INSTITUTE OF ACTUARIAL & QUANTITATIVE STUDIES

Subject : Business Finance II

Consolidated Financial Statements

Consolidated financial statements

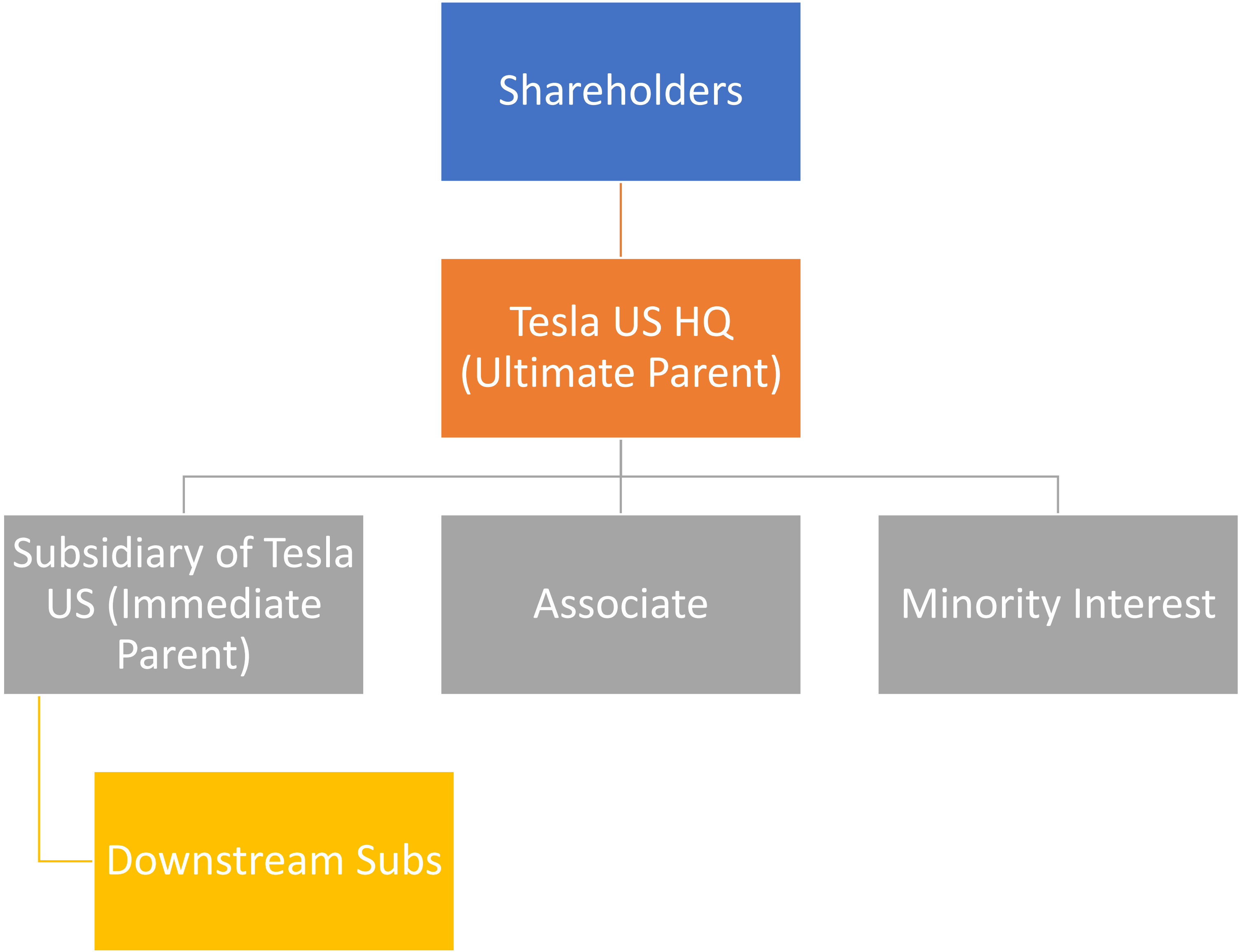
- Large organisations are often organised as groups of inter-related companies
- **Understanding:**
  - **Parent Company**
  - **Subsidiary Companies (CI)**
  - **Minority Interest (MI)**
  - **Associate Company (SI)**

How to consolidate a normal financial statement of each company in the Group to eventually arrive at the Consolidated Financial Statement of the Parent Co.

Controlling Interest
+50% shares / voting rights of a company

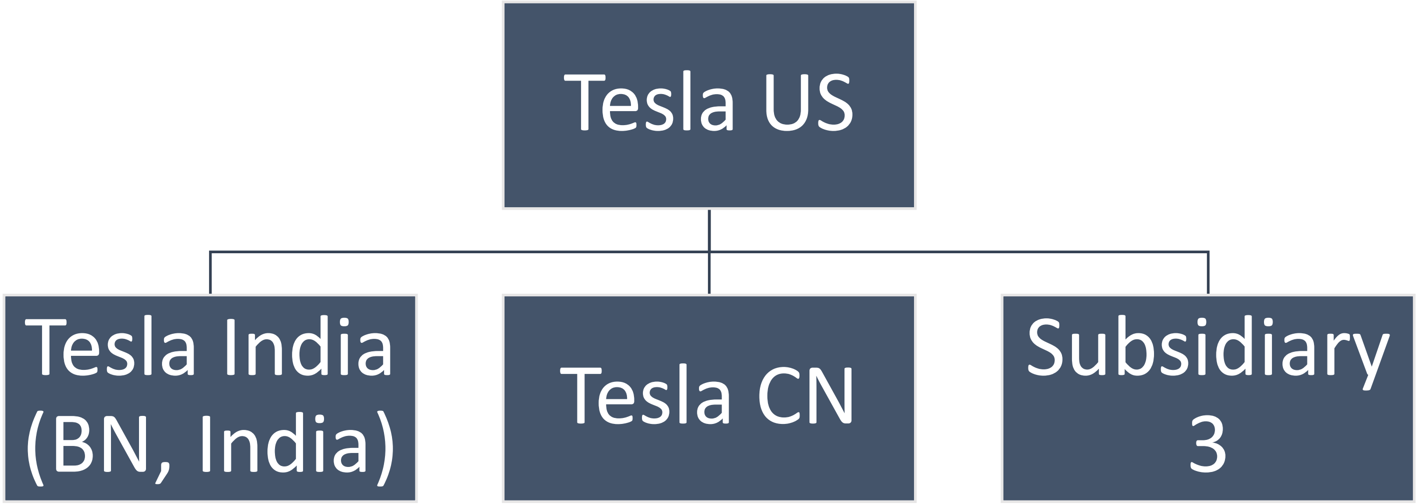
Significant Influence
>20% AND <50% shares / voting rights of a company

<20% of a company


Shareholders
Tesla US HQ (Ultimate Parent)
Subsidiary of Tesla US (Immediate Parent)
Associate
Minority Interest
Downstream Subs

Group of Companies

General Parlance – what is a group? → Segmented keeping in mind the owner of the business (Tata Group)
(No Legal Context)



Subsidiary companies

- The company which holds the controlling interest in the others is known as the 'parent company'. The companies which are controlled by the parent company are known as 'subsidiaries'. Collectively, a parent company and its subsidiaries are known as a 'group
- A controlling interest can arise in a number of ways. The most obvious would be where the parent company owns a majority of the voting rights.
- The shareholders of the parent will certainly be more interested in the performance of the group as a whole than they will be in that of the parent taken on its own.
- The parent is required to publish a set of consolidated financial statements which reflect the economic reality of the group's existence
- Basically, consolidation is a process of **totalling the various items in the statements of profit or loss and statements of financial position of the individual group members**.
- However, it is important to remember that the purpose of the exercise is to present the statements as if the group was a single economic unit. **Certain balances in the statements of the individual group members arise from relationships within the group and must be cancelled out before the figures can be meaningfully combined**

For example, H Ltd acquired 10,000 shares in S Ltd on 31 December 20X0.

The statements of financial position of the two companies at that date were as follows:

	H Ltd	*S Ltd*
	£000	*£000*
Non-current assets	8	6
Investment in S Ltd	☑ 10	–
Current assets	12	10
Total assets	*30*	*16*
Share capital (£1 shares)	20	☑ 10
Current liabilities	10	6
Total equity and liabilities	*30*	*16*

H Ltd (Parent Co) Consolidated Balance Sheet
14
-
22
TA: 36
20
16
TEL: 36

It is necessary to cancel out any internal relationships which arise within the group.

100% of S Ltd – Wholly Owned Subsidiary

	H Ltd	S Ltd		Consolidated H Ltd
Non - Current Assets	8	6	Non - Current Assets	14
Investment in S	~~12~~ 2		Goodwill on Consolidation	2
Current Assets	15	10	Current Assets	25
Total Assets	**35**	**16**	**Total Assets**	**41**
Equity & Reserves	20	~~10~~	Equity & Reserves	20
Current Liabilities	15	6	Current Liabilities	21
TEL	**35**	**16**		**41**

Goodwill on consolidation

- The amount that Parent has to pay to Subsidiary shareholders exceeds the balance sheet value of the share capital and reserves of Subsidiary
- Good will calculates as:
  Cost of acquisition – Book value of shares acquired
- Goodwill is normally shown as a **non-current asset** in the consolidated statement of financial position
- In case the Cost of Acquisition < BV of shares acquired, then goodwill is a negative amount, and shall be shown as Other Reserves in the Consolidated Financial Statements

Non Controlling Interest

Mr X decides to expand by acquiring 80% of the business of a friend Mr Y. The statements of financial position of the two businesses are as follows:

all figures in $	*Mr X*	*Mr Y*
Assets		
Cash	50	200
Trade receivables	200	50
Total assets	**250**	**250**
Equity and liabilities		
Capital ($1 nominal)	50	200
Reserves	100	50
Equity	150	250
Loan	100	0
Total equity and liabilities	**250**	**250**

Mr X pays $240 for an 80% stake in the business of Mr Y and raises this cash by increasing the loan from $100 to $340.

	100%	30%	20%
BV of Share capital of Y	250	75	50
Amount Paid:		240	
Goodwill:		165	

X (Consolidated Balance Sheet)
Cash – 50 + (30% of 200) = 110
Trade Receivables – 200 + (30% of 50) = 215
Goodwill – 165
Total: 490

Capital – 50
Reserves – 100
Loan – 340
Total : 490

Associate Companies

- An associated undertaking is one which is not a subsidiary, but which is subject to significant influence (but not control) by the parent.
- There is normally a presumption that significant influence would arise if the parent owned more than 20% of the associate's voting rights.
- The fact that the parent can merely exert influence means that it would not be appropriate to include the value of its assets in the consolidated financial statements. It would also be inappropriate to treat the associate as a simple investment.
- Instead, compromise is reached by including the parent's share of the associate's results in the consolidated statement of profit or loss – regardless of whether it receives these by way of dividend. The consolidated statement of financial position includes the parent's share of the associate's assets and liabilities. The entries in both the statement of profit or loss and statement of financial position are single line entries, which state the total amounts attributable to associate companies.

Thank You