

## Topics to be covered

|                             |   |                      |
|-----------------------------|---|----------------------|
| Extraordinary gain & loss   | → | HKAS 1               |
| Prior-period adjustments    | → | HKAS 8               |
| Events after the B/S date   | → | HKAS 10              |
| Inventories                 | → | HKAS 2               |
| Property, plant & equipment | → | HKAS 16              |
| Intangible assets           | → | HKAS 38              |
| Leases                      | → | HKAS 17              |
| Equity vs Liabilities       | → | HKAS 32              |
| Consolidation               | → | HKAS 27 &<br>HKFRS 3 |

## Extraordinary Gain & Loss

SSAP 2 Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies: The nature and the amount of extraordinary items should be separately disclosed.

HKAS 1 Presentation of Financial Statements: Presentation of extraordinary items is prohibited

## Prior-period Adjustments

HKAS 8 Accounting Policies, Changes in Accounting Estimates and Errors:

- Consistent application of accounting policies
- Changes in accounting policies : retrospectively
- Changes in estimates: prospectively

### Fundamental errors

- Material prior period errors: retrospectively (prior year adjustments)

## Events after the Balance Sheet Date – HKAS 10

- Dividend proposed
- : proposed on or before the balance sheet date
- : proposed after the balance sheet date but before the date when financial statements are authorised for issue

## Inventories - HKAS 2

- Inventories should be carried at cost or net realisable value whichever is the lower
- Cost is determined by FIFO or weighted average method

~~LIFO~~

## Property, Plant and Equipment (PPE) - HKAS 16

- PPE initially recorded at cost
- Subsequent measurement:
  - : cost model
  - : revaluation model

## Property, Plant and Equipment (PPE) – HKAS 16

### Elements of cost:

- (i) Purchase price (incl. import duties and taxes), after deducting trade discounts and rebates
- (ii) Direct costs to bring the asset to the location and useable condition
- (iii) Estimate of the cost of dismantlement, removal or restoration of PPE

Dr. PPE

Cr. Provision for dismantlement of PPE

It is too New to you,  
you can't understand (ignore it.)  
it.

## Property, Plant and Equipment (PPE) – HKAS 16

### Subsequent measurement:

- (i) Cost model:  
cost (less residual value) is allocated to the useful life of the asset
- (ii) Revaluation model:  
- fair value determined with sufficient regularity

## Property, Plant and Equipment (PPE) – HKAS 16

Subsequent measurement (cont'd):

(ii) Revaluation model:

- Revaluation surplus/deficit: recognised in equity or P/L
- Depreciation: based on the revalued amount allocated to the remaining useful life of the asset
- Revaluation surplus: transferred to retained earnings on disposal of the asset or during the period when the asset is in use

## Property, Plant and Equipment (PPE) – HKAS 16

- Depreciation: Component approach

When an item of PPE comprises individual components for which different depreciation methods or rates are appropriate, each component is accounted for separately

## Property, Plant and Equipment (PPE) – HKAS 16

### - Recognition

#### Initial expenditure

- Probable that future economic benefit will flow to the entity
- Cost measured reliably

#### Subsequent expenditure

- Probable that future economic benefits in excess of the originally assessed standard of performance of the asset will flow to the entity

- Probable that future economic benefit of the asset will flow to the entity
- Cost measured reliably

## Intangible Assets – HKAS 38

- ~~Rebuttable presumption of the useful life of intangible assets of not exceeding 20 years~~
- Distinction between intangible assets with finite and indefinite useful lives
- Intangible assets with indefinite life: not amortised, but subject to annual impairment test
- Goodwill

\* Take note on Impairment loss

## Leases – HKAS 17

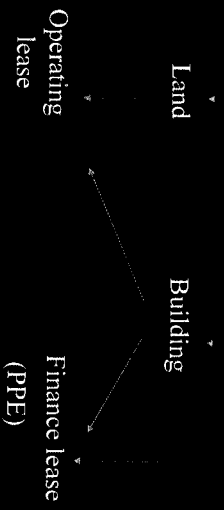
### Leasehold land and building

Lease of land and building

Title passed to the lessee? \_\_\_\_\_

No

Yes



## Leases – HKAS 17

### Leasehold land and building

- Leasehold land
- : operating lease unless the ownership of the land is expected to be transferred at the end of a lease term
- : Prepaid lease payments (land premium) are amortised over the lease term

## Leases – HKAS 17

### Leasehold land and building

- Lease of building
  - : Finance lease → PPE (cost or revaluation model)
  - : Operating lease
- Can land and building be reliably separated?
  - : Yes
  - : No → Finance lease

## Leases – HKAS 17

### Leasehold land and building

- Leasehold land and building classified as investment property:
- Separate measurement of the land and building elements is not required
  - Fair value model is adopted
  - Changes in fair value is recognised in profit or loss

## Equity vs Liabilities

### – HKAS 32

Classification of equity and liabilities

- Impact:
- : distribution
  - equity: dividends;
  - liability: interest
- : Debt to equity ratio, gearing ratio

## Equity vs Liabilities

### – HKAS 32

Examples:

- Ordinary shares
- Preference shares
  - : Non-cumulative, non-redeemable preference shares
  - : Cumulative, redeemable preference shares

## Equity vs Liabilities

### – HKAS 32

#### Compound financial instruments

- Split accounting: equity and liability components should be separately accounted for

Example: convertible debentures (bonds/notes)

- Liability element: contractual obligation to pay interest and principal repayment
- Equity element: right to convert to shares

An entity issued a \$100,000 4% convertible bonds for \$100,000. The prevailing market interest rate is 6%

## Consolidation (HKAS 27)

### Business Combinations (IFRS 3)

1. Determine the cost of a business combination
  - Aggregate of the fair values of assets given, liabilities incurred or assumed, and shares issued, plus any cost directly attributable to the business combination
  - Direct cost: professional services charges, legal fees etc.

**Consolidation (HKAS 27)  
Business Combinations  
(IFRS 3)**

2. Recognise the identifiable assets, liabilities and contingent liabilities of the subsidiary at fair value
  - Intangible assets: separate identification, control, inflow of economic benefit, and reliable measurement (eg. Customer list, in-process R&D, etc)
  - Contingent liabilities at fair value

**Consolidation (HKAS 27)  
Business Combinations  
(IFRS 3)**

3. Cost of combination – Fair value of net assets acquired
  - Goodwill
  - Excess on acquisition

Concept of negative goodwill

4. Initial Accounting determined provisionally – 12 months limit

**Consolidation (HKAS 27)  
Business Combinations  
(IFRS 3)**

**5. Goodwill**

~~Amortisation of goodwill~~

Goodwill not amortised but subject to annual impairment tests

Dr. Consol. P/L  
Cr. Goodwill

**Consolidation (HKAS 27)  
Business Combinations  
(IFRS 3)**

**6. Excess on acquisition**

- recognised in the profit and loss

Dr. Excess on acquisition  
Cr. Consol. P/L

**Consolidation (HKAS 27)  
Business Combinations  
(IFRS 3)**

**7. Minority interest**

MI is measured based on the ~~book~~ value  
of a subsidiary's net assets

MI should be measured based on  
the net fair value of the sub's  
identifiable assets, liabilities and  
contingent liabilities at acquisition  
date

**Consolidation (HKAS 27)  
Business Combinations  
(IFRS 3)**

**7. Minority interest**

B/S: MI presented within equity,  
separate from the parent  
shareholders' equity

I/S: separately disclosed

**Consolidation (HKAS 27)  
Business Combinations  
(IFRS 3)**

**7. Minority interest -Presentation**

|   |               |
|---|---------------|
| Consolidated Balance Sheet (extract)                | Sm            |
| Ordinary share capital                              | 8,000         |
| Reserves  | <u>1,900</u>  |
| Equity attributable to equity holders of the parent | 9,900         |
| Minority interest                                   | <u>700</u>    |
| Total equity  | <u>10,600</u> |

**Consolidation (HKAS 27)  
Business Combinations  
(IFRS 3)**

**7. Minority interest -Presentation**

|   |               |
|---|---------------|
| Consolidated Income Statement (extract) | Sm            |
| Profit after tax                        | <u>10,000</u> |
| Attributable to:                        |               |
| Equity holders of the parent            | 9,750         |
| Minority interest                       | <u>250</u>    |
|   | <u>10,000</u> |

- b. eliminated against the gross carrying amount of the asset and the net amount restated to the revalued amount of the asset (often used for buildings).
31. If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs shall be revalued.
32. If an asset's carrying amount is increased as a result of a revaluation, the increase shall be credited directly to equity under the heading of revaluation surplus.
33. If an asset's carrying amount is decreased as a result of a revaluation, the decrease shall be recognised in profit or loss.

However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.

However, the decrease shall be debited directly to equity under the heading of revaluation surplus to the extent of any credit balance existing in the revaluation surplus in respect of that asset.

**Example 2:**

34. A property is acquired at \$1 million at 1 January 20X4 that has a useful life of 10 years and no residual value. It is depreciated on a straight-line basis and revalued annually. The entity has a policy of computing depreciation based on the beginning carrying amount. At 31 December 20X4 and 20X5 the asset has a market value of \$1,080,000 and \$700,000 respectively.

**Required:**

Compute the revaluation gain/loss for the two years 20X4 and 20X5 and show how they are to be accounted for in the financial statements.

|  | 20X4         | 20X5         |
|--|--------------|--------------|
|  | \$000        | \$000        |
| Carrying amount, 1 January   | 1,000        | 1,080        |
| Depreciation   | <u>(100)</u> | <u>(120)</u> |
| Carrying amount, 31 December   | 900          | 960          |
| Revaluation gain (loss)  |              | (180)        |
| - recognised in the statement of changes in equity - revaluation surplus | 180          | (80)         |
| - recognised in the income statement                                     | <u>-</u>     | <u>(80)</u>  |
| Carrying amount, 31 December (after revaluation)                         | <u>1,080</u> | <u>700</u>   |

35. The revaluation surplus included in equity in respect of an item of property, plant and equipment may be transferred directly to retained earnings when the asset is derecognised. This may involve transferring the whole of the surplus when the asset is retired or disposed of.

However, some of the surplus may be transferred as the asset is used by an entity. In such a case, the amount of the surplus transferred would be the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost. Transfers from revaluation surplus to retained earnings are not made through profit or loss.

**Example 3:**

An item of property, plant and equipment was revalued to \$250,000 when it had a carrying amount of \$150,000 as at 31 December 20X5. The remaining useful life was then 4 years and the asset was sold at 31 December 20X8 for \$100,000.

**Required:**

Show the relevant journal entries (without narratives) for each of the years 20X4 to 20X8.

The journal entry required at 31 December 20X5 is as follows:

|     |                                  |           |           |
|-----|----------------------------------|-----------|-----------|
| Dr. | Property, plant and equipment    | \$100,000 |           |
|     | Cr. Equity - Revaluation reserve |           | \$100,000 |

Annual depreciation = \$62,500 ( $\$250,000/4$ )

The revaluation surplus may be transferred to retained profit and become realised profit on an annual basis. The amount to be transferred is \$25,000 [ $(\$250,000 - \$150,000)/4$ ].

For each of the four years ended 31 December 20X5 to 20X8:

|     |                              |          |          |
|-----|------------------------------|----------|----------|
| Dr. | Equity - Revaluation reserve | \$25,000 |          |
|     | Cr. Retained profit          |          | \$25,000 |

On the disposal of the asset, the gain is \$37,500 [ $\$100,000 - (\$250,000 - 3 \times \$62,500)$ ].

|     |   |           |           |
|-----|---|-----------|-----------|
| Dr. | Cash  | \$100,000 |           |
| Dr. | Accumulated depreciation                            | 187,500   |           |
|     | Cr. Property, plant and equipment                   |           | \$250,000 |
|     | Cr. Income statement - Profit on disposal of assets |           | 37,500    |

Final entry for transferring the remaining revaluation surplus to retained profit:

|     |                              |          |          |
|-----|------------------------------|----------|----------|
| Dr. | Equity - Revaluation reserve | \$25,000 |          |
|     | Cr. Retained profit          |          | \$25,000 |

**Depreciation**

38. Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.
39. The depreciation charge for each period shall be recognised in income statement unless it is included in the carrying amount of another asset.

**Depreciable Amount and Depreciation Period**

40. The depreciable amount of an asset shall be allocated on a systematic basis over its useful life.
41. The residual value and the useful life of an asset shall be reviewed at least at each financial year-end.

If the expectations of the residual value and the useful life differ from previous estimates, the changes shall be accounted for as a change in an accounting estimate in accordance with HKAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors".

57. The following are examples of items that are not investment property:
- property intended for sale in the ordinary course of business or in the process of construction or development for such sale (see HKAS 2 "Inventories");
  - property being constructed or developed on behalf of third parties (see HKAS 11 "Construction Contracts");
  - owner-occupied property;
  - property that is being constructed or developed for future use as investment property; and
  - property that is leased to another entity under a finance lease.
58. When a property is leased to and occupied by a parent or another subsidiary, the property is treated as an owner-occupied property in the consolidated financial statements. However, from the perspective of the entity that owns it, the property is an investment property, and hence the lessor should treat the property as investment property in its individual financial statements.

## IX. MEASUREMENT OF INVESTMENT PROPERTY AT RECOGNITION

59. An investment property shall be measured initially at its cost (the determination of cost is the same as for property, plant and equipment - please refer to paragraphs 16, 21 and 22 of this Chapter.) Transaction costs shall be included in the initial measurement.
60. The cost of a purchased investment property comprises its purchase price and any directly attributable expenditure. Directly attributable expenditure includes, for example, professional fees for legal services, property transfer taxes and other transaction costs.
61. The cost of a self-constructed investment property is its cost at the date when the construction or development is complete. Before the completion date, an entity applies HKAS 16.
- The cost of an investment property does not include:
- start-up costs;
  - operating losses incurred before the investment property achieves the planned level of occupancy, or
  - abnormal amounts of wasted material, labour or other resources incurred in constructing or developing the property.
62. The initial cost of an investment property held under a finance lease is the lower of the fair value of the investment property and the present value of the minimum lease payments.

## X. MEASUREMENT OF INVESTMENT PROPERTY AFTER RECOGNITION

### Accounting policy

63. An entity shall choose either the fair value model or the cost model as the accounting policy for its investment properties. The entity shall apply the policy to all of its investment property.

**Fair value model**

64. After initial recognition, an entity that chooses the fair value model shall measure all of its investment property at fair value.
65. The fair value of investment property shall reflect market conditions at the balance sheet date. A gain or loss arising from a change in the fair value of investment property shall be recognised in profit or loss for the period in which it arises.

**Example 4:**

66. A company purchased a property for \$30 million for the purpose of earning rental income at 1 January 20X5. At 31 December 20X5, the market value of this property is \$50 million. At 31 December 20X6, the market value of the property is \$23 million. The company has chosen the fair value model to account for all of its investment property.

**Required:**

Prepare the journal entries to record the changes in value of the investment property as at 31 December 20X5 and 20X6.

67. At 31 December 20X5

|     |                     |  |       |
|-----|---------------------|--|-------|
| Dr. | Investment property | \$20m  |       |
|     | Cr.                 | Income statement – Investment property gains | \$20m |
|     |                     | (50m - 30m)                                  |       |

At 31 December 20X6

|     |   |                     |       |
|-----|---|---------------------|-------|
| Dr. | Income statement – Investment property losses | \$27m               |       |
|     |   | (23m - 50m)         |       |
|     | Cr.   | Investment property | \$27m |

**Example 4:**

68. X Limited owns a number of properties. An independent surveyor has assessed their market value as follows:

| Property | Cost           | Valuation      |
|----------|----------------|----------------|
|          | 1.1.20X5       | 31.12.20X5     |
|          | \$m            | \$m            |
| A        | 41,000         | 52,000         |
| B        | 76,000         | 82,000         |
| C        | <u>80,000</u>  | <u>70,000</u>  |
|          | <u>197,000</u> | <u>204,000</u> |

All the properties had an estimated life of 40 years when they were acquired. They are all let on short leases under commercial terms however, property C is let to a fellow subsidiary of X Limited. The group policy is to adopt the fair value model in HKAS 40 "Investment Property" for investment properties and to account for owner-occupied properties under the cost model in HKAS 16 "Property, Plant and Equipment".

**Required:**

Prepare extracts of the consolidated financial statements of X Limited in respect of the above properties for the years to 31 December 20X5.

69. In the consolidated financial statements of X Limited property C would have to be classified as an owner-occupied property and accounted for under HKAS 16's cost model. This means that it would be carried at cost less any accumulated depreciation and any accumulated impairment losses.

**Income statement for the year ended 31 December 20X5**

|   | \$m     |
|---|---------|
| Depreciation – Property C (80,000/40 years) | (2,000) |
| Investment property gains/(losses)          | 17,000  |
| [(52,000 + 82,000) - (41,000 + 76,000)]     |         |

**Balance sheet as at 31 December 20X5**

|   | \$m     |
|---|---------|
| Property, plant and equipment – Property C (80,000 - 2,000) | 78,000  |
| Investment property (52,000 + 82,000)                       | 134,000 |

**Inability to determine fair value reliably**

70. There is a rebuttable presumption that an entity can reliably determine the fair value of an investment property on a continuing basis. However, in exceptional cases, there is clear evidence when an entity first acquires an investment property (or when an existing property first becomes investment property following the completion of construction or development, or after a change in use) that the fair value of the investment property is not reliably determinable on a continuing basis. This arises when, and only when, comparable market transactions are infrequent and alternative reliable estimates of fair value (for example, based on discounted cash flow projections) are not available. In such cases, an entity shall measure that investment property using the cost model in HKAS 16. The residual value of the investment property shall be assumed to be zero. The entity shall apply HKAS 16 until disposal of the investment property.
71. If an entity has previously measured an investment property at fair value, it shall continue to measure the property at fair value until disposal (or until the property becomes owner-occupied property or the entity begins to develop the property for subsequent sale in the ordinary course of business) even if comparable market transactions become less frequent or market prices become less readily available.

**Cost model**

72. After initial recognition, an entity that chooses the cost model shall measure all of its investment properties in accordance with the requirements of the model as set out in HKAS 16, except for those that classified as held for sale in accordance with HKFRS 5 “Non-current Assets Held for Sale and Discontinued Operations”.

## XI. TRANSFER OF INVESTMENT PROPERTY

73. Transfers to, or from, investment property shall be made when, and only when, there is a change in use.

#### IV. POST-ACQUISITION DEPRECIATION ADJUSTMENT RELATED TO FAIR VALUE ADJUSTMENT

44. In Section IV of Chapter 18, the fair value adjustment is introduced. However, the case is simplified, since the example involves only the adjustment related to land. Land is a non-depreciable asset and hence no depreciation is to be provided.
45. Examination question may require the fair value adjustment related to a depreciable asset.
46. HKFRS 3 "Business Combinations" provides that subsequent to the acquisition date, the parent's income statement should incorporate the parent's profit or loss by including the subsidiary's income and expenses based on the fair value of the assets and liabilities acquired. For example, the subsidiary's depreciation expense should be included in the parent's income statement based on the fair value of the depreciable assets at the acquisition date. Therefore, post-acquisition depreciation adjustment is to be made in consolidation for the increase or reduction in depreciation due to fair value adjustment in respect of depreciable assets.

**Example 10:**

47. P Ltd acquired 75% ordinary share capital of S Ltd on 1 January 20X2 for \$800,000 when the retained profit amounted to \$200,000. The balance sheets of the two companies at 31 December 20X5 were as follows:

|                                  | P Ltd<br>\$000 | S Ltd<br>\$000 |
|----------------------------------|----------------|----------------|
| Non-current assets               |                |                |
| Plant and equipment              |                |                |
| – Cost                           | 1,500          | 1,250          |
| – Less: Accumulated depreciation | (300)          | (250)          |
|                                  | <u>1,200</u>   | <u>1,000</u>   |
| Investment in S Ltd              | 800            |                |
| Current assets                   |                |                |
| Inventory                        | 1,920          | 1,250          |
| Trade receivables                | 810            | 740            |
| Cash                             | 870            | 560            |
|                                  | <u>3,600</u>   | <u>2,550</u>   |
|                                  | <u>5,600</u>   | <u>3,550</u>   |
| Ordinary shares, \$1 each        | 1,000          | 400            |
| Retained profit                  | 1,500          | 520            |
|                                  | <u>2,500</u>   | <u>920</u>     |
| Current liabilities              |                |                |
| Trade payables                   | 100            | 120            |
| Dividend payable                 | 3,000          | 2,570          |
|                                  | <u>3,100</u>   | <u>2,690</u>   |
|                                  | <u>5,600</u>   | <u>3,550</u>   |



|        |           | Goodwill   |           |
|--------|-----------|--|-----------|
|        |           | \$000  | \$000     |
| C of C | 50        | CRP – Impairment loss                            | –         |
|        |           | Balancing figure (to consolidated balance sheet) | 50        |
|        | <u>50</u> |  | <u>50</u> |

Consolidated Retained Profit (CRP)

|  | P            | S          |                              | P            | S          |
|--|--------------|------------|------------------------------|--------------|------------|
|  | \$000        | \$000      |                              | \$000        | \$000      |
| Unrealised profit – Inventory                    |              | 20         | Profit per account           | 1,500        | 520        |
| Depreciation adjustment – Plant and equipment    |              | 160        | Dividend from S              |              | 90         |
| C of C – Pre-acquisition profit (200 x 75%)      |              | 150        |                              |              |            |
| MI [(520 – 20 – 160) x 25%]                      |              | 85         |                              |              |            |
| Post-acquisition profit of S                     |              | 105        | Post-acquisition profit of S | 105          |            |
| Goodwill – Impairment loss                       | –            |            |                              |              |            |
| Balancing figure (to consolidated balance sheet) | 1,695        |            |                              |              |            |
|  | <u>1,695</u> | <u>520</u> |                              | <u>1,695</u> | <u>520</u> |

Minority Interests (MI) (25%)

|  | \$000      |   | \$000      |
|--|------------|---|------------|
| Balancing figure (to consolidated balance sheet) | 285        | Share capital of S Ltd (400 x 25%)          | 100        |
|  |            | Fair value adjustment – Plant and equipment | 100        |
|  |            | Retained profit of S Ltd                    | 85         |
|  | <u>285</u> |   | <u>285</u> |

P Ltd

Consolidated balance sheet as at 31 December 20X5

Non-current assets

Property, plant and equipment

– Cost [(1,500 + 1,250) + 400]

– Accumulated depreciation [(300 + 250) + 160]

Goodwill

\$000

3,150

(710)

2,440

50

|  |              |
|--|--------------|
| Current assets   | 3,150        |
| Inventory [(1,920 + 1,250) - 20]                               | 1,490        |
| Trade receivables [(810 + 740) - 60]                           | 1,445        |
| Cash [(870 + 560) + 15]  | <u>6,085</u> |
|  | <u>8,575</u> |
|  | 1,000        |
| Ordinary shares, \$1 each                                      | <u>1,695</u> |
| Retained profit  | 2,695        |
|  | 285          |
| Minority interests   | <u>2,980</u> |
| Current liabilities  | 5,465        |
| Trade payables [(3,000 + 2,510) - 45]                          | 1,000        |
| Dividend payable - Parent                                      | 30           |
| Minority interests proposed dividend [(120 - 90) or 120 x 25%] | <u>5,595</u> |
|  | <u>8,575</u> |

### V. ACQUISITION OF A SUBSIDIARY DURING THE YEAR

49. When a subsidiary is acquired during the year, it is necessary to distinguish between:

- (a) profit earned before acquisition; and
- (b) profit earned after acquisition.

50. The normal assumption used in examination is that profit accrues evenly throughout the year. Hence the subsidiary's profit for the whole year is split into pre-acquisition and post-acquisition using the time apportionment basis.

*Example 11:*

51. P Ltd acquired 75% of the ordinary shares of S Ltd on 1 May 20X5 for \$165,000. On 31 December 20X4 S Ltd's balance sheet showed a share premium of \$10,000 and retained profit of \$8,000. The balance sheets of the two companies as at 31 December 20X5 were given below. Neither company has paid or proposed any dividends during the year.

|                     | P Ltd          | S Ltd          |
|---------------------|----------------|----------------|
|                     | \$             | \$             |
| Non-current assets  | 200,000        | 100,000        |
| Land                | 165,000        | -              |
| Investment in S Ltd | 35,000         | <u>40,000</u>  |
| Current assets      | <u>400,000</u> | <u>140,000</u> |

**Required:**

Prepare the consolidated income statement for Ace Ltd for the year ended 31 December 20X1 using the whole year method. Show all workings and ignore goodwill arising on acquisition and its related impairment (if any). (21 marks)

(Adapted HKAAT, Financial Accounting II, December 2001)

The draft financial statements for the year ended 31 March 20X2 for Small Ltd and Little Ltd are as follows:

|                                  | Income statements |                 |
|----------------------------------|-------------------|-----------------|
|                                  | Small Ltd         | Little Ltd      |
| Sales revenue                    | \$000             | \$000           |
| Cost of sales                    | 22,500            | 17,000          |
| Gross profit                     | <u>(15,725)</u>   | <u>(12,640)</u> |
| Administrative expenses          | 6,775             | 4,360           |
| Finance cost                     | (4,725)           | (1,910)         |
| Profit before tax                | <u>(100)</u>      | <u>(200)</u>    |
| Taxation                         | 1,950             | 2,250           |
| Profit after tax                 | <u>(300)</u>      | <u>(360)</u>    |
| Dividends                        | <u>1,650</u>      | <u>1,890</u>    |
|                                  | <u>500</u>        | <u>600</u>      |
|                                  |                   |                 |
|                                  | Balance sheets    |                 |
|                                  | Small Ltd         | Little Ltd      |
| Non-current assets (net)         | \$000             | \$000           |
| Investments                      | 20,700            | 12,250          |
| Shares in Little Ltd at cost     | 12,000            |                 |
| Current assets                   | 6,100             | 3,500           |
| Inventories                      | 5,200             | 4,500           |
| Trade and other receivables      | 1,500             | 750             |
| Cash and bank                    | <u>12,800</u>     | <u>8,750</u>    |
|                                  | <u>45,500</u>     | <u>21,000</u>   |
| Capital and reserves             | 25,000            | 13,000          |
| Issued capital                   | —                 | 1,000           |
| 8% preference shares of \$1 each | <u>15,600</u>     | <u>2,240</u>    |
| Accumulated profits              | <u>40,640</u>     | <u>16,240</u>   |

## Current liabilities

|                               |               |               |
|-------------------------------|---------------|---------------|
| Trade and other payables      |               |               |
| Profits tax                   | 4,100         | 3,800         |
| Proposed dividends – Ordinary | 300           | 360           |
| – Preference                  | 500           | 520           |
|                               | –             | 80            |
|                               | <u>4,900</u>  | <u>4,760</u>  |
|                               | <u>45,500</u> | <u>21,000</u> |

The following information is available:

- (1) Small Ltd acquired 10,400,000 ordinary shares in Little Ltd on 1 January 20X0 when the reserves of Little Ltd. had a credit balance of \$1,270,000.
- (2) During the year Small Ltd sold goods with an invoice value of \$800,000 to Little Ltd. Of these, goods with a value of \$200,000 were in inventory with Little Ltd on 31 March 20X2. The profit element is 20% of selling price for Small Ltd.
- (3) All dividends receivable are not accounted for until they are received.
- (4) Goodwill arising on acquisition is to be dealt with in accordance to HKFRS 3 “Business Combinations”. Reviews of the carrying amount of goodwill had been carried out and no impairment has to be provided.

**Required:**

- a. Calculate the goodwill on consolidation. (2 marks)
- b. Calculate the minority interest. (2 marks)
- c. Calculate the consolidated profit and loss balance. (2 marks)
- d. Prepare a consolidated income statement for Small Ltd for the year ended 31 March 20X2. (10 marks)
- e. Prepare a consolidated balance sheet for Small Ltd as at 31 March 20X2. (9 marks)

All workings must be shown.

(Total 25 marks)

(Adapted HKAAT, Advanced Accounting, June 2003)

|   |                        |
|---|------------------------|
| Less: Minority interest (Workings – above)                          | (314.5)                |
| Profit after tax  | 2,967.5                |
| Transfer to reserves (400 + 200 x 80% x 9/12 + 100 x 90%)           | (610)                  |
| Proposed dividends  | (600)                  |
| Retained profit for the year  | <u>1,757.5</u>         |
| Retained profit brought forward (9,600 + 0 + (2,600 – 1,800) x 90%) | 10,320                 |
| Retained profit carried forward                                     | <u><u>12,077.5</u></u> |

Notes:

- (1) Eliminate inter-company sales and purchases.
- (2) Eliminate inter-company unrealised profit in inventory, \$8,000 = \$40,000 x 25/125.  
a., b. and c.

|                      |                                |  |               |
|----------------------|--------------------------------|--|---------------|
|                      | Cost of Control (C of C) (80%) |  |               |
| Investment in Little | \$000                          |  | \$000         |
|                      | 12,000                         | Share capital of Little (13,000 x 80%) | 10,400        |
|                      |                                | CRP – Pre-acquisition                  | 1,016         |
|                      |                                | Goodwill                               | 584           |
|                      | <u>12,000</u>                  |  | <u>12,000</u> |

|        |            |  |            |
|--------|------------|--|------------|
|        | Goodwill   |  |            |
| C of C | \$000      |  | \$000      |
|        | 584        | CRP – Impairment loss                            | –          |
|        |            | Balancing figure (to consolidated balance sheet) | 584        |
|        | <u>584</u> |  | <u>584</u> |

|  |               |              |               |              |
|--|---------------|--------------|---------------|--------------|
|  | CRP           |              |               |              |
|  | Small         | Little       | Small         | Little       |
|  | \$000         | \$000        | \$000         | \$000        |
| Unrealised profit – Inventory                    | 40            |              | 15,600        | 2,240        |
| C of C – Pre-acquisition profit (1,270 x 80%)    |               | 1,016        | 416           |              |
| MI [(2,760 x 20%) + 80 x 100%]                   |               | 632          |               |              |
| Post-acquisition profit of Little                |               | 592          | 592           |              |
| Balancing figure (to consolidated balance sheet) | 16,568        |              |               |              |
|  | <u>16,608</u> | <u>2,240</u> | <u>16,608</u> | <u>2,240</u> |

| Minority Interests (MI) (20%)                    |              |   |              |
|--|--------------|---|--------------|
|  | \$000        |   | \$000        |
| Balancing figure (to consolidated balance sheet) | 4,232        | Ordinary share capital of Little (13,000 x 20%) | 2,600        |
|  |              | Preference shares (1,000 x 100%)                | 1,000        |
|  |              | Retained profit of Little                       | 632          |
|  | <u>4,232</u> |   | <u>4,232</u> |

d.

Small Ltd  
Consolidated income statement for the year ended 31 March 20X2

|  |                 |
|--|-----------------|
| Sales revenue [(22,500 + 17,000) – 800]      | \$000           |
| Cost of sales [(15,725 + 12,640) – 800 + 40] | 38,700          |
| Gross profit                                 | <u>(27,605)</u> |
| Administrative expenses (4,725 + 1,910)      | 11,095          |
| Finance cost (100 + 200)                     | (6,635)         |
| Profits before tax                           | <u>(300)</u>    |
| Taxation (300 + 360)                         | 4,160           |
| Profit after tax                             | <u>(660)</u>    |
| Minority interest [(1,890 – 80) x 20% + 80]  | 3,500           |
| Profit for the year                          | <u>(442)</u>    |
| Dividends                                    | <u>3,058</u>    |
|  | <u>(500)</u>    |

Notes:

- (1) Eliminate inter-company sales and purchases.
- (2) Eliminate inter-company unrealised profit in inventory, \$40,000 = \$200,000 x 20%.

e.

Small Ltd  
Consolidated balance sheet at 31 March 20X2

|   |              |               |
|---|--------------|---------------|
| Non-current assets (net) (20,700 + 12,250)  | \$000        | \$000         |
| Goodwill                                    |              | 32,950        |
| Current assets                              |              | 584           |
| Inventories [(6,100 + 3,500) – (2) 40]      | 9,560        |               |
| Trade and other receivables (5,200 + 4,500) | 9,700        |               |
| Cash and bank (1,500 + 750)                 | <u>2,250</u> |               |
|   |              | <u>21,510</u> |
|   |              | <u>55,044</u> |

