of $54 000 recognised in the earlier entry. After six periods, the balance of the deferred tax asset related to the sale of the non-current asset will be $nil.

31 March 2012	Dr	Income tax expense	9 000	
		Cr Deferred tax asset		9 000
	Recognising increase in income tax expense			

(f) *Impairment of goodwill*

This entry recognises the impairment loss on goodwill for the current year:

31 March 2012	Dr	Other expenses—impairment of goodwill	5 000	
		Cr Goodwill—accumulated impairment		5 000
	Impairment of goodwill for year			

The consolidation worksheet can now be prepared, as follows:

Eddie Limited and its controlled entity
Consolidation worksheet for the year ended 31 March 2012

	EDDIE LIMITED ($000)	SANDY LIMITED ($000)	ELIMINATIONS AND ADJUSTMENTS DR ($000)	ELIMINATIONS AND ADJUSTMENTS CR ($000)	CONSOLIDATED STATEMENTS ($000)
RECONCILIATION OF OPENING AND CLOSING RETAINED EARNINGS					
Revenue	2 000	900			2 900
Cost of sales	1 400	350			1 750
Gross profit	600	550			1 150
Other income					
Profit on sale of asset	180	–	180(b)		–
Total income	780	550			1 150
Expenses					
Depreciation	–	130		30(d)	100
Other expenses	280	100	5(f)		385
Profit before tax	500	320			665
Income tax expense	150	96	9(e)	54(c)	201

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

	EDDIE LIMITED ($000)	SANDY LIMITED ($000)	ELIMINATIONS AND ADJUSTMENTS DR ($000)	CR ($000)	CONSOLIDATED STATEMENTS ($000)
Profit for the year	350	224			464
Retained earnings—1 April 2011	400	300	300(a)		400
Retained earnings—31 March 2012	750	524			864
STATEMENT OF FINANCIAL POSITION					
Equity					
Contributed equity	1 000	500	500(a)		1 000
Retained earnings b/d	750	524			864
Non-current liabilities					
Loans	400	250			650
Current liabilities					
Tax payable	150	96			246
	2 300	1 370			2 760
Non-current assets					
Land	730	320			1 050
Plant—cost	–	780	220(b)		1 000
Plant—accumulated depreciation	–	130	30(d)	400(b)	500
	–	650			500
Investment in Sandy Limited	850	–		850(a)	–
Goodwill	–	–	50(a)		50
Accumulated impairment—goodwill				5(f)	5
					45
Current assets					
Inventory	420	220			640
Accounts receivable	300	180			480
Deferred tax asset	–	–	54(c)	9(e)	45
	2 300	1 370			2 760

To illustrate how to take account of prior period adjustments (such as adjustments relating to a prior period sale of a non-current asset) when a consolidation is undertaken in periods subsequent to the first consolidation, in Worked Example 25.6 the consolidation of Eddie Limited and its controlled entity is undertaken at 31 March 2013—that is two years after control of the subsidiary was established.

■ **WORKED EXAMPLE 25.6** CONSOLIDATION TWO YEARS AFTER ACQUISITION IN THE PRESENCE OF A PRIOR PERIOD INTRAGROUP SALE OF A NON-CURRENT ASSET

The financial statements of Eddie Limited and Sandy Limited at 31 March 2013 are as follows:

	EDDIE LIMITED ($000)	SANDY LIMITED ($000)
RECONCILIATION OF OPENING AND CLOSING RETAINED EARNINGS		
Revenue	2 700	1 100
Cost of sales	1 550	440
Gross profit	1 150	660
Expenses		
Depreciation	–	130
Other expenses	410	120

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

	EDDIE LIMITED ($000)	SANDY LIMITED ($000)
Profit before tax	740	410
Income tax expense	222	123
Profit for the year	518	287
Retained earnings—1 April 2012	750	524
Retained earnings—31 March 2013	1 268	811
STATEMENT OF FINANCIAL POSITION		
Equity		
Contributed equity	1 000	500
Retained earnings b/d	1 268	811
Non-current liabilities		
Loans	390	245
Current liabilities		
Tax payable	222	123
	2 880	1 679
Non-current assets		
Land	910	320
Plant—cost	–	780
Plant—accumulated depreciation	–	260
	–	520
Investment in Sandy Limited	850	–
Current assets		
Inventory	820	559
Accounts receivable	300	280
	2 880	1 679

Required • Prepare the consolidated financial statement of Eddie Limited and its controlled entity for the reporting period ended 31 March 2013, assuming that the directors believe that goodwill on acquisition has been impaired by a further $5000. In undertaking the consolidation the profit made on the sale, discussed in Worked Example 25.5, needs to be taken into a ccount.

Solution to Worked Example 25.6

As the workings for the consolidation journal entry were prepared earlier, they are not repeated here.

Consolidation journal adjustments for 2013

(a) *Eliminating investment and recognition of goodwill*

			Dr	Cr
31 March 2013	Dr	Contributed equity	500 000	
	Dr	Retained earnings—1 April 2012	300 000	
	Dr	Goodwill	50 000	
		Cr Investment in Sandy Limited		850 000

Eliminating investment in Sandy Limited and recognising goodwill

(b) *Reversal of profit on sale of asset recognised in the previous period, and reinstatement of cost and accumulated depreciation*

This entry reinstates the asset cost and accumulated depreciation, and eliminates the profit on the sale of the asset recognised in the previous period.

			Dr	Cr
31 March 2013	Dr	Retained earnings—1 April 2012	126 000	
	Dr	Deferred tax asset	54 000	
	Dr	Plant	220 000	
		Cr Accumulated depreciation		400 000

Consolidation adjustment eliminating gain on sale of assets

[The debit to retained earnings = the gain on sale × (1 – tax rate) = $180 000 × 0.7.]

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

(c) *Depreciation adjustment for current and prior period*

This entry is necessary to restate the accumulated depreciation to what it would have been had the sale of the asset not occurred.

31 March 2013	Dr	Plant—accumulated depreciation	60 000	
		Cr Depreciation expense		30 000
		Cr Retained earnings—1 April 2012		30 000
		Depreciation adjustment for the current and prior period		

(d) *Tax consideration on current and previous periods' depreciation*

This entry takes into account the tax effect of the reduction in the depreciation charge.

31 March 2013	Dr	Retained earnings—1 April 2012	9 000	
	Dr	Income tax expense	9 000	
		Cr Deferred tax asset		18 000
		Tax effects of current and previous periods' depreciation adjustments		

With tax-effect accounting, each decrease of $30 000 in depreciation leads to an increase in accounting income of $30 000 and an associated increase in income tax expense of $18 000 ($30 000 × 30%).

(e) *Impairment of goodwill*

This entry recognises the goodwill impairment loss for the period. The retained earnings adjustment that takes into account the goodwill impairment loss of the previous period is made in the next entry.

31 March 2013	Dr	Other expenses—impairment of goodwill	5 000	
	Dr	Retained earnings—1 April 2012	5 000	
		Cr Goodwill—accumulated impairment		10 000
		Goodwill impairment loss for current and prior periods		

The consolidation worksheet can now be prepared, as follows.

Eddie Limited and its controlled entity
Consolidation worksheet for the year ended 31 March 2013

	EDDIE LIMITED ($000)	SANDY LIMITED ($000)	ELIMINATIONS AND ADJUSTMENTS DR ($000)	CR ($000)	CONSOLIDATED STATEMENTS ($000)
RECONCILIATION OF OPENING AND CLOSING RETAINED EARNINGS					
Revenue	2 700	1 100			3 800
Cost of sales	1 550	440			1 990
Gross profit	1 150	660			1 810
Expenses					
Depreciation expense	–	130		30(c)	100
Other expenses	410	120	5(e)		535
Profit before tax	740	410			1 175
Income tax expense	222	123	9(d)		354
Profit for the year	518	287			821
Retained earnings—1 April 2012	750	524	300(a)	30(c)	
			126(b)		
			9(b)		
			5(e)		864
Retained earnings—31 March 2013	1 268	811			1 685
STATEMENT OF FINANCIAL POSITION					
Equity					
Contributed equity	1 000	500	500(a)		1 000
Retained earnings b/d	1 268	811			1 685
Non-current liabilities					
Loans	390	245			635
Current liabilities					
Tax payable	222	123			345
	2 880	1 679			3 665

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

	EDDIE LIMITED ($000)	SANDY LIMITED ($000)	ELIMINATIONS AND ADJUSTMENTS DR ($000)	CR ($000)	CONSOLIDATED STATEMENTS ($000)
Non-current assets					
Land	910	320			1 230
Plant—at cost	–	780	220(b)		1 000
Plant—accumulated depreciation	–	260	60(c)	400(b)	600
	–	520			400
Investment in Sandy Limited	850	–		850(a)	–
Goodwill—at cost			50(a)		50
Goodwill—accum. impairment loss				10(e)	10
					40
Current assets					
Inventory	820	559			1 379
Accounts receivable	300	280			580
Deferred tax asset	–	–	54(b)	18(d)	36
	2 880	1 679			3 665

The consolidated financial statements can now be prepared:

Eddie Limited and its controlled entity
Consolidated statement of comprehensive income for the year ended 31 March 2013

	GROUP ($)	EDDIE LIMITED ($)
Sales	3 800 000	2 700 000
Cost of goods sold	(1 990 000)	(1 550 000)
Gross profit	1 810 000	1 150 000
Depreciation	(100 000)	–
Other expenses	(535 000)	(410 000)
Profit before tax	1 175 000	740 000
Income tax expense	(354 000)	(222 000)
Profit for the year	821 000	518 000
Other comprehensive income	–	–
Total comprehensive income for the year	821 000	518 000

Eddie Limited and its controlled entity
Statement of changes in equity for the year ended 31 March 2013

	CONTRIBUTED EQUITY ($000)	GROUP RETAINED EARNINGS ($000)	TOTAL EQUITY ($000)
Balance at 1 April 2012	1 000	864	1 864
Total comprehensive income for the year		821	821
Distributions—Dividends		–	–
Balance at 31 March 2013	1 000	1 685	2 685

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

Eddie Limited
Statement of changes in equity for the year ended 31 March 2013

	CONTRIBUTED EQUITY ($000)	EDDIE LIMITED RETAINED EARNINGS ($000)	TOTAL ($000)
Balance at 1 April 2012	1 000	750	1 750
Total comprehensive income for the year		518	518
Distributions		–	–
Balance at 31 March 2013	1 000	1 268	2 268

Eddie Limited and its controlled entity
Consolidated statement of financial position at 31 March 2013

	GROUP ($)	EDDIE LIMITED ($)
Current Assets		
Accounts receivable	580 000	300 000
Inventory	1 379 000	820 000
	1 959 000	1 120 000
Non-current assets		
Land	1 230 000	910 000
Plant and equipment	1 000 000	–
Accumulated depreciation	(600 000)	–
	400 000	–
Deferred tax asset	36 000	–
Goodwill	50 000	–
less Accumulated impairment loss	(10 000)	–
	40 000	–
Investment in Sandy Limited	–	850 000
	1 706 000	1 760 000
Total assets	3 665 000	2 880 000
Current liabilities		
Tax payable	345 000	222 000
Non-current liabilities		
Loan	635 000	390 000
Total liabilities	980 000	612 000
Equity		
Contributed equity	1 000 000	1 000 000
Retained earnings	1 685 000	1 268 000
Total equity	2 685 000	2 268 000
	3 665 000	2 880 000

INTRAGROUP SALES OF DEPRECIABLE NON-CURRENT ASSETS WHEN THEIR ESTIMATED TOTAL USEFUL LIFE CHANGES ON ACQUISITION

It is important to remember that the sale of a non-current asset might result in the depreciation rate charged by the purchaser differing from that charged by the seller. In addition, the purchaser of a non-current asset might utilise the asset in a different manner, in a different location and for a different purpose. These changes result in the service potential or future economic benefits embodied in the asset being consumed by the purchaser of the asset at a rate different from that of the seller. The

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

depreciation charge in the consolidated financial statements should be adjusted to reflect the purchaser's changed expectation. This is consistent with the requirement of NZ IAS 16 'Property, Plant and Equipment', paragraph 51, which requires the residual value and the useful life of an item of property, plant and equipment to be reviewed at least at the end of each reporting period and, where expectations differ from previous estimates, the change to be accounted for as a change in an accounting estimate as required by NZ IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' (see Chapter 17 for an explanation of how a change in accounting estimate should be made). What this means is that where the original useful life of an item of property, plant and equipment is no longer appropriate, the depreciation charge for the current and future periods must be reviewed and, if necessary, adjusted. The consolidation adjustments that should be made where the useful life of a non-current asset sold intragroup changes are detailed in Worked Example 25.7.

■ **WORKED EXAMPLE 25.7** INTRAGROUP SALE OF A NON-CURRENT ASSET WHERE USEFUL LIFE CHANGES

Assume the same information as provided for Worked Example 25.5, except that in this example the remaining useful life of the depreciable non-current asset sold by Eddie Limited to Sandy Limited is assessed as being four years.

Required • Prepare the journal entries necessary to account for the sale of the non-current asset for the years ending 31 March 2012 and 31 March 2013.

Solution to Worked Example 25.7

(a) *Reversal of gain recognised on sale of asset and reinstatement of cost and accumulated depreciation*

The result of the sale of the item of plant to Sandy Limited is that the profit of $180 000 will be shown in Eddie Limited's financial statements. As there has been no transaction with a party outside the economic entity, the following entry is necessary so that the financial statements will reflect the balances that would have been in place had the intragroup sale not occurred.

31 March 2012	Dr	Gain on sale of asset	180 000	
	Dr	Plant	220 000	
		Cr Accumulated depreciation		400 000

Reversal of gain recorded in Eddie Limited's financial statements and reinstatement of accumulated depreciation

(b) *Impact of tax on profit of sale of asset*

Eddie Limited would have recorded a related income tax expense of $180 000 × 30 per cent. From the economic entity's perspective no gain has been made, which means that the income tax expense must be reversed. A deferred tax asset is recognised because, from the group's perspective, the amount paid to the Inland Revenue Department represents a prepayment of tax.

31 March 2012	Dr	Deferred tax asset	54 000	
		Cr Income tax expense		54 000

Reducing related income tax expense

(c) *Restating statement of financial position accumulated depreciation*

Sandy Limited would be depreciating the asset by $780 000 ÷ 4 = $195 000. From the economic entity's perspective, the depreciation should be $600 000 ÷ 4 = $150 000.

31 March 2012	Dr	Plant—accumulated depreciation	45 000	
		Cr Depreciation		45 000

Reducing depreciation expense

(d) *Consideration of tax effect of reduction of depreciation expense*

The increase in the income tax expense is due to the reduction in depreciation expense. The additional income tax expense is $13 500 ($45 000 × 30%). This entry represents a partial reversal of the deferred tax asset of $54 000 recognised in the earlier entry. After four periods, the balance of the deferred tax asset related to the sale of the non-current asset will be nil.

31 March 2012	Dr	Income tax expense	13 500	
		Cr Deferred tax asset		13 500

Recognising increase in income tax expense

Consolidation journal adjustments for 31 March 2013

(e) *Reversal of gain on sale of asset recognised in the previous period, and reinstatement of cost and accumulated depreciation*

This entry reinstates the asset cost and accumulated depreciation, and eliminates the gain on sale of the asset recognised in the previous period.

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

31 March 2013	Dr	Retained earnings—31 March 2012	126 000	
	Dr	Deferred tax asset	54 000	
	Dr	Plant	220 000	
		Cr Accumulated depreciation		400 000

Consolidation adjustment eliminating gain on sale of assets

[The debit to retained earnings = the gain on sale × (1 – tax rate) = $180 000 × 0.7.]

(f) *Depreciation adjustment for current and prior period*

This entry is necessary to reinstate the accumulated depreciation to what it would have been had the sale of the asset not occurred.

31 March 2013	Dr	Accumulated depreciation	90 000	
		Cr Depreciation expense		45 000
		Cr Retained earnings—31 March 2012		45 000

Depreciation adjustment for the current and prior periods

(g) *Tax consideration on current and previous periods' depreciation*

This entry takes into account the tax effect of the reduction in the depreciation charge.

31 March 2013	Dr	Retained earnings—31 March 2012	13 500	
	Dr	Income tax expense	13 500	
		Cr Deferred tax asset		27 000

Tax effects of current and previous periods' depreciation adjustments

By adopting tax-effect accounting, each decrease of $45 000 in depreciation leads to an increase in accounting income of $45 000 and an associated increase in income tax expense of $13 500 ($45 000 × 30%).

INTRAGROUP SALE OF A NON-CURRENT ASSET RESULTING IN A LOSS

Where a loss is made on the intragroup sale of a non-current asset, the treatment is similar to that where a profit is made on an intragroup transaction. However, the entries to account for depreciation shown in Worked Example 25.6, for example, would need to be reversed, while the tax-effect entry would reduce the deferred tax asset that was created as a result of the loss.

It is, of course, possible for a non-current asset that is sold within the economic entity to change its classification on sale. For example, an item of inventory in one entity within the economic entity might become a non-current asset and might be used in the manufacturing process of another company within the economic entity. From the legal entity's perspective, there has been a sale of inventory and the acquisition of a non-current asset. From the economic entity's perspective, however, there has been no sale of inventory and no acquisition of a non-current asset. There has merely been a reclassification of an item of inventory as a non-current asset.

SUMMARY

The chapter considered the consolidation process and, in particular, how to account for intragroup transactions—that is, intragroup dividend payments, sales of inventory and sales of non-current assets.

The chapter indicated that only dividends paid externally should be shown in the consolidated financial statements, so that intragroup dividends paid by one entity within the group are offset against dividend revenue recorded in another entity. Further, for intragroup dividends, the liability associated with dividends payable is to be offset against the asset, dividend receivable, as recorded by other entities within the group.

Individual entities within a group often provide goods and services to one another at a profit. From the economic entity's perspective, however, revenue related to the sale of goods and services should be shown only where the inflow of economic benefits has come from parties external to the group. As such, on consolidation it is often necessary to provide adjusting entries that eliminate the effects of intragroup sales. Where there have been intragroup sales and some of the inventory is still on hand within the group at the end of the reporting period, consolidation adjustments will need to be made that reduce the consolidated balance of closing inventory. This is required to ensure that the consolidated financial statements measure inventory at the lower of cost and net realisable value from the group's perspective (consistent with NZ IAS 2).

Where there is a sale of non-current assets within the group, consolidation adjustments are to be made to eliminate any intragroup profit on the sale of the assets and to adjust the cost of the assets to reflect their cost to the economic entity. Where there are intragroup sales of non-current assets there is also, typically, a requirement to adjust depreciation as part of the consolidation process.

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

KEY TERM

intragroup transactions 815

END-OF-CHAPTER EXERCISE

PART A

After completing this chapter, readers should be able to provide answers to the following questions. (If they are not able to, the relevant sections of this chapter should be reviewed.)

1. Following consolidation, should dividends paid to the parent entity by its subsidiaries be shown in the economic entity's financial statements?
2. Will dividends paid by subsidiaries out of their pre-acquisition earnings affect the amount of goodwill that will be calculated on consolidation?
3. If a subsidiary sells inventory to the parent entity and some of the inventory is still on hand at the end of the reporting period, what adjustments are necessary at the end of the reporting period? Will adjustments be required to restate the balance of opening inventory as at the beginning of the next financial period?

PART B

The following financial statements of Mungo Limited and its subsidiary Barry Limited have been extracted from their financial records at 31 March 2012.

	MUNGO LIMITED ($000)	*BARRY LIMITED ($000)*
RECONCILIATION OF OPENING AND CLOSING RETAINED EARNINGS		
Sales revenue	1 380.0	1 160.0
Cost of goods sold	(928.0)	(476.0)
Gross profit	452.0	684.0
Dividends received from Barry Limited	186.0	–
Management fee revenue	53.0	–
Gain on sale of plant	70.0	–
Expenses		
Administrative expenses	(98.8)	(77.4)
Depreciation	(49.0)	(113.6)
Management fee expense	–	(53.0)
Other expenses	(202.2)	(154.0)
Profit before tax	411.0	286.0
Income tax expense	123.0	84.4
Profit for the year	288.0	201.6
Retained earnings—1 April 2011	638.8	478.4
	926.8	680.0
Dividends paid	(274.8)	(186.0)
Retained earnings—31 March 2012	652.0	494.0
STATEMENT OF FINANCIAL POSITION		
Equity		
Contributed equity	700.0	400.0
Retained earnings b/d	652.0	494.0
Current liabilities		
Accounts payable	109.4	92.6
Tax payable	82.6	50.0
Non-current liabilities		
Loans	347.0	232.0
	1 891.0	1 268.6

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

	MUNGO LIMITED ($000)	BARRY LIMITED ($000)
Current assets		
Accounts receivable	118.8	124.6
Inventory	184.0	58.0
Non-current assets		
Land and buildings	448.0	652.0
Plant—at cost	599.7	711.6
Accumulated depreciation	(171.5)	(277.6)
	428.2	434.0
Investment in Barry Limited	712.0	–
	1 891.0	1 268.6

Other information •

- Mungo Limited acquired its 100 per cent interest in Barry Limited on 1 April 2008, that is four years earlier. The payment for the interest in Barry Limited represented the fair value of the consideration transferred. At that date the contributed equity and reserves of Barry Limited were:

	$
Contributed equity	400 000
Retained earnings	250 000
	650 000

At the date of acquisition all assets were considered to be fairly valued.

- During the year Mungo Limited made total sales to Barry Limited of $130 000, while Barry Limited sold $104 000 in inventory to Mungo Limited.
- The opening inventory in Mungo Limited as at 1 April 2011 included inventory acquired from Barry Limited for $84 000 that had cost Barry Limited $70 000 to produce.
- The closing inventory in Mungo Limited includes inventory acquired from Barry Limited at a cost of $67 200. This cost Barry Limited $52 000 to produce.
- The closing inventory of Barry Limited includes inventory acquired from Mungo Limited at a cost of $24 000. This cost Mungo Limited $19 200 to produce.
- The management of Mungo Limited believe that goodwill acquired was impaired by $5000 in the current reporting period. Previous impairments of goodwill amounted to $10 000.
- On 1 April 2011 Mungo Limited sold an item of plant to Barry Limited for $100 000 when its carrying value in Mungo Limited's financial statements was $80 000 (cost $120 000, accumulated depreciation $40 000). This plant is assessed as having a remaining useful life of six years from the date of sale.
- Barry Limited paid $53 000 in management fees to Mungo Limited.
- The tax rate is 30 per cent.

Required • Prepare the consolidated financial statement of Mungo Limited and its controlled entity for the reporting period ended 31 March 2012.

Solution to Part B

(a) *Elimination of the investment in Mungo Limited and the recognition of goodwill on acquisition date*

ELIMINATION OF INVESTMENT IN BARRY LIMITED	BARRY LIMITED ($)	ELIMINATE PARENT 100% ($)
Fair value of consideration transferred		712 000
less Fair value of identifiable assets acquired and liabilities assumed		
Contributed equity	400 000	400 000
Retained earnings—on acquisition	250 000	250 000
		650 000
Goodwill on acquisition date		62 000

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

As shown above, the net assets of Barry Limited are $650 000 on acquisition date. As $712 000 is paid for the investment, the goodwill amounts to $62 000. The consolidation entry to eliminate the investment is:

31 March 2012	Dr	Contributed equity	400 000	
	Dr	Retained earnings—1 April 2011	250 000	
	Dr	Goodwill	62 000	
		Cr Investment in Barry Limited		712 000
		Eliminating investment in Sandy Limited and recognising goodwill		

Adjustments for intragroup sales

(b) *Elimination of intragroup sales*

The intragroup sales need to be eliminated because, from the perspective of the economic entity, no sales have in fact occurred. This will ensure that the turnover of the economic entity is not overstated.

31 March 2012	Dr	Revenue—sales Barry Limited	104 000	
		Cr Cost of goods sold		104 000
		Eliminating sale of inventory from Barry Limited to Mungo Limited		

Under the periodic inventory system, the above credit entry would instead be to purchases, which would ultimately lead to a reduction in cost of goods sold. (Cost of goods sold equals opening inventory plus purchases less closing inventory, so any reduction in purchases leads to a reduction in cost of goods sold.)

(c) *Elimination of the unrealised profit in the closing inventory of Mungo Limited*

In this case, the unrealised profit in closing amounts to $15 200. In accordance with NZ IAS 2 'Inventories', the inventory must be valued at the *lower of cost and net realisable value*. Therefore on consolidation the value of recorded inventory must be reduced as the amount shown in the financial statements of Mungo Limited exceeds what the inventory cost the economic entity.

31 March 2012	Dr	Cost of goods sold	15 200	
		Cr Inventory		15 200
		Eliminating unrealised profit in closing inventory		

Under the periodic inventory system, the above debit entry would be to closing inventory—profit and loss. The cost of goods sold is increased by the unrealised profit in closing inventory because reducing closing inventory effectively increases cost of goods sold. (Remember, cost of goods sold equals opening inventory plus purchases less closing inventory.) The effect of the above entries is to adjust the value of inventory so that it reflects the cost of the inventory to the group.

(d) *Consideration of the tax paid or payable on the sale of inventory that is still held within the group*

From the group's perspective, $15 200 has not been earned. However, from Barry Limited's individual perspective (as a separate legal entity), the full amount of the sale has been earned. This will attract a tax liability in Barry Limited's financial statements of $4560 (30 per cent of $15 200). However, from the group's perspective some of this will represent a prepayment of tax as the full amount has not been earned by the group even if Barry Limited is obliged to pay the tax.

31 March 2012	Dr	Deferred tax asset	4 560	
		Cr Income tax expense		4 560
		Income tax expense attributed to unrealised profit in closing inventory ($15 200 × 30 per cent)		

(e) *Sale of inventory from Mungo Limited to Barry Limited*

During the current financial period Mungo Limited sold inventory to Barry Limited at a price of $130 000. The unrealised profit component is $4800.

31 March 2012	Dr	Revenue—sales Mungo Limited	130 000	
		Cr Cost of goods sold		130 000
		Eliminating intragroup sales		

(f) *Elimination of unrealised profits in the closing inventory of Barry Limited*

In this case, the unrealised profit in closing inventory amounts to $4800. In accordance with NZ IAS 2 'Inventories', the inventory must be valued at the *lower of cost and net realisable value*. Therefore on consolidation the value of recorded inventory must be reduced as the amount shown in the financial statements of Barry Limited exceeds what the inventory cost the economic entity.

31 March 2012	Dr	Cost of goods sold	4 800	
		Cr Inventory		4 800
		Eliminating unrealised profit in closing inventory		

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

(g) *Consideration of the tax paid or payable on the sale of inventory that is still held within the group*
From the group's perspective, $4800 has not been earned. However, from Mungo Limited's individual perspective (as a separate legal entity), the full amount of the sale has been earned. This will attract a tax liability in Mungo Limited's financial statements of $1440 (30 per cent of $4800). However, from the group's perspective some of this will represent a prepayment of tax as the full amount has not been earned by the group even if Mungo Limited is obliged to pay the tax.

31 March 2012	Dr	Deferred tax asset	1 440	
		Cr Income tax expense		1 440
		Income tax expense attributed to unrealised profit in closing inventory ($4800 × 30 per cent)		

(h) *Unrealised profit in opening inventory*
At the end of the preceding reporting period, Mungo Limited had $84 000 of inventory on hand, which had been purchased from Barry Limited. The inventory had cost Barry Limited $70 000 to produce. Assume that the inventory has been sold to an external party in the current period and is therefore realised—so there is no need to adjust the closing balance of inventory.

31 March 2012	Dr	Retained earnings—1 April 2011	9 800	
	Dr	Income tax expense	4 200	
		Cr Cost of sales		14 000
		Eliminating profit and associated income tax expense in opening inventory		

Adjustments for intragroup sale of plant
On 1 April 2011 Mungo Limited sold an item of plant to Barry Limited for $100 000 when its carrying value in Barry Limited's financial statements was $80 000 (cost of $120 000 and accumulated depreciation of $40 000). This item of plant was being depreciated over a further six years from acquisition date, with no expected residual value.

(i) *Reversal of gain recognised on sale of asset and reinstatement of cost and accumulated depreciation*
The result of the sale of the item of plant to Barry Limited is that the gain of $20 000—the difference between the sales proceeds of $100 000 and the carrying amount of $80 000—will be shown in Mungo Limited's financial statements. However, from the economic entity's perspective there has been no sale and, therefore, no gain on sale given that there has been no transaction with a party external to the group. The following entry is necessary for the financial statements to reflect the balances that would have applied had the intragroup sale not occurred.

31 March 2012	Dr	Gain on sale of plant	20 000	
	Dr	Plant	20 000	
		Cr Accumulated depreciation		40 000
		Reversal of gain recorded in Mungo Limited's financial statements and reinstatement of accumulated depreciation		

The result of this entry is that the intragroup gain is removed and the asset and accumulated depreciation financial statements revert to reflecting no sales transaction. The gain of $20 000 will be recognised progressively in the consolidated financial statements of the economic entity by adjustments to the amounts of depreciation charged by Barry Limited in its financial statements. As the service potential or economic benefits embodied in the asset are consumed, the $20 000 profit will be progressively recognised from the economic entity's perspective. This is shown in journal entry (k).

(j) *Effect of tax on gain on sale of item of plant*
From Mungo Limited's individual perspective it would have made a gain of $20 000 on the sale of the plant. As this gain is taxable (as depreciation recouped) at a tax rate of 30 per cent, $6000 would then be payable by Mungo Limited. However, from the economic entity's perspective, no gain has been made, which means that the related 'tax expense' must be reversed and a related deferred tax benefit be recognised. A deferred tax asset is recognised because, from the economic entity's perspective, the amount paid to the tax office represents a prepayment of tax.

31 March 2012	Dr	Deferred tax asset	6 000	
		Cr Income tax expense		6 000
		Reducing related income tax expense		

(k) *Reinstating accumulated depreciation in the statement of financial position*
Mungo Limited would be depreciating the asset on the basis of the cost it incurred to acquire the asset. Its depreciation charge would be $100 000 ÷ 6 = $16 667. From the economic entity's perspective, the asset had a carrying value of $80 000, which was to be allocated over the next six years, giving a depreciation charge of $80 000 ÷ 6 = $13 333. An adjustment of $3334 is therefore required.

31 March 2012	Dr	Accumulated depreciation	3 334	
		Cr Depreciation expense		3 334
		Reducing depreciation expense		

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

(l) *Consideration of the tax effect of the reduction in depreciation expense*

The increase in the income tax expense from the perspective of the economic entity is due to the reduction in the depreciation expense. The additional income tax expense is $1000, which is $3334 × 30 per cent. This entry represents a partial reversal of the deferred tax asset of $6000 recognised in an earlier entry. After six years the balance of the deferred tax asset relating to the sale of the item of plant will be $nil.

31 March 2012	Dr	Income tax expense	1 000	
		Cr Deferred tax asset		1 000
		Recognising increase in income tax expense		

(m) *Impairment of goodwill*

This entry recognises the goodwill impairment loss for the period. The retained earnings adjustment takes into account the goodwill impairment loss of the prior period.

31 March 2012	Dr	Retained earnings—1 April 2011	10 000	
	Dr	Other expenses—impairment goodwill	5 000	
		Cr Goodwill—accumulated impairment		15 000
		Goodwill impairment loss for current and prior period		

(n) *Elimination of intragroup transactions—management fees*

All of the management fees paid within the group will need to be eliminated on consolidation.

31 March 2012	Dr	Management fee revenue	53 000	
		Cr Management fee expense		53 000
		Eliminating intragroup management fees paid and received		

(o) *Dividends paid*

Dividends paid within the group must be eliminated. Only dividends paid to parties outside the entity (non-controlling interests) are to be shown in the consolidated financial statements.

31 March 2012	Dr	Other income—dividend revenue	186 000	
		Cr Dividend paid		186 000
		Eliminating intragroup dividends paid		

The consolidation journal entries can now be posted to the consolidation worksheet, as follows:

Mungo Limited and its controlled entity
Consolidation worksheet for the year ended 31 March 2013

	MUNGO LIMITED ($000)	*BARRY LIMITED ($000)*	*ELIMINATIONS AND ADJUSTMENTS DR ($000)*	*ELIMINATIONS AND ADJUSTMENTS CR ($000)*	*CONSOLIDATED STATEMENTS ($000)*
RECONCILIATION OF OPENING AND CLOSING RETAINED EARNINGS					
Sales revenue	1 380.0	1 160.0	104.0(b)		2 306.0
			130.0(e)		
Cost of goods sold	(928.0)	(476.0)	15.2(c)	104.0(b)	1 176.0
			4.8(f)	130.0(e)	
				14.0(h)	
Gross profit	452.0	684.0			1 130.0
Dividends received from Barry Limited	186.0	–	186(o)		–
Management fee revenue	53.0	–	53.0(n)		–
Gain on sale of plant	70.0	–	20(i)		50.0
Expenses					
Administrative expenses	(98.8)	(77.4)			(176.2)
Depreciation expense	(49.0)	(113.6)		3.334(k)	(159.266)
Management fee expense	–	(53.0)		53(n)	–
Other expenses	(202.2)	(154.0)	5.0(m)		(361.2)
Profit before tax	411.0	286.0			483.334
Income tax expense	(123.0)	(84.4)	4.2(h)	4.56(d)	
			1(l)	1.44(g)	
				6.0(j)	(200.6)

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

	MUNGO LIMITED ($000)	BARRY LIMITED ($000)	ELIMINATIONS AND ADJUSTMENTS DR ($000)	CR ($000)	CONSOLIDATED STATEMENTS ($000)
Profit for the year	288.0	201.6			282.734
Retained earnings—1 April 2011	638.8	478.4	250.0(a)		
			9.8(h)		
			10(m)		847.4
	926.8	680.0			1 130.134
Dividends paid	(274.8)	(186.0)		186.0(o)	(274.8)
Retained earnings—31 March 2012	652.0	494.0			855.334
STATEMENT OF FINANCIAL POSITION					
Equity					
Contributed equity	700.0	400.0	400.0(a)		700.0
Retained earnings b/d	652.0	494.0			855.334
Current liabilities					
Accounts payable	109.4	92.6			202.0
Tax payable	82.6	50.0			132.6
Non-current liabilities					
Loans	347.0	232.0			579.0
	1 891.0	1 268.6			2 468.934
Current assets					
Accounts receivable	118.8	124.6			243.4
Inventory	184.0	58.0		15.2(c)	
				4.8(f)	222.0
Non-current assets					
Deferred tax asset	–	–	4.56(d)	1(l)	11.0
			1.44(g)		
			6.0(j)		
Land and buildings	448.0	652.0			1 100.0
Plant—at cost	599.7	711.6	20.0(i)		1 331.3
Accumulated depreciation	(171.5)	(277.6)	3.334(k)	40(i)	(485.766)
	428.2	434.0			845.534
Investment in Barry Limited	712.0	–		712.0(a)	–
Goodwill	–	–	62.0(a)		62.0
Goodwill—accumulated impairment	–	–		15.0(m)	15.0
	–	–			47.0
	1 891.0	1 268.6	1 257.334	1 257.334	2 468.934

The next step would be to present the consolidated financial statements. A suggested format for the consolidated financial statements would be as follows (prior year comparatives for the financial statements of the parent entity, both of which would be required in practice, have not been provided):

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

Mungo Limited and its subsidiaries
Consolidated statement of comprehensive income for the year ended 31 March 2012

	GROUP ($)	*MUNGO LIMITED ($)*
Sales	2 306 000	1 380 000
Cost of goods sold	(1 176 000)	(928 000)
Gross profit	1 130 000	452 000
Dividends received	–	186 000
Management fee revenue	33 000	53 000
Profit on sale of plant	50 000	70 000
Administrative expenses	(176 200)	(98 800)
Depreciation	(159 266)	(49 000)
Goodwill impairment expense	(5 000)	–
Management fee expense	(33 000)	–
Other expenses	(356 200)	(202 200)
Profit before tax	483 334	411 000
Income tax expense	(200 600)	(123 000)
Profit for the year	282 734	288 000
Other comprehensive income	–	–
Total comprehensive income for the year	282 734	288 000

Mungo Limited and its controlled entity
Statement of changes in equity for the year ended 31 March 2012

		GROUP	
	CONTRIBUTED EQUITY ($)	*RETAINED EARNINGS ($)*	*TOTAL EQUITY ($)*
Balance at 1 April 2011	700 000	847 400	1 547 400
Total comprehensive income for the year		282 734	282 734
Distributions—dividends		(274 800)	(274 800)
Balance at 31 March 2012	700 000	855 334	1 555 334

Mungo Limited
Statement of changes in equity for the year ended 31 March 2012

		MUNGO LIMITED	
	CONTRIBUTED EQUITY ($)	*RETAINED EARNINGS ($)*	*TOTAL EQUITY ($)*
Balance at 1 April 2011	700 000	638 800	1 338 800
Total comprehensive income for the year		288 000	288 000
Distributions—dividends		(274 800)	(274 800)
Balance at 31 March 2012	700 000	652 000	1 352 000

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

Mungo Limited and its subsidiaries
Consolidated statement of financial position at 31 March 2012

	GROUP ($)	*MUNGO LIMITED ($)*
Current assets		
Accounts receivable	243 400	118 800
Inventory	222 000	184 000
	465 400	302 000
Non-current assets		
Land and buildings	1 100 000	448 000
Plant and equipment	1 331 300	599 700
less Accumulated depreciation	(485 766)	(171 500)
	845 534	428 200
Goodwill	62 000	–
less Accumulated impairment loss	(15 000)	–
	47 000	–
Deferred tax asset	11 000	–
Investment in Barry Limited	–	712 000
	2 003 534	1 588 200
Total assets	2 468 934	1 891 000
Current liabilities		
Accounts payable	202 000	109 400
Tax payable	132 600	82 600
	334 600	192 000
Non-current liabilities		
Loan	579 000	347 000
Total liabilities	913 600	539 000
Equity		
Contributed equity	700 000	700 000
Retained earnings—31 March 2012	855 334	652 000
Total equity	1 555 334	1 352 000
	2 468 934	1 891 000

FURTHER READING

ARTHUR, N., GROSE, R., CAMPBELL, J. & LUFF, J., *Accounting for Corporate Combinations and Associations.* 6th edn, Prentice Hall, Sydney, 2008.

GOODWIN, J. & ALFREDSON, K., 'Consolidation Accounting—How you should account for intragroup sales of depreciable non-current assets when their estimated total useful life changes on acquisition?', *Accounting Research Journal*, 13(2), 2000, pp. 95–101.

REVIEW QUESTIONS

1. What is an intragroup transaction and why is it necessary to know about them?
2. When does an intragroup inventory transaction require us to perform a consolidation adjustment to income tax expense?
3. In the consolidated financial statements, which dividends are to be shown as paid, declared, payable and receivable?
4. How would dividends that have been paid out of pre-acquisition earnings of a subsidiary be treated in the financial statements of the parent entity?

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

5 What effect, if any, would the payment of dividends by a controlled entity, out of its pre-acquisition earnings, have on the amount of goodwill that would be recognised on consolidation?

6 If one entity sells inventory to another entity, which is 80 per cent owned, what percentage of the sales revenue needs to be eliminated in the consolidation process?

7 Alpha Limited owns 100 per cent of Beta Limited, which in turn owns 100 per cent of Charlie Limited. During the reporting period, Alpha Limited sells inventory to Beta Limited at a sales price of $150 000. The inventory cost Alpha Limited $100 000 to produce.

Within the same reporting period, Beta Limited subsequently sells the same inventory to Charlie Limited for $200 000 without incurring any additional costs. At the end of the reporting period, Charlie Limited has sold half of this inventory to companies outside the group for a sales price of $180 000. At the end of the reporting period Charlie Limited still has half the stock on hand.

Required • From the economic entity's perspective (that is, the group's perspective), determine:

(a) the sales revenue for the reporting period; and

(b) the value of closing inventory.

8 Big Company owns all the issued capital of Small Company Limited. Big Company Limited acquired its 100 per cent interest in Small Company on 1 April 2011 for a cost of $2000 which represented the fair value of the consideration transferred. All assets were fairly stated on acquisition date. The contributed equity and reserves of Small Company on the date of acquisition were:

	$
Contributed equity	1 250
Retained earnings	750
	2 000

The draft financial statements of Big Company and Small Company at 31 March 2012 are as follows:

	BIG LIMITED ($)	*SMALL LIMITED ($)*
RECONCILIATION OF OPENING AND CLOSING RETAINED EARNINGS		
Profit before tax	500	250
Income tax expense	125	100
Profit for the year	375	150
Opening retained earnings	1 000	750
	1 375	900
Dividends proposed	175	125
Closing retained earnings	1 200	775
STATEMENT OF FINANCIAL POSITION		
Equity		
Contributed equity	1 250	1 250
Retained earnings	1 200	775
Liabilities		
Accounts payable	2 500	250
Dividends payable	175	125
	5 125	2 400
Assets		
Cash	230	175
Accounts receivable	145	325
Dividends receivable	125	–
Inventory	500	400
Plant and equipment	2 125	1 500
Investment in Small Company	2 000	–
	5 125	2 400

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

Required • Prepare the consolidated financial statement for Big Company Limited and its controlled entity for the reporting period ended 31 March 2012.

9 Bernie Boffin Limited owns 100 per cent of Computer Limited. On 1 April 2011, Bernie Boffin Limited sold an item of plant to Computer Limited for $3.6 million. This plant cost Bernie Boffin Limited $4.5 million and had accumulated depreciation of $1.8 million at the date of sale. (The original depreciation period was 15 years and the plant was being depreciated on the straight-line basis.) The remaining useful life of the plant is assessed as nine years and the tax rate is 30 per cent.

Required •

(a) Provide the consolidation journal entries for 31 March 2012 and 31 March 2013 to adjust for the above sale.

(b) What would the journal entries be if the remaining useful life at the date of sale was assessed at:

(i) six years; and

(ii) 15 years.

10 Bigger Company owns all the issued capital of Smaller Company. The financial statements of Bigger Company and Smaller Company at 31 March 2012 are as follows:

	BIGGER LIMITED ($)	*SMALLER LIMITED ($)*
RECONCILIATION OF OPENING AND CLOSING RETAINED EARNINGS		
Profit before tax	500	500
Income tax expense	125	200
Profit for the year	375	300
Opening retained earnings	4 000	1 500
	4 375	1 800
Dividends proposed	175	250
Closing retained earnings	4 200	1 550
STATEMENT OF FINANCIAL POSITION		
Equity		
Contributed equity	1 250	2 500
Retained earnings	4 200	1 550
Liabilities		
Accounts payable	2 500	500
Dividends payable	175	250
	8 125	4 800
Assets		
Cash	150	350
Accounts receivable	100	650
Dividends receivable	250	–
Inventory	500	800
Plant and equipment	2 125	3 000
Investment in Smaller Company	5 000	–
	8 125	4 800

Bigger Company acquired its 100 per cent interest in Smaller Company on 1 April 2011 for a cost of $5000 representing the fair value of the consideration transferred. The contributed equity and reserves of Smaller Company on the date of acquisition were:

	$
Contributed equity	2 500
Retained earnings	1 500
	4 000

At 31 March 2012, the directors believe goodwill had been impaired by 20 per cent.

Required • Prepare the consolidated financial statements for Bigger Company and its controlled entity for the reporting period ended 31 March 2012.

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

11 Nat Limited acquired all the issued capital of Midget Limited for a cash payment of $1.5 million, representing the fair value of the consideration transferred, on 31 March 2012. The statements of financial position of both entities immediately following the purchase are:

	NAT LIMITED ($000)	*MIDGET LIMITED ($000)*
STATEMENT OF FINANCIAL POSITION		
Current assets		
Cash	60	45
Accounts receivable	900	135
Non-current assets		
Plant	4 440	1 800
Investment in Midget Limited	1 500	–
	6 900	1 980
Current liabilities		
Accounts payable	300	90
Non-current liabilities		
Loans	2 400	540
Equity		
Contributed equity	3 000	600
Retained earnings	1 200	750
	6 900	1 980

Additional information • Immediately following the acquisition, a dividend of $600 000 was proposed by Midget Limited. The financial statements provided above do not reflect this dividend payment (the receivable will need to be treated as a reduction in the investment in Midget Limited account in the statement of financial position of Nat Limited). The directors consider that at the end of the reporting period goodwill on the acquisition of Midget Limited had been impaired by $15 000.

Required • Provide the consolidated statement of financial position of Nat Limited and Midget Limited at 31 March 2012.

CHALLENGING QUESTIONS

12 Jacko Limited owns a hundred per cent of the shares of Jackson Limited. These shares were acquired on 1 March 2011 for $3.5 million representing the fair value of the consideration transferred when the equity of Jackson Limited was:

	$
Contributed equity	1 750 000
Retained earnings	1 400 000
	3 150 000

All assets of Jackson Limited were fairly stated on acquisition date. At the end of the reporting period the directors believe that the goodwill associated with the acquisition of Jackson Limited had been impaired by 10 per cent.

During the 2012 reporting period, Jackson Limited sold inventory to Jacko Limited at a sales price of $700 000. The inventory cost Jackson Limited $420 000 to produce. At 31 March 2012, half of the inventory is still on hand with Jacko Limited. The tax rate is 30 per cent.

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

The financial statements of Jacko Limited and Jackson Limited at 31 March 2012 are as follows:

	JACKO LIMITED ($000)	JACKSON LIMITED ($000)
RECONCILIATION OF OPENING AND CLOSING RETAINED EARNINGS		
Revenue	4 200.0	1 400.0
Cost of goods sold	(1 750.0)	(490.0)
Other expenses	(210.0)	(105.0)
Other income	245.0	87.5
Profit before tax	2 485.0	892.5
Income tax expense	(700.0)	(350.0)
Profit for the year	1 785.0	542.5
Retained earnings—1 April 2011	3 500.0	1 400.0
	5 285.0	1 942.5
Dividends paid	(700.0)	(140.0)
Retained earnings—31 March 2012	4 585.0	1 802.5
STATEMENT OF FINANCIAL POSITION		
Equity		
Retained earnings	4 585.0	1 802.5
Contributed equity	14 000.0	1 750.0
Current liabilities		
Accounts payable	350.0	297.5
Non-current liabilities		
Loans	2 100.0	875.0
	21 035.0	4 725.0
Current assets		
Cash	875.0	87.5
Accounts receivable	525.0	612.5
Inventory	2 100.0	1 050.0
Non-current assets		
Land	5 040.0	1 400.0
Plant	8 645.0	1 400.0
Investment in Jackson Limited	3 500.0	–
Deferred tax asset	350.0	175.0
	21 035.0	4 725.0

Required • Provide the consolidated financial statement for Jacko Limited and its controlled entity for the reporting period ended 31 March 2012.

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

13 The following financial statements of Andy Limited and its subsidiary Irons Limited have been extracted from their financial records at 31 March 2012.

	ANDY LIMITED ($)	*IRONS LIMITED ($)*
RECONCILIATION OF OPENING AND CLOSING RETAINED EARNINGS		
Sales revenue	862 500	725 000
Cost of goods sold	(580 000)	(297 500)
Gross profit	282 500	427 500
Dividends received from Irons Limited	93 000	–
Management fee revenue	33 125	–
Gain on sale of plant	43 750	–
Expenses		
Administrative expenses	(38 500)	(48 375)
Depreciation	(30 625)	(71 000)
Management fee expense	–	(33 125)
Other expenses	(126 375)	(96 250)
Profit before tax	256 875	178 750
Income tax expense	(76 875)	(52 750)
Profit for the year	180 000	126 000
Retained earnings—1 April 2011	399 250	299 000
	579 250	425 000
Dividends paid	(171 750)	(116 250)
Retained earnings—31 March 2012	407 500	308 750
STATEMENT OF FINANCIAL POSITION		
Equity		
Contributed equity	437 500	250 000
Retained earnings	407 500	308 750
Current liabilities		
Accounts payable	62 500	57 875
Tax payable	100 000	31 250
Non-current liabilities		
Loans	236 000	145 000
	1 243 500	792 875
Current assets		
Accounts receivable	74 250	77 875
Inventory	115 000	36 250
Non-current assets		
Land and buildings	261 250	407 500
Plant—at cost	400 000	444 750
Accumulated depreciation	(107 000)	(173 500)
	293 000	271 250
Investment in Irons Limited	500 000	–
	1 234 500	792 875

Other information •

- Andy Limited acquired its 100 per cent interest in Irons Limited on 1 April 2005—that is seven years earlier. The cost of the investment was $500 000 representing the fair value of the consideration transferred. At that date the contributed equity and reserves of Irons Limited were:

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

	$
Contributed equity	250 000
Retained earnings	200 000
	450 000

At the date of acquisition all assets were considered to be fairly valued.

- During the year Andy Limited made total sales to Irons Limited of $81 250, while Irons Limited sold $65 000 in inventory to Andy Limited.
- The opening inventory in Andy Limited as at 1 April 2011 included inventory acquired from Irons Limited for $52 500 that cost Irons Limited $43 750 to produce.
- The closing inventory in Andy Limited includes inventory acquired from Irons Limited at a cost of $42 000. This cost Irons Limited $35 000 to produce.
- The closing inventory of Irons Limited includes inventory acquired from Andy Limited at a cost of $15 000. This cost Andy Limited $12 000 to produce.
- The management of Andy Limited believe that goodwill acquired was impaired by $3750 in the current reporting period. Previous impairments of goodwill amounted to $20 000.
- On 1 April 2011 Andy Limited sold an item of plant to Irons Limited for $145 000 when its carrying value in Andy Limited's financial statements was $101 250 (cost $168 750, accumulated depreciation $67 500). This plant is assessed as having a remaining useful life of six years.
- Irons Limited paid $33 125 in management fees to Irons Limited.
- The tax rate is 30 per cent.

Required • Prepare the consolidated statement of financial position, statement of comprehensive income and statement of changes in equity of Andy Limited and Irons Limited at 31 March 2012.

14 The following financial statements of Joel Limited and its subsidiary Parko Limited have been extracted from their financial records at 31 March 2012.

	JOEL LIMITED ($000)	*PARKO LIMITED ($000)*
RECONCILIATION OF OPENING AND CLOSING RETAINED EARNINGS		
Sales revenue	690	540
Cost of goods sold	(464)	(238)
Gross profit	226	302
Dividends received from Parko Limited	74.4	–
Management fee revenue	26.5	–
Gain on sale of plant	40	35
Expenses		
Administrative expenses	(30.8)	(38.7)
Depreciation	(29.5)	(56.8)
Management fee expense	–	(26.5)
Other expenses	(101.1)	(72)
Profit before tax	205.5	143
Income tax expense	(61.5)	(42.2)
Profit for the year	144	100.8
Retained earnings—1 April 2011	319.4	239.2
	463.4	340
Dividends paid	(137.4)	(93)
Retained earnings—31 March 2012	326	247

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

	JOEL LIMITED ($000)	PARKO LIMITED ($000)
STATEMENT OF FINANCIAL POSITION		
Equity		
Contributed equity	350	200
Retained earnings	326	247
Current liabilities		
Accounts payable	54.7	46.3
Tax payable	41.3	25
Non-current liabilities		
Loans	173.5	116
	945.5	634.3
Current assets		
Accounts receivable	59.4	62.3
Inventory	92	29
Non-current assets		
Land and buildings	224	326
Plant—at cost	299.85	355.8
Accumulated depreciation	(85.75)	(138.8)
	214.1	217
Investment in Parko Limited	356	–
	945.5	634.3

Other information •

- Joel Limited acquired its 100 per cent interest in Parko Limited on 1 April 2007, that is five years earlier. The amount paid by Parko Limited representing the fair value of the consideration transferred. At that date the contributed equity and reserves of Parko Limited were:

	$
Contributed equity	200 000
Retained earnings	180 000
	380 000

  At the date of acquisition all assets were considered to be fairly valued.

- During the year Joel Limited made total sales to Parko Limited of $60 000, while Parko Limited sold $50 000 in inventory to Joel Limited.
- The opening inventory in Joel Limited as at 1 April 2011 included inventory acquired from Parko Limited for $40 000 that cost Parko Limited $30 000 to produce.
- The closing inventory in Joel Limited includes inventory acquired from Parko Limited at a cost of $33 000. This cost Parko Limited $28 000 to produce.
- The closing inventory of Parko Limited includes inventory acquired from Joel Limited at a cost of $12 000. This cost Joel Limited $10 000 to produce.
- On 1 April 2011 Parko Limited sold an item of plant to Joel Limited for $116 000 when its carrying value in Parko Limited's financial statements was $81 000 (cost $135 000, accumulated depreciation $54 000). This plant is assessed as having a remaining useful life of six years.
- Parko Limited paid $26 500 in management fees to Parko Limited.
- The tax rate is 30 per cent.

Required • Prepare a consolidated statement of financial position, statement of comprehensive income and statement of changes in equity for Joel Limited and Parko Limited at 31 March 2012.

Due to copyright restrictions listed in The Copyright Act 1968, this document may not be reproduced or copied without prior permission from McGraw-Hill

Due to copyright restrictions listed in
The Copyright Act 1968, this document
may not be reproduced or copied without
prior permission from McGraw-Hill