Preparation of consolidated financial statements using the worksheet method

Solution

(a)

	$
Book value of net assets of Entity B	350 000[1]
Add: Increase in equipment to fair value	40 000[2]
Less: Deferred tax liability – revaluation of equipment	(12 000)[3]
Fair value of net assets of Entity B	**378 000**

[1] The book value of the net assets of Entity B is derived from the book value of its equity (issued capital + retained earnings) at acquisition ($250 000 + $100 000)

[2] The increase in the equipment to fair value is calculated as fair value *less* book value ($120 000 - $80 000)

[3] Calculated as 30 per cent of the increase in equipment to fair value ($40 000 * .30)

(b)

The goodwill on consolidation would be calculated as follows:

	$
Consideration transferred	500 000
Less: Fair value of identifiable net assets[1]	378 000
Goodwill	**122 000**

[1]Calculated in part (a) above.

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(c)

The consolidation worksheet entries for 30 June 2015 would be as follows:

(1) Revaluation of plant to fair value

Accumulated depreciation[1]	20 000	
Equipment[2]	20 000	
Business combinations reserve		28 000
Deferred tax liability[3]		12 000

(1) Accumulated depreciation adjustment / consolidation entry is reversing the accumulated depreciation previously recognised by Entity B.

(2) The increase in equipment on revaluation is calculated as the net increase in the value of the equipment ($40 000 [being $120 000 fair value *less* $80 000 book value] *less* $20 000 [reversal of accumulated depreciation] = $20 000).

(3) Deferred tax liability is calculated as 30 per cent of the increase in value of the equipment ($40 000 * 30%).

(2) Depreciation entry and associated tax effect

Depreciation expense	8000	
Accumulated depreciation		8000

(Calculated as difference in carrying value between Entity A and Entity B for the equipment divided by 5 years [the useful life of the equipment] $40 000 / 5 = $8000).

Deferred tax liability	2400	
Income tax expense		2400

(Calculated as 30 per cent of the depreciation expense adjustment above)

(3) Pre-acquisition elimination entry:

Issued capital	250 000	
Retained earnings	100 000	
Business combination reserve	28 000	
Goodwill	122 000	
Investment in Entity B		500 000

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The following worksheet illustrates the pre-acquisition elimination entries required.

Account	Entity A Ltd	Entity B Ltd	Adjustments		Consolidated financial statements
			DR	CR	
Statement of financial performance					
Depreciation expense			8000		8000
Income tax expense				2400	2400
Statement of financial position					
Issued capital	400 000	250 000	250 000		400 000
Retained earnings	200 000	100 000	100 000		200 000
	600 000	**350 000**			**600 000**
Equipment	-	100 000	20 000		120 000
Accumulated depreciation		(20 000)	20 000	8000	(8000)
Other net assets	100 000	270 000			370 000
Investment in Entity B	500 000			500 000(3)	-
Goodwill			122 000		122 000
Deferred tax liability			2400	12 000	(9600)
Business combinations reserve			28 000	28 000	-
	600 000	**350 000**	**550 400**	**550 400**	

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