Semester VI

Subject FRFSA

Consolidated Financial Statements of Holding Company & its Subsidiary Company(ies)

Dr. A D N Roy [7980222067, adnray2015@gmail.com]

Holding Company [H. Ltd.] is the parent company of its subsidiary company [S. Ltd]. One Holding Company may be the parent of more than one Subsidiary Company.

H. Ltd. and S. Ltd., both maintain their separate legal entities. Each company prepares and publishes its own financial statements as per the requirements of Companies Act, 2013. But the Group of H. Ltd. And S. Ltd. is formed for some advantages :

1. Decentralizing the financial risk of any of the companies

2. To comply with legal requirements (e.g., a Bank has to set up a Subsidiary to do leasing business, or has to create a separate Trust / Asset Management company, to do the business of mutual funds.]

3. Diversification of busibess at least cost.

If there is a group of H. Ltd. and S. Ltd. , H. Ltd. prepares the Consolidated P/L A/c and Consolidated Balance Sheet of the Group as those of a single enterprise. The consolidated statements will disclose:

1. The economic activities of the group;
2. The economic resources controlled by the group;
3. The obligations of the group; &
4. The results achieved using the group-resources.

In order to become Holding Company (i.e. the Parent Company) it has to exercise control over its Subsidiary Company in any one of the following ways:

1. Ownership of more than 50% of Shares of S. Ltd. having voting rights.
2. Controlling the composition of the Board of Directors of S. Ltd.
3. Controlling anothef Holding Company that controls the Subsidiary Company. [If A. Ltd. is the subsidiary of B. Ltd, and B. Ltd. is the subsudiary of C. Ltd. , then A. Ltd. is deemed to be the subsidiary of C. Ltd. also, or C. Ltd. is the holding company of A. Ltd. also.]

Now, we shall try to understand the method of preparation of CBS with the help of small illustrations.

Problem 1

Point of consideration: Investment by H is replaced by Assets and Liabilities of S

Two simple Balance Sheets are given below. If these are consolidated, see the changes:

	H. Ltd.	S. Ltd		H. Ltd.	S. Ltd.
Share Capital (Re. 1 each share)	12000	5000	Sundry Assets	15000	8000
Sundry Liabilities	8000	3000	Investment (5000 shares in S. Ltd)	5000	---
	20000	8000		20000	8000

Consolidated Balance Sheet

Share Capital of H. Ltd	12000	Sundry Assets (15000+8000)	23000
Sundry Liabilities (8000+3000)	11000		
	23000		23000

Changes:

a. Equity share capital of S. Ltd is not shown
b. Investment of H. in S. is also not shown

The above changes indicate that the investment by H is replaced by Assets and Liabilities of S

Problem 2

Point of consideration : Minority Interest = Equity held by outsiders.

The Balance Sheets shown below show that H. Ltd. has not acquired all equity shares of S. Ltd. See the effect of consolidation.

	H. Ltd.	S. Ltd		H. Ltd.	S. Ltd.
Share Capital (Re. 1 each share)	12000	5000	Sundry Assets	16000	8000
Sundry Liabilities	8000	3000	Investment (4000 shares in S. Ltd)	4000	---
	20000	8000		20000	8000

Consolidated Balance Sheet

Share Capital of H. Ltd	12000	Sundry Assets (16000+8000)	24000
Minority Interest	1000		
Sundry Liabilities (8000+3000)	11000		
	24000		24000

Changes:

Minority Interest is shown in the liability side of CBS.

Minority Interest = Equiry held by outsiders.

Formula for determination of MI

a) **Outsiders' share in share capital, reserves and p/l a/c balances of S. Ltd.** In this problem, it is 1/5th of equity share capital of S. Ltd. only = Rs. 5000 x 1/5 = Rs. 1000. Or,
b) **Outsiders' share in the net assets of S. Ltd.** In this problem it is 1/5th of (Sundry Assets less Sundry Liabilities) = 1/5 x (8000—3000) = 1000

Problem 3.

Point of consideration : Capital Reserve

[Consolidation of two Balance Sheets is not possible without first ascertaining Capital Reserve orGoodwill]

Balance Sheets as on 31/3/2020

	H. Ltd. Rs.	S. Ltd. Rs.		H. Ltd. Rs.	S. Ltd. Rs
Share Capital (Re. 1 each share)	12000	6000	Sundry Assets	20000	12000
Reserve	3000	2000	Investment (6000 shares in S)	7500	----
P/L A/c	2000	1000			
Sundry Liabilities	10500	3000			
	27500	12000		27500	12000

H. Ltd. acquired shares on 31/3/2020.

We will first calculate Capital Reserve by any of the two methods:

Method 1

Equity acquired in S. Ltd.

Share Capital	6000
Reserve	2000
P/L A/c	1000
Total equity	9000
Less: Price paid for Investment	7500
Capital Reserve	1500

Method 2

Net Assets acquired in S. Ltd.

Sundry Assets	12000
Less: Sundry Liabilities	3000
	9000
Less: Price paid for Investment	7500
Capital Reserve	1500

Consolidated Balance Sheet as on 31/3/2020

Share Capital [H Ltd.]	12000	Sundry Assets (20000+12000)	32000
Capital Reserve	1500		
Reserve [H. Ltd.]	3000		
P/L A/c [H. Ltd.]	2000		
Sundry Liabilities (10500+3000)	13500		
	32000		32000

Note: Capital Reserve arising from acquisition of shares in Subsidiary means the excess of share in equity (or net assets) over and above the price paid for investment.

Problem 4.

Point of consideration :

i) **Goodwill or Cost of Control & ii) Minority Interest**

Balance Sheets as on 31/12/2019

	H Rs	**S Rs**		**H Rs**	**S Rs**
Eq. Shares (Rs 10 each fully paid up)	12000	5000	Fixed Assets	10000	6000
Pref. Shares (Rs 10 each fully paid up)	4000	1000	Current Assets	11500	2000
P/L A/c	2500	1000	Cash at Bank	7000	1000
Creditors	10000	2000			
	28500	9000		28500	9000

H. Ltd. acquired 90% of Equity Shares of S. Ltd. on 1st January 2020 at Rs 15 per share. Prepare CBS as on 1/1/2020.

Step 1: Calculation of Goodwill

Investment A/c (500 equity shares x 90% x Rs15)		Rs 6750
Less: Paid up value of 450 equity shares	Rs 4500	
90% of Pre-Acquisition Profit (Rs1000)	900	5400
Goodwill (or Cost of Control)		**1350**

Step 2: Ascertaining Minority Interest

Paid up value of 50 Equity Shares	Rs 500

Paid up value of Preference Shares	1000
Share of Pre-acquisition profit (10% of Rs 1000)	100
MI	**1600**

Consolidated Balance Sheet as on 01/01/2020

Eq. Share Capital [H Ltd.]	12000	Goodwill	1350
Pref. Share Capital [H Ltd.]	4000	Fixed Assets (10000+6000)	16000
P/L A/c [H. Ltd.]	2500	Current Assets (11500+2000)	13500
Minority Interest	1600	Cash at Bank (250+1000)	1250
Creditors (10000+2000)	12000		
	32100		32100

Note: Goodwill arising from acquisition of shares in Subsidiary means the excess of price paid for investment over and above the share in equity (or net assets).

Problem 5.

Point of consideration:

Pre-acquisition and Post-acquisition Profit of S. Ltd.

Balance Sheets as on 31/3/2020

	H. Ltd. Rs.	S. Ltd. Rs.		H. Ltd. Rs.	S. Ltd. Rs
Share Capital (Re. 1 each share)	12000	5000	Sundry Assets	20000	8000
Reserve	5000	1000	Investment (5000 shares in S)	6500	----
P/L A/c	2000	1000			

Sundry Liabilities	7500	1000			
	26500	8000		26500	8000

Shares were acquired by H. Ltd. On 30/9/2019.

S. Ltd. Transferred Rs. 500 from profit to reserve on 31/3/2020.

Prepare CBS as on 31/3/2020.

Special point to note: Here CBS is to be prepared 6 months after acquisition.

It is needed in this case to first divide all profits of S. Ltd. in to Pre-acquisition profit and Post-acquisition profit.

After ascertaining both "pre and post acquisition profit of S. Ltd.", these two are shared between H. Ltd. and Minority shareholders.

1. The portion of pre-acquisition profit of H. Ltd. Is used as usual in the calculation of Capital Reserve, or it reduces Goodwill.
2. The portion of post-acquisition profit of H. Ltd. Is added with its P/L A/c credit balanc.
3. The portions of pre-acquisition profit and post-acquisition profit of outsider shareholders are added with Minority Interest.

Step 1: Profit made by S during the current year (ending on 31/3/2020) and its division

P/L A/c balance on 31/3/2020	Rs. 1000
Add: Transfer to Reserve	500
Total Profit of the year	1500
Profit for pre-acquisition period (1/4/2019 to 30/9/2019)	750 [Capital Profit]
Profit for post-acquisition period	750 [Revenue Profit or Current Profit]

Step 2: Division of Reserve of S. Ltd.

Balance of Reserve on 31/3/2020	Rs. 1000
Less: Amount	<u>500</u>

transferred from current year's profit	
Opening balance of Reserve on 1/4/2019	500 [Capital Profit]

Step 3: Goodwill / Capital Reserve

Investment A/c (5000 equity shares)		Rs 6500
Less: Paid up value of 5000 equity shares	Rs 5000	
Reserve (Opening Balance)	500	
Profit made prior to holding	750	6250
Goodwill (or Cost of Control)		**250**

Consolidated Balabce Sheet as on 31/3/2020

Share Capital [H. Ltd]	12000	Goodwill	250
Reserve [H. Ltd.]	5000	Sundry Assets (20000+8000)	28000
P/L A/c [H. Ltd. 2000 + S. Ltd 750]	2750		
Sundry Liabilities (7500+1000)	8500		
	28250		28250

Note: Pre-acquisition Loss of S. Ltd. Is also to be shared between H. Ltd. and Minority, if any. H. Ltd.'s share will increase Goodwill. Outsiders' share will reduce MI.

Exercise 1. Point of consideration: Pre-acquisition Loss to be added with Goodwill

Balance Sheets as on 31/12/2019

	H. Ltd. Rs.	S. Ltd. Rs.		H. Ltd. Rs.	S. Ltd. Rs
Share Capital (Re. 1 each share)	10000	5000	Sundry Assets	16000	10000
General Reserve	5000		Investment (5000 shares in S)	6000	----
P/L A/c	4000	1800			
Creditors	3000	3200			
	22000	10000		22000	10000

Shares were acquired by H. Ltd. on 30/6/2019. On 1/1/2019 Balabce Sheet of S. Ltd. showed a loss of Rs. 3000, which was written off out of profits earned during 2019. Profits are assumed to accrue evenly throughout the year. Prepare CBS as on 31/12/2019.

Ans. Profit of 2019 = 4800

[½ earned upto date of holding (2400) & ½ earned after date of holding (2400)**]

Pre-acquisition Loss = 600

Goodwill = 1600

P/L A/c in CBS:

H. Ltd. 4000

S. Ltd. 2400**

Total of CBS 27600

In my next post on Holding Company Accounts, I will present:

1. **Problem on simple calculation of Minority Interest when there is only Pre-acquisition Profit.**
2. **Problem on Pre and Post-acquisition Profit, calculation of Goodwill and Minority Interest.**
3. **Discussion on elimination of Intra-group Transactions and resulting Unrealized Profits.**
4. **Treatment of Contingent Liabilities arising due to transactions between H. Ltd. and S. Ltd. and between anyone of the group (H or S) and the outsiders.**
5. **Treatment of unrealized Profits made by H or S, when one of them has sold to the other goods, at a profit, but the goods remain unsold and included in the stock of the purchaser company.**
6. **Treatment of Profit or Loss on Revaluation of Fixed Assets of S. Ltd.**
7. **Treatment of Bonus Shares**
   (Problems on calculation of Goodwill arising before or after issue of Bonus Shares out of
   I] Pre-acquisition Profit or ii]Post- acquisition Profit).

8. Treatment of Dividend from S. Ltd.

i) Unclaimed Dividend

ii) Proposed Dividend

iii) Dividend paid out of pre-acquisition profit or post-acquisition profit or from both.

Thank You

Dr. A D N Roy

Umeschandra College
