CHAPTER 18
CONSOLIDATED FINANCIAL STATEMENTS:
ASSOCIATES, JOINT ARRANGEMENTS AND STATEMENTS OF CASH FLOW

Quick test

Question 1

This question may be tackled in *two stages*, since it involves the consolidation of both a subsidiary company and an associated company.
Stage 1: Consolidate the subsidiary using subsidiary consolidation rules
Stage 2: Add in the subsidiary using associate consolidation rules

However both stages will have to be completed at the same time under exam conditions.

Shareholdings are as follows:

In Norman Ltd	18,000 / 30,000 = 60% ⇒	Subsidiary
In Thorne Ltd	18,000 / 60,000 = 30% ⇒	Associate

Stage 1 - ***consolidation of Lanchester and Norman only***

Lanchester Ltd
Consolidated statement of financial position at 31 December 20X6

		£000
Non-current assets		
Property, plant & equipment		425
Investments (investment in Thorne still shown at cost)		30
Goodwill		16
		471
Other net assets		480
		951
Equity		
Equity shares of £1 each	250	
Retained earnings		457
		707
Non-controlling interest		94
		801
Long-term loans		150
		951

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Stage 2 ***- full consolidation***

Lanchester Ltd
Consolidated statement of financial position at 31 December 20X6

		£000
Non-current assets		
Property, plant & equipment		425
Investment in associate		49.8
Goodwill		16
		490.8
Other net assets		480
		970.8
Equity		
Equity shares of £1 each	250	
Retained earnings		476.8
		726.8
Non-controlling interest		94
		820.8
Long-term loans		150
		970.8

Workings

1. Goodwill on acquisition of Norman Ltd		£000
Consideration		100
NCI in FV of net assets of Norman at acquisition		
Share capital	30	
Retained earnings	70	
Fair value adjustment	40	
	40% x 140	56
		156
Less: Net assets at acquisition		(140)
Goodwill		16

2. Property, plant & equipment		
Lanchester		300
Norman	100	
FV adjustment	40	
Additional FV depreciation (3 years x 40/8)	(15)	125
		425

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3. Investment in associate *(Stage 2 only)*

Consideration			30
Share of post-acquisition changes in net assets			
Post-acquisition profits	(100 – 30)	70	
Additional FV depreciation	(1 year x 20/5)	(4)	
		30% x 66	19.8
			49.8

4. Consolidated retained earnings

Lanchester			400
Share of Norman's post-acq. profits			
Post-acquisition profits	(180 – 70)	110	
Additional FV depreciation	(3 x 40/8)	(15)	
		60% x 95	57
			457
Consolidated in stage 2:			
Share of Thorne's post-acq. profits			
Post-acquisition profits	(100 – 30)	70	
Additional FV depreciation	(1 x 20/5)	(4)	
		30% x 66	19.8
			476.8

5. Non-controlling interest

40% x Norman's net assets at statement of financial position date			
Equity		210	
Fair value adjustment		40	
Additional FV depreciation	(3 x 40/8)	(15)	
		40% x 235	94

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Question 2

Aroma plc
Consolidated statement of profit or loss for the year ended 30 June 20X4

		£000
Revenue		5,000
Cost of sales		(3,000)
Gross profit		2,000
Expenses		(790)
Profit from operations		1,210
Interest income (W1)		40
Finance charges		(50)
Share of profit of associate	(30% x PAT 700)	210
Profit before tax		1,410
Tax		(400)
Profit after tax		1,010

[NB - No NCI in statement of profit or loss since all subsidiaries are 100% owned.]

Aroma plc
Consolidated statement of changes in equity for the year ended 30 June 20X4

	Share capital	*Revaln. reserve*	*Retained earnings*	*Total*
	£000	£000	£000	£000
At 1 July 20X3	2,000	1,090 (W3)	2,446 (W4)	5,536
Change in year		30		30
Profit for year			1,010	1,010
Dividends paid			(300)	(300)
At 30 June 20X4	2,000	1,120	3,156	6,276

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Aroma plc
Consolidated statement of financial position at 30 June 20X4

	£000
Non-current assets	
Goodwill	800
Property, plant & equipment	3,200
Investment in associate (W2)	1,726
	5,726
Current assets	
Inventories	670
Receivables	500
Cash & cash equivalents	130
	1,300
Total assets	7,026
Equity	
Called up share capital	2,000
Revaluation reserve	1,120
Retained earnings	3,156
	6,276
Current liabilities	750
Total equity and liabilities	7,026

Workings

1. Investment income check

30% x Therapy's dividend	30% x 50		15
Other interest			40
Investment and interest income in Aroma's statement of profit or loss			55

2. Investment in associate

Consideration			1,000
Share of post-acq. change in net assets			
Retained earnings	2,470 – 450	2,020	
Revaluation reserve	500 – 100	400	
	30% x	2,420	726
			1,726

3. Revaluation reserve

At start of year	
Aroma plc	1,000
Share of change in Therapy's reserve since acquisition	
30% x (400 – 100)	90
	1,090

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[Check: At end of year			
Aroma plc			1,000
Share of change in Therapy's reserve since acquisition			
30% x (500 – 100)			120
			1,120]

4. Retained earnings

At start of year			
Aroma plc	2,550 + 300 – 815		2,035
Share of Therapy's post-acq. profits			
Retained earnings at start of year	2,470 + 50 – 700	1,820	
Pre-acq. retained earnings		(450)	
	30% x	1,370	411
			2,446
[Check: At end of year			
Aroma plc			2,550
Share of Therapy's post-acq. profits	30% x (2,470 - 450)		606
			3,156]

Question 3

The joint arrangement is carried out through a separate company, Fairfax Ltd., whose legal form causes it to be considered in its own right (i.e. the assets and liabilities held in Fairfax are the assets and liabilities of the company and not the assets and liabilities of Hafford and Lysters). In addition, the terms of the contractual arrangement do not specify that Hafford and Lysters have rights to the assets, or obligations for the liabilities, relating to the arrangement. Instead, the terms of the contractual arrangement establish that Hafford and Lysters have rights to the net assets of Fairfax.

On the basis of the description above, there are no other facts and circumstances that indicate that the parties have rights to substantially all the economic benefits of the assets relating to the arrangement, and that Hafford and Lysters have an obligation for the liabilities relating to the arrangement. The joint arrangement is therefore a joint venture.

Hafford and Lysters recognise their rights to the net assets of Fairfax as investments and account for them using the equity method.

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Develop your understanding

Question 4

Shareholdings are as follows:

In Samuel Smith Ltd	75%	⇒	Subsidiary
In Adnams Ltd	40%	⇒	Associate

Hartleys plc
Consolidated statement of profit or loss for the year ended 31 December 20X6

		£
Profit from operations	(Hartleys + SS – FV deprn. 400)	55,600
Share of profit of associate	(40% x Adnams (PAT 13,000 – FV deprn. 200))	5,120
Profit before tax		60,720
Tax	(Hartleys + SS)	20,000
Profit after tax		40,720
Attributable to:		
Owners of Hartleys	(balancing figure)	36,070
Non-controlling interest	(W2)	4,650
		40,720

Hartleys plc
Consolidated statement of changes in equity for the year ended 31 December 20X6

	Share capital	General reserve	Retained earnings	NCI	Total
	£	£	£	£	£
At 1 Jan 20X6	100,000	60,000	23,420 (W5)	14,900(W6)	198,320
Profit for year			36,070	4,650	40,720
Dividends paid			(10,000)	(2,000)	(12,000)
At 31 Dec 20X6	100,000	60,000	49,490 (W7)	17,550(W8)	227,040

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Hartleys plc
Consolidated statement of financial position at 31 December 20X6

		£
Non-current assets		
Property, plant & equipment (W3)		240,200
Investment in associate (W4)		8,840
Goodwill (W1)		3,000
		252,040
Current assets	(Hartleys + SS)	47,000
Total assets		299,040
Equity		
Called up share capital	(Hartleys only)	100,000
General reserve		60,000
Retained earnings (W5)		49,490
		209,490
Non-controlling interest (W6)		17,550
		227,040
Current liabilities		
Payables	(Hartleys + SS)	52,000
Corporation tax	(Hartleys + SS)	20,000
		72,000
Total equity and liabilities		299,040

Workings

W1 Goodwill

		£
On acquisition of Samuel Smith		
Consideration		45,000
NCI at acquisition		
25% x SS's net assets acquired		
Share capital	40,000	
Pre-acq. profits	12,000	
Fair value adjustment	4,000	
	25% x 56,000	14,000
		59,000
Less: SS's net assets at acquisition		(56,000)
Goodwill		3,000

W2 Non-controlling interest (SoPL)

Samuel Smith PAT	19,000	
Additional FV depreciation (1 x 400)	(400)	
	25% x 18,600	4,650

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W3 Property, plant & equipment

Hartleys		163,000
Samuel Smith		74,000
Fair value adjustment		4,000
Less: additional depreciation	(2 x 10% x 4,000)	(800)
		240,200

W4 Investment in associate

Cost	7,000
Share of post-acquisition changes in net assets	
≡ share of post-acquisition profits (adjusted for additional depreciation on fair values) (see W5 below)	
40% x [(13,000 – 8,000) – deprn 2 x 200]	1,840
	8,840

W5 Consolidated retained earnings at start of year

Hartleys	20,000
Share of Samuel Smith post-acq. profits at start of year	
75% x [(16,000 – R/E on acquisition 12,000) – deprn 1 x 400]	2,700
Share of Adnams post-acq. profits at start of year	
40% x [(10,000 – R/E on acquisition 8,000) – deprn 1 x 200]	720
	23,420

W6 Non-controlling interest at start of year

Share of interest in Samuel Smith		
Net assets		
(Share capital 40,000 + R/E at start of year 16,000)	56,000	
Fair value adjustment	4,000	
Less: FV deprn. (1 x 400)	(400)	
25% x	59,600	14,900

[PROOF of:

W7 Consolidated retained earnings at end of year

Hartleys	37,000
Share of Samuel Smith post-acq. profits	
75% x [(27,000 – 12,000) – deprn 2 x 400]	10,650
	47,650
Share of Adnams post-acq. profits	
40% x [(13,000 – 8,000) – deprn 2 x 200]	1,840
	49,490

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W8 Non-controlling interest at end of year

Share of interest in Samuel Smith		
Net assets	67,000	
Fair value adjustment	4,000	
Less: deprn. (2 x 400)	(800)	
	25% x 70,200	17,550]

Question 5

Worcester plc
Consolidated statement of profit or loss for the year ended 31 March 20X6

		£000
Revenue	10,630 + 4,260 – 2,450	12,440
Cost of sales	7,760 + 3,200 – 2,450 + 156 (W2)	(8,666)
Gross profit		3,774
Distribution costs	730 + 275	1,005
Administrative expenses	1,290 + 405 + 60 FV deprn. (W3)	1,755
		(2,760)
Profit from operations		1,014
Finance costs	231 + 15	(246)
		768
Share of profit of associate	35% x (246 – 90 FV deprn. (W3))	54.6
Profit before tax		822.6
Income tax expense	160 + 80	(240)
Profit for the year		582.6
Attributable to:		
Shareholders of Worcester plc (balancing figure)		555
Non-controlling interest (W5)		27.6
		582.6

Worcester plc
Consolidated statement of changes in equity for the year ended 31 March 20X6

	Equity share capital	*Preference share capital*	*Share premium*	*Retained earnings*	*NCI*	*Total*
	£000	£000	£000	£000	£000	£000
At 1 April 20X5	3,000	900	1,840	4,926 (W6)	984 (W7)	11,650
Profit for year				555	27.6	582.6
Dividends paid				(144)	(36)	(180)
At 31 March 20X6	3,000	900	1,840	5,337 (W13)	975.6(W14)	12,052.6

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Worcester plc
Consolidated statement of financial position at 31 March 20X6

		£000
Assets		
Non-current assets		
Property, plant & equipment (W10)		10,950
Intangible – Goodwill (W9)		312
Investment in associate (W11)		2,281.5
		13,543.5
Current assets		
Inventories	1,860 + 645 – 156	2,349
Trade and other receivables	1,785 + 960 – 320 (W12)	2,425
Cash & cash equivalents		450
		5,224
Total assets		18,767.5
Equity		
Equity share capital		3,000
6% preference share capital		900
Share premium		1,840
Retained earnings		5,337
		11,077
Non-controlling interest		975.6
		12,052.6
Non-current liabilities		
Debentures		3,750
Current liabilities		
Bank overdraft	375 – 140 (W12)	235
Trade and other payables	1,725 + 1,185 – 180 (W12)	2,730
		2,965
Total equity & liabilities		18,767.6

0.1 rounding difference on Worcester's income from investments, which should be 77.1

Workings

1. **Investments**

in Pershore	450/750	=	60%	Subsidiary
in Evesham	840/2,400	=	35%	Associate

2. Unrealised profit in inventories

	£000
25/125 x 780	156

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3. **Additional FV depreciation**

Pershore	10% x (2,100 – 1,500)		60
Evesham	10% x (5,400 – 4,500)		90

4. **Worcester investment income check**

Pershore equity dividend (60% x 90)		54
Evesham equity dividend (35% x 66)		23.1
		77.1

No other investment income.

5. **Non-controlling interest (SoPL)**

Pershore profit after tax	285		
Less: additional depreciation	(60)		
Less: Unrealised profit in inventories	(156)		
	69	x 40%	27.6

6. **Consolidated retained earnings at start of year**

Worcester			4,863
Share of Pershore's post-acquisition retained earnings			
975 – 810	165		
Additional FV depreciation (1 year x 60)	(60)		
	105	x 60%	63
			4,926

Note – Evesham was acquired 1 April 20X5, hence no share of profits included at start of year.

7. **Non-controlling interest at start of year**

Pershore net assets at fair value			
Equity share capital	750		
Share premium	195		
Retained earnings	975		
Fair value adjustment	600		
Additional FV depreciation	(60)		
	2,460	x 40%	984

8. **Non-controlling interest dividends**

40% x 90	36

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9. **Goodwill**

Consideration			1,725
NCI share of FV of net assets of Pershore at acquisition:			
Equity share capital	750		
Share premium	195		
Retained earnings	810		
Adjustment for fair values	600		
	2,355	x 40%	942
			2,667
Less: FV of net assets			(2,355)
Goodwill			312

10. **Property, plant & equipment**

Worcester		8,400
Pershore Book value	2,070	
Adjustment for fair value	600	
Additional depreciation (2 years x 60)	(120)	2,550
		10,950

11. **Investment in associate**

Cost of investment			2,250
Increase in net assets			
≡ post-acquisition retained earnings			
2,610 – 2,430	180		
Additional FV depreciation	(90)		
	90	x 35%	31.5
			2,281.5

12. **Intercompany balances**

Accounts receivable reduce by	320
Accounts payable reduce by	180
Reduce Pershore's bank overdraft for cash-in-transit	140

[Check of closing balances:

13. **Consolidated retained earnings at end of year**

Worcester			5,255
Share of Pershore's post-acquisition retained earnings			
1,170 – 810	360		
Additional FV depreciation	(120)		
Unrealised profit in inventories	(156)		
	84	x 60%	50.4

Share of Evesham's post-acquisition retained earnings

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2,610 – 2,430	180		
Additional FV depreciation	(90)		
	90	x 35%	31.5
			5,336.9

0.1 rounding difference on Worcester's income from investments, which should be 77.1

14. **Non-controlling interest at end of year**

Pershore net assets	2,115		
Fair value adjustment	600		
Additional FV depreciation	(120)		
Unrealised profit in inventories	(156)		
	2,439	x 40%	975.6 **]**

Question 6

The framework agreement sets up the terms under which Fyfield and Gresham conduct the manufacturing and distribution of product P. These activities are undertaken through joint arrangements whose purpose is either the manufacturing or the distribution of product P.

Fyfield and Gresham carry out the manufacturing arrangement through Mixit whose legal form confers separation between Fyfield and Gresham and the entity. In addition, neither the framework agreement nor the contractual arrangement dealing with the manufacturing activity specifies that Fyfield and Gresham have rights to the assets, and obligations for the liabilities, relating to the manufacturing activity. However, when considering the following facts and circumstances Fyfield and Gresham have concluded that the manufacturing arrangement is a joint operation:

(a) Fyfield and Gresham have committed themselves to purchasing the whole production of product P manufactured by the manufacturing arrangement. Consequently, the companies have rights to substantially all the economic benefits of the assets of the manufacturing arrangement.

(b) The manufacturing arrangement manufactures product P to meet the quantity and quality needs of Fyfield and Gresham so that they can fulfil the demand for product P of the distribution arrangement. The exclusive dependence of the manufacturing arrangement upon Fyfield and Gresham for the generation of cash flows and Fyfield's and Gresham's commitments to provide funds when the manufacturing arrangement incurs any cash shortages indicate that the companies have an obligation for the liabilities of the manufacturing arrangement, because those liabilities will be settled through Fyfield's and Gresham's purchases of product P or by Fyfield's and Gresham's direct provision of funds.

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Fyfield and Gresham carry out the distribution activities through Donna, whose legal form confers separation between Fyfield and Gresham and this company. In addition, neither the framework agreement nor the contractual arrangement dealing with the distribution activity specifies that Fyfield and Gresham have rights to the assets, and obligations for the liabilities, relating to the distribution activity.

There are no other facts and circumstances that indicate that Fyfield and Gresham have rights to substantially all the economic benefits of the assets relating to the distribution arrangement or that Fyfield and Gresham have an obligation for the liabilities relating to that arrangement. The distribution arrangement is a joint venture.

Fyfield and Gresham each recognise in their financial statements their share of the assets (e.g. property, plant and equipment, cash) and their share of any liabilities resulting from the manufacturing arrangement (e.g. accounts payable to third parties) on the basis of their ownership interest in Mixit. Each party also recognises its share of the expenses resulting from the manufacture of product P incurred by the manufacturing arrangement and its share of the revenues relating to the sales of product P to the distribution arrangement.

Fyfield and Gresham recognise their rights to the net assets of the distribution arrangement as investments and account for them using the equity method.

Take it further

Question 7

Strauss plc
Consolidated statement of profit or loss for the year ended 30 June 20X5

		£000
Revenue	(5,090 + 2,650 – 375)	7,365
Cost of sales	(2,955 + 2,075 – 375 + 50 + 4 (W5))	(4,709)
Gross profit		2,656
Distribution and admin expenses	(1,775 + 415 + 30 FV deprn + 82 G/W impairment (W2))	(2,302)
Operating profit		354
Share of profit of associate	(25% x 180)	45
Profit before tax		399
Tax on profit on ordinary activities	(168 + 35)	(203)
Profit after tax		196
Attributable to:		
Shareholders of Strauss (balancing figure)		177
Non-controlling interest (W7)		19
		196

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Strauss plc
Extract from consolidated statement of changes in equity for the year ended 30 June 20X5

	Retained earnings	*Non-controlling interest*
	£000	£000
Balance at 1 July 20X4	492 (W8)	197 (W9)
Profit for the year	177	19
Dividends paid	(100)	(4)
Balance at 30 June 20X5	569 (W10)	212 (W11)

Strauss plc
Consolidated statement of financial position at 30 June 20X5

		£000	£000
Non-current assets			
Property, plant & equipment (W4)			2,760
Intangible – Goodwill (W2)			100
Investment in associate (W3)			361
			3,221
Current assets			
Inventories	(830 + 450 – 50)	1,230	
Accounts receivable	(970 + 410 – 75)	1,305	
Cash & cash equivalents		70	
			2,605
Total assets			5,826
Equity			
Called up share capital			2,000
Share premium			800
Retained earnings			569
			3,369
Non-controlling interest			212
			3,581
Current liabilities			
Bank overdraft		30	
Accounts payable	(780 + 750 – 75)	1,455	
Corporation tax	(560 + 200)	760	
			2,245
Total equity and liabilities			5,826

Workings

1. % shareholding

Cook	480,000 / 600,000	= 80%	Parent/subsidiary relationship
Anderson	625,000 / (500,000 x 5)	= 25%	Parent/associate relationship

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2. Goodwill on acquisition

	£000	£000
Consideration		950
NCI in FV of net assets of Cook at date of acquisition:		
Share capital	600	
Share premium	100	
Retained earnings	110	
Fair value adjustment (960 – 810)	150	
20% x	960	192
		1,142
Less: FV of net assets of Cook at date of acquisition		(960)
Goodwill arising on acquisition		182
Impairment		(82)
Goodwill at 30 June 20X5		100

3. Investment in associate

Cost of investment		370
Change in post-acquisition retained earnings (490 – 510)	(20)	
Adjustment for unrealised profit in inventories (see W5 below)	(15)	
25% x	(35)	(9)
		361

4. Property, plant & equipment

Strauss	1,580
Cook	1,090
Adjustment for fair values	150
Additional FV depreciation (2 x 150/5)	(60)
	2,760

5. Unrealised profit in inventories

Total gross profit earned by Strauss on sales to Cook	40% x 375	150
Unrealised profit in inventories	$^1/_3$ x 150	50
Total gross profit earned by Strauss on sales to Anderson	40% x 150	60
Unrealised profit in inventories	$^1/_4$ x 60	15

Note

IAS 28 *Investments in Associates and Joint Ventures* requires partial elimination of unrealised profits on transactions between associates and group entities. Profits can only be included to the extent that they relate to the non-group share. This means that the investor's share of such profits is eliminated. The IAS does not specify exactly how such an adjustment should be reported in the consolidated income statement. The most logical way is as follows:

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The adjustment is made in the books of the seller. The way that the adjustment is made depends on whether the selling company is the investor or the associate.
Note:
1. Unrealised profit will only arise if the goods transferred are still held by the investor or associate. If the goods have been sold to a third party there is no unrealised profit.
2. Unrealised profit adjustments apply to the transfer of non-current assets as well as the transfer of goods.

Investor sells goods to the associate – applicable here
Consolidated statement of financial position:
- Reduce investor's retained earnings by its share of the unrealised profit.
- Reduce the carrying amount of the investment in the associate by the investor's share of the unrealised profit.

Note – the carrying amount of the associate is adjusted rather than inventory as the inventory of the associate is not consolidated.

Consolidated statement of profit or loss:
- Increase investor's cost of sales by its share of the unrealised profit.

Note – this adjustment reduces group profit by its share of the unrealised profit.

Adjustment to cost of sales (25% x ¼ x (150 x 40%))	4

[Associate sells goods to the investor
Consolidated statement of financial position:
- Reduce investor's share of associate's retained earnings by its share of the unrealised profit.
- Reduce investor's inventory on consolidation by its share of the unrealised profit.

Note – the effect on retained earnings is dealt with by deducting the group share of the unrealised profit from the group retained earnings and from group inventory.

Consolidated statement of profit or loss
- Reduce investor's share of associate's profits after tax by its share of the unrealised profit.]

6. Strauss investment income check

Equity dividend from Cook (80% x 20)	16
Equity dividend from Anderson (25% x 200)	50
Income from investments in Strauss' income statement	66

7. Non-controlling interest (SoPL)

Cook profit after tax	125	
Less: fair value depreciation (20% x 150)	(30)	
	20% x 95	19

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8. Retained earnings at start of year

Strauss		472
Share of post-acq. retained earnings of Cook		
Retained earnings at start of year	165	
Less retained earnings at acquisition	(110)	
	55	
Additional depreciation (1 x 20% x 150)	(30)	
	80% x 25	20
		492

9. Non-controlling interest at start of year

Net assets of Cook		
Share capital	600	
Share premium	100	
Retained earnings	165	
Fair value adjustment	150	
Less: additional depreciation	(30)	
	20% x 985	197

[Proof of closing balances:

10. Consolidated retained earnings at end of year

Strauss		630
Less: unrealised profit in inventories (from sales to Cook)		(50)
Less: share of unrealised profit in inventories (from sales to Anderson)		(4)
Less: impairment of goodwill		(82)
		494
Share of post-acq. retained earnings of Cook		
Retained earnings at 30/6/X5	270	
Less retained earnings at acquisition	(110)	
	160	
Additional depreciation (2 x 20% x 150)	(60)	
	80% x 100	80
Share of post-acq. retained earnings of Anderson		
Retained earnings at 30/6/X5	490	
Less retained earnings at acquisition	(510)	
	25% x (20)	(5)
		569

11. Non-controlling interest at end of year

Net assets of Cook	970	
Add: Fair value adjustment	150	
Less: Additional depreciation	(60)	
	20% x 1,060	212 **]**

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Question 8

(a) (i) Significant influence – definition from IAS 28:
"... the power to participate in the financial and operating policy decisions of the investee, but is not control of those policies."
It is presumed if the holding is between 20-50% of voting share capital, unless it can be demonstrated that it is not the case. If the holding is less than 20%, the assumption is that significant interest does not exist unless other factors, e.g. representation on the board of directors, are present.

If significant influence exists the investor's interest is more than a passive recipient of dividends, but control is not present. The investment is accounted for as an associate and the *equity method* of accounting applies. This means the investor's share of the associate's results and value of investment are included in the consolidated financial statements in one line on the statement of profit or loss and statement of financial position.

(ii) For control to be present, IAS 10 now requires three elements to be present:

- Power (i.e. the ability of the investor to direct those activities which significantly affect the investee's returns) must exist
- The investor has exposure or rights to variable returns from the investee
- The investor has the ability to use its power to affect the returns from the investee

Control is assumed if the holding is more than 50% of the voting share capital, but if it is less, other factors, e.g. control of the board of directors through majority presence, could also determine this.

If control exists, the investee is a subsidiary and the *acquisition method* of accounting applies. Users require information about all the resources that are controlled by the investor (parent company) and that generate returns, so the financial statements follow the single entity concept by including the subsidiary's income, expenses, assets and liabilities line-by-line, with intra-group transactions and balances eliminated. Any other non-controlling interest in the results and net assets of the subsidiary is shown as part of equity.

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(b) **Hexham plc**
Consolidated statement of profit or loss for the year ended 30 June 20X7

		£
Revenue	(5,268 +1,950 – 75)	7,143,000
Cost of sales	(3,531 + 1,458 – 75 + 7.5 (W5))	(4,921,500)
Gross profit		2,221,500
Distribution costs	(846 + 243)	(1,089,000)
Administrative costs	(417 + 90 + 6 FV deprn. (W4) + 42.8 G/W impairment (W2))	(555,800)
Profit from operations		576,700
Finance charges		(45,000)
Share of profit of associate	(40% x $^6/_{12}$ x 18)	3,600
Profit before tax		535,300
Tax	(96 + 36)	(132,000)
Profit for the year		403,300
Attributable to:		
Shareholders of Hexham	(balancing figure)	368,200
Non-controlling interest (W6)		35,100
		403,300

Hexham plc
Consolidated statement of changes in equity for the year ended 30 June 20X7

	Share capital	Share premium	Retained earnings	NCI	Total
	£	£	£	£	£
At 1 July 20X6	450,000	195,000	177,000 (W9)	100,800(W10)	922,800
Profit for year			368,200	35,100	403,300
Dividends paid			(80,000)	(18,000)	(98,000)
At 30 June 20X7	450,000	195,000	465,200 (W11)	117,900(W12)	1,228,100

Hexham plc
Consolidated statement of financial position at 30 June 20X7

		£
Non-current assets		
Goodwill (W2)		100,000
Property, plant & equipment (W8)		951,000
Investment in associate (W7)		78,600
		1,129,600
Current assets		
Inventories	(435 + 120 – 7.5)	547,500
Receivables	(603 + 156 – 30)	729,000
Cash and cash equivalents	(166 + 96)	262,000
		1,538,500
Total assets		2,668,100

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Equity		
Equity share capital		450,000
Share premium		195,000
Retained earnings		465,200
		1,110,200
Non-controlling interest		117,900
		1,228,100
Non-current liabilities		450,000
Current liabilities		
Payables	(795 + 225 – 30)	990,000
		1,440,000
Total equity and liabilities		2,668,100

Workings

W1 Shareholdings

Colwell	63,000 / 90,000	70%	Subsidiary
Alston	60,000 / 150,000	40%	Associate – acquired 1 January 20X7 – 6 months only consolidated

W2 Goodwill

			£
Consideration			378,000
NCI in FV of net assets of Colwell at date of acquisition:			
Share capital		90,000	
Share premium		60,000	
Retained earnings		126,000	
Fair value adjustment (240 – 180)		60,000	
	30% x	336,000	100,800
			478,800
Less: FV of net assets of Colwell at date of acquisition			(336,000)
Goodwill arising on acquisition			142,800
Impairment write-down			(42,800)
Goodwill			100,000

W3 Hexham income from shares in group companies check

Share of dividend from Colwell	70% x 60	42,000

W4 Fair value depreciation

Colwell	(240 – 180) / 10	6,000

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W5 Unrealised profit in inventories

Total unrealised profit	40% x 75,000	30,000
In inventories at year end	¼ x 30,000	7,500
Downstream sale		

W6 Non-controlling interest (I/S)

Colwell profit for year	123,000	
Less: FV depreciation	(6,000)	
	30% x 117,000	35,100

W7 Investment in associate

Cost	75,000
Share of increase in net assets post-acquisition	
≡ Share of post-acquisition profits since 1 January 20X7	
40% x $^{6}/_{12}$ x 18	3,600
	78,600

W8 Property, plant & equipment

Hexham			705,000
Colwell	NBV		198,000
	Fair value adjustment		60,000
	Additional depreciation	(2 x 6,000)	(12,000)
			951,000

W9 Retained earnings at start of year

Hexham		
Closing retained earnings	472,000	
Add back: Dividend paid	80,000	
Deduct: Profit for year	(375,000)	
Retained earnings at start of year		177,000
Share of Colwell's post-acq. retained earnings		
Closing retained earnings	195,000	
Add back: Dividend paid	60,000	
Deduct: Profit for year	(123,000)	
Retained earnings at start of year	132,000	
Retained earnings at acquisition	(126,000)	
	6,000	
Less: FV depreciation (1 x 6,000)	(6,000)	-
		177,000

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W10 Non-controlling interest at start of year

Share of Colwell's net assets (at fair values)		
Share capital	90,000	
Share premium	60,000	
Retained earnings (see W7)	132,000	
FV adjustment	60,000	
FV depreciation (1 x 6,000)	(6,000)	
	30% x 336,000	100,800

[Check of closing balances:

W11 Retained earnings at end of year

Hexham		472,000
Less: Unrealised profit in inventories		(7,500)
Less: Goodwill impairment		(42,800)
		421,700
Share of Colwell's post-acq. retained earnings		
Post-acq. profits (195,000 – 126,000)	69,000	
FV depreciation (2 x 6,000)	(12,000)	
	70% x 57,000	39,900
Share of Alston's post-acq. retained earnings		
40% x 6/12 x 18,000		3,600
		465,200

W12 Non-controlling interest at end of year

Share of Colwell's net assets (at fair values)		
Share capital	90,000	
Share premium	60,000	
Retained earnings	195,000	
FV adjustment	60,000	
FV depreciation (2 x 6,000)	(12,000)	
	30% x 393,000	117,900 **]**

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Question 9

Tahir plc group
Statement of cash flows for the year ended 31 December 20X8

	£000	£000
Cash flows from operating activities		
Cash generated from operations (Note 1)	767	
Income taxes paid (W1)	(160)	
Net cash from operating activities		607
Cash flows from investing activities		
Acquisition of subsidiary Amex Ltd,		
net of cash acquired (Note 2)	(48)	
Purchase of property, plant and equipment	(463)	
Dividends received from associates (W2)	100	
Net cash used in investing activities		(411)
Cash flows from financing activities		
Dividends paid	(63)	
Net cash used in financing activities		(63)
Net increase in cash and cash equivalents		133
Cash and cash equivalents at beginning of period (77 – 406)		(329)
Cash and cash equivalents at end of period (43 – 239)		(196)

Notes to the statement of cash flows

(1) Reconciliation of profit before tax to cash generated from operations

	£000
Profit before taxation	666
Adjustments for:	
Depreciation	78
Share of profit of associates	(120)
	624
Increase in receivables (2,658 – 2,436 – 185)	(37)
Increase in inventories (1,735 – 1,388 – 306)	(41)
Increase in payables (1,915 – 1,546 – 148)	221
Cash generated from operations	767

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(2) Acquisition of subsidiary

During the period the group acquired subsidiary Amex Ltd. The fair value of the assets acquired and liabilities assumed were as follows:

		£000
Bank balances and cash		7
Inventories		306
Receivables		185
Property, plant and equipment		694
Payables		(148)
		1,044
Goodwill		42
Total purchase price		1,086
Less: Cash of Amex Ltd		(7)
Less: Non-cash consideration:	– Loan stock issued	(695)
	– Shares issued	(336)
Cash flow on acquisition net of cash acquired		48

Workings

	£000
W1 Income tax payable	
Balance b/f at 31 December 20X7	380
Statement of profit or loss charge	126
	506
Cash paid (balancing figure)	(160)
Balance c/f at 31 December 20X8	346

W2 Investments in associates

Investments in associates b/f at 31 December 20X7	2,175
Share of profit (from statement of profit or loss)	120
	2,290
Dividends received (balancing figure)	(100)
Investments in associates c/f at 31 December 20X8	2,195

W3 Share capital and premium

Balance b/f at 31 December 20X7	4,776
Issued to acquire subsidiary (120,000 x 2.80)	336
Balance c/f at 31 December 20X8	5,112

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