ACCA SBR

REVISION NOTES

Group Accounts

TomClendon.co.uk

The SBR Exam Focus

Groups will be tested at Q1 of the SBR exam. Every time. There will be numbers. There will be words. You will have to update a prepopulated spread sheet with numbers that you are either given or more likely have to calculate. 10-14 marks for the numbers. So, the majority of the marks in Q1 will be for the explanations. The topic of group accounts can also be examined in other questions as well.

The pre-populated spread sheet at Q1 could take the form of a statement of financial position, profit or loss account and other comprehensive income or even a cash flow statement. See later revision notes for group cash flow statements.

If you have not done so already – please attempt the questions of **Six Nations** (group statement of financial position) and **Cricket** (group profit or loss account) to get used to the style of the exam questions with a pre-populated spread sheet. Even if you have done them, it will be worth your while reviewing.

In the SBR exam you will not be asked to prepare the group accounts from scratch. The adjustments that you will have to make to the pre-populated spread sheet and explain will include consolidation adjustments such as:

- Acquisition of a subsidiary and goodwill to calculate etc
- Step acquisition
- Impairment losses on goodwill
- Disposal of a subsidiary
- Control to control transactions
- An overseas subsidiary
- Investments in associates and joint ventures
- AND you will also be asked to adjust for and explain other accounting issues e.g. updating for the accounts for defined benefit scheme entries or changes in an accounting policy.

There is plenty to revise. Let me try and keep it exam focussed and simple.

What is a group?

A group comprises at minimum a parent and a subsidiary.

Group Accounts

What is a subsidiary?

A subsidiary is where there is **control**.
Control is present where all of the following elements apply:

- **p**ower over the investee, i.e. the investor has existing rights that give it the ability to direct the relevant activities (the activities that significantly affect the investee's returns)
- **e**xposure, or rights, to variable returns from its involvement with the investee
- the **a**bility to use its power over the investee to affect the amount of the investor's returns.

All circumstances should be considered before concluding whether the entity is controlled e.g. options, shareholder agreements and the size of other shareholdings.

How is a subsidiary accounted for in the group accounts?

Using acquisition accounting!

This means in the group statement of financial position a line-by-line cross casting of the subsidiary's assets and liabilities. The group retaining earnings and group other components of equity will only include the group share of the subsidiary's post-acquisition changes.

In the group profit or loss and other comprehensive income for the year there will be a line-by-line cross casting of the subsidiary's income and expenses.

Goodwill on acquisition will arise. An intangible asset subject to annual impairment review.

Unless the parent has acquired all the equity of the subsidiary a non-controlling interest will also be reported in the equity of group statement of financial position and in the group profit or loss and other comprehensive income for the year the profits attributable to the NCI will be disclosed.

Goodwill

When the aggregate of the fair value of the parent's investment and the NCI exceeds the fair value of the net assets of the subsidiary acquired, a premium arises that is accounted for as an intangible asset in the group accounts. This is subject to an annual impairment review.

1	FV of the parent's investment	X
2	NCI (FV or proportion of net assets)	X
3	FV of net assets	(X)
	Goodwill at acquisition	X

If at acquisition goodwill is negative, then this is unusual. It is a bargain purchase as the net assets of the subsidiary have been acquired at a discount. The discount is recognised as a profit in the group's profit or loss account.

1. FV of the parent's investment

The parent's investment (the controlling interest) has to be recorded at fair value. This is normally given, but if it is not, remember that shares issued by the parent are recorded at market value and deferred consideration discounted to the present value of the future cash flow. Transaction costs are not capitalised.

Where there has been a **step acquisition** there will have been two investments in the subsidiary on different dates. The first investment must be restated to fair value from its carrying value and the gain recognised as a profit. If that first investment had been at FVTOCI then the balance of the gains sitting in OCE is now moved to RE.

2. NCI at acquisition

NCI can be measured at acquisition either at fair value or as a proportion of net asset. This is an accounting policy that can be made on an acquisition-by-acquisition basis. It has a direct bearing on the measurement of goodwill and the treatment of impairment losses.

NCI at acquisition can be measured at **fair value** of the subsidiary's shares. Goodwill will be in full, and any **impairment loss split** between the parent and the NCI.

NCI% x number of equity shares x market price = FV of NCI

NCI at acquisition can be measured as a **proportion of net assets**. Goodwill is then attributable to **the parent only** and any impairment loss on that goodwill is suffered by the parent only.

NCI% x FV of net assets = NCI as a proportion of net assets

3. **Fair Value of the net assets**

The net assets of the subsidiary will be represented by its equity.

The carrying value of the subsidiary's net asset can require adjusting to the fair value. Fair value adjustments are consolidation adjustments and are not recognised at the individual company stage.

Fair value adjustments can include recognising **intangible assets** like brands and customer lists which have a fair value but are prohibited from being recognised as assets at the individual company stage.

Fair value adjustments can include **contingent liabilities** that have a fair value but are prohibited from being recognised at the individual company stage.

Strictly fair value adjustments are temporary differences as the carrying value of the assets and liabilities are revised but not the tax base. Thus, a **fair value adjustment** that represents an **increase in an asset**, is a **taxable temporary difference** and creates a **deferred tax liability** at the given tax rate. The deferred tax liability is therefore a further fair value adjustment. But don't go making up tax rates. Only account for deferred tax on fair value adjustments if directed.

Provisional fair values ascribed to the net assets at acquisition can be revised and goodwill restated if the revised information is received within 12 months of the date of acquisition and relates to the fair value at the date of acquisition.

Corrections to the ingredients of the goodwill calculation

Goodwill is a balancing figure. If goodwill has already been determined and one of the three ingredients is revised, then there will be an impact on goodwill that will need to reflect as a plus or minus in that pre-populated spreadsheet!

	Potential reason		Impact on goodwill
Parent's investment increases	Part of the consideration was not recorded	→	Goodwill increases
Parent's investment decreases	Deferred consideration was not discounted	→	Goodwill decreases
NCI increases	NCI needs to be measured at FV and not as a proportion of net assets	→	Goodwill increases
NCI decreases	NCI is measured as a proportion of net assets and a fair value adjustment now reduces the net assets	→	Goodwill decreases
FV net assets increases	A positive fair value adjustment on PPE was not recognised.	→	Goodwill decreases
FV net assets decreases	A contingent liability was not recognised as a fair value adjustment.	→	Goodwill increases

Example

Q

Alpha buys 100% of the equity in Beta. Goodwill was determined as $20m but now needs to be revised to reflect the information below.

The consideration was a share for share exchange. Alpha issued 1 million shares with a nominal value of $1 per share. The fair value was $5 per share. Alpha recorded the investment at the nominal value.

The provisional fair value of PPE at the date of acquisition has been revised upwards by $2m.

Required: Explain and show the adjustments to goodwill.

A

Alpha's recorded the investment in Beta as $1m when it should have been recorded at $5m. The consideration needs to be increased by $4m. The investment in Beta has been subsumed and cancelled in the goodwill calculation. The higher the consideration paid by the parent, the higher the goodwill figure. This adjustment will also increase group equity by $4m as the shares issued had a value of $4m over the nominal value of the share capital issued.

Provisional fair values to the assets of the subsidiary can be revised upwards if the information is received within 12 months and relates to the date of acquisition. An increase in the subsidiary's PPE at acquisition of $2m will decrease the goodwill. It is not a post-acquisition gain of the group.

Statement of financial position	Per Q $m	Adjustment $m	Correct $m
PPE		less 2	
Goodwill	20	plus 4 less 2	22
OCE		plus 4	

Impairment review of goodwill

Goodwill is subject to an annual impairment review.

Goodwill cannot be sold on its own, nor can it in isolation generate any cash flows. Thus, the annual impairment review of goodwill is done at the level of the cash-generating unit (CGU). The net assets of the subsidiary at the reporting date and the goodwill combine to form the carrying value of the CGU.

The impairment loss can be given or may have to be calculated if the question discloses the recoverable amount. The recoverable amount is the higher of the fair value less costs to sell and the value in use.

Carrying value = CGU = subsidiary		
Year-end net assets	X	
Goodwill (grossed up IF only attributable to parent)	X	X
> Recoverable amount		X
Impairment loss		X

NCI at fair value and the impairment loss

Where NCI at acquisition is measured at fair value then goodwill is **full goodwill** and attributable to both the parent and the NCI. As such impairment losses will be charged against profit but then **split with the NCI.**

Thus, if there is an impairment loss of $100m on full goodwill in an 80% subsidiary.

S of FP	Adjust $m	P&L	Adjust $m
Goodwill	Less 100	Operating costs	Plus 100
RE	Less 80	Profits attributable to parent	Less 80
NCI	Less 20	Profits attributable to NCI	Less 20

NCI as a proportion of net assets and the impairment loss

Where NCI at acquisition is measured as a proportion of net assets then **goodwill is attributable to the parent only.** In the impairment review goodwill attributable to the parent is notionally grossed up to include notional NCI. The notional NCI in the impairment loss is not recorded and the actual impairment loss on the goodwill is charged against profits **without charge to the NCI.**

If all the goodwill is impaired and there is still a further impairment loss against other assets in the CGU, then this further impairment loss will be split between the parent's profits and the NCI.

Thus, if there is an impairment loss of $100m on goodwill when NCI has been measured as a proportion of net asset and it's an 80% subsidiary.

S of FP	Adjust $m	P&L	Adjust $m
Goodwill	Less 100	Operating costs	Plus 100
RE	Less 100	Profits attributable to parent	Less 100
NCI	No change	Profits attributable to NCI	No change

Profit (or loss) to the group on disposal of a subsidiary

When control is lost there will be a profit or loss to the group arising.

On the disposal of the subsidiary the net assets and goodwill and NCI will all be de-recognised.

Any residual holding will be re-introduced at fair value.

If it is an overseas subsidiary the group exchange difference will be recycled to form part of the profit or loss arising.

Proceeds	X
Less all net assets at disposal date	(X)
Less all goodwill at disposal date	(X)
Plus all the NCI at disposal date	X
Plus the residual holding at fair value	X
Group exchange difference recycled to profit or loss on disposal	X / (X)
Group profit (or loss)	X / (X)

Control to control transactions (changes in the NCI)

One example of a control-to-control transaction is where the parent buys shares from the NCI. For example, the parent of an 80% subsidiary buys all the remaining shares, thus reducing the NCI% of 20% to nil.

Another example of a control-to-control transaction is where the parent sells shares but retains control thus the NCI increases. For example, the parent of an 80% subsidiary could sell a 10% interest thus increasing the NCI% from 20% to 30%.

Such transactions do not change goodwill. **No gain or loss** for the group arises. This is because they are transaction between the parent and the NCI and so within group equity. However, these transactions do create a difference that goes to directly to group other components of equity.

Decrease in the NCI - "parent buys out the NCI"

Cash out (an investment)	X
Decrease in the NCI (fraction x NCI balance)	X
Difference to equity	X/(X)

If the cash paid exceeds the decrease in the NCI then the difference is negative that is taken to equity (OCE), and if the cash is less, then the difference is positive.

Increase in the NCI - "parent sells a slice to the NCI"

Cash in (proceeds)	X
Increase in the NCI (% x (net assets + full goodwill))	X
Difference to equity	X/(X)

If the cash received exceeds the increase in the NCI then the difference is positive that is taken to equity (OCE), and if the cash is less, then the difference is negative.

Overseas subsidiary

Assets and liabilities of the overseas subsidiary are translated into the presentational currency of the group at the closing rate.

Income and expenses of the overseas subsidiary are translated into the presentational currency of the group at the average rate.

Goodwill should be calculated in the subsidiary's functional currency. The closing balance of goodwill will be translated at the closing rate for inclusion in the group statement of financial position. Any impairment loss will be translated at the average rate.

A **group exchange difference** will arise on the retranslation of the goodwill. Group exchange differences are reported in the group other comprehensive income and not the group profit or loss.

On the same principle as the impairment loss, if goodwill is in full (NCI at acquisition at fair value) the exchange difference on goodwill is split between the group's OCE and the NCI. However, if goodwill is attributable to the parent only then the whole of the exchange difference on goodwill will be recognised in the group OCE and OCI without charge to the NCI.

	In a foreign currency	Translated at	In $
Opening goodwill	X	Opening rate	X
Less impairment loss	(X)	Average rate	(X)
Group for ex difference	_	Balancing figure	X / (X)
Closing goodwill	X	Closing rate	X

For an overseas subsidiary a group exchange difference will also arise on the retranslation of the net assets. Group exchange differences are reported in the group other comprehensive income and not the group profit or loss.

	In a foreign currency	Translated at	In $
Opening net assets	X	Opening rate	X
Post- acquisition profit	X	Average rate	X
Group for ex difference	_	Balancing figure	X / (X)
Closing net assets	X	Closing rate	X

What is an associate?

An associate is where there is significant influence.

Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies.

Where the investor holds 20% or more of the voting power on an investee, it will be presumed the investor has significant influence unless it can be clearly demonstrated that this is not the case. If the holding is less than 20%, the entity will be presumed not to have significant influence unless such influence can be clearly demonstrated.

The existence of significant influence by an entity is usually evidenced in one or more of the following ways:

- representation on the board of directors or equivalent governing body of the investee;
- participation in the policy-making process, including participation in decisions about dividends or other distributions;
- material transactions between the entity and the investee;
- interchange of managerial personnel; or provision of essential technical information

How is an associate accounted for in the group accounts?

Using equity accounting. In practical terms this means representing the interest in the associate in a single line in the group accounts.
In the group statement of financial position, the single line is a non-current asset "Investment in the associate".

Parent's investment	X
Plus group % of the subsidiary's post-acquisition profit	X
Less any impairment loss	(X)
Investment in the associate	X

In the group profit and loss, the single line presented before group profit before tax as "Income from the associate".

Group % of the profit after tax	X
Less any impairment loss	(X)
Income from the associate	X

The post-acquisition profits of the associate should be adjusted for consolidation adjustments that would be made when consolidating a subsidiary. For example, by the associate's share of additional depreciation if the fair value of the associate's PPE were different at acquisition or if there a provision for unrealised profit.

Example of equity accounting with updating prepopulated spread sheet

Q The parent has a 30% interest in an associate that was acquired at the start of the accounting period for $500m. The associate's PPE had a fair value of $30m in excess of their carrying value and a remaining useful life of 5 years. During the year the associate reported a profit after tax of $100m and paid a dividend of $10m. Equity accounting has not been applied. The dividend received has been incorrectly recognised as income.

A Group PL. The income from the associate is the share of the profit after tax, as adjusted for the additional depreciation (1/5 x 30 = 6).

Income from the associate 30% x (100 – 6) = $28.2m

The dividend received from the associate (30% x 10 = 3) is not income for the group, rather a reduction of the investment.

Group S of FP. The investment in the associate and the group retained earnings need to rise by the share of the retained earnings.

Investment in the associate (500 + 28.2 less dividend 3) = $525.2m

S of FP	**Q**	**Adjs**	**Adjs**	**Answer**	**P&L**	**Q**	**Adjs**	**Adjs**	**Answer**
	$m	**$m**	**$m**	**$m**		**$m**	**$m**	**$m**	**$m**
NCA Investment in Associate	500	-3	28.2	525.2	Income from the associate	3	-3	28.2	28.2
Group Retained earnings	Not given	-3	28.2						

What is a joint venture?

A joint venture is where there is a **joint arrangement**, and the parties have rights to **the net assets** of the arrangement.

Joint arrangements are arrangements where two or more parties have joint control of a business. Joint control will only apply if the relevant activities require unanimous consent of those who collectively control the arrangement.

How is a joint venture accounted for in the group accounts?

Using equity accounting.
Same as for associates – see above.

Detailed workings

Whilst it is not practical to be comprehensive, as corrections and updates can take many forms, these are the main consolidation adjustments to group's other components of equity, retained earnings together with the NCI in the statement of financial position and the profits for the year attributable to the NCI.

Group Other Components of Equity (OCE)

Balance per Q	X
P% of the group exchange difference on retranslation of net assets	X/(X)
P% or all of the group exchange difference on retranslation of goodwill	X/(X)
Less transfer to RE on a step acquisition when investment was FVTOCI	(X)
Difference arising on the increase / decrease of NCI control to control	X/(X)
	X

Group Retained Earnings

Parent's balance	X
Plus the % of the sub's post-acquisition profit	X
Less % (or all if NCI a proportion) of the impairment loss on goodwill	(X)
Plus the associate / JV % of the post-acquisition profit	X
Less the impairment loss on the investment in the associate / JV	(X)
Plus from OCE on a step acquisition when investment was FVTOCI	X
Gain / loss on the disposal of a subsidiary	X/(X)
	X

NCI (Non-Controlling Interest)

Balance per Q	X
Plus the % of the sub's post-acquisition profit	X
Less the % of the impairment loss on full goodwill	(X)
NCI% of the group exchange difference on retranslation of net assets	X/(X)
NCI% of the group exchange difference on retranslation of full goodwill	X/(X)
Increase / Decrease in the NCI – control to control	X/(X)
NCI at reporting date	X

Profit for the year attributable to the NCI

NCI % x subsidiary's profit after tax	X
Less NCI% x Depreciation on FVA	(X)
Less NCI% x Impairment loss (on full goodwill)	(X)
Less NCI% x any new expense of the subsidiary	(X)
Profit / loss attributable to the NCI	X/(X)