	Port	Alfred
	$'000	$'000
Equity and liabilities		
Equity		
$1 Equity shares	200	100
Share premium	500	85
Retained earnings	2,900	331
	3,600	516
Non-current liabilities		
Loan from Port	–	2,300
Current liabilities		
Sundry	200	323
Total equity and liabilities	3,800	3,139

Notes

(a) Port has not accounted for the issue of its own shares or for the acquisition of the investment in Alfred.

(b) There has been no impairment in the value of the goodwill.

(c) It is the group policy to value the non-controlling interest at acquisition at its proportionate share of the fair value of the subsidiary's identifiable net assets.

Required

Prepare the income statement for the Port Group for the year ending 31 December 20X4 and a statement of financial position at that date.

Approaching the question

1. Establish the **group structure**, noting for how long Alfred was a subsidiary.
2. Adjust Port's statement of financial position for the issue of its own shares and the cost of the investment in Alfred.
3. Sketch out the **format** of the group income statement and statement of financial position, and then fill in the amounts for each company directly from the question. (Note, sub-totals are not normally needed when you do this.)
4. **Time apportion** the income, expenditure and taxation for the subsidiary acquired.
5. Calculate the **goodwill**.
6. Remember to time-apportion the non-controlling interest in Alfred.

33 Hillusion (2.5 6/03) 45 mins

In recent years Hillusion has acquired a reputation for buying modestly performing businesses and selling them at a substantial profit within a period of two to three years of their acquisition. On July 20X2 Hillusion acquired 80% of the ordinary share capital of Skeptik at a cost of $10,280,000. On the same date it also acquired 50% of Skeptik's 10% loan notes at par. The summarised draft financial statements of both companies are:

INCOME STATEMENTS: YEAR TO 31 MARCH 20X3

	Hillusion	Skeptik
	$'000	$'000
Sales revenue	60,000	24,000
Cost of sales	(42,000)	(20,000)
Gross profit	18,000	4,000
Operating expenses	(6,000)	(200)
Loan interest received (paid)	75	(200)
Profit before tax	12,075	3,600
Income tax expense	(3,000)	(600)
Profit for the year	9,075	3,000

STATEMENTS OF FINANCIAL POSITION: AS AT 31 MARCH 20X3

	Hillusion	Skeptik
	$'000	$'000
Assets		
Tangible non-current Assets	19,320	8,000
Investments	11,280	Nil
	30,000	8,000
Current assets	15,000	8,000
Total assets	45,600	16,000
Equity and liabilities		
Equity		
Ordinary shares of $1 each	10,000	2,000
Retained earnings	25,600	8,400
	35,600	10,400
Non-current liabilities		
10% loan notes	Nil	2,000
Current liabilities	10,000	3,600
Total equity and liabilities	45,600	16,000

The following information is relevant:

(i) The fair values of Skeptik's assets were equal to their book values with the exception of its plant, which had a fair value of $3·2 million in excess of its book value at the date of acquisition. The remaining life of all of Skeptik's plant at the date of its acquisition was four years and this period has not changed as a result of the acquisition. Depreciation of plant is on a straight-line basis and charged to cost of sales. Skeptik has not adjusted the value of its plant as a result of the fair value exercise.

(ii) In the post acquisition period Hillusion sold goods to Skeptik at a price of $12 million. These goods had cost Hillusion $9 million. During the year Skeptik had sold $10 million (at cost to Skeptik) of these goods for $15 million.

(iii) Hillusion bears almost all of the administration costs incurred on behalf of the group (invoicing, credit control etc). It does not charge Skeptik for this service as to do so would not have a material effect on the group profit.

(iv) Revenues and profits should be deemed to accrue evenly throughout the year.

(v) The current accounts of the two companies were reconciled at the year-end with Skeptik owing Hillusion $750,000.

(vi) The goodwill was reviewed for impairment at the end of the reporting period and had suffered an impairment loss of $300,000, which is to be treated as an operating expense.

(vii) Hillusion's opening retained earnings were $16,525,000 and Skeptik's were $5,400,000. No dividends were paid or declared by either entity during the year.

(viii) It is the group policy to value the non-controlling interest at acquisition at fair value. The directors valued the non-controlling interest at $2.5m at the date of acquisition.

Required

(a) Prepare a consolidated income statement and statement of financial position for Hillusion for the year to 31 March 20X3. **(20 marks)**

(b) Explain why it is necessary to eliminate unrealised profits when preparing group financial statements; and how reliance on the entity financial statements of Skeptik may mislead a potential purchaser of the company. **(5 marks)**

(Total = 25 marks)

Hillusron

1.7.X2

10280

80%

OSC	2000	
Ret	6150	8400 − 3000 + $\cancel{3}$/12 × 3000
FV Adj		FV Reserves 9350
plant	3200	
FVNA @ Acq 11350		

W1 Goodwill

	Group	NCI
cost	10280	2500
FVNA 80% × 11350 / 20% ~~80%~~ × 11350	9080	2270
Gw at Acq	1200	230
Imparment 300 × 80%	(240)	300 × 20% (60)
	960	170

W2 Reserves

	H	S
Per Accts	25600	8400
FV Adj ~~3200-600~~		3200
FV Dep $3.2m \times 1/4 \times 9/12$		(600)
UTP $3m \times 4/12$	(500)	
Updated	25100	11000

H	25100
Add GW Share Post Acq in S $80\%(11000-9350)$	1320
Less GW	(240)
	26180

NCI

FVNA m S

OSC 2[illegible]	2000	
Upd Res	11000	
	13000	
NCI @ 20%		2600
Unamort GW		170
		2770