Student Notes

Module A (December 2012)

Workshop Outline and Learning Methodologies

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Workshop 1			
1. Introduction	• Presentation • Group discussion		
2. Property related standards	• Case study • Group discussion	Ch. 4, 5, 6, 8 and 17	Pg. 1 – 22
3. Resolving accounting issues	• Case study • Group discussion	Ch. 8, 10, 14 and 15	Pg, 23 – 41
4. Wrap up	• Presentation • Group discussion		
Workshop 2			
5. Reboot	• Presentation • Group discussion		
6. Financial instruments	• Case study • Group discussion	Ch. 18 and 21	Pg. 1 – 13
7. Consolidation	• Case study • Group discussion	Ch. 27, 28, 29 and 30	Pg. 14 – 36
8. Leading a team and teamwork	• Group discussion		
9. Conclusion	• Presentation • Group discussion		

Financial instruments

Case study 1 – MTC

Maddox Trading Company (MTC) is the parent company of a group with diverse operations. All group companies have a financial year ended 30 September 2012.

MTC made an interest free, fixed term loan of HK$100,000 to its subsidiary Pappy Manufacturing Company (PMC) on 1 October 2011. The contractual terms of the loan contain that it will be repaid at par value on 30 September 2014. If PMC were to obtain a similar loan on commercial terms from an unrelated company, it would pay interest at 8%.

MTC has held its investment in PMC for several years and does not plan to dispose of its shareholding. MTC does not envisage any difficulties in PMC being able to repay the loan in 2014.

Required:

(i) Discuss how the loan should be initially recognised in MTC's individual financial statements.

(ii) Calculate the amounts to be recognised in MTC's individual financial statements in the year ended 30 September 2012.

(iii) Outline the disclosure requirements in respect of the loan.

(iv) Explain the accounting treatment for the loan in the MTC Group financial statements for the year ended 30 September 2012.

Discussion points

Financial instruments – Interest free loan

Case Study 1– MTC

What are the issues?

In the year ended 30 September 2012, MTC has made an interest free loan to a subsidiary. The matters to consider are:

1. How should the loan be initially measured and recognised in MTC's financial statements
2. How should the loan be measured subsequent to initial recognition in MTC's financial statements
3. The disclosure requirements needed in respect of the loan, and
4. The accounting treatment for the loan in the consolidated financial statements.

Which accounting standards should be used?

HKAS 32	*Financial instruments: Presentation*
HKAS 39	*Financial instruments: Recognition and measurement*
HKFRS 9	*Financial instruments*
HKFRS 7	*Financial instruments: Disclosures*
HKAS 24	*Related party disclosures*

What are the requirements of the accounting standards?

The definition of a *financial asset* includes the following: "a contractual right to receive cash or another financial asset from another entity".

(HKAS 32 paragraph 11, LP chapter 18 section 1.2)

Initial recognition

An entity shall recognise a financial asset in its statement of financial position when, and only when, the entity becomes party to the contractual provisions of the instrument.

(HKFRS 9 paragraph 3.1.1, LP chapter 18 section 3.2)

At initial recognition, an entity shall measure a financial asset or financial liability at its fair value, plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, *transaction costs* that are directly attributable to the acquisition or issue of the financial asset or financial liability.

(HKFRS 9 paragraph 5.1.1, LP chapter 18 section 4.1)

The fair value of a financial instrument on initial recognition is normally the transaction price (i.e. the fair value of the consideration given or received). However, if part of the consideration given or received is for something other than the financial instrument, the fair value of the financial instrument is estimated, using a valuation technique. For example, the fair value of a long-term loan or receivable that carries no interest can be estimated as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating. Any additional amount lent is an expense or a reduction of income unless it qualifies for recognition as some other type of asset.

(HKAS 39 paragraph AG64, LP chapter 18 section 4.2)

Subsequent measurement

After initial recognition, an entity shall measure a financial asset at fair value or amortised cost.

This classification is made on the basis of both:

(a) the entity's business model for managing the financial asset, and

(b) the contractual cash flow characteristics of the financial asset.

A financial asset is classified as measured at amortised cost where:

(a) the objective of the business model within which the asset is held is to hold assets in order to collect contractual cash flows, and

(b) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding.

(HKFRS 9 paragraph 5.2.1, LP chapter 18 section 3.2.1, 4.2)

Disclosure

An entity shall disclose the following items of income, expense, gains or losses either in the statement of comprehensive income or in the notes: total interest income and total interest expense (calculated using the effective interest method) for financial assets or financial liabilities that are not at fair value through profit or loss.

(HKFRS 7 paragraph 20, LP chapter 18 section 7.4)

A party is related to an entity if it directly, or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with, the entity (this includes parents, subsidiaries and fellow subsidiaries).

(HKAS 24 paragraph 9, LP chapter 21 section 1.3)

If there have been transactions between related parties, an entity shall disclose the nature of the related party relationship as well as information about the transactions and outstanding balances necessary for an understanding of the potential effect of the relationship on the financial statements. At a minimum, disclosures shall include:

(a) the amount of the transactions;

(b) the amount of outstanding balances and:

  (i) their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and

  (ii) details of any guarantees given or received;

(c) provisions for doubtful debts related to the amount of outstanding balances; and

(d) the expense recognised during the period in respect of bad or doubtful debts due from related parties.

(HKAS 24 paragraph 18, LP chapter 21 section 1.4)

How to apply the standards to the case

(i) **Initial recognition**

Fixed term inter-company loans meet the definition of a financial asset in the accounts of the lender, in this case the parent company MTC. According to HKAS 39, the amount of the loan should be recognised initially at fair value.

As there is generally no commercial market for an inter-company loan, its fair value is estimated using its present value. This is determined by discounting the future loan repayments using a rate based on the rate the borrower would pay to an unrelated lender for a loan with similar terms (such as the amount, period to redemption, and collateral).

The amount to be initially recognised as a financial asset is determined as follows:

HK$100,000 × 0.794 = HK $79,400 (0.794 is the 3 year discount factor for 8%)

As MTC has paid HK $100,000 in cash to its subsidiary, the difference of HK$20,600 needs to be accounted for. Because the loan is from a parent to a subsidiary, it would be inappropriate to recognise a gain or loss for the discount or premium in MTC's profit or loss. In substance this is an additional contribution or investment by the parent in the subsidiary. Contributions from and distributions to "equity participants" do not meet the basic definition of income or expenses as given in the Framework document, and so the HK $20,600 should be recorded as part of the investment in subsidiary in MTC's financial statements.

The entry would be recorded as follows:

DEBIT	Investment in PMC	HK $20,600	
DEBIT	Financial asset	HK $79,400	
CREDIT	Cash		HK $100,000

(ii) **Subsequent measurement**

Subsequent to initial measurement, the loan should be measured at amortised cost, using the effective interest method. This is in accordance with HKFRS 9 which requires that financial assets that give rise to contractual cash flows and which are held for that purpose should be measured at amortised cost.

Amortised cost involves "unwinding" the discount such that, at repayment, the carrying value of the loan equals the amount to be repaid. The unwinding over the 3 year period of the loan results in the following amounts to be recognised (HK$):

	Financial asset b/d	8% interest	Financial asset c/d
y/e 2012	79,400	6,352	85,752
y/e 2013	85,752	6,860	92,612
y/e 2014	92,612	7,388 (bal. fig.)	100,000

The unwinding of the discount should be reported as interest income, and added to the amount of the financial asset each year.

Therefore in the year ended 30 September 2012, HK $6,352 should be recognised as follows:

DEBIT	Financial asset	HK $6,352	
CREDIT	Interest income		HK $6,352

(iii) **Disclosure requirements**

There are two relevant disclosure issues to discuss – those relating to the financial asset itself, and those relating to the fact that the loan is a related party transaction.

Disclosure relating to the financial asset

HKFRS 7 requires disclosure in relation to financial instruments, especially those giving rise to significant concentration of risk. In this case there does not appear to be a specific risk attached to the loan, as it is envisaged that PMC will be able to repay the loan at redemption date.

HKFRS 7 also requires disclosure, either on the face of the financial statements, or in the notes, of interest received that has been calculated based on the effective interest method. This is the case for the loan to PMC, and therefore disclosure must be made of the amount and how it has been calculated.

Related party disclosures

HKAS 24 requires that disclosures are made in the notes to the financial statements in respect of transactions between related parties. MTC and PMC are related parties because PMC is under the control of MTC and therefore in both of their individual financial statements there should be disclosure relating to the loan made by the parent company.

In MTC's financial statements there should be disclosure of the amount of the loan, and the amount outstanding at the year end. The terms and conditions of the loan should be described in order for the non-commercial aspect of the loan to be understood by the users of the financial statements.

(iv) **Accounting treatment at Group level**

At Group level the loan is an inter-company transaction, and should be eliminated on consolidation. The loan (measured at HK $85,752 at 30 September 2012 as calculated above) is a financial asset in the financial statements of MTC, and the corresponding liability in PMC should be cancelled against each other. Similarly, the interest received (calculated above as HK $ 6,352) in MTC's statement of profit or loss would be cancelled against the corresponding finance charge in PMC's financial statements. Finally, the HK $20,600 recognised as part of the cost of investment in MTC's accounting records would be cancelled against the corresponding equity figure in PMC's financial statements. (In PMC's financial statements there would be, after adjusting to correct the treatment in accordance with HKAS 39, an equity element of HK $20,600, being the difference between the loan at fair value in PMC's financial statements and the cash paid by MTC to PMC.)

Recommendation / Justification

MTC recognises the following in its individual financial statements as at 30 September 2012:

Statement of financial position	**HK$**	**HK$**
Non-current assets		
Investment in subsidiary		20,600
Financial asset		85,752
Statement of profit or loss		
Interest receivable	6,352	

Notes to the financial statements (extract to illustrate content in relation to the loan):

A loan of HK$ 100,000 was made to PMC, a subsidiary of MTC on 1 October 2011. MTC is a related party of PMC, because it owns a controlling interest in PMC.

The loan will be repaid on 30 September 2014, and it is interest free.

For the purpose of preparing the financial statements, MTC recognises notional interest receivable on the loan of HK$ 6,352 in the year ended 30 September 2012. This has been calculated using the effective interest method, using a notional interest rate of 8% applied to the outstanding capital balance. 8% is the interest that would be applicable for a similar loan with an unconnected party.

MTC's statement of financial position includes a financial asset of HK$ 85,752 at 30 September 2012, representing the fair value (present value) of the amount receivable from PMC.

Key Learning Points

1. *Interest free loans should be recognised at fair value, which is the present value of future cash inflows in respect of the loan.*
2. *Interest should be calculated using the effective interest (amortised cost) method, with the interest rate being the rate applicable to a loan with similar terms with an unconnected party.*
3. *Disclosures are needed under both HKFRS 7 and HKAS 24 to ensure that users of the financial statements understand the nature of the loan and the non-commercial aspects of it.*
4. *At Group level the transaction is cancelled out, with the accounting entries in the parent company being cancelled against the mirror image accounting entries in the subsidiary.*

Financial instruments

Case study 2 – DCS

Dingle Crag Sutcliffe Limited (DCS) is a Hong Kong based manufacturing company. The company has a long term strategy of expanding its manufacturing operations in order to offer a wider variety of goods to an enlarged market. In order to fund this expansion, the company made an issue of convertible bonds on 1 October 2011.

On this date 20,000 bonds of HK$1,000 each were issued at par. Each bond is convertible at the option of the holder into 450 HK$1 ordinary shares between 1 October 2015 and 30 September 2016 ('the conversion period'). Alternatively the bonds may be redeemed at par. Any bonds which remain unconverted at 30 September 2016 will automatically be redeemed. The coupon rate attached to the bonds is 6% and the market rate of interest on a similar non-convertible bond is 9%. Interest is paid annually in arrears up to and including 30 September 2015.

At the date of issue DCS anticipates that half of the bondholders will convert to ordinary shares and the other half will redeem for cash after the minimum four year term.

DCS maintains a 'Convertible bond – equity' account within the equity section of the statement of financial position for as long as such instruments are outstanding, after which the balance is transferred to form part of share premium. At 1 October 2011 the balance on DCS's share capital account is HK$18 million and the balance on share premium is HK$27million.

Required:

(i) **Discuss the accounting treatment of the convertible bond from DCS's perspective.**

(ii) **Calculate amounts to be recognised in the financial statements of DCS in respect of the convertible bond in the year ended 30 September 2012 and subsequent years, assuming that all bondholders convert their bonds to ordinary shares at the earliest opportunity.**

(iii) **List the disclosures required by HKFRS 7 in respect of the convertible bond.**

Discussion points

Financial instruments – Convertible bond

Case Study 2 – DCS

What are the issues?

DCS has issued convertible bonds during the financial year in order to finance an upcoming expansion plan.

Students must:

(a) Consider the accounting treatment required to reflect the issue and subsequent measurement of the convertible bonds.

(b) Calculate amounts for inclusion in the financial statements of DCS for the year ended 30 September 2012 and subsequent years until the bonds are either converted or redeemed.

(c) List the disclosures required by HKFRS 7 in respect of the convertible bonds.

Which accounting standards should be used?

HKAS 32	*Financial Instruments: Presentation*
HKFRS 7	*Financial Instruments: Disclosures*
HKFRS 9	*Financial Instruments*

What are the requirements of the accounting standards?

An entity shall recognise separately the components of a financial instrument that (a) creates a financial liability of the entity and (b) grants an option to the holder of the instrument to convert it into an equity instrument of the entity. For example a bond convertible by the holder into a fixed number of ordinary shares is a compound financial instrument comprising a financial liability and an equity instrument.

(HKAS 32.29, LP Chapter 18, Section 2.4.4)

Classification of the liability and equity components of a convertible instrument is not revised as a result of a change in likelihood that the conversion option will be exercised. The entity's contractual obligation to make future payments remains outstanding until it is extinguished through conversion, maturity of the instrument or some other transaction.

(HKAS 32.30, LP Chapter 18, Section 2.4.4)

The issuer of a bond convertible into ordinary shares should first determine the carrying amount of the liability component by measuring the fair value of a similar liability that does not have an associated equity component. The carrying amount of the equity instrument is then determined by deducting the fair value of the financial liability from the fair value of the compound financial instrument as a whole.

(HKAS 32.32, LP Chapter 18, Section 2.4.4)

On initial recognition the fair value of the liability component of a compound instrument is the present value of the contractually determined stream of future cash flows discounted at the rate of interest applied by the market to instruments of comparable credit status and providing substantially the same cash flows, on the same terms, but without the conversion option.

(HKAS 32.AG31, LP Chapter 18, Section 2.4.4)

Financial liabilities are classified as subsequently measured at amortised cost using the effective interest method unless they are financial liabilities at fair value through profit or loss ie they are either held for trading or designated as at fair value through profit or loss.

(HKFRS 9.4.2.1, LP Chapter 18, Section 3.2.2)

The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating the interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial instrument.

(HKAS 39.9, LP Chapter 18, Section 4.3.1)

On conversion of a convertible instrument at maturity, the entity derecognises the liability component and recognises it as equity. The original equity component remains as equity, although it may be transferred from one line item to another within equity. There is no gain or loss on conversion at maturity.

(HKAS 32.AG32)

Information that enables users of the financial statements to evaluate the significance of financial instruments for financial position and performance should be disclosed, including:

- The carrying amount of financial liabilities measured at amortised cost

  (HKFRS 7.8)

- Net gains or net losses on financial liabilities measured at amortised cost

  (HKFRS 7.20)

- Total interest expense calculated using the effective interest method

  (HKFRS 7.20)

- The fair value of each class of financial assets and liabilities

  (HKFRS 7.25)

Qualitative and quantitative data which enables users to assess the nature and extent of risks arising from financial instruments

(HKFRS 7.31-32A)

(HKFRS 7, LP Chapter 18 Section 7)

How to apply the standards to the case

(a) ***Initial recognition***

In the first instance the proceeds of the convertible bond issue of HK$20m (20,000 x HK$1,000) must be split between the liability and equity component. The fair value of the liability component is established by discounting the future cash flows associated with the bonds to the present value using a rate of interest that would apply to similar bonds without conversion rights:

	HK$
PV of interest HK$1.2m (HK$20m × 6%) payable annually in arrears for four years:	
Y1: HK$1.2m × 0.91743 (w)	1,100,916
Y2: HK$1.2m × 0.84168 (w)	1,010,016
Y3: HK$1.2m × 0.77218 (w)	926,616
Y4: HK$1.2m × 0.70843 (w)	850,116
	3,887,664
PV of principal HK$20m payable at the end of four years:	
HK$20m × 0.70843 (w)	14,168,600
Liability component	18,056,264

Working: Discount factors

4 years	$1/1.09^4$	=	0.70843
3 years	$1/1.09^3$	=	0.77218
2 years	$1/1.09^2$	=	0.84168
1 year	1/1.09	=	0.91743

The equity component is therefore the balance of the proceeds on issue of HK$1,943,736 (HK$20m - HK$18,056,264).

The issue is recorded by (HK$):

DEBIT	Cash	20,000,000	
CREDIT	Convertible bond – liability		18,056,264
	Convertible bond – equity		1,943,736

To recognise the issue of convertible debt on 1 October 2011.

Subsequent accounting

Subsequent to initial recognition:

- The liability is 'wound up' using the effective interest rate to redemption value at 1 October 2015, being the earliest possible redemption date / start of the conversion period.
- The equity component does not change in value.

The change in value of the liability from the date of issue of the bonds to the start of the conversion period is shown in the following table (HK$):

	Liability b/f	Interest charge at 9%	Interest paid at 6%	Liability c/f
y/e 30.9.12	18,056,264	1,625,064	(1,200,000)	18,481,328
y/e 30.9.13	18,481,328	1,663,319	(1,200,000)	18,944,647
y/e 30.9.14	18,944,647	1,705,018	(1,200,000)	19,449,665
y/e 30.9.15	19,449,665	1,750,470	(1,200,000)	20,000,000*

*rounding difference of HK$135

The interest charge, interest paid and amortisation of the liability is accounted for in each of the years of the term of the debt as follows (HK$):

DEBIT	Interest charge (SOCI)	1,625,064	
CREDIT	Cash (interest paid)		1,200,000
	Convertible bond - liability		425,064

To recognise the interest charge in the year ended 30 September 2012.

DEBIT	Interest charge (SOCI)	1,663,319	
CREDIT	Cash (interest paid)		1,200,000
	Convertible bond - liability		463,319

To recognise the interest charge in the year ended 30 September 2013.

DEBIT	Interest charge (SOCI)	1,705,018	
CREDIT	Cash (interest paid)		1,200,000
	Convertible bond - liability		505,018

To recognise the interest charge in the year ended 30 September 2014.

DEBIT	Interest charge (SOCI)	1,750,470	
CREDIT	Cash (interest paid)		1,200,000
	Convertible bond - liability		550,470

To recognise the interest charge in the year ended 30 September 2015.

On conversion

Assuming that all bondholders convert their bonds to ordinary shares at the earliest opportunity, 9 million HK$1 ordinary shares (20,000 x 450 shares) will be issued on 1 October 2015.

This issue extinguishes the liability and therefore the balance on the 'convertible bond – liability' account is transferred to the share capital and share premium accounts.

This is recorded by (HK$):

DEBIT	Convertible bond – liability	20,000,000	
CREDIT	Share capital		9,000,000
	Share premium		11,000,000

To recognise the conversion of the bonds to ordinary shares.

In addition, the balance on the 'convertible bond – equity' account should be transferred to the share premium account by:

DEBIT	Convertible bond – equity	1,943,736	
CREDIT	Share premium		1,943,736

To transfer the equity element of the convertible bond to the share premium account.

Recommendation / Justification

(b) ***Statement of financial position for DCS as at 30 September***

	2012 HK$	2013 HK$	2014 HK$	2015 HK$	2016 HK$
Equity					
Convertible bond - equity	1,943,736	1,943,736	1,943,736	1,943,736	-
Share capital	18,000,000	18,000,000	18,000,000	18,000,000	27,000,000
Share premium	27,000,000	27,000,000	27,000,000	27,000,000	39,943,736
Non-current liabilities					
Convertible bond	18,481,328	18,944,647	19,449,665	20,000,000	-

Statement of comprehensive income for DCS for the year ended 30 September

	2012 HK$	2013 HK$	2014 HK$	2015 HK$	2016 HK$
Finance costs	1,625,064	1,663,319	1,705,018	1,750,470	-

In addition to the amounts disclosed in the financial statements and shown above, DCS should disclose the following in the notes to its financial statements:

- The fair value of the liability
- Qualitative data including:
  - Exposures to different types of risk and how they arise
  - Objectives, policies and processes for managing the risk
  - Methods for monitoring the risk
  - Any changes in these since the previous period
- Quantitative data including:
  - Summary quantitative data about the exposure to risk at the period end
  - A maturity analysis of non-derivative financial liabilities
  - A description of how liquidity risk in relation to non-derivative financial liabilities is managed
  - A sensitivity analysis for market risk
  - Concentrations of risk if not apparent from other disclosures.

Key Learning Points

1. The proceeds of a convertible bond are split between a liability and equity component.
2. The liability component is initially measured at the present value of future cash flows associated with the bond, discounted at the rate of interest that would apply to similar bonds without conversion rights.
3. The equity component is initially measured as the residual of proceeds raised.
4. The liability element is subsequently wound up to redemption value using the effective interest rate; the equity component does not change in value.
5. If conversion occurs, the balance on the liability account is transferred to the share capital and share premium accounts and the balance on the equity account is transferred to the share premium account.

What are the issues?

Holloway has owned 100% of Thomson for a number of years. During the current accounting period, Holloway acquired 75% of Russell.

The consolidated statement of financial position must be prepared for the group, and the following issues considered:

(a) The non-controlling interest is to be measured as a proportion of the net assets of the acquiree.

(b) A fair value adjustment must be made to Russell's inventory balance for consolidation purposes.

(c) Thomson has sold goods to Holloway during the period, resulting in a year end intercompany balance and inventory balance.

Which accounting standards should be used?

HKFRS 3 (Revised)	*Business Combinations*
HKFRS 10	*Consolidated Financial Statements*

What are the requirements of the accounting standards?

A parent that controls one or more subsidiaries should present consolidated financial statements.

(HKFRS 10.2, LP Chapter 27 Section 2.2)

The assets and liabilities of parent and subsidiary are added together on a line by line basis, eliminating the investment in subsidiary shown in the parent's statement of financial position and any intercompany items.

(HKFRS 10.B86, LP Chapter 27 Section 2.3.1, 2.3.2)

Goodwill arising in a subsidiary acquired in a single transaction is calculated as the excess of consideration transferred plus the non-controlling interest at the acquisition date over the fair value of the net assets of the subsidiary on the acquisition date. It is included in the consolidated statement of financial position as an intangible asset.

(HKFRS 3.32, LP Chapter 27 Section 4.3.4)

The non-controlling interest is measured at the acquisition date either at fair value or as a proportion of the fair value of the net assets of the acquiree. It is subsequently measured at this amount plus the non-controlling interest share of post acquisition movement in reserves and is included in the equity section of the consolidated statement of financial position.

(HKFRS 3.19, LP Chapter 27 Section 5.2)

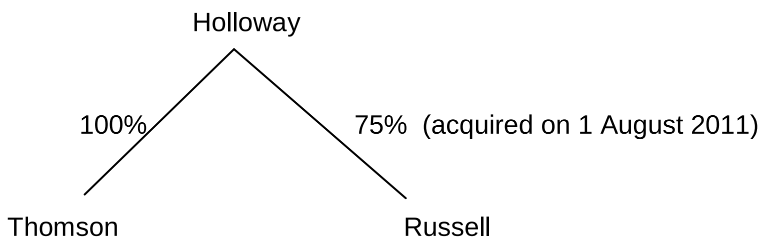
How to apply the standards to the case

Consolidation

The following approach should be taken in answering the requirement:

1. Set up a working schedule and insert the individual company statement of financial position information provided in the case study
2. Add across each line item to produce totals for each in the fourth column of the working schedule
3. Ensure that you understand the group structure by drawing a structure diagram, noting the date of any mid year acquisitions (W1)
4. Calculate the net assets of each company at the acquisition date and reporting date, taking into account any fair value adjustments (W2)
5. Using the net assets at the acquisition date from (W2), calculate goodwill arising on the acquisition of each company (W3), and record the associated journal in the fifth and sixth columns of the working schedule
6. Calculate the post acquisition profits in Russell and reallocate the relevant proportion to the non-controlling interest (W4)
7. Cancel the intercompany balances (W5)
8. Adjust for the unrealised profit in inventory (W5)
9. Cast the working schedule line by line in order to complete the consolidation.

(W1) Group structure



(W2) Net assets at acquisition

The fair value of the net assets of the subsidiary is calculated at the acquisition date for inclusion in the goodwill calculation and at the reporting date in order to calculate post acquisition movements in reserves (NCI share) for inclusion in NCI (Russell only)

Thomson	Net assets at acquisition	Net assets at reporting date
	HK$000	
Share capital	10,000	
Retained earnings	62,500	
	72,500	

Russell		
	HK$000	HK$000
Share capital	18,000	18,000
Retained earnings*	115,000	118,000
Fair value adjustment for inventory	1,600	1,600
	134,600	137,600

Retained earnings of Russell at acquisition: 118,000 – (2/12 x 18m) = 115,000

(W3) (i) Goodwill on acquisition - Thomson

	HK$000
Cost of investment	83,000
Net assets at acquisition (W2)	(72,500)
Goodwill	10,500

Journal for initial recognition of goodwill (HK$000)

DEBIT	Share capital	10,000	
DEBIT	Retained earnings	62,500	
DEBIT	Goodwill	10,500	
CREDIT	Cost of investment in Thomson		83,000

(W3) (ii) Goodwill on acquisition - Russell

	HK$000
Cost of investment	112,000
Non-controlling interest 25% x HK$134,600 (W2)	33,650
	145,650
Net assets at acquisition (W2)	(134,600)
Goodwill	11,050

Journal for initial recognition of goodwill (HK$000)

DEBIT	Share capital	18,000	
DEBIT	Retained earnings	115,000	
DEBIT	Inventory	1,600	
DEBIT	Goodwill	11,050	
CREDIT	Cost of investment in Russell		112,000
CREDIT	Non-controlling interest		33,650

(W4) Non-controlling interest in Russell

25% of post acquisition profits in Russell must be allocated to the non-controlling interest in net assets. Post acquisition profits are HK$3 million (137,600 – 134,600 (W2)), therefore (HK$000):

DEBIT	Retained earnings 25% x 3m	750	
CREDIT	Non-controlling interest		750

(W5) Intercompany trading

(i) The intercompany receivable account in Thomson and payable account in Holloway must be cancelled (HK$000):

DEBIT	Trade payables - Holloway	5,500	
CREDIT	Trade receivables - Thomson		5,500

(ii) There is an unrealised profit in inventory of HK$2.4million (20% x HK$12m). This is eliminated from inventory of Holloway and profit in Thomson, the selling company (HK$000):

DEBIT	Retained earnings	2,400	
CREDIT	Inventory		2,400

Consolidated statement of financial position at 30 September 2011

	Holloway	Thomson	Russell	Total	(W3) (i)	(W3) (ii)	(W4)	(W5) (i)	(W5) (ii)	Consolidated
	HK$000	HK$000	HK$000	HK$000	HK$000	HK$000	HK$000	HK$000	HK$000	HK$000
Property, plant and equipment	263,210	97,650	147,650	508,510						508,510
Intangible assets	80,000	-	-	80,000						80,000
Goodwill	-	-	-	-	10,500	11,050				21,550
Investment in Thomson	83,000	-	-	83,000	(83,000)					-
Investment in Russell	112,000	-	-	112,000		(112,000)				-
	538,210	97,650	147,650	783,510						610,060
Inventories	98,700	26,140	45,210	170,050		1,600			(2,400)	169,250
Trade receivables	27,340	12,700	34,330	74,370				(5,500)		68,870
Cash	-	3,210	10,870	14,080						14,080
	126,040	42,050	90,410	258,500						252,200
	664,250	139,700	238,060	1,042,010						862,260
Ordinary share cap	40,000	10,000	18,000	68,000	(10,000)	(18,000)				40,000
Retained earnings	384,270	98,390	118,000	600,660	(62,500)	(115,000)	(750)		(2,400)	420,010
	424,270	108,390	136,000	668,660						460,010
Non controlling interest	-	-	-	-		33,650	750			34,400
										494,410
Deferred tax liability	35,320	8,760	12,860	56,940						56,940
Bank loan	100,000	-	40,000	140,000						140,000
	135,320	8,760	52,860	196,940						196,940
Trade payables	37,890	16,740	39,120	93,750				(5,500)		88,250
Income tax payable	52,130	4,440	4,650	61,220						61,220
Accrual	13,100	1,370	5,430	19,900						19,900
Overdraft	1,540	-	-	1,540						1,540
	104,660	22,550	49,200	176,410						170,910
	664,250	139,700	238,060	1,042,010						862,260

Consolidation

Additional information 1

On 1 October 2011, Holloway acquired a 40% shareholding in another company, The Dobson Company Limited ('Dobson'), at a cost of HK$114million. The acquisition was partly financed by a share issue and partly by way of a bank loan.

Dobson is a distribution company, set up by one of Holloway's competitors, Moorfield, a number of years ago. Moorfield has recently suffered losses as a result of poor strategic planning, and over the last year has sold tranches of Dobson off in order to raise cash. The shareholders of Dobson are now made up as follows:

Holloway	40%
Briggate (an unrelated company)	25%
Moorfield	25%
Individual investors	10%

Decisions about relevant activities require approval by 65% of shareholders. There is no agreement in place between any of the shareholders to agree on relevant activities.

Since investing in Dobson, Holloway has transferred 75% of its distribution requirements to the company, and in order to integrate the Holloway business into Dobson's operations, has seconded a number of management personnel to the company.

Dobson paid an interim dividend of HK$5million in respect of the year ended 30 September 2012 on 8 April 2012.

Dobson's financial statements for the year ended 30 September 2012 are as follows:

Statement of financial position	HK$000
Non-current assets	
Property, plant and equipment	226,500
Current assets	
Trade receivables	43,200
Cash	58,000
	101,200
	327,700
Equity	
HK$1 ordinary share capital	15,000
Retained earnings	195,060
Revaluation reserve	30,000
	240,060
Non-current liabilities	
Deferred tax liability	12,870
Provision	350
Finance lease obligation	4,150
	17,370

Current liabilities	
Trade payables	40,030
Finance lease obligation	12,900
Income tax payable	5,120
Accrual	12,220
	70,270
	327,700

Statement of comprehensive income	HK$000
Revenue	342,000
Cost of sales	(178,000)
Gross profit	164,000
Administration expenses	(122,485)
Operating profit	41,515
Finance costs	(1,800)
Profit before tax	39,715
Tax	(5,340)
Profit for the year	34,375
Other comprehensive income	
Items that will not be recycled to profit, net of tax effect	
Gain on property revaluation	12,000
Total comprehensive income for the year	46,375

Required:

(a) **Discuss how the investment in Dobson should be treated in the Holloway Group accounts in the year ended 30 September 2012.**

(b) **Calculate amounts to be included in the Holloway Group accounts in respect of Dobson in the year ended 30 September 2012.**

Discussion points

Consolidation

Additional information 1

What are the issues?

Holloway acquires 40% of another entity, Dobson on the first day of the financial year ended 30 September 2012. Students must:

(a) determine whether the investment is an associate, joint operation or joint venture

(b) based on their conclusion, use the financial information provided in the case study to calculate amounts to be included in the Holloway Group financial statements for the year ended 30 September 2012.

Which accounting standards should be used?

HKFRS 11 Joint Arrangements

HKAS 28 (2011) Investments in Associates and Joint Ventures

What are the requirements of the accounting standards?

An associate is an entity over which an investor has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies.

(HKAS 28.3, LP Chapter 29, Section 1.1)

Significant influence is assumed where an entity holds 20% or more of the voting power of another entity, unless it can be demonstrated that this is not the case. The existence of significant influence is usually evidenced by:

1. representation on the board of directors
2. participation in policy making processes
3. material transactions between an investor and investee
4. interchange of managerial personnel
5. provision of essential technical information.

(HKAS 28.5-6, LP Chapter 29, Section 1.1.1)

A joint arrangement is an arrangement of which two or more parties have joint control.

A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement.

A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

(HKFRS 11 Appendix A, LP Chapter 29, Section 2.1)

Joint control is the contractually agreed sharing of control of an arrangement which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control. The relevant activities are those activities that significantly affect the returns of the arrangement. Where there is no contractual arrangement to establish joint control or where unanimous consent is not required to make decisions, there is no joint control. In addition:

- Where joint control exists, no single party controls the arrangement on its own
- A party with joint control of an arrangement can prevent any of the other parties from controlling the arrangement
- An arrangement can be a joint arrangement even if not all parties have joint control

(HKFRS 11.7-13, LP Chapter 29, Section 2.1.1)

Contractual arrangements can be evidenced in a number of different ways. They may be written documents, documented discussions or detailed within the articles or by-laws of the joint arrangement. Agreements deal with matters such as the purpose and duration of the joint arrangement, how the members of the governing body are appointed, the decision making process and how the parties share assets, liabilities, revenues and expenses or profit or loss of the joint arrangement.

(HKFRS 11.B2-4, LP Chapter 29, Section 2.1.1)

An investment in an associate is accounted for using the equity method in accordance with HKAS 28 (2011) *Investments in Associates and Joint Ventures.* Under the equity method, an investment in associate or joint venture is initially recognised at cost, and the carrying amount is increased or decreased thereafter to recognise the investor's share of the profit or loss and other comprehensive income of the investee after the acquisition date. Distributions received from the investee reduce the carrying amount. The investor's share of profit or loss of the investee is recognised in the investor's profit or loss and their share of changes in the investee's other comprehensive income is recognised in other comprehensive income.

(HKAS 28.10, LP Chapter 29, Section 1.3,2.3.3)

How to apply the standards to the case

(a) *Does joint control exist?*

Joint control is defined by HKFRS 11 as the contractually agreed sharing of control of an arrangement which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

In this case, decisions about the relevant activities require approval by 65% of shareholders. Holloway could achieve this percentage by voting together with either Briggate or Moorfield, therefore together with one of these entities, Holloway has collective control over the arrangement.

However, as there is no agreement between either Holloway and Briggate or Holloway and Moorfield, there is no joint control, and this is not a joint arrangement within the scope of HKFRS 11.

Does significant influence exist?

Given that joint control does not exist, the question of whether Holloway has significant influence over Dobson should be addressed.

Holloway holds 40% of the shares in Dobson, and according to HKAS 28 it is therefore presumed that significant influence exists.

Further indicators of significant influence are:

1. The fact that 75% of Holloway's distribution requirement is supplied by Dobson, assuming that this is considered to be a material transaction

2. The fact that Holloway has seconded a number of personnel to Dobson may be interpreted as the interchange of managerial personnel.

Therefore it can be concluded that Dobson is an associate of Holloway.

(b) *Accounting treatment*

Equity accounting must be applied. The investment in Dobson is held in the Holloway Group consolidated statement of financial position as follows:

	HK$000
Cost of investment	X
Plus group share of post-acquisition profits	X
Plus group share of post-acquisition OCI	X
Less dividends paid by Dobson to Holloway	(X)
	X
Less impairment	(X)
	X

measured at cost plus the group share of profits and other comprehensive income made by Dobson since acquisition less any dividends paid from Dobson to the group less any impairment losses.

On 1 October 2011, the investment is initially recorded at cost (HK$000):

DEBIT	Investment in associate	114,000	
CREDIT	Cash		114,000

To record the investment in Dobson at cost.

At 30 September 2012, the group share of Dobson's profits and other comprehensive income in the year are recognised.

	HK$000
Profit (40% x 34,375)	13,750
Other comprehensive income (40% x 12,000)	4,800
	18,550

The journal required to recognise this in the consolidated financial statements is (HK$000):

DEBIT	Investment in associate (SOFP)	18,550	
CREDIT	Share of profit of associates (SOCI)		13,750
	Share of gain on property revaluation of associate (SOCI)		4,800

In the consolidated statement of financial position, group share of the associate's profit is accumulated in retained earnings and group share of the associate's gain on property revaluation is accumulated in a revaluation reserve.

The investment in the associate must also be adjusted for the interim dividend paid by Dobson in April 2012. Group share is HK$2million (40% x 5m) therefore (HK$000):

DEBIT	Investment income	2,000	
CREDIT	Investment in associate		2,000

At the period end the investment in Dobson is therefore stated at:

	HK$000
Cost	114,000
Group share of profits since acquisition	13,750
Group share of other comprehensive income since acquisition	4,800
Dividend received	(2,000)
	130,550

Recommendation / Justification

Consolidated statement of financial position for the Holloway Group as at 30 September 2012

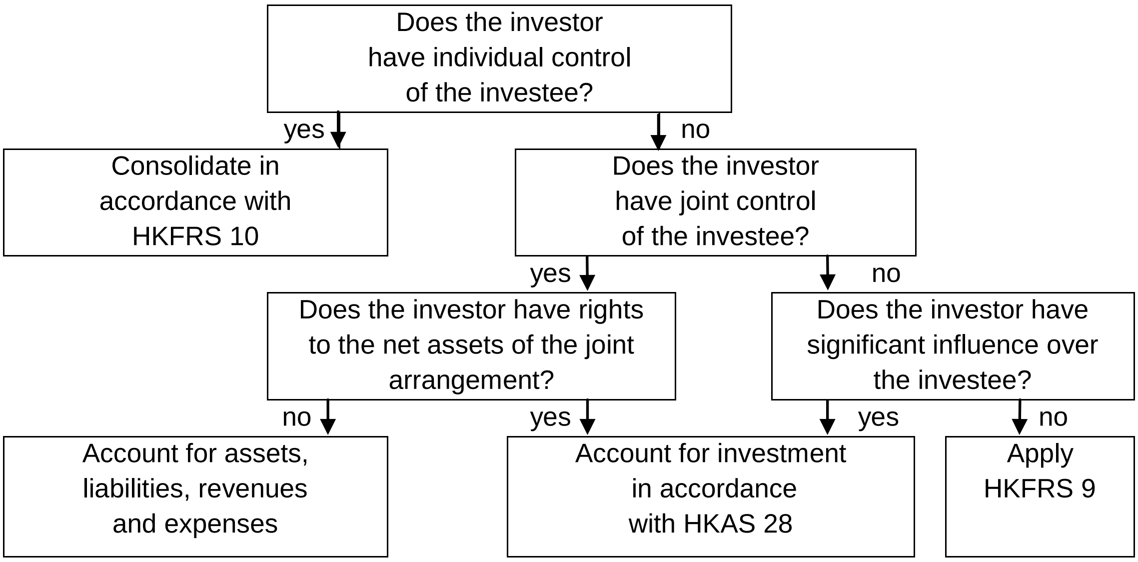
	HK$000
Investment in associate	130,550

Consolidated statement of comprehensive income for the Holloway Group for the year ended 30 September 2012

	HK$000
Share of profit of associate	13,750
Other comprehensive income	
Share of gain on revaluation of associate	4,800

Decision flowchart to assess type of investment

The following flowchart may help you to assess how to account for an investment:



Key Learning Points

1. *The distinction between an investment in an associate, a joint venture and a joint operation.*
2. *The accounting treatment applied to an associate.*
3. *The calculation of amounts to be included within consolidated financial statements in respect of an associate.*

Consolidation

Additional information 2

In the year ended 30 September 2012, the following transactions took place between group companies:

1. Thomson sold goods to Holloway for HK$60 million, charging a mark up of 25% on cost on these sales. At the year end, 10% of the items remain in stock. At 30 September 2012, Thomson's accounts show that Holloway has settled its intercompany account in full.
2. On 1 April 2012 Russell sold an item of plant to Holloway for HK$250,000. The plant originally cost HK$600,000 on 1 April 2002. At acquisition, the plant was assessed to have a useful life of 15 years, and this estimate remains unchanged.
3. Holloway sold goods to Dobson for HK$30 million, charging a margin of 30%. A third of these goods remain in stock at the period end. At 30 September 2012, Holloway's accounts show an amount of HK$7 million receivable from Dobson, and Dobson's accounts show a corresponding amount payable.

You should assume that all inventory held at 30 September 2011 by Holloway Group companies is sold during the course of the year ended 30 September 2012.

There have been no impairments to Holloway's investments in the year ended 30 September 2012.

Required:

Prepare the consolidated statement of financial position and statement of comprehensive income for the Holloway Group for the year ended 30 September 2012.

Proforma consolidation workings which include the results of Holloway, Thomson and Russell for the year ended 30 September 2012 are included in the appendix.

You should work to the nearest HK$'000 and ignore the tax effects of consolidation adjustments.

Discussion points

Consolidation

Additional information 2

What are the issues?

Holloway has owned 100% of Thomson for a number of years and 75% of Russell since 1 August 2011. In addition, Holloway acquired a 40% shareholding in Dobson on 1 October 2011.

The consolidated statement of financial position must be prepared for the group, taking into account:

1. inter-company sales of goods and a consequential unrealised profit
2. an intercompany transfer of a non-current asset
3. sales from the parent company to the associate and a consequential unrealised profit.

In addition, the following issues from the pre-workshop case study and additional information 1 should be considered:

- The inventory which was subject to a fair value uplift at acquisition and remained in stock at 30 September 2011 has been sold in the year ended 30 September 2012, and therefore the fair value uplift should be reversed.
- The unrealised profit in inventory at 30 September 2011 has been realised through onward sale of the relevant inventory and the related provision for unrealised profit (W4) should therefore be reversed.
- The results of the associate, Dobson should be included in the consolidated financial statements.

Which accounting standards should be used?

HKFRS 3 (Revised) *Business Combinations*

HKFRS 10 *Consolidated Financial Statements*

HKAS 28 *Investments in Associates and Joint Ventures*

What are the requirements of the accounting standards?

A parent that controls one or more subsidiaries should present consolidated financial statements.

(HKFRS 10.2, LP Chapter 27 Section 2.2)

The assets and liabilities of parent and subsidiary are added together on a line by line basis, eliminating the investment in subsidiary shown in the parent's statement of financial position and any intercompany items.

(HKFRS 10.B86, LP Chapter 27 Section 2.3.1, 2.3.2)

Goodwill arising in a subsidiary acquired in a single transaction is calculated as the excess of consideration transferred plus the non-controlling interest at the acquisition date over the fair value of the net assets of the subsidiary on the acquisition date. It is included in the consolidated statement of financial position as an intangible asset.

(HKFRS 3.32, LP Chapter 27 Section 4.3.4)

The non-controlling interest is measured at the acquisition date either at fair value or as a proportion of the fair value of the net assets of the acquiree. It is subsequently measured at this amount plus the non-controlling interest share of post acquisition movement in reserves and is included in the equity section of the consolidated statement of financial position.

(HKFRS 3.19, LP Chapter 27 Section 5.2)

An investment in an associate is accounted for using the equity method in accordance with HKAS 28 *Investments in Associates and Joint Ventures.* Under the equity method, an investment in associate or joint venture is initially recognised at cost, and the carrying amount is increased or decreased thereafter to recognise the investor's share of the profit or loss and other comprehensive income of the investee after the acquisition date. Distributions received from the investee reduce the carrying amount. The investor's share of profit or loss of the investee is recognised in the investor's profit or loss and their share of changes in the investee's other comprehensive income is recognised in other comprehensive income.

(HKAS 28.10, LP Chapter 29, Section 1.3,2.3.3)

Gains and losses resulting from 'upstream' and 'downstream' transactions between an entity and its associate are recognised in the entity's financial statements only to the extent of unrelated investors' interests in the associate or joint venture. The investor's share in the associate's gains or losses resulting from these transactions is eliminated.

(HKAS 28.28, LP Chapter 29, Section 1.5.1)

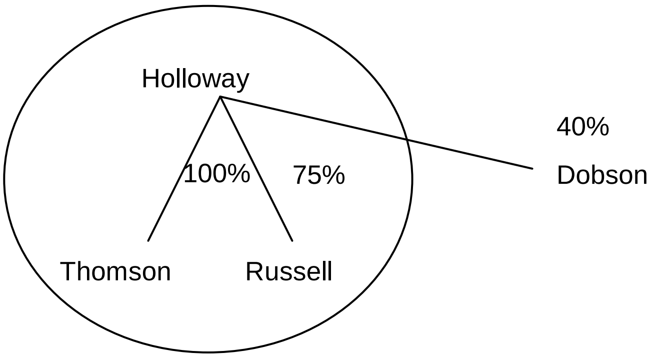
How to apply the standards to the case

As we saw in the pre-workshop case study, the following approach should be taken in answering the requirement. In this case, steps 1 and 2 have already been provided:

1. Set up a working schedule and insert the individual company statement of financial position information provided in the case study
2. Add across each line item to produce totals for each in the fourth column of the working schedule
3. Ensure that you understand the group structure by drawing a structure diagram, noting the date of any mid year acquisitions (W1)
4. Calculate the net assets of each subsidiary at the acquisition date and reporting date, taking into account any fair value adjustments (pre-workshop case study W2)
5. Using the net assets at the acquisition date from step 4, calculate goodwill arising on the acquisition of each subsidiary (pre-workshop case study W3), and record the associated journals in the working schedule
6. Reverse the fair value adjustment made to inventory on acquisition, as this inventory has been sold in the period (W2)
7. Calculate the post acquisition profits in Russell and reallocate the relevant proportion to the non-controlling interest (W3)
8. Reverse the opening unrealised profit in inventory (W4)
9. Bring in the associate's results (W5)
10. Cancel the intercompany sales between Holloway and Thomson and adjust for the related unrealised profit in inventory (W6)

11. Adjust for the unrealised profit in the transfer of property, plant and equipment (W7)
12. Adjust for the unrealised profit in inventory between Holloway and Dobson (W8)

(W1) Group structure



(W2) Fair value adjustment to inventory

On acquisition of Russell, inventory was found to have a fair value HK$1.6million in excess of book value, and adjustment was made to reflect this fact (pre-workshop case study W3).

The relevant goods had not been sold at 30 September 2011 and accordingly the value of closing inventory in the statement of financial position remained increased by HK$1.6million for consolidation purposes at that date.

When preparing this year's financial statements, closing inventory at 30 September 2011 must be journalled out of the statement of financial position and into the statement of comprehensive income to form part of cost of sales.

In Russell's individual accounts this journal will already have been made based on Russell's closing inventory at 30 September 2011 of HK$45,210,000 as follows (HK$000):

DEBIT	Cost of sales	45,210	
CREDIT	Inventory (SOFP)		45,210

For consolidation purposes, the additional HK$1.6million should also be journalled into cost of sales so that:

1. group profits are based upon group cost of the inventory (in this case fair value at acquisition)
2. the fair value uplift to inventory is reversed to reflect the fact that the inventory is no longer held in the statement of financial position (HK$000):

DEBIT	Cost of sales	1,600	
CREDIT	Inventory (SOFP)		1,600

The adjustment is allocated to the parent (HK$1.2m) and NCI (HK$ 400,000) in proportion to their respective shareholdings (and so reflected in retained earnings and the NCI in the statement of financial position).

(W3) Non-controlling interest

(i) 25% of post acquisition profits in Russell must be allocated to the non-controlling interest in net assets. As we saw in the pre-workshop case study (W4), post acquisition profits up to 30 September 2011 were HK$3 million and so 25% of this amount should be transferred from retained earnings in the statement of financial position to the non-controlling interest (HK$000):

DEBIT	Retained earnings	750	
CREDIT	Non-controlling interest		750

(ii) In addition, the profits of Russell for the year ended 30 September 2012 should be allocated between the group and the non-controlling interest. Profits are HK$7,780,000, and 25% of these are attributed to the non-controlling interest in the statement of comprehensive income. The required journal in the statement of financial position is (HK$000):

DEBIT	Profit attributable to NCI	1,945	
CREDIT	Non-controlling interest		1,945

(W4) Opening unrealised profit in inventory

In the pre-workshop case study, an unrealised profit in inventory of HK$2.4million was calculated at 30 September 2011 on sales from Thomson to Holloway. This amount was eliminated from the inventory value in the statement of financial position and also from profits to ensure that:

(i) inventory in the consolidated financial statements was shown at cost to the group

(ii) the profit on the sale from Thomson to Holloway was not reflected in earnings.

The journal entry for this was as follows (HK$000):

DEBIT	Retained earnings	2,400	
CREDIT	Inventory		2,400

This elimination should now be reversed to reflect the fact that the inventory in question has been sold on to a third party, and therefore the profit realised. The required journal:

(i) reduces cost of sales (opening inventory) by the unrealised amount in order to increase the profit on sale of the inventory to be group profit (ie the difference between cost to Thomson and selling price to the third party)

(ii) adjusts retained earnings to reflect the consolidation adjustment made in the previous year.

The required journal is (HK$000):

DEBIT	Retained earnings	2,400	
CREDIT	Cost of sales		2,400

Note that there is no impact on inventory in the statement of financial position as the goods in question have now been sold.

(W5) Results of associate

In additional information 1, the amount to be recognised in respect of the investment in Dobson in the statement of financial position was calculated as:

	HK$000
Cost	114,000
Group share of profits since acquisition	13,750
Group share of other comprehensive income since acquisition	4,800
Dividend received	(2,000)
	130,550

The journal required to recognise this investment in the consolidated financial statements is (HK$000):

DEBIT	Investment in associate (SOFP) (18,550 – 2,000)	16,550	
DEBIT	Investment income (SOCI)	2,000	
CREDIT	Share of profit of associates (SOCI)		13,750
CREDIT	Share of gain on property revaluation of associate (SOCI)		4,800

In the statement of financial position the debit entry to remove the investment income and credit entry to record the share of profit of the associate are accumulated in retained earnings; the share of gain on the property revaluation is accumulated in the revaluation reserve.

(W6) Intercompany sales and closing unrealised profit in inventory (Thomson to Holloway)

(i) Intercompany sales are cancelled from the consolidated statement of comprehensive income by (HK$000):

DEBIT	Revenue	60,000	
CREDIT	Cost of sales		60,000

(ii) There is an unrealised profit in inventory of HK$1.2m (10% × HK$60m × 25/125). This is removed from inventory and profit in Thomson, the selling company (HK$000):

DEBIT	Cost of sales	1,200	
CREDIT	Inventory		1,200

(W7) Unrealised profit in transfer of property, plant and equipment

During the year, Russell transferred an item of plant to Holloway. Any profit or loss recognised on this transfer in Russell's accounts must be eliminated on consolidation:

	HK$	*HK$*
Proceeds on disposal		250,000
Carrying value at disposal:		
Cost	600,000	
Depreciation (10/15 yrs)	(400,000)	
		(200,000)
Profit on disposal		50,000

In addition, any increase or decrease in the depreciation charge as a result of the transfer must be eliminated from the consolidated accounts.

		HK$
Annual depreciation charge prior to transfer	HK$600,000/15 years	40,000
Annual depreciation charge post transfer	HK$250,000/ 5 years	50,000
Increase		10,000

As the transfer took place half way through the financial year, the required adjustment is HK$5,000 (HK$10,000 × 6/12).

The journal to adjust for the unrealised profit and increased depreciation charge is (HK$000):

DEBIT	Other gain or loss	50	
CREDIT	PPE (50 – 5)		45
CREDIT	Administrative expenses		5

As Russell is the seller, the relevant proportion of the adjustment to profits of HK$12,500 (25% × HK$50,000) and depreciation of HK$1,250 (25% x HK$5,000) are charged to the non-controlling interest.

(W8) Intercompany sales and closing unrealised profit in inventory (Holloway to Dobson)

Since Dobson is not part of the Holloway Group, the outstanding intercompany balances between Holloway and Dobson are not cancelled.

The group share of the unrealised profit must, however be eliminated. The unrealised profit is HK$3million (HK$30m x 1/3 x 30%), and therefore group share is HK$1.2m (40% x HK$3m).

This is adjusted by (HK$000):

DEBIT	Cost of sales	1,200	
CREDIT	Investment in associate		1,200

Recommendation / Justification

Consolidated statement of financial position at 30 September 2012

	Holloway	Thomson	Russell	Subtotal	Pre-workshop W3(i)	Pre-workshop W3(ii)	(W2)	(W3)(i)	(W3)(ii)	(W4)	(W5)	(W6)(ii)	(W7)	(W8)	Consolidated
	HK$000	HK$000	HK$000	HK$000	HK$000	HK$000	HK$000	HK$000	HK$000	HK$000	HK$000	HK$000	HK$000	HK$000	HK$000
Property, plant and equipment	290,300	168,400	165,670	624,370									(45)		624,325
Intangible assets	72,000	-	-	72,000											72,000
Goodwill	-	-	-	-	10,500	11,050									21,550
Investment in Dobson	114,000	-	-	114,000							16,550			(1,200)	129,350
Investment in Thomson	83,000	-	-	83,000	(83,000)										-
Investment in Russell	112,000	-	-	112,000		(112,000)									-
	671,300	168,400	165,670	1,005,370											847,225
Inventories	101,250	28,220	42,300	171,770		1,600	(1,600)					(1,200)			170,570
Trade receivables	29,100	14,200	34,560	77,860											77,860
Cash	-	1,300	12,120	13,420											13,420
	130,350	43,720	88,980	263,050											261,850
	801,650	212,120	254,650	1,268,420											1,109,075

Ordinary share cap	70,000	10,000	18,000	98,000	(10,000)	(18,000)									70,000
Share premium	30,000	-	-	30,000											30,000
Revaluation reserve	-	40,000	-	40,000							4,800				44,800
Retained earnings	398,730	104,070	125,780	628,580	(62,500)	(115,000)	(1,200)	(750)	(1,945)	0*	11,750	(1,200)	(31)	(1,200)	456,504
	498,730	154,070	143,780	796,580											601,304
Non controlling interest						33,650	(400)	750	1,945				(14)		35,931
															637,235
Deferred tax	38,210	14,300	13,200	65,710											65,710
Bank loan	174,000	24,520	50,000	248,520											248,520
	212,210	38,820	63,200	314,230											314,230
Trade payables	40,330	17,340	39,570	97,240											97,240
Income tax payable	17,300	1,000	1,560	19,860											19,860
Accrual	10,200	890	6,540	17,630											17,630
Overdraft	22,880			22,880											22,880
	90,710	19,230	47,670	157,610											157,610
	801,650	212,120	254,650	1,268,420											1,109,075

* In W4 the debit and credit entries are both made to retained earnings; therefore the net effect is nil.

Consolidated statement of comprehensive income for the year ended 30 September 2012

	Holloway	Thomson	Russell	Subtotal	(W2)	(W3)(ii)	(W4)	(W5)	(W6)(i)	(W6)(ii)	(W7)	(W8)	Consolidated
	HK$000	HK$000	HK$000	HK$000	HK$000	HK$000	HK$000	HK$000	HK$000	HK$000	HK$000	HK$000	HK$000
Revenue	220,500	113,600	141,270	475,370					(60,000)				415,370
Cost of sales	(88,200)	(46,580)	(64,990)	(199,770)	(1,600)		2,400		60,000	(1,200)		(1,200)	(141,370)
Gross profit	132,300	67,020	76,280	275,600									274,000
Distribution costs	(33,120)	(20,230)	(24,610)	(77,960)									(77,960)
Administrative expenses	(55,700)	(36,800)	(38,270)	(130,770)							5		(130,765)
Share of profits of associate	-	-	-	-				13,750					13,750
Investment income	2,000	-	-	2,000				(2,000)					-
Other gains and losses	(4,960)	(1,450)	-	(6,410)							(50)		(6,460)
Profit before interest and tax	40,520	8,540	13,400	62,460									72,565
Finance charge	(10,440)	(1,680)	(3,900)	(16,020)									(16,020)
Profit before tax	30,080	6,860	9,500	46,440									56,545
Income tax charge	(15,620)	(1,180)	(1,720)	(18,520)									(18,520)
Profit for the year	14,460	5,680	7,780	27,920									38,025
Gain on property revaluation	-	40,000	-	40,000									40,000
Share of associate's OCI								4,800					4,800
Total comp income	14,460	45,680	7,780	67,920									82,825
Profit attributable to owners of parent (balancing figure)													36,493
Profit attributable to NCI		-			(400)	1,945					(14)		1,531
TCI attributable to owners of parent (bal. fig)													81,293
TCI attributable to NCI					(400)	1,945					(14)		1,531

Guidance Notes

Key Learning Points

1. *The requirement to reverse a provision for unrealised profit in opening inventory.*

2. *The reversal of fair value adjustments when the relevant item has been realised.*

3. *The treatment of unrealised profits arising on transactions with an associate.*