


Consolidated Financial Statements

Tan Liong Tong

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acquisition-date amounts of the identifiable assets acquired and liabilities assumed. For example, if the consideration transferred to acquire a wholly-owned subsidiary is RM150 million and the identifiable net assets (assets less liabilities) acquired is RM100 million, goodwill on combination is recognised at RM50 million.

If we are to prepare the group accounts of a parent immediately after it has acquired a subsidiary, the parent's investment in the subsidiary (measured based on the fair value of the purchase consideration) is eliminated with subsidiary's share capital and pre-acquisition reserves, and substituted by the underlying fair value of the net assets of the subsidiary so that the assets and liabilities of both companies are added across and presented in aggregates. This elimination of intragroup balances is necessary to avoid double-counting in the group accounts.

Note that the net asset values of the subsidiary at the date of acquisition shall be stated at their fair values to the parent. These values may not necessarily be the book values in the accounts of the subsidiary. Thus, consolidation adjustments may be necessary to revise the book values to their fair values. In effect, the revalued amounts of the assets and liabilities at the acquisition date represent costs to the parent.

Example 1.1

On 1 January 20x0, P Bhd acquired a 100% equity interest in S Bhd paying RM500,000 in cash and the balance by issuing 200,000 P Bhd's ordinary shares with a market value of RM2.50 each.

The respective statements of financial position of the 2 companies immediately before the acquisition on that date are as follows:

	P Bhd	S Bhd
No. of ordinary shares ('000)	<u>1,000</u>	<u>400</u>
	RM'000	RM'000
Share capital, issued at RM1 each	1,000	400
Retained profits	600	200
Long-term liabilities	300	200
Current liabilities	<u>100</u>	<u>100</u>
	<u>2,000</u>	<u>900</u>
Represented by:		
Property, plant and equipment		
Properties	1,000	400
Plant and machinery	300	200
Current assets	<u>700</u>	<u>300</u>
	<u>2,000</u>	<u>900</u>

In arriving at the purchase consideration, the buyer and seller took into account the following items:

- The fair value of S Bhd's properties was RM500,000; and
- S Bhd owned patents and licences worth RM200,000.

Required

Prepare the consolidated statement of financial position immediately after the acquisition of shares in S Bhd.

Explanation

The acquisition method of accounting for business combination requires that the fair value of the purchase consideration be allocated to the fair value of identifiable net assets with the goodwill arrived at as a balancing figure. This principle, which is known as the purchase price allocation (PPA) in practice, is demonstrated in the working below:

	RM'000	RM'000
i) Fair value of purchase consideration given:		
♦ Cash consideration	500	
Shares issued at fair value 200,000 × RM2.50	<u>500</u>	1,000
ii) Allocated to fair value of identifiable net assets:		
Properties	500	
Plant and machinery	200	
Patents and licences	200	
Current assets	300	
Less: Current liabilities	(100)	
Long-term liabilities	<u>(200)</u>	
Fair value of net assets acquired		<u>900</u>
iii) Goodwill on combination (as a balancing figure)		<u>100</u>

The following points in relation to the above principle should be remembered:

- The shares issued by P Bhd are recorded in its accounts at their fair value. Thus, to record the purchase of S Bhd, P Bhd will have to record, in its own accounts, the following journal entries.

	RM'000	RM'000
Dr Investment in S Bhd, at cost	1,000	
Cr Cash Account		500
Cr Contributed Share Capital		500

Note: In a no-par value share regime, shares issued are recorded at their issue price.

- The value of the properties is to be taken in at a fair value of RM500,000. This value, in effect, represents cost to the group. The surplus of RM100,000, which arises from a consolidation adjustment, forms part of the pre-acquisition reserves (ie reserves at the acquisition date).

- The identifiable intangible assets, consisting of patents and licences, are to be taken in at their fair value. Since these intangible assets are not recorded in the books of the subsidiary, a consolidation adjustment is necessary to record them in the consolidated accounts. Again, the surplus of RM200,000 forms part of the pre-acquisition reserves.
- The whole retained profits of S Bhd at the date of acquisition are frozen permanently and form part of the pre-acquisition reserves.

Solution 1.1

Workings

1. Journal entries to effect consolidation adjustments

	RM'000	RM'000
a) Dr Properties	100	
Dr Patents and licences	200	
Dr Goodwill on combination	100	
Cr Revaluation reserves		400
<i>- to adjust assets of subsidiary to their fair values and recognise goodwill on combination.</i>		
b) Dr Share capital of S	400	
Dr Revaluation reserves	400	
Dr Retained profits of S	200	
Cr Investment in S		1,000
<i>- to eliminate cost of investment against share capital and pre-acquisition reserves.</i>		

The adjustment to eliminate cost of investment with the net assets acquired through the credit side of the subsidiary's statement of financial position illustrates the equality of shareholders' funds to net assets by virtue of the accounting equation of:

Shareholders' Funds	=	Assets - Liabilities
Share Capital + Reserves	=	Net Assets

Since, on consolidation, the whole net assets (assets and liabilities) are to be brought into the consolidated accounts, the investment in subsidiary account (ie the purchase consideration) is cancelled against the share capital and pre-acquisition reserves of the subsidiary leaving any balancing figure as the goodwill on combination.

2. Consolidation Worksheet

	P Bhd RM'000	S Bhd RM'000	Consolidation Adjustments		P Group RM'000
			(Dr) RM'000	Cr RM'000	
Contributed share capital	1,500	400	(400)b		1,500
Revaluation surplus	-	-	(400)b	400a	-
Retained profits	600	200	(200)b		600
Long-term liabilities	300	200			500
Current liabilities	100	100			200
Total Equity & Liabilities	2,500	900			2,800
Investment in S Bhd	(1,000)	-		1,000b	-
Goodwill on combination	-	-	(100)a		(100)
Properties	(1,000)	(400)	(100)a		(1,500)
Plant and machinery	(300)	(200)			(500)
Patents and licences	-	-	(200)a		(200)
Current assets	(200)	(300)			(500)
Total Assets	(2,500)	(900)	(1,400)	1,400	(2,800)

*P Bhd and its Subsidiary
Consolidated Statement of Financial Position
As at 1 January 20x0*

	RM'000	RM'000
Property, plant and equipment:		
Properties	1,500	
Plant and machinery	500	2,000
Goodwill on combination		100
Patents and licences		200
Current assets		500
Total Assets		2,800
Financed By:		
No. of ordinary shares ('000)		1,200

	RM'000
Contributed share capital	1,500
Retained profits	600
	<u>2,100</u>

Long-term liabilities	500
Current liabilities	200
Total Equity and Liabilities	<u>2,800</u>

The key points to remember in this Example are as follows:

- The share capital of the Group will be the same as the share capital of the Parent.
- Under the acquisition method, the retained profits and other reserves (including those arising on fair value adjustments of assets and liabilities) of the subsidiary at the acquisition date are eliminated on consolidation.
- The assets and liabilities of the subsidiary at the acquisition date are consolidated based on their respective fair values.

1.5.2 Post-acquisition Profits and Group Adjustments

Under the acquisition method of accounting, the results of operations of a subsidiary can only be included in the consolidated statement of profit or loss with effect from the date of its acquisition. The increase in profits of the subsidiary from the acquisition date, known as the post-acquisition profits, forms part of the group's reserves and it is reflected by the corresponding increase in the net assets of the subsidiary from its acquisition date.

At the acquisition date, any fair value adjustment to the assets and liabilities of the subsidiary is performed at the group level only so that the respective assets and liabilities are given a fresh-start measurement at cost to the group. There shall be no adjustments to the carrying book values of the assets and liabilities in the individual accounts of the subsidiary, except for measurement changes to align the accounting policies of the subsidiary to those of the group.

If the consolidation adjustment results in a higher carrying amount of an item of property, plant and equipment (PPE) at the group level, an additional depreciation expense shall be adjusted to reflect the depreciation expense of the PPE at the group level. Similarly, if the consolidation adjustment results in recognition of an intangible asset, the amortisation expense of the intangible asset shall be effected only at the group level.

Example 1.2 (P Bhd - continued)

Assume we are to produce the consolidated statement of financial position of P Bhd and its subsidiary, S Bhd, one year after its acquisition. The properties revalued at the acquisition date have a remaining useful life of 50 years. The intangible asset has a useful life of 5 years. Depreciation and amortisation expense are on the straight-line basis.

The statements of financial position of the 2 companies at 31 December 20x0 are as follows:

	P Bhd	S Bhd
No. of ordinary shares ('000)	<u>1,200</u>	<u>400</u>
	RM'000	RM'000
Contributed share capital	1,500	400
Retained profits	900	400
Long-term liabilities	700	150
Current liabilities	<u>200</u>	<u>150</u>
	<u>3,300</u>	<u>1,100</u>
Represented by:		
Investment in S Bhd	1,000	
Property, plant and equipment:		
Properties	1,000	500
Plant and machinery	400	250
Current assets	<u>900</u>	<u>350</u>
	<u>3,300</u>	<u>1,100</u>

The other information relating to the acquisition of S Bhd is as in Example 1.1

Required

Prepare the consolidated statement of financial position of P Bhd and its subsidiary as at 31 December 20x0.

Explanation

Having made the pre-acquisition adjustments and the consolidated statement of financial position at the acquisition date, the goodwill on combination should remain at RM100,000 (ignore, for the time being, accounting treatments for purchased goodwill). Implied in this is that the parent's share of the fair value of net assets of the subsidiary at the acquisition date should not change with subsequent consolidations.

The net assets of S Bhd have increased, since the acquisition date, by RM200,000 as indicated by the increase in the retained profits. On consolidation, the whole net assets of the subsidiary are again brought in and the corresponding increase in the subsidiary's net assets is reflected in the group's post-acquisition retained profits.

Solution 1.2

Consolidation Worksheet

	P Bhd RM'000	S Bhd RM'000	Consolidation Adjustments		P Group RM'000
			(Dr) RM'000	Cr RM'000	
Contributed share capital	1,500	400	(400)b		1,500
Revaluation surplus	-	-	(400)b	400a	-
Retained profits	900	400	(200)b		1,058
			(42) c		
Long-term liabilities	700	150			850
Current liabilities	200	150			350
Total Equity & Liabilities	3,300	1,100			3,758
Investment in S Bhd	(1,000)	-		1,000b	-
Goodwill on combination	-	-	(100)a		(100)
Properties	(1,000)	(500)	(100)a	2(c)	(1,598)
Plant and machinery	(400)	(250)			(650)
Patents and licences	-	-	(200)a	40(c)	(160)
Current assets	(900)	(350)			(1,250)
Total Assets	(3,300)	(1,100)	(1,442)	1,442	(3,758)

For adjustments (a) and (b), refer to Example 1.1

Adjustment (c)

	RM'000	RM'000
Dr Retained profits	42	
Cr Accumulated depreciation (100/50)		2
Cr Accumulated amortisation (200/5)		40

Note: The group's retained profits are as follows:

	RM'000
P Bhd	900
S Bhd – post-acquisition profits	200
Less: Depreciation and amortisation expense	(42)
	<u>1,058</u>

P Bhd and its Subsidiary
Consolidated Statement of Financial Position
As at 31 December 20x0

	RM'000	RM'000
Property, plant and equipment:		
Properties	1,598	
Plant and machinery	650	2,248
Goodwill on combination		100
Patents and licences (200 – 40)		160
Current assets		1,250
Total Assets		3,758
Financed By:		
No. of ordinary shares ('000)		1,200
Contributed share capital		1,500
Retained profits		1,058
Equity attributable to owners of the parent		2,558
Long-term liabilities		850
Current liabilities		350
Total Equity and Liabilities		3,758

The key points to remember in this Example are as follows:

- The retained profits of the Group shall include the post-acquisition profits of the subsidiary after the acquisition date.
- The post-acquisition profits of the subsidiary must adjust for depreciation and amortisation expenses from fair value adjustments of net assets and intangible assets acquired.

1.5.3 Non-Controlling Interest

Where the parent owns less than 100% of the issued shares of its subsidiary, a NCI exists. MFRS 10 defines NCI as "the equity in a subsidiary not attributable, directly or indirectly, to a parent". Thus, NCI is the non-controlling shareholders' proportionate share in the net assets of a subsidiary and this is represented by their capital contribution together with their share of reserves.

On consolidation, the assets and liabilities (net assets) of the parent and all its subsidiaries are aggregated a 100% irrespective of whether a subsidiary is wholly-owned or partly-owned. This is in accordance with the entity concept, which requires that the group's net assets reflect all economic resources under the parent's control.

For partly-owned subsidiaries, we must show the extent of the net assets funded by share capital and reserves belonging to shareholders other than the parent company. The NCI's share of net assets should be classified as equity and presented separately from the controlling shareholders' equity. This distinction is

to highlight the ownership or proprietary aspect which defines the basis on which net assets, profits or losses and other comprehensive income are divided between the controlling (parent) and NCIs.

1.5.3.1 Measurement of NCI at Acquisition Date

MFRS 3 requires that at the acquisition date, "the acquirer shall measure any NCI in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets". This choice can be made on an acquisition-by-acquisition basis; it is not necessary for reporting entities to adopt a consistent measurement policy for NCI. However, in the MPERS Framework used by private entities, NCI shall only be measured at the share of an acquiree's identifiable net assets (the option of the fair value measurement for NCI at acquisition date is disallowed in MPERS).

If the NCI is measured at its acquisition-date fair value, the goodwill on combination recognised would include a portion attributable to the NCI. However, if the NCI is measured at its proportionate share of the acquiree's identifiable net assets, the goodwill on combination recognised is attributable only to the parent and it does not include any goodwill attributable to the NCI, which is a mandatory requirement in MPERS.

1.5.3.2 NCI at end of Reporting Period

The choice to measure NCI at fair value applies only at the acquisition date (ie the date when the acquirer obtains control of the acquiree). There is no remeasurement of the NCI to fair value subsequent to the acquisition date, even if the share price or fair value of the acquiree has increased. The subsequent carrying amount of the NCI in the statement of financial position will be based on the initial measurement of NCI at the acquisition date plus or minus the NCI's share of post-acquisition results of the subsidiary.

Since NCI is to reflect non-controlling shareholders' share of the net assets and goodwill, if applicable, of partly-owned subsidiaries, the separation of pre-acquisition and post-acquisition reserves, as regards NCI, is irrelevant. At the end of each reporting period, the closing NCI in each partly-owned subsidiary should represent the NCI's share of the subsidiary's share capital and reserves. Thus, for each partly-owned subsidiary, the amount of the closing NCI can always be proved by reference to the closing net assets and goodwill.

Example 1.3

Maju Bhd acquired 80% of the issued share capital of Laju Bhd for RM120,000 on 31 December 20x1. The contributed share capital of Laju Bhd on that date consisted of 60 million ordinary shares with a contributed amount of RM90 million. The retained profits at that date were RM20,000. The fair value of the ordinary shares of Laju Bhd at the acquisition date was RM150,000.

The following statements of financial position as at 31 December 20x2 have been prepared:

	Maju Bhd RM	Laju Bhd RM
Property, plant and equipment:		
Freehold land, at cost	70,000	20,000
Other property, plant and equipment, at net book value	100,000	36,000
	170,000	56,000
Investment: 48,000 shares in Laju Bhd, at cost	120,000	—
Current assets	320,000	168,000
	610,000	224,000
Contributed share capital	250,000	90,000
Retained profits	90,000	50,000
Liabilities	270,000	84,000
	610,000	224,000

At the acquisition date, the freehold land of Laju Bhd had a fair value of RM40,000. No adjustment had been made for this fair value and there were no subsequent movements in this asset account. Ignore tax effect of fair value adjustment to the freehold land.

Required

Prepare the consolidated statement of financial position of Maju Bhd as at 31 December 20x2.

Explanation

- At the acquisition date, the fair value of the net assets of Laju Bhd is determined as follows:

	RM
Share capital	90,000
Pre-acquisition reserves:	
Revaluation surplus of freehold land (adjustment)	20,000
Retained profits	20,000
	130,000

If NCI is measured at fair value:

At acquisition date, the fair value of the ordinary shares of Laju Bhd is RM150,000. The NCI's share of this fair value is RM30,000. Thus, the goodwill on combination and its allocation to parent and NCI would be as follows:

	Total	Parent (80%)	NCI (20%)
	RM	RM	RM
Aggregate of:			
(a) (i) Fair value of consideration transferred	120,000	120,000	-
(ii) NCI at fair value	<u>30,000</u>	-	30,000
	150,000		
(b) Net assets acquired: (90,000 + 20,000 + 20,000)	<u>130,000</u>	<u>104,000</u>	<u>26,000</u>
Goodwill on combination	<u>20,000</u>	<u>16,000</u>	<u>4,000</u>

If NCI is measured at share of net assets:

	Total	Parent (80%)	NCI (20%)
	RM	RM	RM
Aggregate of:			
(a) (i) Fair value of consideration transferred	120,000	120,000	-
(ii) NCI's share of net assets (20% × 130,000)	<u>26,000</u>	-	26,000
	146,000		
(b) Net assets acquired	<u>130,000</u>	<u>104,000</u>	<u>26,000</u>
Goodwill on combination	<u>16,000</u>	<u>16,000</u>	-

2. The net assets of Laju Bhd, since the acquisition date, have increased by RM30,000 as reflected in the increase in retained profits. Thus, the group's retained profits would consist of:

	RM
Maju Bhd	90,000
Share of post-acquisition retained profits in Laju 80% × RM30,000	<u>24,000</u>
	<u>114,000</u>

3. At 31 December 20x2, the net assets of Laju Bhd are:

	RM
Share capital	90,000
Revaluation surplus on freehold land	20,000
Retained profits	<u>50,000</u>
	<u>160,000</u>

Thus, NCI's share of net assets = 20% × 160,000 = RM32,000. However, if NCI is measured at acquisition-date fair value, the NCI in the closing financial position would be = 32,000 + 4,000 = RM36,000.

The above figures could be sorted out much faster by making use of a proof technique. In this technique, the items that make up the shareholders' funds (net assets) of the subsidiary, after adjusting for fair values at acquisition date, are allocated between the controlling parent and the NCI based on their respective shareholdings. The following demonstrates how this technique may be applied:

Interest in Laju Bhd

	Total	Parent (80%)		NCI (20%)
	RM	Pre-acqn RM	Post-acqn RM	RM
Share capital	90,000	72,000	-	18,000
Revaluation surplus	20,000	16,000	-	4,000
Retained profits:				
Pre-acquisition	20,000	16,000	-	4,000
Post-acquisition (bal.)	<u>30,000</u>	-	24,000	6,000
	160,000	104,000	24,000	32,000
Goodwill on combination	<u>20,000</u>	<u>16,000</u>	-	<u>4,000</u>
	<u>180,000</u>	<u>120,000</u>		<u>36,000</u>
Cost of investment		<u>(120,000)</u>		
Elimination				
Add: Retained profits of Maju Bhd			90,000	
Consolidated retained profits			<u>114,000</u>	

Solution 1.3

Maju Bhd
Consolidated Statement of Financial Position
As at 31 December 20x2

	NCI at fair value RM	NCI at net assets RM
Property, plant and equipment:		
Freehold land, at cost (70,000 + 40,000)	110,000	110,000
Other property, plant and equipment (100,000 + 36,000)	<u>136,000</u>	<u>136,000</u>
	246,000	246,000

	NCI at fair value RM	NCI at net assets RM
Goodwill on combination (W1)	20,000	16,000
Current assets (320,000 + 168,000)	488,000	488,000
Total Assets	754,000	750,000
Contributed share capital	250,000	250,000
Retained profits (W2)	114,000	114,000
Equity attributable to owners of the parent	364,000	364,000
NCI (W3)	36,000	32,000
Total equity	400,000	396,000
Liabilities (270,000 + 84,000)	354,000	354,000
Total Equity and Liabilities	754,000	750,000

The key points to remember in this Example are as follows:

- For a partly-owned subsidiary, share capital and other equity components attributable to other shareholders are classified as NCI; and
- At the acquisition date, NCI shall be measured at its the fair value or its share of the net assets of the acquiree. If NCI is measured at its fair value at the acquisition date, a portion of the goodwill recognised is attributable to the NCI.

1.5.4 Post-Acquisition Other Comprehensive Income

Under the acquisition method, the principle of recognising post-acquisition profits also applies to post-acquisition changes in the subsidiary's net assets that have not been included in profit or loss. Examples of such changes include those arising from the revaluation of property, plant and equipment after the acquisition date, from foreign exchange translation differences and from fair value changes of equity or debt investments measured at fair value through OCI. These post-acquisition gains or losses are recognised in other comprehensive income in the consolidated statement of profit or loss and other comprehensive income and remain as components of equity (the respective reserves).

For example, if a subsidiary revalues any of its property, plant and equipment in the post-acquisition period, any increase in the carrying amount is credited to other comprehensive income and retained in a revaluation reserve account. In the group accounts, the increase in the post-acquisition revaluation reserve of the subsidiary is allocated between the NCI and the parent accordingly, with the latter's share being reflected in the group's revaluation reserves. Similar, the allocation procedures are applied to changes in post-acquisition foreign exchange reserves and reserves arising on other transactions, such as fair value changes of equity or debt investments measured at FVOCI (fair value reserve) and derivative instruments accounted for as cash flow hedges (hedge reserve).

Example 1.4

Bujang Bhd acquired 6 million (a 60% interest) of the issued 10 million shares of Lapuk Bhd on 31 December 20x2. The contributed share capital of Lapuk Bhd on this date was RM12 million. The purchase consideration was RM10 million, of which RM2 million was paid in cash and the balance, by an issue of 4 million Bujang ordinary shares valued at RM2 each. At the acquisition date, the balance of the retained profits of Lapuk Bhd was RM2 million. On the acquisition date, the total fair value of the ordinary shares of Lapuk Bhd was RM16,666,667.

Apart from recording the cash paid, Bujang has not recorded the issuance of shares to reflect the acquisition.

The draft statements of financial position of the 2 companies as at 31 December 20x5 are as follows:

	Bujang Bhd RM'000	Lapuk Bhd RM'000
Property, plant and equipment:		
Freehold land, at cost	8,000	4,000
Other fixed assets, at NBV	30,000	16,000
	38,000	20,000
Investment in Lapuk: (cash paid)	2,000	-
Current assets	16,000	15,000
	56,000	35,000
Share capital, issued at RM1 each	24,000	12,000
Revaluation reserves	5,000	-
Retained profits	10,000	8,000
	39,000	20,000
Long-term loans	7,000	5,000
Current liabilities	10,000	10,000
	56,000	35,000

At the acquisition date, the freehold land of Lapuk Bhd had a fair value of RM6 million. No adjustment has been made for this value. On 31 December 20x5, Lapuk Bhd, on the advice of a professional valuer, placed a valuation of RM10 million on the freehold land. This new valuation has not been incorporated in the draft statement of financial position. The directors wish to incorporate this new valuation in the final accounts.

The retained profits for the current year ended 31 December 20x5 are as follows:

	Bujang Bhd RM'000	Lapuk Bhd RM'000
Retained profit for the year	3,000	2,000
Retained profits brought forward	7,000	6,000
Retained profits carried forward	10,000	8,000

Bujang Bhd's accounting policy is to measure NCI at its acquisition-date fair value.

Required

- a) Show the journal entries required:
- in Bujang's accounts, to correct the investment in Lapuk Bhd,
 - in the group accounts, to adjust for the fair value of the freehold land at the acquisition date and to eliminate cost of investment against share of net assets; and
 - in the group accounts, to incorporate the post-acquisition revaluation of the freehold land.
- b) Prepare the consolidated statement of financial position of Bujang Bhd as at 31 December 20x5. Also, show the movements in group revaluation reserves and retained profits for the 20x5 financial year.

Calculation of goodwill on combination

	Total	Parent (60%)	NCI (40%)
	RM'000	RM'000	RM'000
Aggregate of:			
(a) (i) Consideration transferred	10,000	10,000	-
(ii) NCI at fair value	<u>6,667</u>	-	6,667
	16,667		
(b) Net assets acquired at fair value: (12,000+2,000+2,000)	<u>16,000</u>	<u>9,600</u>	<u>6,400</u>
Goodwill on combination	<u>667</u>	<u>400</u>	<u>267</u>

Solution 1.4

- (a) i) Journal entries to correct the investment in Lapuk Bhd:

Dr Investment in Lapuk	RM'000	RM'000
	8,000	
Cr Contributed share capital of Bujang		8,000

- ii) Journal entries to adjust for the fair value of the freehold land and to recognise goodwill at acquisition date:

Dr Freehold land account	RM'000	RM'000
	2,000	
Dr Goodwill on combination	667	
Cr Revaluation reserve (pre-acqn)		2,667

Journal entries to eliminate cost of investment against share of share capital and pre-acquisition reserves:

Dr Share capital of Lapuk	RM'000	RM'000
	7,200	
Dr Revaluation reserve (pre-acqn)	1,600	
Dr Retained profits (pre-acqn)	1,200	
Cr Investment in Lapuk		10,000

Journal entries to allocate net assets and goodwill at acquisition date to NCI:

Dr Share capital of Lapuk	RM'000	RM'000
	4,800	
Dr Revaluation reserve (pre-acqn)	1,067	
Dr Retained profits (pre-acqn)	800	
Cr NCI at acquisition date		6,667

- iii) Journal entries to incorporate post-acquisition revaluation of the freehold land:

Dr Freehold land	RM'000	RM'000
	4,000	
Cr NCI		1,600
Cr Revaluation reserve (post-acqn)		2,400

- (b)

Bujang Bhd Consolidated Statement of Financial Position As at 31 December 20x5		
	RM'000	RM'000
Property, plant and equipment:		
Freehold land (8,000 + 10,000)	18,000	
Other property, plant and equipment	<u>46,000</u>	64,000
Goodwill on combination		667
Current assets		<u>31,000</u>
Total Assets		<u>95,667</u>
Contributed share capital (24,000 + 8,000)		32,000
Revaluation reserves (5,000 + 2,400) (W2)		7,400
Retained profits (W1)		<u>13,600</u>
Equity attributable to owners of the parent		53,000
NCI (W3)		<u>10,667</u>
Total Equity		<u>63,667</u>
Long term loans		12,000
Current liabilities		<u>20,000</u>
Total Equity and Liabilities		<u>95,667</u>

Movements in Group Reserves

	Company RM'000	Subsidiary RM'000	Group RM'000
Revaluation Reserves:			
Balance brought forward	5,000	—	5,000
Share of surplus on revaluation of freehold land	—	2,400	2,400
Balance carried forward	<u>5,000</u>	<u>2,400</u>	<u>7,400</u>
Retained Profits:			
Balance brought forward	7,000	2,400	9,400
Retained profit for the year	<u>3,000</u>	<u>1,200</u>	<u>4,200</u>
Balance carried forward	<u>10,000</u>	<u>3,600</u>	<u>13,600</u>

Workings

1. Group retained profits consist of:

	RM'000
Bujang Bhd	10,000
Share of post-acquisition retained profits in Lapuk 60% × (8,000 – 2,000)	<u>3,600</u>
	<u>13,600</u>

2. Group revaluation reserves consist of:

	RM'000
Bujang Bhd	5,000
Share of post-acquisition revaluation reserves in Lapuk 60% × (6,000 – 2,000)	<u>2,400</u>
	<u>7,400</u>

3. NCI

	RM'000
Net assets of Lapuk per the accounts	20,000
Revaluation surplus in Lapuk	6,000
Goodwill on combination	<u>667</u>
Net assets after incorporation of surplus	26,667
NCI's share at 40%	<u>10,667</u>

The proof technique would derive the above figures as follows:

Interest in Lapuk Bhd

	Total	Parent (60%)		NCI (40%)
	RM'000	Pre-acqn	Post-acqn	RM'000
Share capital	12,000	7,200	—	4,800
Revaluation surplus:				
Pre-acquisition	2,000	1,200	—	800
Post-acquisition (balance)	4,000	—	2,400	1,600
Retained profits:				
Pre-acquisition	2,000	1,200	—	800
Post-acquisition (balance)	<u>6,000</u>	—	<u>3,600</u>	<u>2,400</u>
	26,000	9,600	6,000	10,400
Goodwill on combination	<u>667</u>	<u>400</u>	—	<u>267</u>
	<u>26,667</u>	10,000	<u>6,000</u>	<u>10,667</u>
Cost of investment		(10,000)		
Elimination		—		

The key point to remember in this Example is that the post-acquisition results of the Group include the parent's share of other comprehensive income in the subsidiary.

1.5.5 Potential Voting Rights

An entity may hold share warrants, share options or convertible securities that are exercisable, or convertible, into ordinary shares, or other similar instruments that have the potential, if exercised or converted, to give the entity voting power or reduce another party's voting power over the financial and operating policies of another entity (potential voting rights). MFRS 10 requires that the existence and effect of potential voting rights that are substantive, including potential voting rights held by another entity, are considered when assessing whether an entity has the power to direct the relevant activities of another entity.

In assessing whether potential voting rights contribute to control, the entity examines all facts and circumstances (including the terms of the exercise of the potential voting rights and any other contractual arrangements whether considered individually or in combination) that affect potential voting rights, except the intention and the financial ability to exercise or convert. The main consideration is that the potential voting rights must be substantive, such as when they are not so deeply out-of-the money (ie when the exercise price is substantially higher than the fair value).

The existence of potential voting rights is considered only for assessing control of an investee. However, in preparing consolidated financial statements, the

proportion of profit or loss and other comprehensive income allocated to the parent and NCIs is determined solely on the basis of existing ownership interests and does not reflect the possible exercise or conversion of potential voting rights and other derivatives, in the absence of other arrangements [see MFRS 10.B89].

Example 1.5

Alpha Bhd holds a 40% interest in the ordinary shares of Beta Bhd. At the acquisition date of 1 January 20x6, the balance of the retained profits of Beta Bhd was RM50 million. Cama Bhd also holds a 40% interest in the ordinary shares of Beta Bhd. At the acquisition date, the market price of the ordinary shares of Beta was RM2.50 per share.

Alpha Bhd also holds 90 million share warrants of Beta Bhd that are currently exercisable into 90 million ordinary shares at an exercise price of RM4 per share. The other shareholders of Beta Bhd hold 10 million share warrants of Beta Bhd with the same terms.

The draft statements of financial position of Alpha Bhd and Beta Bhd as at 31 December 20x8 are as follows:

	Alpha Bhd RM'000	Beta Bhd RM'000
Property, plant and equipment	600,000	500,000
Investment in Beta Bhd:		
– Ordinary shares of Beta	300,000	–
– Share warrants of Beta	90,000	–
Current assets	<u>210,000</u>	<u>200,000</u>
	<u>1,200,000</u>	<u>700,000</u>
Ordinary shares, issued at RM1 each	400,000	300,000
Share warrant reserves	–	100,000
Retained profits	300,000	200,000
Non-current liabilities	250,000	60,000
Current liabilities	<u>250,000</u>	<u>40,000</u>
	<u>1,200,000</u>	<u>700,000</u>

The fair value of the share warrants at the issue date was RM1 per warrant. Alpha Bhd and the other warrant holders have no intention to exercise their rights at this moment. Also, Alpha Bhd has no financial ability to exercise the warrants currently as its cash reserve is low.

At the acquisition date of Beta Bhd, a depreciable property was carried in its books at RM100 million whilst the fair value was RM200 million. No adjustment has been made in its accounts to reflect the fair value. On that date, the property had a remaining useful life of 50 years.

NCIs are measured at their acquisition-date fair value.

Required

- Explain how the share warrants should be considered in assessing whether Alpha Bhd has control over the financial and operating policies of Beta Bhd.
- Prepare the consolidated statement of financial position of Alpha Bhd as at 31 December 20x8.

Solution 1.5

- Alpha Bhd currently holds 120 million (or 40%) of the total 300 million ordinary shares of Beta Bhd. If all the 100 share warrants were exercised by the holders, Alpha Bhd's equity stake in Beta Bhd would be $(120m + 90m) / (300m + 100m)$ or 52.5%. This would enable it to hold more than 50% of the voting rights of Beta Bhd. Therefore, in this case, Alpha Bhd would most likely have control over the financial and operating policies of Beta Bhd. Note that in assessing whether the share warrants contribute to control, Alpha Bhd's intention and ability to exercise the warrants are ignored.
- When potential voting rights exists, MFRS 10 requires that the proportions of profit or loss and changes in equity allocated to the parent and NCIs are determined on the basis of present ownership interests and do not reflect the possible exercise or conversion of potential voting rights. In this case, Alpha Bhd should consolidate and allocate the results and net assets of Beta Bhd based on the present ownerships of 40% to parent and 60% to NCIs. Nonetheless, Alpha Bhd's investment in the share warrants shall be eliminated with its proportionate share of the share warrant reserve. The balance of the share warrant reserve attributable to share warrants held by other shareholders is classified as a component of NCIs.

Alpha Bhd
Consolidated Statement of Financial Position
As at 31 December 20x8

	RM'000
Property, plant and equipment $(600,000 + 500,000 + 100,000 - 6,000)$	1,194,000
Goodwill on combination (W1)	300,000
Current assets $(210,000 + 200,000)$	<u>410,000</u>
Total Assets	<u>1,904,000</u>
Ordinary shares, issued at RM1 each	400,000
Retained profits $[300,000 + 57,600 (W2)]$	<u>357,600</u>
Equity attributable to owners of the Parent	757,600
NCIs (W2)	<u>546,400</u>
Total Equity	1,304,000
Non-current liabilities $(250,000 + 60,000)$	310,000
Current liabilities $(250,000 + 40,000)$	<u>290,000</u>
Total Equity and Liabilities	<u>1,904,000</u>