

PART II - ADVANCED SECTION

CHAPTER VII. Control held by two members.

Alteration in Holdings.

Two or more members of a group may hold shares in the same subsidiary. The Revenue Account balances as at the dates on which the various blocks of shares were acquired, are used to determine the amounts to be treated as pre-acquisition in each case. The adjustment for these pre-acquisition revenue balances is made in the accounts of each member which holds the shares, so that in the aggregation of the adjusted Balance Sheets, all holdings are shown at "Adjusted Cost" and all adjusted Revenue Account balances can then be regarded as revenue from the group's stand-point.

A member may acquire an additional block of shares in a subsidiary, and in subsequent Consolidated Statements, a portion of the balance at credit or debit of the Revenue Account of the subsidiary as at the date of the second acquisition, must be treated as pre-acquisition.



EXAMPLE - 13.

H



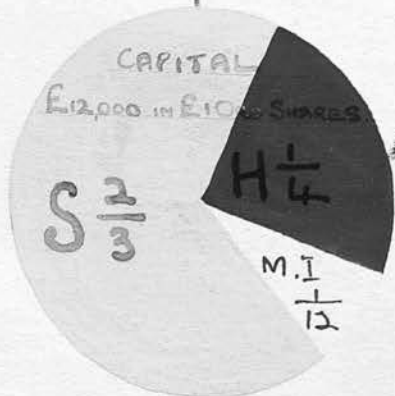
$\frac{3}{4}$ BOUGHT - 21/4/39

\$



$\frac{2}{3}$ BOUGHT - 27/5/39

T



$\frac{1}{4}$ BOUGHT - 3/4/41

Ex. 23. Subsidiary controlled by two members:

The summarised Balance Sheets of a group, as at 31st December 1946 are:-

								<u>ASSETS</u>		
								<u>H.</u>	<u>S.</u>	<u>T.</u>
Sundry Assets	..	..	..	..	..	..	..	£ 98,500	£ 18,000	£ 19,500
<u>Investments at Cost:</u>										
In S	(15,000 shares)	..	..	..	..	..	..	18,000	-	-
T	(8,000 shares)	..	..	..	..	..	..	-	12,000	-
T	(3,000 shares)	..	..	..	..	..	..	4,500	-	-
								<u>£121,000</u>	<u>£ 30,000</u>	<u>£ 19,500</u>

								<u>LIABILITIES</u>		
Share Capital (in £1 Ord. Shares)	..	..	..	..	..	..	..	£100,000	£ 20,000	£ 12,000
Creditors	..	..	..	..	..	..	..	9,000	2,000	2,500
Revenue Account	..	..	..	..	..	..	..	12,000	8,000	5,000
								<u>£121,000</u>	<u>£ 30,000</u>	<u>£ 19,500</u>

H bought $\frac{5}{4}$ of S on 21st April 1939 when it was estimated S had a credit balance on Revenue Account of £ 2,000
 S bought $\frac{2}{3}$ of T on 27th May 1939 when it was estimated T had a credit balance on Revenue Account of £ 3,600
 H bought $\frac{1}{4}$ of T on 3rd April 1941 when it was estimated T had a credit balance on Revenue Account of £ 3,000

SOLUTION(a) The Adjustments required in each company's accounts are:-

S(1) Revenue Account Dr. £2,400
 To Investment Account (in T) £ 2,400

(Being $\frac{2}{3}$ of T's balance on Revenue Account on 27.5.39 (£3,600 cr.) - pre-acquisition when S bought 8,000 shares in T $\frac{2}{3}$ rd.)

H(1) Revenue Account Dr. £1,500
 To Investment Account (in S) £1,500

(Being $\frac{5}{4}$ of S' Balance on Revenue Account on 21.4.39 (£2,000 cr.) - pre-acquisition when H bought 15,000 shares in S ($\frac{5}{4}$))

H(2) Revenue Account Dr. £ 750
 To Investment Account (in T) £ 750

(Being $\frac{1}{4}$ of T's balance on Revenue Account on 3.4.41 (£3,000 cr.) - pre-acquisition when H bought 3,000 shares in T ($\frac{1}{4}$))

(b) The Aggregation of the Adjusted Balance Sheets is:-

								<u>ASSETS</u>			
								<u>Total</u>	<u>H.</u>	<u>S.</u>	<u>T.</u>
Sundry Assets.	..	..	..	..	..	..	..	£136,000	£ 98,500	£ 18,000	£ 19,500
<u>Investments at Adjusted Cost:</u>											
In S	15,000 shares	..	..	..	..	..	..	16,500	16,500	-	-
T	8,000 shares	..	..	..	..	..	..	9,600	-	9,600	-
T	3,000 shares	..	..	..	..	..	..	3,750	3,750	-	-
								<u>£165,850</u>	<u>£118,750</u>	<u>£ 27,600</u>	<u>£ 19,500</u>

LIABILITIES/

(b) Continued.

VII (3)

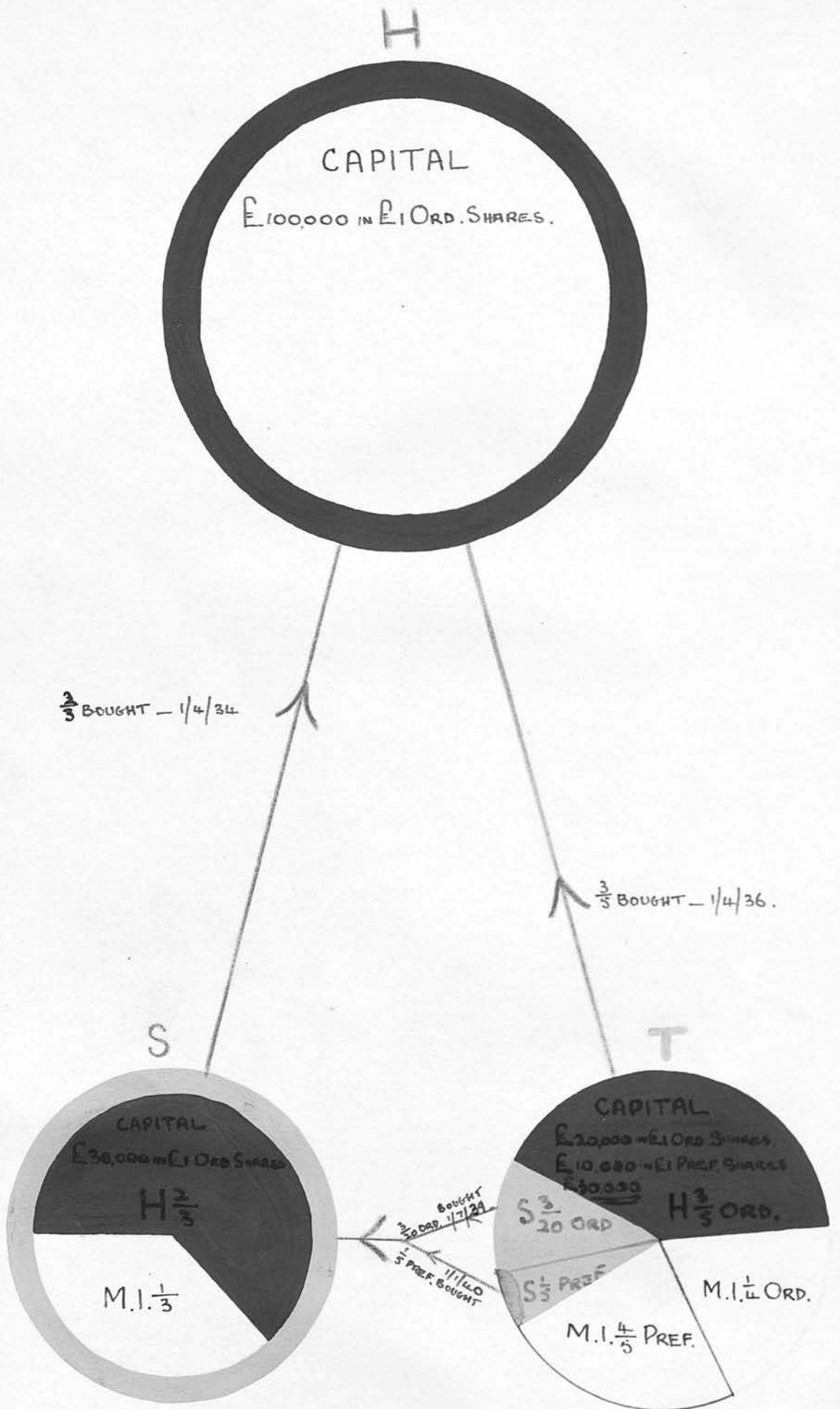
								<u>LIABILITIES</u>			
								<u>Total</u>	<u>H.</u>	<u>S.</u>	<u>T.</u>
Capital .. .. .	..	..	..	..	..	..	..	£132,000	£100,000	£ 20,000	£ 12,000
Creditors .. .. .	..	..	..	..	..	..	..	13,500	9,000	2,000	2,500
Revenue Account..	..	..	..	..	..	..	..	20,350	9,750	5,600	5,000
								<u>£165,850</u>	<u>£118,750</u>	<u>£ 27,600</u>	<u>£ 19,500</u>

(c) The Consolidated Statement of Assets and Liabilities is:-

<u>ASSETS</u>												
Sundry Assets												£136,000
<u>Goodwill - Net Cost of Control to the Group:</u>												
								<u>By S</u>	<u>By H</u>			
								<u>In T $\frac{2}{3}$ rds</u>	<u>In T $\frac{1}{4}$</u>	<u>In S $\frac{3}{4}$</u>		
Adjusted Cost .. .. .	..	..	..	..	..	..	..	£ 9,600	£ 3,750	£ 16,500	
Par .. .. .	..	..	..	..	..	..	..	8,000	3,000	15,000	
								£ 1,600	£ 750	£ 1,500		
<u>Less: Minority Interests S $\frac{1}{4}$</u>	..	..	..	..	..	..	..	400	-	-	
								<u>£ 1,200</u>	<u>£ 750</u>	<u>£ 1,500</u>	3,450	
											<u>£139,450</u>	

<u>LIABILITIES</u>												
Share Capital H.. .. .	..	..	..	..	..	..	..			£100,000	
Creditors .. .. .	..	..	..	..	..	..	..			13,500	
Revenue Account..	..	..	..	..	..	..	..			£ 20,350	
<u>Less: Minority Interests:</u>												
S $\frac{1}{4}$ (5,600 + $\frac{2}{3}$ x 5,000)	..	..	..	..	..	..	..	£ 2,233			
T $\frac{1}{12}$ x 5,000 .. .. .	..	..	..	..	..	..	..	417	2,650	17,700	
<u>Minority Interests:</u>								<u>S $\frac{1}{4}$</u>		<u>T $\frac{1}{12}$ th</u>		
Capital .. .. .	..	..	..	..	..	..	..	£ 5,000	£ 1,000		
Revenue Account .. .. .	..	..	..	..	..	..	..	2,233	417		
Net Cost of Control.	..	..	..	..	..	..	..	Dr. 400	-		
								<u>£ 6,833</u>	<u>£ 1,417</u>	8,250		
											<u>£139,450</u>	

EXAMPLE - 24.



Ex. 24. Holding Company and Subsidiary both holding shares in another Subsidiary.
Different Balance Sheet dates. Computation of pre-acquisition revenue
balance. Sub. with Preference Capital.

The summarised Balance Sheets of a group are:-

	<u>ASSETS</u>		<u>H</u>	<u>S</u>	<u>T</u>
	as	at	31:12:46	30:9:46	31:12:46
Sundry Assets			£150,500	£ 54,600	£ 49,500
Goodwill at cost.			10,000	4,000	-
Investments in Subsidiaries			28,000	5,400	-
			<u>£188,500</u>	<u>£ 64,000</u>	<u>£ 49,500</u>
 <u>LIABILITIES</u> 					
<u>Share Capital (in £1 shares)</u>					
Ordinary Shares			£100,000	£ 30,000	£ 20,000
5% F.O.T. Preference Shares			-	-	10,000
					£ 30,000
Creditors.			72,000	15,000	12,000
General Reserve			-	1,000	4,000
Profit and Loss Account.. .. .			16,500	18,000	3,500
			<u>£188,500</u>	<u>£ 64,000</u>	<u>£ 49,500</u>

Notes:

1. The abstract of "Investments in Subsidiaries" is:-

H.	20,000 Ord. Shares ($\frac{2}{3}$) of S acquired 1st April 1934 at cost ..	£ 10,000
	12,000 Ord. Shares ($\frac{3}{5}$) of T acquired 1st April 1936, at cost.. ..	£ 24,000
	<u>Less: Dividend received for year to 31:12:35 credited..</u>	<u>6,000</u>
	<u>As per H's Balance Sheet ..</u>	<u>£ 28,000</u>
S.	3,000 Ord. Shs. ($\frac{3}{20}$) of T acquired 1st July 1939, at cost ..	£ 4,500
	<u>Less: Dividend received for year to 31:12:38, credited.</u>	<u>1,200</u>
		£ 3,300
	2,000 Pref. Shs. ($\frac{1}{5}$) of T acquired 1st Jan. 1940, at cost ..	£ 2,200
	<u>Less: Dividend at 5% F.O.T. received for year to 31:12:39 credited</u>	<u>100</u>
	<u>As per S's Balance Sheet ..</u>	<u>£ 5,400</u>

2. The Accounts of the Subsidiaries disclose the following information:-

	<u>P. & L</u>	<u>General</u>	<u>Total</u>
	<u>Account</u>	<u>Reserve</u>	
S as at 30:9:33 had a credit balance of	£ 1,000	£ 6,000	£ 7,000
The Net Loss for year to 30:9:34 was £15,000			
T as at 31:12:35 had credit balances of (before accruing the Preference Dividend).. .. .	15,125	2,000	17,125
The Net Profit for the year 31:12:36 was £18,000			
T as at 31:12:38 had credit balances of (before accruing the Preference Dividend)	9,250	2,500	11,750
The Net Profit for the year to 31:12:39 was £12,000			

Alteration in T's and S's General Reserve are due to transfers to or from Profit and Loss Account.

3. T's Preference Dividend £500 is paid on 1st February each year. The 1946 dividend is not accrued in the Balance Sheets of T or S. The Preference Shares have a preference for capital and no interest in Surplus Assets.

4. As at 31:12:46 under Sundry Assets of H, S was due £5,000 and T due £4,000. Under Sundry Creditors of T as at 31:12:46 £4,000 is due to H. Under Sundry Creditors of S as at 30:9:46 £5,500 is due to H.

SOLUTION.

(a) The adjustments required in each company's accounts are:-

H (1)	Investment Account (in S).. .. .	Dr. £ 333	
	To Revenue Account.. .. .		£ 333
	(Being $\frac{2}{3}$ rds of S's estimated <u>Debit</u> balance on Revenue Account on 1:4:34		
	£500, when H acquired 20,000 shares $\frac{2}{3}$ rds in S made up thus:-		
	Credit balance on S Revenue Accounts at 30:9:33		£ 7,000
	<u>Less:</u> Proportion to 1:4:34 of the loss for year to 30:9:34, half of £15,000 (loss)..		<u>7,500</u>
		<u>S's estimated Dr. Balance at 1:4:34.</u>	<u>£ 500</u>
H (2)	Revenue Account.. .. .	Dr. £6,600	
	To Investment Account (in T).. .. .		£ 6,600
	(Being portion of $\frac{3}{5}$ ths of T's estimated credit balance on Revenue Account on 1:4:36 £21,000 when H. bought 12,000 Ord. Shares in T ($\frac{3}{5}$ ths), made up thus:-		
	Credit Balance on T's Revenue Account at 31:12:35		£ 17,125
	<u>Add:</u> Proportion to 1:4:36 of profit for year to 31:12:36, $\frac{1}{4}$ of £18,000..		<u>4,500</u>
			£ 21,625
	<u>Less:</u> T's 1935 Preference Dividend paid 1:2:36	£ 500	
	T's 1936 do. accrued to 1:4:36 (3 months)		<u>125</u>
			<u>625</u>
		<u>T's estimated Cr. Balance at 1:4:36.</u>	<u>£ 21,000</u>
	$\frac{3}{5}$ ths thereof to H		£ 12,600
	<u>Less:</u> Dividend credited by H to Investment Account.. .. .		<u>6,000</u>
		<u>Balance to be Capitalised</u>	<u>£ 6,600</u>
S (1)	Revenue Account.. .. .	Dr. £ 1,350	
	To Investment Account (in T. Ord).. .. .		£1,350
	(Being portion of $\frac{3}{20}$ ths of T's estimated credit balance on Revenue Account on 1:7:39 - £17,000 when S bought 3,000 Ord. Shares $\frac{3}{20}$ ths in T made up thus:-		
	Credit balance on T's Revenue Accounts at 31:12:38		£ 11,750
	<u>Add:</u> Proportion to 1:7:39 of profit for year to 31:12:39 - $\frac{1}{2}$ of £12,000..		<u>6,000</u>
			£ 17,750
	<u>Less:</u> T's 1938 Preference Dividend paid 1:2:39	£ 500	
	1939 Preference Dividend accrued to 1:7:39 (6 months).		<u>250</u>
			<u>750</u>
		<u>T's estimated credit balance at 1:7:39.</u>	<u>£ 17,000</u>
	<u>Less:</u> $\frac{3}{20}$ ths thereof to S		£ 2,550
	Dividend credited by S to Investment Account.. .. .		<u>1,200</u>
		<u>Balance to be capitalised</u>	<u>£ 1,350</u>

(a) Continued.

S (2) Outstanding Dividends Receivable Account .. Dr. £ 75
 To Revenue Account £ 75

(Being 5% Preference Dividend on 2,000 Preference Shares
 held in T for year 1946, accrued for 9 months to 30:9:46
 (date of S's Balance Sheet)

T (1) Revenue Account Dr. £ 500
 To Outstanding Preference Dividend Account £ 500

(Being accrual of 1946 Preference Dividend 5% on £10,000)

(b) The Aggregation of the adjusted Balance Sheets is:-

	ASSETS	Total	H.	S.	T.
Goodwill per Balance Sheets		£ 14,000	£ 10,000	£ 4,000	£ -
Sundry Assets.. .. .		245,600	141,500	54,600	49,500
Due by S.		-	5,000	-	-
Due by T.		-	4,000	-	-
Dividends Receivable Account.. .. .		-	-	75	-
<u>Investments at Adjusted Cost:</u>					
In S $\frac{2}{3}$ rds (20,000 Ord. Shares)		10,333	10,333	-	-
In T $\frac{3}{5}$ ths (12,000 Ord. Shares)		11,400	11,400	-	-
In T $\frac{3}{20}$ ths (3,000 Ord. Shares)		1,950	-	1,950	-
In T $\frac{1}{5}$ th (2,000 Pref. Shares)		2,100	-	2,100	-
		<u>£285,383</u>	<u>£182,233</u>	<u>£ 62,725</u>	<u>£ 49,500</u>

LIABILITIES.

Capital Ordinary	£150,000	£100,000	£ 30,000	£ 20,000
Pref.. .. .	10,000	-	-	10,000
Creditors	89,500	72,000	9,500	8,000
Due to H.	500	-	5,500	4,000
Preference Dividend Outstanding	425	-	-	500
Revenue Account	34,958	10,233	17,725	7,000
x Adjustment Account.				
	<u>£285,383</u>	<u>£182,233</u>	<u>£ 62,725</u>	<u>£ 49,500</u>

(c) The Consolidated Statement is:-ASSETS

Sundry Assets.. .. . £245,600
 Goodwill per Balance Sheets 14,000
Net Cost of Control to the group:

	By S		By H	
	In T Ord	In T Pref	In T	In S
	$\frac{3}{20}$.	$\frac{1}{5}$.	$\frac{3}{5}$	$\frac{2}{3}$.
Adjusted Cost.. .. .	£ 1,950	£ 2,100	£ 11,400	£ 10,333
Par.. .. .	3,000	2,000	12,000	20,000
	Cr. £ 1,050		£ 600	£ 9,667
	Dr.	£ 100		600
		£ 950		
<u>Less: Minority Interests S $\frac{1}{3}$</u>		<u>317</u>		<u>633</u>

Capital Reserve £ 10,900

£259,600

LIABILITIES/

(c) Continued.

LIABILITIES

Share Capital H	£100,000
Creditors.	89,500
Adjustment Account. Transactions with Subsidiary between date of its Balance Sheet and 31.12.46	525
Capital Reserve - Net Cost of Control to group	10,900

Revenue Account £ 34,958

Less: Minority Interests:

T $\frac{1}{4}$ of 7,000	£ 1,750		
S $\frac{1}{3} \left(\frac{17,725}{S} + \frac{3}{20} \times \frac{7,000}{T} \right)$	6,258	8,008	26,950

Minority Interests:

	S $\frac{1}{3}$ rd	T Ord $\frac{1}{4}$	T Pref $\frac{4}{5}$	
Capital.. .. .	£ 10,000	£ 5,000	£ 8,000	
Pref. Dividend	-	-	400	
Revenue Account	6,258	1,750	-	
Net Cost of Control of T Cr.	317	-	-	
	<u>£ 16,575</u>	<u>£ 6,750</u>	<u>£ 8,400</u>	<u>31,725</u>
				<u>£259,600</u>

Notes:

- Adjustment Account £525: This item is the result of S's Balance Sheet date being 30th September. Debtors and Creditors in the Consolidation and ^{are} exclusive of inter-company indebtedness which does not exactly cancel out. The difference £500 is shown as "Adjustment Account". The balance on Adjustment Account £25 represents the difference on T's accrued Pref. Dividend £500, of which the Minority Interests take $\frac{4}{5}$ ths and S $\frac{1}{5}$ th or £100. But S has accrued this dividend to 30th September 1946 only - the date of S's Balance Sheet and this accrual is £75. (£100 - £75 = £25).
- Revenue Account: The Controllers may allocate this between General Reserve and Profit and Loss Account according to their wishes.

The Mathematical calculation of the General Reserve is:-

$$\begin{aligned}
 \text{Gen. Res.} &= H + \frac{3}{5} \times T \text{ (post-acqn)} + \frac{2}{3} \left(S \text{ (post-acqn.)} + \frac{3}{20} T \text{ post-acqn.} \right) \\
 &= 0 + \frac{3}{5} (4,000 - 2,000) + \frac{2}{3} \left\{ (1,000 - 6,000 + \frac{3}{20} (4,000 - 2,500)) \right\} \\
 &= 0 + 1,200 + \frac{2}{3} (\text{say nil} + 225) \\
 &= 1,350
 \end{aligned}$$

On this basis Revenue Account is sub-divided thus:-

General Reserve	£ 1,350
Profit and Loss Account	<u>25,600</u>
	<u>£ 26,950</u>

- The Capital Reserve - Net Cost of Control - £10,900 arises mainly through the cheap purchase by H of S's Ordinary shares. As there is no information as to whether H regarded S's Assets (including Goodwill) overvalued, or whether H anticipated post-acquisition losses by S, on the purchase date, the Capital Profit should be shown as a separate heading in the final Consolidation while "Goodwill per Balance Sheets" should be shown as an Asset.

Disposal of shares in a subsidiary to outside parties.

It must be already apparent that a subsidiary is related to a holding company in a special way. When an acquisition of shares is made, the proportion of the pre-acquisition profits of the subsidiary is regarded as included in the purchase price and any dividends subsequently received by the holding company, in so far as they are paid out of these profits, cannot be looked upon as revenue to the holding company, but must be credited to Investment Account in the financial books. Conversely when such an Investment is realised, or partly realised, the holding company is entitled to regard the proportion of undistributed profits of the subsidiary as at the date of sale, as being included in the realisation price, and so part of that price may be a correct credit to the holding company's Profit and Loss Account in its books. It comes to this, that the general accounting principles used in the treatment of profits in Branch Accounts, apply also to subsidiaries and the relative proportion of the subsidiary's total net profit earned between the acquisition and the realisation dates of the shares in question, is a legitimate credit to the holding company's Profit and Loss Accounts. Dividends paid from the profits and received by the holding company from time to time will be credited to the holding company's Profit and Loss Account in the normal way, and only when the shares are realised, will the balance of the profits, if any, require to be specially dealt with. In the case of the share of profit exceeding the dividends paid and credited by the holding company to the Profit and Loss Accounts, the amount of the excess may be credited to the holding company's Profit and Loss Account when the shares are realised. This credit to revenue is made out of the realised price and at the discretion of the directors of the holding company. They may prefer to be conservative and ignore this additional credit to revenue. In the /

Investment Account will disclose the true capital profit or loss

the case of an excess of dividends paid (and credited on receipt by the holding company to Profit and Loss Account), over the share of profits earned between acquisition and realisation dates, the holding company's Profit and Loss Account must be debited with the excess and Investment Account credited. It is a true revenue loss which has emerged on the realisation of the shares and which must therefore be charged to revenue. pending further realisations, the

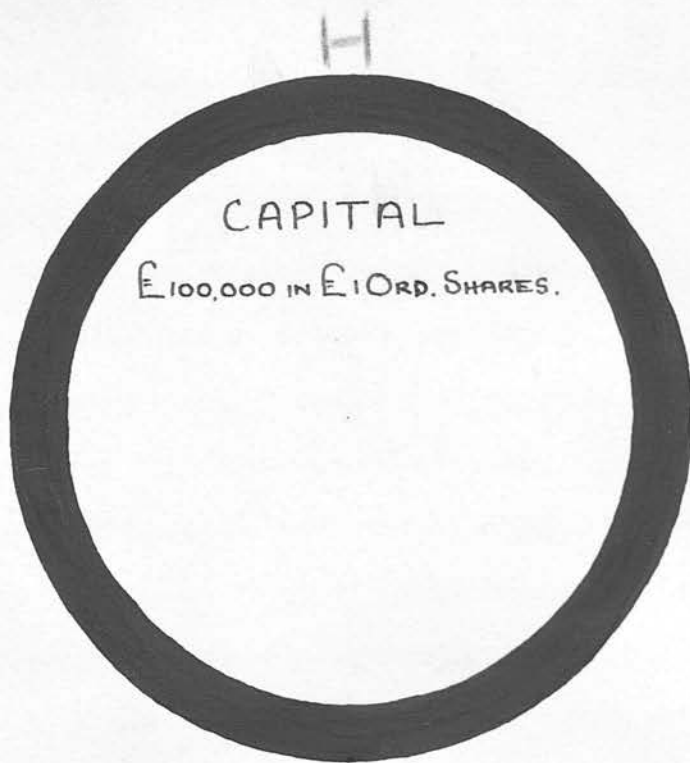
To arrive at the excess either way, it is quite unnecessary to investigate in detail the accounts of the subsidiary for all the years that the shares have been held, since the difference between the subsidiary's Revenue Account balance (credit or debit) on acquisition date and that balance on realisation date (credit or debit) discloses at once whether there has been an excess of profit earned over dividends paid by the subsidiary, or vice versa. By taking the necessary proportion of this, as represented by the shares sold, and making an adjustment for dividends received by the holding company and not credited to its Profit and Loss Account - Investment Account in the holding company's books will show the amount of such dividends (if any) credited to capital and this is the adjustment figure required - one can arrive at the excess of profits earned over dividends paid by the subsidiary and credited to the holding company's Profit and Loss Account, or the deficiency, as the case may be.

When the facts disclose that the subsidiary has made a net loss between acquisition and realisation dates, it is considered that the proportion of this loss as represented by the shares realised, must be debited to the holding company's Profit and Loss Account to the extent that the loss has not been provided for by the holding company making appropriations from its own profits in the past years and writing down the value of the shares held. The corresponding credit would be to Investment Account.

If the revenue adjustment either way is put through the financial books on the realisation of the shares, the balance on Investment /

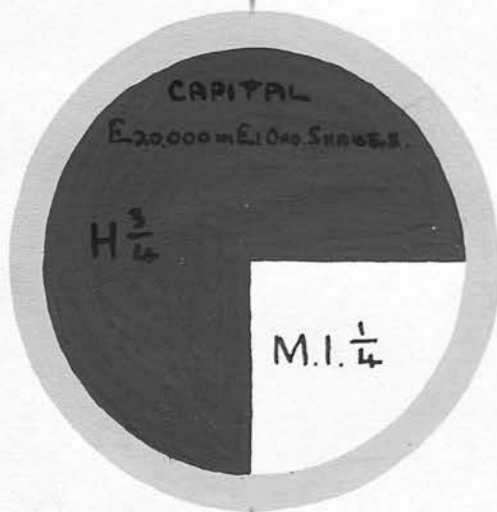
Investment Account will disclose the true capital profit or loss on the transaction; a profit is a Capital Reserve, while a loss should be written off against the holding company's profits as soon as possible. No adjustment requires to be made during the process of preparing subsequent Consolidated Statements if the transaction is so closed in the holding company's books. But where only a few shares are realised, the entire proceeds being credited to Investment Account pending further realisations, the transaction can be regarded as left open in the financial books, and the Accounts should be adjusted during the process of consolidation in accordance with the above principles.

EXAMPLE — 25.



$\frac{3}{4}$ BOUGHT — 1940

\$



ALL BOUGHT — 1942. $\frac{2}{3}$ SOLD — 31/12/46

T



Ex. 25. Disposal of Shares without losing control:

The summarised Balance Sheets of a group as at 31st December 1946 are:-

<u>ASSETS</u>		<u>H</u>	<u>S</u>	<u>T</u>
Sundry Assets	£111,000	£ 19,700	£ 15,000	
<u>Investments:</u>				
In S 15,000 shares at cost	19,000	-	-	
T 12,000 shares at cost (23/4d each) £ 14,000	-	11,300		
less: Realised 2,400 shares	2,700	-	-	
	£130,000	£ 31,000	£ 15,000	

LIABILITIES

Share Capital (in £1 Ord. Shares)	£100,000	£ 20,000	£ 12,000
Creditors	20,000	6,000	2,000
Revenue Account	10,000	5,000	1,000
	£130,000	£ 31,000	£ 15,000

H bought $\frac{3}{4}$ S in 1940 when the Revenue Account balance of S was credit £3,000
 S bought all T in 1942 when the Revenue Account balance of T was credit £2,800. On
 31st December 1946 S sold 2,400 shares in T for £2,700 (22/6d per share) & credited
 Investment Account with the proceeds.

SOLUTION

(a) The adjustments required in each company's accounts are:-

H (1) Revenue Account Dr. £ 2,250
 To Investment Account (in S) £ 2,250

(Being $\frac{3}{4}$ the Revenue Account balance in S in 1940 (credit £3,000) when H
 bought 15,000 shares in S ($\frac{3}{4}$))

S (1) Capital Reserve Account Dr. £ 100
 To Investment Account (in T) £ 100

(Being loss on sale of 2,400 shares in T included in Investment Account,
 transferred, thus leaving in Investment $\frac{1}{5}$ the cost price of shares now
 held)

	<u>Total</u>	<u>4/5th</u>	<u>1/5th</u>
Cost of shares in T in 1942	£ 14,000	£ 11,200	£ 2,800
Sold (1/5th) 2,400 shares on 31:12:46 for	-	-	2,700
			£ 100
			Loss: Book Value

S (2) Revenue Account Dr. £ 2,240
 To Investment Account in T £ 2,240

(Being $\frac{4}{5}$ the Revenue Account balance of T in 1942 (credit £2,800) when S
 bought 12,000 shares in T but has since disposed of 2,400 leaving 9,600
 ($\frac{4}{5}$ ths) still held).

S (3) Revenue Account Dr. £ 360
 To Capital Reserve £ 360

(Being adjustment of Revenue position on purchase and on sale of 2,400 shares
 bought by S in T in 1942 and sold on 31st December 1946, thus:-

Revenue included in purchase in 1942 ($\frac{1}{5}$ of 2,800) and which should have capitalised	£ 560
Less: set off Revenue do sale in 1946 ($\frac{1}{5}$ of 1,000)	200
$\frac{1}{5}$ th excess of Dividends paid over profits earned 1942-1946 by T	£ 360
or/	

(a) S (3) Continued.

or 1/5th Net loss of T for period 1942-1946 (£1,800)
(see note (2) ex. 17)

Note:

S's books show T's shares at cost. The above adjustment takes out the proportion of Revenue in the purchase and sale prices of 2,400 shares.

(b) The aggregation of the adjusted Balance Sheets is:-

<u>ASSETS</u>							<u>Total</u>	<u>H</u>	<u>S</u>	<u>T</u>
Sundry Assets	..	..	..	..	..	..	£145,700	£111,000	£ 19,700	£ 15,000
<u>Investments at Adjusted Cost:</u>										
In S 15,000 shares	..	..	..	..	..	..	16,750	16,750	-	-
T 9,600 shares	..	..	..	..	..	..	8,960	-	8,960	-
							£171,410	£127,750	£ 28,660	£ 15,000
<u>LIABILITIES</u>										
Share Capital	..	..	..	..	..	..	£132,000	£100,000	£ 20,000	£ 12,000
Creditors	..	..	..	..	..	..	28,000	20,000	6,000	2,000
Revenue Account	..	..	..	..	..	..	11,150	7,750	2,400	1,000
Capital Reserve	..	..	..	..	..	..	260	-	260	-
							£171,410	£127,750	£ 28,660	£ 15,000

(c) The Consolidated Statement is:-

<u>ASSETS</u>											
Sundry Assets	..	..	..	..	..	..	..	..	..	£145,700
<u>Goodwill - Net Cost of Control to the group:</u>											
								<u>By S</u>	<u>By H</u>		
								In T $\frac{4}{5}$	In S $\frac{3}{4}$		
Adjusted Cost	..	..	..	..	..	..	£	8,960	£ 16,750	
Par	..	..	..	..	..	..		9,600	15,000	
<u>Less: Minority Interests S $\frac{1}{4}$</u>								Cr. £ 640	Dr. 1,750		
								160			
								Cr. £ 480	Dr. 1,750		
<u>Less: Capital Reserve $\frac{4}{5}$ S (cr).</u>									£ 1,270	Dr.	
								195		1,075	
											£146,775
<u>LIABILITIES</u>											
Share Capital H	..	..	..	..	..	..	..	..	..	£100,000
Creditors	..	..	..	..	..	..	..	..	..	28,000
Revenue Account	..	..	..	..	..	..	..	..	£ 11,150	
<u>Less: Minority Interests:</u>											
T $\frac{1}{5}$ of 1,000	..	..	..	..	..	..	£	200		
S $\frac{1}{4}$ (2,400 + 800)	..	..	..	..	..	..		800	1,000	10,150
											Forward
											£138,150

(c) Liabilities (Continued)

Forward £138,150

Minority Interests:

	<u>S $\frac{1}{4}$</u>	<u>T $\frac{1}{5}$</u>	
Capital	£ 5,000	£ 2,400	
Revenue Account	800	200	
Net Cost of Control of T.	Cr. 160	-	
Capital Reserve	Cr. 65	-	
	<u>£ 6,025</u>	<u>£ 2,600</u>	8,625

Capital Reserve:

S	£ 260	
<u>Less: Minority Interests S $\frac{1}{4}$.</u>	<u>65</u>	
To H (Contra Goodwill).	<u>£ 195</u>	
		<u>£146,775</u>

Notes:

- (1) This example is the same as No.17 except that in the above S disposed of 2,400 shares in T on 31st December 1946. A comparison should be made of the adjustments and of the results. The Revenue Account balance £10,150 is the same in both examples; both groups have enjoyed the revenue of the members for the same time.
- (2) The Minority Interests S and T can be reconciled from the actual Balance Sheets as at 31st December 1946.

T 2,400 shares at 21/8d (Balance Sheet price).. .. .	£ 2,600(as above)
S Sundry Assets.. .. .	£ 19,700
<u>Add: 9,600 shares in T at 21/8d (T's Balance Sheet price).. .. .</u>	<u>10,400</u>
	£ 30,100
<u>Less: Creditors</u>	<u>6,000</u>
Value of S (20,000 shares)	<u>£ 24,100</u>
$\frac{3}{4}$ thereof (5,000 shares).. .. .	£ 6,025(as above)

- (3) As regards S's financial Accounts, no provision has been made for the loss on the sale of 2,400 share in T. The realised price, being credited to Investment Account, gives a book value of £11,300 for the remaining 9,600 shares (£1.3.6 $\frac{1}{2}$ d per share) still held by S.

It is doubtful from a legal point of view if S is able to leave this matter unadjusted. A revenue loss of £1,800 has been made by T since acquisition and as S has sold 2,400 shares (1/5th), S should debit to P. & L. Account 1/5th of the loss. In any event apart from legal considerations the prudent course for S to take would be to debit its P. & L. Account with £360 (1/5th of 1,800).

On the other hand the matter is properly adjusted in the Consolidated Statement since it is prepared on the basis of treating all revenue losses of T since acquisition as a charge to Revenue Account.

Inter-member transfer of shares.

A transfer of shares between members of the same group may take place for the purpose of simplifying or improving administration, or by reason of the fact that the group is about to sell or lose control of a subsidiary and desired to retain its control of another member whose shares are held by that subsidiary.

When shares held in a subsidiary or sub-subsidiary are transferred from one member of a group to another, the group's effective financial interest in the subsidiary or sub-subsidiary, as the case may be, will usually alter. It will increase if the transfer of shares is from any partly-owned member to the holding company, or from a partly-owned member, say $\frac{3}{4}$ ths owned, to another partly-owned member in which the holding company has a greater interest, e.g. where it is, say, $\frac{9}{10}$ ths owned. It will decrease in the converse circumstances, where the transfer of shares is from the holding company to any partly-owned member, or from a partly-owned member, say $\frac{9}{10}$ ths owned, to another partly-owned member in which the holding company has a lesser interest, e.g. where it is, say, $\frac{3}{4}$ ths owned. The transfer price of the shares will include the relative proportion (represented by the holding transferred), of the balance on Revenue Account of the subsidiary. In the subsequent Consolidated Statement this relative proportion has to be dealt with from two points of view, the transferee (buying) member's, and the transferor (selling) member's. The following method is simple and has universal application.

Adjustment of the Accounts of the transferee (buying) member.

The pre-acquisition revenue balance included in the amount paid for the shares should be treated in exactly the same way as if the shares had been bought from complete outsiders. The accounts of the buying member should be adjusted by a debit to Revenue Account and a credit /

credit to Investment Account (pre-acquisition profits) or vice versa for a pre-acquisition loss.

Adjustment of the Accounts of the transferor (selling) member.

The accounts of the transferor member should be dealt with in the same way as those of a member which has disposed of its holding in a subsidiary to outside parties. These principles have been discussed in the previous section. Shortly stated, the following are the entries to be made in the financial books of the member which has realised the holding or, alternatively, the adjustments to be made during the process of consolidation in the accounts of that member, when the transaction can be considered as left open in the financial books, i.e. when the proceeds have been credited to Investment Account and no further action has been taken.

(a) Debit $\left. \begin{array}{l} \text{P. \& L. A/c or} \\ \text{Rev. A/C} \end{array} \right\}$ and credit Investment Account with -

- (1) The excess of dividends received on the shares transferred (which dividends have already been credited to the Profit and Loss Account of the transferor member), over the relative proportion of profits earned by the subsidiary between acquisition and realisation dates, or -
- (2) The relative proportion of a net loss of the subsidiary between acquisition and realisation dates in so far as not already provided for in the books of the transferor member.

(b) Debit Investment Account and credit $\left. \begin{array}{l} \text{P. \& L. A/c } \\ \text{or Rev. A/c} \end{array} \right\}$ with the excess of the relative proportion of profits earned by the subsidiary between acquisition & realisation dates, over dividends received on the shares transferred and which have already been credited to the Profit and Loss Account of the transferor member (the reverse of (a)).

It is stressed that unless the necessary adjustment is made to the Revenue Account of the transferor member, the Revenue Account balance /

balance as brought out in the subsequent Consolidated Statement will not be correct. The relative proportion, as represented by the holding now transferred, of the balance on Revenue Account of the subsidiary, will be treated as pre-acquisition and capitalised by the transferee member by a debit to Revenue Account (pre-acquisition profit). To rectify the matter from the group's view-point, the same figure must be credited to Revenue in the adjustment of the Accounts of the transferor member.

EXAMPLE - 26.

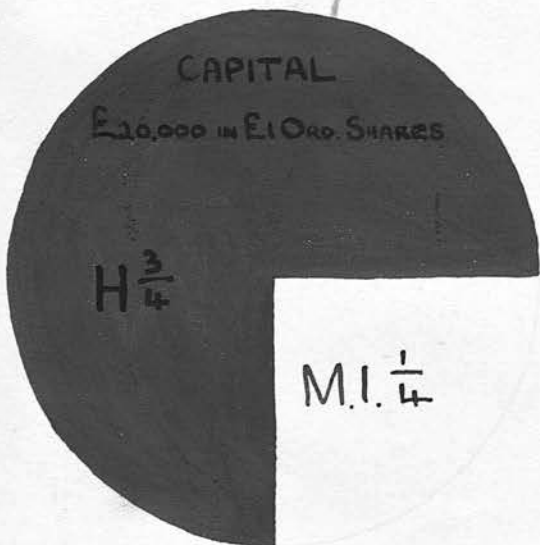
H



$\frac{1}{4}$ BOUGHT - 3/4/41
 $\frac{2}{3}$ BOUGHT - 31/12/46

$\frac{3}{4}$ BOUGHT - 21/4/39

S



T



26. Inter-member transfer of Shares:

In example 23 let it be assumed that S transfers to H on 1st January 1947 the 8,000 shares held in T for £14,000 cash. The trading transactions for 1st January, are ignored. The Balance Sheets are:-
(one day)

	<u>ASSETS</u>	<u>H</u>	<u>S</u>	<u>T</u>
Sundry Assets		£ 84,500	£ 32,000	£ 19,500
<u>Investments at Cost:</u>				
In S (15,000 shares)		18,000	-	-
T (3,000 shares)		4,500	-	-
T (8,000 shares from S).. .. .		<u>14,000</u>	<u>-</u>	<u>-</u>
		<u>£121,000</u>	<u>£ 32,000</u>	<u>£ 19,500</u>
	<u>LIABILITIES</u>			
Share Capital		£100,000	£ 20,000	£ 12,000
Creditors.. .. .		9,000	2,000	2,500
Revenue Account.		12,000	8,000	5,000
Reserve				
Profit on Sale of Investments.. .. .		<u>-</u>	<u>2,000</u>	<u>-</u>
		<u>£121,000</u>	<u>£ 32,000</u>	<u>£ 19,500</u>

SOLUTION

(a) The Adjustments required in each company's accounts are:-

H(1) and H(2) As in previous example. "Ex 23"

H(3) Revenue Account Dr. £ 3,333
 To Investment Account (in T) £ 3,333

(Being 2/3rds T's credit balance on Revenue Account £5,000 on 1st January 1947 when H acquired 8,000 shares in T 2/3rds.

S (1) Profit on Sale of Investment Account Dr. £ 933
 To Revenue Account.. .. . £ 933

(Being revenue included in sale price of 8,000 shares in T sold to H on 1st January 1947, made up thus:-

$\frac{2}{3}$ T's Revenue Balance at 31:12:46 (Cr. £5,000)	£ 3,333
Less: do. 27:5:39 (Cr. £3,600 when S bought $\frac{2}{3}$ T - the investment remaining in S's books at cost	<u>2,400</u>
	<u>£ 933</u>

(b) The Aggregation of the adjusted Balance Sheets is:-

	<u>ASSETS</u>	<u>Total</u>	<u>H</u>	<u>S</u>	<u>T</u>
Sundry Assets		£136,000	£ 84,500	£ 32,000	£ 19,500
<u>Investments at Adjusted Cost:</u>					
In S 15,000 shares.		16,500	16,500	-	-
T 3,000 shares.		3,750	3,750	-	-
T 8,000 shares.		<u>10,667</u>	<u>10,667</u>	<u>-</u>	<u>-</u>
		<u>£ 166,917</u>	<u>£115,417</u>	<u>£ 32,000</u>	<u>£ 19,500</u>

LIABILITIES/

(b) Continued.

	<u>LIABILITIES</u>	<u>Total</u>	<u>H</u>	<u>S</u>	<u>T</u>
Capital		£132,000	£100,000	£ 20,000	£ 12,000
Creditors. .. .		13,500	9,000	2,000	2,500
Revenue Account .. .		20,350	6,417	8,933	5,000
Capital Reserve (profit on sale of Investments) .. .		1,067	-	1,067	-
		<u>£166,917</u>	<u>£115,417</u>	<u>£ 32,000</u>	<u>£ 19,500</u>

(c) The Consolidated Statement is:-

<u>ASSETS</u>		<u>By</u>			
		<u>In T 2/3</u>	<u>In T 1/4</u>	<u>In S 3/4</u>	
Sundry Assets.. .. .					£136,000
<u>Goodwill - Net Cost of Control to the group:</u>					
Adjusted Cost.. .. .		£ 10,667	£ 3,750	£ 16,500	
Par.. .. .		8,000	3,000	15,000	
		£ 2,667	£ 750	£ 1,500	
			V		
			£ 4,917		
<u>Less: Share of Capital Reserve S.. .. .</u>			800		4,117
					<u>£140,117</u>

<u>LIABILITIES</u>					
Share Capital H					£100,000
Creditors. .. .					13,500
Revenue Account .. .				£ 20,350	
<u>Less: Minority Interests:</u>					
S 1/4 of £8,933 .. .				£ 2,233	
T 1/2 of £5,000.. .				417	17,700
				2,650	
<u>Minority Interests:</u>					
			<u>S 1/4</u>	<u>S 1/2</u>	
Capital.. .. .			£ 5,000	£ 1,000	
Revenue Account .. .			2,233	417	
Capital Reserve .. .			267	-	
			£ 7,500	£ 1,417	8,917
<u>Capital Reserve:</u>					
S				£ 1,067	
To Minority Interests S 1/4 .. .			£ 267		
H 3/4 .. .			800	1,067	
					<u>£140,117</u>

Notes:

(1) The Revenue Account £17,700 remains the same in the two examples. H has capitalised £3,333 being 2/3rds of T's Revenue Balance (cr.£5,000) at 31st December 1946, but S has credited to its Revenue Account the same figure, being Revenue included in the profit on the sale of its Investments

(2)/

Notes (Continued)

- (2) In comparison of the two examples the figures which have altered are Minority Interests (increased by £667) and Net Cost of Control (increased by £667) This is explained thus:-

	<u>Net Cost of Control</u>	<u>S's Minority Interests</u>
(a) H's interest in T has increased for it now holds directly 2/3rds of T instead of indirectly through S (partly-owned).		
The $\frac{1}{4}$ share in the Net Cost of Control of T is therefore no longer borne by S's Minority Interests	£ 400 Dr	£ 400 Cr
(b) H paid £14,000 for shares bought in 1939 for £12,000 The additional price £2,000 was to the extent of £933 (2/3rds of (£5,000 - £3,600)) in respect of the increase of T's Revenue Account balance between 1939 and 1946. This leaves £1,067 paid by H for additional Goodwill	<u>1,067 Dr</u>	
	£ 1,467	
(c) S's Capital Reserve £1,067 being the capital profit to S on the transfer is shared H $\frac{3}{4}$ Minority Interests S $\frac{1}{4}$	800 Cr	267
	<u>£ 667 Dr</u>	<u>£ 667 Cr</u>

- (3) The Profit on sale of Investment £2,000 shown temporarily in S's Balance Sheet may be treated in S's financial books thus:-

Transfer to Profit and Loss Account (Revenue Profit) .. .	£ 933
<u>Thus: T's Cr. balance on Revenue Account at 1947 sale</u>	
date ..£ 5,000	
" " " 1939 purchase	
date increase .. <u>3,600</u>	
Increase ..£ <u>1,400</u>	
To S 2/3rds thereof.. ..	<u>£ 933</u>
Capital Reserve (balance).. .. .	<u>1,067</u>
	<u>£ 2,000</u>

It is considered that S can take, as a maximum, £933 to the credit of the Profit and Loss Account in its financial Accounts but the directors of S must decide whether this sum; a lesser sum, or nil is to be treated as a Revenue Profit. They may be conservative and decide to leave the whole £2,000 at credit of a Reserve Account in which case £933 can be regarded as a General Reserve and £1,067 as a Capital Reserve.

- (4) H has capitalised 2/3rds of T's Revenue balance on 31:12:46 £5,000 (see H 3) although prior thereto, H had an interest in T through S (2/3rds of $\frac{3}{4} = \frac{1}{2}$). H, however, receives a share of the revenue earned by T up to 31:12:46 ($\frac{1}{2}$ of (£5,000 - £3,600) = £700) as S's revenue is adjusted for it (see S) and H receives $\frac{3}{4}$ of S's revenue ($\frac{3}{4}$ of (933 (see S 1)) = £700).

CHAPTER VIII. The Larger Group.

In a large group, most of the adjustments required in the preparation of the Consolidated Statement have been covered in the preceding pages dealing with groups of two or three members. Particular care must be taken to see that correctly adjusted pre-acquisition revenue balances are used when these are capitalised, and that an accurate allocation of the Net Cost of Control of each member is made when the shares are not held by the holding company itself. These are practical points and they will be demonstrated in the examples which follow. ^{M.L.} There are ~~really~~ only two matters which require further theoretical study - the question of assets revaluation and of unrealised profit on stock.

Fixed Assets re-valuation.

A theoretical difficulty arises when two members hold shares in the same subsidiary and on the respective acquisition dates different views were then held by the purchasers as to over or under-valuation of the fixed assets of the subsidiary.

In the Consolidated Statement it will be appreciated that a re-valuation of fixed assets adjustment has the effect of increasing or decreasing the value of the asset concerned, with a proportional alteration in the Net Cost of Control figure, according to the number of shares held.

For consolidation purposes, two different adjusted Balance Sheets of the same subsidiary is untenable and the only feasible solution seems to be either to take the re-valuation figures at the later purchase date, so that aggregation figures for Property, Plant, etc., appear as the total of the most recent figures available, or, alternatively, where the second acquisition of shares is trifling, to take the re-valuation figures at the date when the larger purchase of shares was made.

Another case of an assets re-valuation is where a holding company /

company acquires control of another holding company and the former company re-values the fixed assets of the old subsidiaries. (Sub-subsidiaries of the new group) on a different basis from the valuation made when the latter company acquired control at the earlier date. What really happens here is that the new holding company re-values the "Investments in subsidiaries" as shown in the Balance Sheet of the old holding company and fixes its offer for the shares in the old holding company accordingly. In such a case there is no question of a choice of treatment. In the preparation of the Consolidated Statement of the new group, the later re-valuation figures only should be used, for so far as the new group is concerned, the earlier valuation of the assets of the sub-subsidiary is simply history and not relevant to the question at issue.

An example of this type of re-valuation is given in the last illustration in this chapter (see example 29 (a) - Consolidated Statement of Alpha Ltd. and its subsidiaries at 1/1/46).

Unrealised Profit on Stock.

The reserve which is required in the case of a transfer of stock to or by the holding company has been discussed (see Chapter V p. 12) but where stock is held by a partly-owned member, and that stock has been bought from another partly-owned member, the latter having earned a profit on the transaction, the position from the group's point of view is more complicated. The reserve required for consolidation purposes still depends on the same three factors, namely:

- (a) The amount of profit falling to group revenue as a result of the transaction.
- (b) The group's effective financial interest in the stock on hand.
- & (c) Which member will sell the goods eventually to the public.

Of the total profit included in the valuation of any parcel of stock /

stock on hand, the amount of the profit which eventually finds its way to the Group Profit and Loss Account in the Consolidated Statement must be ascertained. This will depend on the group's effective financial interest in the selling member, i.e. the proportion of the Ordinary Share Capital of the selling member held by the holding company either directly and/or indirectly through another subsidiary or other subsidiaries. If H. owned $\frac{3}{4}$ ths S. and $\frac{1}{8}$ th T. and S. owns $\frac{2}{3}$ rds T., the group's effective financial interest in T. is $\frac{1}{8}$ th directly plus $\frac{3}{4}$ ths of $\frac{2}{3}$ rds or $\frac{1}{2}$ through S. (indirectly), together $\frac{5}{8}$ ths. The group's effective financial interest in T. is therefore $\frac{5}{8}$ ths. Of the total profit on stock, the Minority Interests of the selling member and of any partly owned subsidiary which holds shares in the selling member, have earned their profit, and in normal circumstances must be left undisturbed with it. The group's share, however, is unrealised profit to the group for which an adequate reserve must be created in the holding company's accounts as representing the group (debit Revenue Account and credit Stock Reserve when the accounts of the holding company are being adjusted).

In ^{practice} ~~certain circumstances~~, the normal reserve as computed above, may be perhaps somewhat restricted. The determining factor is the group's real interest in the stock on hand, and this depends upon the effective financial interest of the group in the buying member which now holds the stock.

Case 1. Group's effective financial interest in the buying member less than that in the selling member.

In the case where it is quite definite that the buying member will dispose of the goods to the public, it is open to discussion whether ~~in case 1~~ the normal reserve can be reduced, owing to the fact that one can regard the group as having partly "sold" the stock to outsiders - the "outsiders" in this case being the Minority Interests of the buying member (see argument in Chapter V on p.15).

Provided /

Provided that the reserve is restricted only to the extent that the Minority Interests in the buying ~~company~~^{member} exceed those of the selling ~~company~~^{member}, that is to say that the reserve previously calculated by taking the total profit less a proportion according to the Minority Interests of the selling member, is now restricted to the total profit in the stock in question less a proportion - and a greater proportion - according to the Minority Interests of the buying member, the writer feels this view might be upheld.

Ex. X invoices to Y £10,000 of stock which includes a profit of £1,200 to X. The goods are unsold by Y at the balance date, but Y will dispose of the goods to the public. Both X and Y are members of a large combine, and the group's effective financial interest is $\frac{9}{10}$ ths in X and $\frac{3}{4}$ ths in Y. No reserve for unrealised profit has been made in the financial accounts.

The group's share of unrealised profit is $\frac{9}{10}$ ths of £1,200 = £1,080. That profit will be included in the Profit and Loss Account balance in the Consolidated Statement, and a reserve of £1,080 created in the adjustment of the holding company's accounts would cancel the profit. The group's interest in the stock in hand is, however, only a $\frac{3}{4}$ ths interest, as $\frac{1}{4}$ th is now the affair of the Minority Interests of Y (the buying company). The reserve required might, therefore, be reduced from £1,080 to £900 ($\frac{3}{4}$ ths of £1,200) on the basis of the above argument.

If it is once admitted that the Minority Interests of a buying member can be looked upon as "outsiders" and the stock "sold" to them, it might be contended further that in the foregoing example the group's share of the sale to Y ($\frac{9}{10}$ ths of £10,000 of stock) has been "sold" to the extent of the Minority Interests of the buying member ($\frac{1}{4}$ th) and that the reserve required can be still further reduced to $\frac{9}{10}$ ths of $\frac{3}{4}$ th of £1,200 = £810. The writer feels, however, that this contention cannot be maintained. The transaction must be considered from the point of view of the group, and what has really happened is that a $\frac{9}{10}$ th interest in a parcel of stock has been reduced /

reduced by the physical transfer of the goods, to a $\frac{3}{4}$ th interest. Accordingly the reserve for unrealised profit must be as a minimum $\frac{3}{4}$ th of the profit. In other words, from the group's standpoint, the Minority Interests of the buying company merely take the place of those of the selling company, but where they more than take their place, the group's interests are involved, and one may consider a restriction of the reserve to a certain extent (in the above example the reserve of £1,080 is restricted to £900 and that is the minimum figure).

Where the buying member may not sell the goods to the public but perhaps returns them at a later date to the selling member, all profit on the transaction should be cancelled by the adjustment of the accounts of the member which took credit for the profit, (in the above example one would debit Revenue Account and credit Stock Reserve Account with £1,200 when adjusting X's Accounts for consolidation).

Case 2. Group's effective financial interest in the buying member greater than that in the selling member.

The reserve does not require to be more than that which cancels out unrealised profit which finds its way to the Group Profit and Loss Account in the Consolidated Statement. The reserve will be made by the adjustment of the accounts of the holding company as representing the group.

In the special case where the selling member may have the goods returned to it at a subsequent date, all profit should be cancelled by the adjustment of the accounts of the selling member.

Ex. X invoices to Y £10,000 of stock which includes a profit of £1,200 to X. The goods are unsold at balance date. Both X and Y are members of a group and the group's effective interest is in X $\frac{2}{3}$ rds and in Y $\frac{9}{10}$ ths.

If the goods may be returned to X at a subsequent date, all profit should be cancelled meantime. In the adjusting of X's accounts /

accounts for consolidation, Revenue Account would be debited, and Stock Reserve credited with £1,200.

If X will definitely dispose of the goods to the public, X's Accounts should be left undisturbed, so that their Minority Interests receive their share of the profit on the goods transferred to Y. The group's share of the profit, £800 ($\frac{2}{3}$ rds of £1,200) should, however, be reserved for, ^{which is done} when one adjusts the accounts of the holding company, by a debit to Revenue Account and a credit to Stock Reserve of £800. The controllers might well decide to have a reserve of a greater amount. Any reserve exceeding £800, however, is not a cancellation of unrealised profit but a provision for a loss on realisation, which is quite another matter.

Enquiry must be made into the circumstances of a transfer of stock. In a horizontal combine, slow-selling stock may be transferred to various members in order to take advantage of local sale periods, and, if not sold, the stock will be passed on thereafter to other members. In the Consolidated Statement, any profit added to the invoice price of transfers should be cancelled in total by the creation of a full reserve in the selling members' accounts - debit Revenue Account; credit Stock Reserve: - the Minority Interests of the selling member ^{being} ~~will be~~ affected by such a provision. On the other hand, an inter-company transfer of stock may be made to meet demand and preserve the goodwill of customers. If the selling member could have sold such stock readily to the public, but transfers it instead to a group member, only the group's share of the profit on any goods still in the hands of the buying company must be excluded in the Consolidated Statement by the creating of the appropriate reserve in the holding company's accounts.

In a large vertical combine, it is likely that each company from the first process of production, say, Company A, to the selling of the finished product to the public, say Company Z, will add a fair margin for profit to the price it sells stock to any other member.

The /

The group's share of the profit on unsold stock at any balancing date will be an aggregate of amounts calculated from the group's effective financial interest in the profit earned by each member on all such stock held by other members which follow in the flow of production, i.e. if it is assumed B follows A, C follows B, etc., the total reserve required is the group's proportion of profit earned by Company A on stocks which passed through A and are still held by Companies B-Z, added to the group's proportion of profit earned by Company B on stocks which passed through B and are still held by Companies C-Z and so on. To restrict the reserve owing to the group's effective financial interest in any one subsequent member which holds stock, being less than that of the particular selling member, would not be justifiable if the group's interest in other members later in the flow of production was again greater and, in any event, probably would not be worth the trouble involved in the mathematical calculations of portions of profits on numerous parcels of stock.

In all the above cases, in order to arrive at the adjustment figure for consolidation purposes, the total reserve as computed for the group would be restricted by any reserve or a proportion thereof as the case may be, made in the financial books of any member in respect of unrealised profit on stock.

Examples of large groups.

In the examples which ~~will~~ follow, particular attention should be paid to the capitalisation of pre-acquisition revenue balances and also to the allocation of the Net Cost of Control of each member, by each member which holds the shares.

EXAMPLE — 27.

H



$\frac{1}{6}$ BOUGHT — 30/6/43

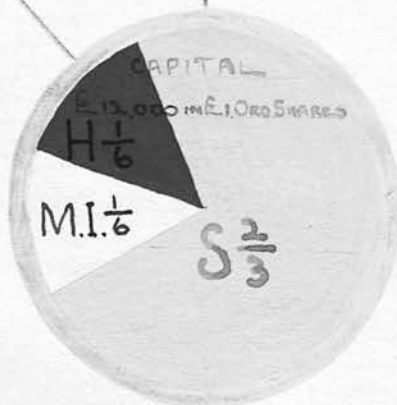
$\frac{4}{8}$ BOUGHT — 31/12/42.

S



$\frac{2}{3}$ BOUGHT — 30/6/39

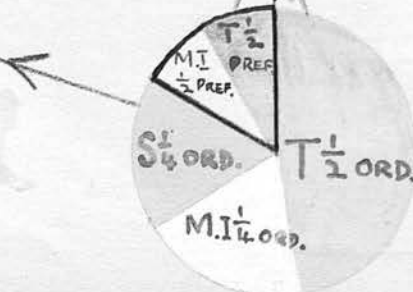
$\frac{1}{4}$ ORD. BOUGHT — 31/8/38



$\frac{1}{2}$ PREF. BOUGHT — 31/8/38

$\frac{1}{2}$ ORD. BOUGHT — 31/8/38.

V



Group of four members: one being controlled through a Sub-subsidiary. Subsidiary with Preference Capital.

The summarised Balance Sheets of a Group as at 31st December 1943 are:

		<u>Assets</u>			
		<u>H.</u>	<u>S.</u>	<u>T.</u>	<u>V.</u>
Property at Cost,	£ 59,000	£ -	£ 4,000	£ 6,000	
Plant at cost less depreciation,	21,700	3,000	1,000	1,300	
Stock,	25,000	6,000	5,000	4,000	
Debtors,	30,000	6,600	3,800	3,150	
Cash,	1,300	100	20	50	
Loans to Members,	4,000	1,500	-	-	
<u>Investments:</u>					
In V., 4,000 Ordinary Shares at cost,					
less dividends £600,	-	-	5,600	-	
In V., 1,000 Preference Shares at Cost,					
less dividends £40,	-	-	1,080	-	
In V., 2,000 Ordinary Shares at cost,					
less dividends £300,	-	2,800	-	-	
In T., 8,000 Ordinary Shares at cost, ..	-	6,000	-	-	
In S., 16,000 " " " " ..	16,500	-	-	-	
In T., 2,000 " " " " ..	2,500	-	-	-	
Profit and Loss Account,	-	3,000	-	-	
	£160,000	£ 29,000	£ 20,500	£ 14,500	

LIABILITIES

<u>Share Capital (in £1 Shares)</u>				
Ordinary Shares,	£100,000	£ 20,000	£ 12,000	£ 8,000
6% Preference Shares,	-	-	-	2,000
Sundry Creditors,	20,000	6,000	4,000	2,000
Loans from Members of Group,	-	3,000	1,500	1,000
General Reserve,	30,000	-	1,000	500
Profit and Loss Account,	10,000	-	2,000	1,000
	£160,000	£ 29,000	£ 20,500	£ 14,500

Notes:

- (1) On 31st August 1938, when it was estimated from V.'s books that V.'s balance on Revenue Account, before providing for V.'s accrued Preference Dividend, was Cr. £2,280,
 - (a) T. bought 4,000 Ordinary Shares in V.
 " " 1,000 Preference " " "
 As arranged in the Agreement by T. to buy shares in V., one of T.'s Directors was appointed Chairman of V. immediately after the acquisition of the shares.
 - (b) S. bought 2,000 Ordinary Shares in V.
 (V.'s Preference Shares have a preference for dividend and capital).
- (2) On 30th June 1939 S. bought 8,000 Ordinary Shares in T., when it was estimated from -
 - (a) T.'s books that T.'s balance on Revenue Account was Dr. £1,000,
 - (b) V.'s " " V.'s " " " " " " Cr. £1,560, before providing for V.'s accrued Preference dividend.
 In making the offer S. considered that T.'s Property was over-valued by £2,000. T.'s books were not adjusted for this.
- (3) On 31st December 1942 H. bought 16,000 Ordinary Shares in S., when it was estimated from -
 - (a) S.'s books that S.'s Revenue Account balance was Cr. £1,530.
 - (b) T.'s " " T.'s " " " " " " Dr. £600,
 - (c) V.'s " " V.'s " " " " " " Cr. £1,000 before providing for V.'s accrued Preference dividend.

In making the offer H. considered S.'s Plant was under-valued by £1,000, but S.'s books were not adjusted for this. Since that date S. has written off 10% depreciation per annum, which is considered fair.

Notes (Continued):

- (4) On 30th June 1943 H. bought 2,000 Ordinary Shares in T., when it was estimated from -
- (a) T.'s books that T.'s balance on Revenue Account was Cr. £1,400.
- (b) V.'s " " V.'s " " " " " " Cr. £1,260, before providing for V.'s accrued Preference dividend.
- H. also considered T.'s Property was over-valued by £2,000.
- (5) On 31st December 1943 a reserve for inter-company profit on Stock, of £1,500, is required to be made, ^{for consolidation purposes} by the Holding Company on behalf of the group.
- (6) V.'s Preference dividend is regularly paid on the 15th January for each previous calendar year. V.'s Ordinary dividends are regularly paid in March for the preceding calendar year.
- (7) All the estimated balances on Revenue Accounts are exclusive of accrued profit or dividends from other members.
- (8) All companies have credited to Investment Account all dividends declared for any period prior to the relative acquisition dates.

Solution

a) The adjustments required in each Company's Accounts are:

V. V.'s Revenue Account position is -	31/8/38	30/6/39	31/12/42	30/6/43	31/12/43
As per question (P. & L. Account and General Reserve),	£ 2,280	£ 1,560	£ 1,000	£1,260	£1,500
<u>Less: Preference Dividend accrued to date,</u>	<u>80</u>	<u>60</u>	<u>120</u>	<u>60</u>	<u>120</u>
<u>Balance falling to Ordinary Shareholders.. .. .</u>	<u>£ 2,200</u>	<u>£ 1,500</u>	<u>£ 880</u>	<u>£1,200</u>	<u>£1,380</u>

V.(1) Revenue Account, Dr. £ 120
 To Preference Dividend Outstanding Account, £ 120
 (Being provision for Preference Dividend for 1943.)

T.(1) Preference Dividend Receivable Account, Dr. £ 60
 To Revenue Account, £ 60
 (Being 1943 Preference Dividend accrued but not received at 31st December 1943 in respect of 1,000 6% Preference Shares held by T. in V.)

T.(2) Revenue Account, Dr. £ 500
 To Investment Account (in V.), £ 500

(Being portion of V.'s Revenue Account balance at 31st August 1938 (£2,200 Cr.) - pre-acquisition-when T. bought 4,000 Ordinary Shares in V., made up thus:

$\frac{1}{2}$ of V.'s Revenue Balance,	£ 1,100
<u>Less: Dividend credited to Investment A/c,</u>	<u>600</u>
<u>Balance to be capitalised,</u>	<u>£ 500</u>

T. (3) Capital Reserve, Dr. £2,000
 To Property Account, £2,000

(Being over-valuation of T.'s Property on 30th June 1939 when S. acquired control of T.)

Note: The Preference Shares bought by T. in V. require no adjustment, as the dividend credited to Investment Account, £40, represents the full pre-acquisition Preference Dividend. (Shares bought 31st August 1938 - $\frac{2}{3}$ rds of £60 = £40)

The Revenue position of T. is therefore -

As per question (P. & L. Account and General Reserve)	30/6/39	31/12/42	30/6/43	31/12/43
Dr. £1,000	Dr. £ 600	Cr. £1,400	Cr. £3,000	
Capitalisation per T.(2) above,	<u>500</u>	<u>500</u>	<u>500</u>	<u>500</u>
<u>Forward</u>	<u>Dr. £1,500</u>	<u>Dr. £1,100</u>	<u>Cr. £ 900</u>	<u>Cr. £2,500</u>

(a) (Continued)

	30/6/39	31/12/42	30/6/43	31/12/43
<u>Forward</u>	£1,500	£1,100	£ 900	£2,500
<u>Add:</u> Accrued Preference Dividend from V.	30	60	30	60
	Dr. £1,470	Dr. £1,040	Cr. £ 930	Cr. £2,560
<u>Add:</u> $\frac{1}{2}$ of Revenue from V.,	750	440	600	690
	Dr. £ 720	Dr. £ 600	Cr. £ 1,530	Cr. £3,250
S.(1)	No pre-acquisition revenue adjustment is required in respect of the 2,000 Ordinary Shares in V. bought by S. on 31st August 1938. This was an ordinary investment, as no group existed, so far as S. is concerned, until a later date.			
S.(2)	Investment Account (in T.) Dr. £ 480			
	To Revenue Account,			£ 480
	(Being two-thirds of T.'s adjusted Revenue Account balance at 30th June 1939 (Dr. £720) - pre-acquisition - when S. bought 8,000 Ordinary Shares in T. (two-thirds).)			
S.(3)	Plant Account Dr. £ 900			
	To Capital Reserve			£ 900
	(Being current under-valuation of Plant, i.e. under-valuation of £1,000 on 31st December 1942 when H. acquired control of S., less depreciation at 10% p.a. for 1 year).			
S.'s Revenue position is -	31/12/42	31/12/43		
As per question (P.&L. Account and General Reserve)	Cr. £ 1,530	Dr. £ 3,000		
Adjustment in Investment Account (£480 Cr)..	480	480		
	Cr. £ 2,010	Dr. £ 2,520		
Proportion of T.'s Revenue Account $\frac{2}{3}$	..Dr. 400	Cr. 2,167		
" " V.'s " " $\frac{1}{3}$	..Cr. 220	Cr. 345		
	Cr. £ 1,830	Dr. £ 8		
H.(1)	Revenue Account, Dr. £ 255			
	To Investment Account (in T.)			£ 255
	(Being one-sixth of T.'s adjusted Revenue Account balance at 30th June 1943 (Cr. £1,530) - pre-acquisition - when H. bought 2,000 shares in T. (one-sixth).)			
H.(2)	Revenue Account, Dr. £1,464			
	To Investment Account (in S.)			£ 1,464
	(Being four-fifths of S.'s adjusted Revenue Account balance at 31st December 1942 (Cr. £1,830) - pre-acquisition - when H. bought 16,000 Shares in S. (four-fifths).)			
H.(3)	Revenue Account, Dr. £1,500			
	To Stock Reserve,.. .. .			£1,500
	(Being reserve required at 31st December 1943 for inter-company profit on Stock not yet realised.)			

(b) The aggregation of the adjusted Balance Sheets is:

	Assets				
	Total	H.	S.	T.	V.
Property,	£ 67,000	£ 59,000	£ -	£ 2,000	£ 6,000
Plant,	27,900	21,700	3,900	1,000	1,300
Stock,	40,000	25,000	6,000	5,000	4,000
Debtors,	43,550	30,000	6,600	3,800	3,150
Cash,	1,470	1,300	100	20	50
Inter-Company Loans,	-	4,000	1,500	-	-
<u>Investments at Adjusted Cost:</u>					
In V. 4,000 Ordinary Shares,	5,100	-	-	5,100	-
" " 1,000 Preference Shares,	1,080	-	-	1,080	-
" " 2,000 Ordinary Shares,	2,800	-	2,800	-	-
" T. 8,000 " "	6,480	-	6,480	-	-
" S. 16,000 " "	15,036	15,036	-	-	-
" T. 2,000 " "	2,245	2,245	-	-	-
<u>Forward</u>	£212,661	£158,281	£ 27,380	£ 18,000	£14,500

b) Assets (Continued)

	Forward	£212,661	£158,281	£27,380	£ 18,000	£ 14,500
Capital Reserve,	2,000	-	-	2,000	-	-
Preference Dividend receivable,	-	-	-	60	-	-
Revenue Account,	-	-	2,520	-	-	-
		<u>£214,661</u>	<u>£158,281</u>	<u>£29,900</u>	<u>£ 20,060</u>	<u>£ 14,500</u>

Liabilities

	Total	H.	S.	T.	V.
Capital - Ordinary,	£140,000	£100,000	£20,000	£ 12,000	£ 8,000
Preference,	2,000	-	-	-	2,000
Creditors,	32,000	20,000	6,000	4,000	2,000
Capital Reserve,	900	-	900	-	-
Preference Dividend outstanding,	60	-	-	-	120
Stock Reserve,	1,500	1,500	-	-	-
Revenue Account,	38,201	36,781	-	2,560	1,380
Inter-Company Loans,	-	-	3,000	1,500	1,000
	<u>£214,661</u>	<u>£158,281</u>	<u>£29,900</u>	<u>£ 20,060</u>	<u>£ 14,500</u>

c) The Consolidated Statement of Assets and Liabilities is:Assets

Property,	£ 67,000
Plant,	27,900
Stock, less reserve	38,500
Debtors,	43,550
Cash,	1,470
Goodwill - Net Cost of Control to the Group:	

	By T.		By S		By H.	
	In V. $\frac{1}{2}$ Ord.	In V. $\frac{1}{2}$ Pref.	In T. $\frac{2}{3}$	In V. $\frac{1}{4}$	In S. $\frac{4}{5}$	In T. $\frac{1}{6}$
Adjusted Cost	£ 5,100	£ 1,080	£ 6,480	£ 2,800	£15,036	£2,245
Less: Capital Reserve,			Dr. 1,334		720	Dr. 333
			£ 7,814		£14,316	£2,578
Par,	4,000	1,000	8,000	2,000	16,000	2,000
	Dr. £ 1,100	£ 80	£ 800	£ 800		£ 578
	Cr.		£ 186		£ 1,684	
		<u>Dr. £1,180</u>		<u>Dr. £ 614</u>		<u>Cr. £1,106</u>
To H. $\frac{1}{6}$	£ 197					Dr. 197
To S. $\frac{2}{3}$	786			786		
To Minority Interest						
T. $\frac{1}{6}$	<u>197</u>	<u>1,180</u>				
				<u>Dr. £1,400</u>		
To H. $\frac{4}{5}$		£1,120				Dr. 1,120
" Minority Interest						
S. $\frac{1}{5}$		<u>280</u>		<u>1,400</u>		
						<u>211</u>
						<u>£178,631</u>

Liabilities/

(c) (Continued).

		<u>Liabilities</u>					
Share Capital H.,	.. .. .	.. .. .	.. .. .	.. .. .	.. .. .	.. .. .	£ 100,000
Creditors,	.. .. .	.. .. .	.. .. .	.. .. .	.. .. .	.. .. .	32,000
<u>Capital Reserve:</u>							
S.	.. .. .	.. .. .	.. .. .	.. .. .	.. .. .	Cr. £900	
To H.	$\frac{4}{5}$	.. .. .	.. .. .	.. .. .	.. .. .	£ 720	
"	Minority Interest S.	$\frac{1}{5}$	.. .. .	.. .. .	.. .. .	<u>180</u>	<u>900</u>
T.	.. .. .	.. .. .	.. .. .	.. .. .	.. .. .	Dr. £2,000	
To H.	$\frac{1}{6}$	.. .. .	.. .. .	.. .. .	.. .. .	Dr. £ 333	
"	S.	$\frac{2}{3}$	.. .. .	.. .. .	.. .. .	Dr. 1,334	
"	Minority Interest T	$\frac{1}{6}$	.. .. .	.. .. .	.. .. .	<u>Dr. 333</u>	<u>2,000</u>
Revenue Account,	.. .. .	.. .. .	.. .. .	.. .. .	.. .. .	£ 38,201	
<u>Less: Minority Interests -</u>							
V.	$\frac{1}{4}$ of £1,380..	.. .. .	.. .. .	.. .. .	.. .. .	£ 345	
T.	$\frac{1}{6}$ of (£2,560 + $\frac{1,380}{2}$)	.. .. .	.. .. .	.. .. .	.. .. .	542	
S.	$\frac{1}{5}$ of Dr. £8,	.. .. .	.. .. .	.. .. .	.. .. .	<u>Dr. 2</u>	<u>885</u>
							<u>37,316</u>
<u>Minority Interests:</u>		<u>S. $\frac{1}{5}$</u>	<u>T. $\frac{1}{6}$</u>	<u>V. Ord $\frac{1}{4}$</u>	<u>V. Pref. $\frac{1}{2}$</u>		
Capital	£ 4,000	£ 2,000	£ 2,000	£ 1,000			
Revenue Account	Dr. 2	542	345	60			
Capital Reserve	180	Dr. 333	-	-			
Net Cost of Control	<u>Dr. 280</u>	<u>Dr. 197</u>	-	-			
		<u>£ 3,898</u>	<u>£ 2,012</u>	<u>£ 2,345</u>	<u>£ 1,060</u>	<u>9,315</u>	
							<u>£ 178,631</u>

Notes.

- (1) The controllers of the Group must decide how the Revenue Account is to be divided between Profit and Loss Account and General Reserve. As a minimum the General Reserve must be £30,000 (H's General Reserve), but it may be increased at the discretion of the controllers.

The following mathematical proportion of Revenue Account might be taken to General Reserve:

H.	£30,000.	.. .. .	.. .. .	.. .. .	.. .. .	.. .. .	.. .. .	£ 30,000
S.	Nil,	.. .. .	.. .. .	.. .. .	.. .. .	.. .. .	.. .. .	-
T.	1,000	$\frac{1}{6}$ direct.	.. .. .	.. .. .	.. .. .	.. .. .	£ 167	
	$\frac{4}{5}$ of $\frac{2}{3}$	through S.	$\frac{8}{15}$	.. .. .	.. .. .	.. .. .	<u>533</u>	700
V.	500	$\frac{4}{5}$ of $\frac{1}{4}$	" S.	$\frac{1}{5}$	.. .. .	.. .. .	£ 100	
	$\frac{1}{2}$ of $\frac{1}{6}$	" T.	$\frac{1}{12}$	.. .. .	.. .. .	.. .. .	42	
	$\frac{4}{5}$ of $\frac{2}{3}$	of $\frac{1}{2}$ " S. & T.	$\frac{4}{15}$	.. .. .	.. .. .	.. .. .	<u>133</u>	
							<u>275</u>	
							<u>£ 30,975</u>	

- (2) The Minority Interests can be calculated by an examination of the original Balance Sheets, e.g. -

T. Ordinary $\frac{1}{6}$ th:

Share Capital	$\frac{1}{6}$	£ 2,000
Revenue Account	$\frac{1}{6}$ of (T + $\frac{1}{2}$ V)	
	= $\frac{1}{6}$ of (£3,000 + 60) + $\frac{1}{2}$ (1,500 - 120)	
	= $\frac{1}{6}$ of (3,060 + 690).. .. .	625
Capital Reserve created	$\frac{1}{6}$ of £2,000 Dr,.. .. .	333 Dr.

Cost of Control of Shares held by T:

	In V.Ord	In V.Pref.
Cost	£ 5,600	£ 1,080
Par	<u>4,000</u>	<u>1,000</u>
	£ 1,600	£ 80

$\frac{1}{6}$ of £ 1,680 280 Dr.

£ 2,012

S. Ordinary $\frac{1}{5}$ th:

Share Capital	$\frac{1}{5}$	£ 4,000
Revenue Account	$\frac{1}{5}$ of [$\frac{S}{3},000 - \frac{1}{4} \times 1,380 + \frac{2}{3} (T + \frac{1}{2}V)$]	
	= $\frac{1}{5}$ of [$\frac{Dr.}{3},000 + 345 + \frac{2}{3} \times 3,750$]	
	$\frac{1}{5}$ of 155 Dr.	31 Dr.
Capital Reserve created	$\frac{1}{5}$ of 900 - $\frac{1}{5}$ of $\frac{2}{3}$ of 2,000 ^{Dr.}	
	= 180 - 267.	87 Dr.

Cost of Control:

	V	T
Book Value.. .. .	£ 2,800	£ 6,000
Par	<u>2,000</u>	<u>8,000</u>
	£ 800 Dr.	£ 2,000 Cr.
	<u>£ 1,200 Cr.</u>	

$\frac{1}{5}$ of 1,200 Cr. + $\frac{1}{5}$ of $\frac{2}{3}$ of cost of control of V. by T.
 = $\frac{1}{5}$ (1,200 Cr. + $\frac{2}{3}$ of 1,680 Dr.) 16 Cr.
£ 3,898

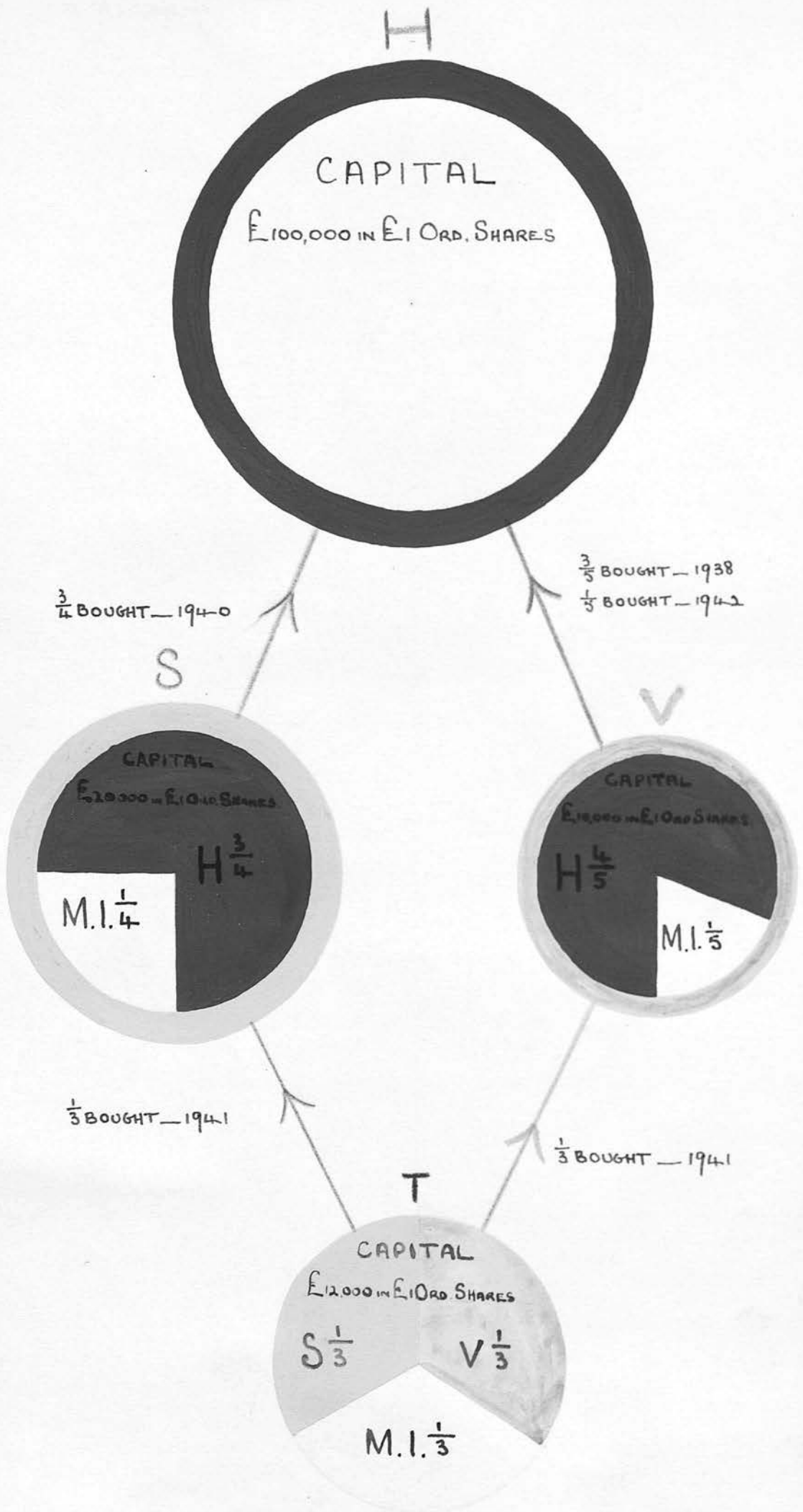
- (3) When H. acquired S. on 31st December 1942, H. considered S's Plant undervalued by £1,000. As S. will ^{not} provide for depreciation on the valuation difference, £1,000, H. in its financial books should do so by writing down the value of "Investment in S." The writing down for 1943 should be -

£1,000 @ 10% p.a. £100, whereof falling to H. $\frac{4}{5}$ ths .. £80

As H. is not following this policy, the original net Cost of Control figure will increase in subsequent Consolidated Statements by the cumulative amount of depreciation on the valuation difference to any particular date.

- (4) S's investment in T. As no Group existed between S and T when S bought 2,000 Ordinary Shares in V. this can be regarded as an Ordinary investment.

EXAMPLE — 28.



One Subsidiary bought when post-acquisition losses were anticipated. Special writing down of Investment in another Subsidiary.

The summarised Balance Sheets of a group as at 31st December 1946 were:-

<u>Assets</u>				
	<u>H.</u>	<u>S.</u>	<u>T.</u>	<u>V.</u>
Sundry Assets	£108,500	£ 20,200	£ 18,400	£ 9,150
<u>Investments:</u>				
In V., 6,000 Shares (cost £3,000)	3,000			
S., 15,000 Shares (cost £18,900)	16,000			
T., 4,000 Shares (cost £5,000)				4,850
T., 4,000 Shares (cost £5,000)		4,800		
V., 2,000 Shares (cost £2,500)	2,500			
Revenue Account.. .. .		1,000		
	<u>£130,000</u>	<u>£ 26,000</u>	<u>£ 18,400</u>	<u>£ 14,000</u>

<u>Liabilities</u>				
	<u>H.</u>	<u>S.</u>	<u>T.</u>	<u>V.</u>
Share Capital (in £1 Ordinary Shares) ..	£100,000	£ 20,000	£ 12,000	£ 10,000
Creditors	20,000	6,000	4,000	2,000
Revenue Account.. .. .	10,000	-	2,400	2,000
	<u>£130,000</u>	<u>£ 26,000</u>	<u>£ 18,400</u>	<u>£ 14,000</u>

Notes:

(1) In January 1938 H. bought 6,000 Shares in V when it was estimated V's balance on Revenue Account was Dr. £2,000. In making the offer H. considered V's Property over-valued by £500 (V's Books were not adjusted for this) H. also anticipated V. would continue to incur losses, estimated at £1,600, until reorganised. These losses materialised to the extent of £1,800 in 1938/9 and were capitalised in V's books under "Reorganisation Expenses." These expenses were written off against V's profits in 1941.

(2) In February 1940 H. bought 15,000 Shares in S. when it was estimated S's balance on Revenue Account was Cr. £1,200. The Investment Account in H's books is:-

Cost of 15,000 Shares in S in February 1940	£ 18,900
<u>Less:</u> Dividends received from S 1940/41 credited ..	£ 900
Special Depreciation written off in December 1946 by H from Revenue Account to cover S's current losses as shown by S's Accounts to 31st December 1946 and fall in value of Goodwill	<u>2,000</u>
	<u>2,900</u>
	<u>£ 16,000</u>

(3) In March 1941 both S. and V. bought 4,000 Shares each in T when it was estimated T's balance on Revenue Account was Cr. £600. In each Company the difference between Book Value and Cost represents dividends credited.

(4) In April 1942 H. bought a further 2,000 Shares in V. when it was estimated

(a) From V's books that V's balance on Revenue Account was ..	Cr.£ 800
(b) " T's " T's " " ..	Cr.£ 1,500

As in 1938 H. considered V's Property overvalued by £ 500.

Solution/

(a) The adjustments required in each Company's Accounts are:-

H (1) Investment Account (In V) Dr. £ 1,200
 To Revenue Account.. .. . £ 1,200
 (Being 3/5ths the debit balance on V's Revenue Account £2,000 in 1938 - pre-acquisition - when H bought 6,000 Shares in V (3/5ths))

H (2) Investment Account (In S) Dr. £ 2,000
 To Special Reserve.. .. . £ 2,000
 (Being the amount provided by H in December 1946, to cover current losses in Subsidiary S and a reduction in the Book Value of the Investment, now transferred to a Special Reserve Account, thereby adjusting the valuation of Investment in S to cost, less pre-acquisition revenue balance)
Note: The Dividend credited £900 exactly covers the pre-acquisition balance ($\frac{3}{4}$ of £1,200)

H (3) Revenue Account Dr. £ 250
 To Investment Account (in V).. .. . £ 250
 (Being 1/5th of V's true credit balance on Revenue Account in 1942 - pre-acquisition - when H bought a further 2,000 Shares in V (1/5th) made up thus:-

Revenue Account balance in 1942 per V's Books.	Cr. £ 800
<u>Less:</u> Balance of T's Revenue Account in 1941 which should have been capitalised by V (see V2)	<u>50</u>
	£ 750
<u>Add:</u> 1/3rd of T's credit balance on Revenue Account in 1942 (£1,500) falling to V ..	<u>500</u>
	<u>£ 1,250</u>
1/5th thereof to H	<u>£ 250</u>

S No adjustments required. Holding in T 4,000 Shares written down by dividends received to an amount of £200 which exactly equals 1/3rd of T credit balance in 1941 (£600).

T No adjustments required.

V (1) Capital Reserve Account.. .. . Dr. £ 500
 To Sundry Assets (Property).. .. . £ 500
 (Being over-valuation of V8s Property in 1938 when H acquired control of V)

V (2) Revenue Account Dr. £ 50
 To Investment Account (In T) £ 50
 (Being portion of 1/3rd of T's credit balance on Revenue Account in 1941 - pre-acquisition - when V bought 4,000 Shares in T (1/3rd) arrived at thus:-

1/3rd of T's credit balance on Revenue Account 1941	
1/3rd of 600	£ 200
<u>Less:</u> Dividend credited to Investment Account by V ..	<u>150</u>
	<u>£ 50</u>

(b) The aggregation of the adjusted Balance Sheets is/

b) The aggregation of the adjusted Balance Sheets is:-

<u>Assets</u>	<u>Total</u>	<u>H.</u>	<u>S.</u>	<u>T.</u>	<u>V.</u>
Sundry Assets	£155,750	£108,500	£ 20,200	£ 18,400	£ 8,650
Capital Reserve.. .. .	500	-	-	-	500
Revenue Account.. .. .	-	-	1,000	-	-
<u>Investments at Adjusted Cost</u>					
In V (6,000 Shares)	4,200	4,200	-	-	-
" S (15,000 Shares).. .. .	18,000	18,000	-	-	-
" T (4,000 Shares)	4,800	-	-	-	4,800
" T (4,000 Shares)	4,800	-	4,800	-	-
" V (2,000 Shares additional).. .. .	2,250	2,250	-	-	-
	<u>£190,300</u>	<u>£132,950</u>	<u>£ 26,000</u>	<u>£ 18,400</u>	<u>£ 13,950</u>

Liabilities

Share Capital	£142,000	£100,000	£ 20,000	£ 12,000	£ 10,000
Creditors	32,000	20,000	6,000	4,000	2,000
Special Reserve for S. by H	2,000	2,000	-	-	-
Revenue Account.. .. .	14,300	10,950	-	2,400	1,950
	<u>£190,300</u>	<u>£132,950</u>	<u>£ 26,000</u>	<u>£ 18,400</u>	<u>£ 13,950</u>

b) The Consolidated Statement is:-

Assets.

Sundry Assets						£155,750
Capital Reserve V... .. .						500
To Minority Interests V. 1/5th			Dr. £ 100			
" H 4/5ths			400			500

Goodwill Net Cost of Control to the group less sums written off

	By V. <u>In T 1/3</u>	By S. <u>In T 1/3</u>	By H. <u>In V. 4/5</u>	<u>In S 3/4</u>	
Adjusted Cost	£4,800	£4,800	£4,200	£2,250	£18,000
Add: Share of V's Dr. balance on Capital Reserve.			300	100	
			£4,500	£2,350	
Par	4,000	4,000	6,000	2,000	15,000
	Dr. £ 800	£ 800		£ 350	£ 3,000
			£1,500		
<u>Less: Minority Interests</u>					
V 1/5th	160				
S 1/4th		200			
Balance of Special Reserve					1,850
	<u>£ 640</u>	<u>£ 600</u>	<u>Cr. £1,500</u>	<u>£ 350</u>	<u>£ 1,150</u>
					<u>£ 1,240</u>
					<u>£156,990</u>

Liabilities

Share Capital H.	£100,000
Creditors	32,000
Special Reserve H.	£ 2,000
<u>Less: H's share of S Revenue balance (debit).. .. .</u>	<u>150</u>
To Goodwill	<u>£ 1,850</u>

Revenue Account /

Forward £ 132,000

Revenue Account

T	£ 2,400	
Divisible thus:-		
Minority Interests 1/3rd	£ 800	
S 1/3rd	800	
V 1/3rd	800	2,400
<hr/>		
S .. .. .	.Dr. £ 1,000	
<u>Less:</u> Share of T's credit balance	800	
	£ 200	
<u>Less:</u> Minority Interests S $\frac{1}{4}$	50	
Balance to H (Special Reserve Account)	£ 150	
<hr/>		
V	£ 1,950	
<u>Add:</u> Share of T's credit balance	800	
	£ 2,750	
<u>Less:</u> Minority Interests V 1/5th	550	
	To H . . .	£ 2,200
H	10,950	13,150

Minority Interests

	<u>S 1/4th</u>	<u>T 1/3rd</u>	<u>V 1/5th</u>	
Capital	£ 5,000	£ 4,000	£ 2,000	
Revenue Account	Dr.. 50	800	550	
Capital Reserve			100	Dr.
Net Cost of Control	Dr. 200		160	Dr.
	£ 4,750	£ 4,800	£ 2,290	11,840
				<u>£156,990</u>

Notes:

- (1) In December 1946 H wrote down the value of its Investment in S by £2,000 to cover S's current losses and depreciation on the value of the holding. The actual amount of S's current losses to 31st December 1946 falling to H is £150 so that after deducting this from the provision made by H, £1,850 is available as a set off against the Net Cost of Control in the Consolidated Statement.
- (2) No adjustment is made for V's post-acquisition losses in 1938/39 £1,800 which were anticipated to an amount of £1,600 by H on acquisition of 3/5ths of V, since these re-organisation expenses, at first capitalised by V, were written off against V's subsequent profits in 1941. The net cost of control in respect of the 3/5th holding in V is credit £1,500 which to the extent of £960 (3/5th of £1,600) represents the reserve made by H on the acquisition of the shares, for this matter.
- (3) Pre-acquisition debit balance of a Subsidiary
V is a Subsidiary which was acquired in 1938 when it had a debit balance of £2,000 on Profit and Loss Account. V's profits since that date have more than wiped out this debit balance. Accordingly, if a deviation of Revenue Account was being made between Group Profit and Loss Account and Group General Reserve, one should keep in mind that part of V's post-acquisition profit is "frozen" to the group and it would be preferable to take H's share (3/5th of £2,000 - H 1 adjustment) to the credit of Group General Reserve. By this transfer, Group Profit and Loss Account is kept in line with the divisible profits of the members.

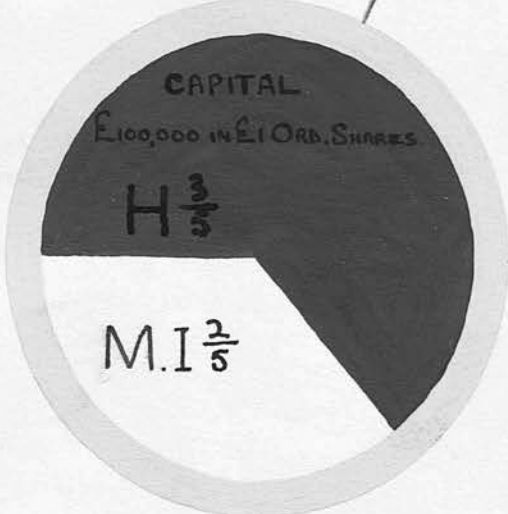
EXAMPLES — 29 AND 41.

H



$\frac{3}{5}$ BOUGHT — 30/4/41

S



$\frac{2}{3}$ BOUGHT — 30/6/42

V



$\frac{1}{3}$ BOUGHT — 30/6/44

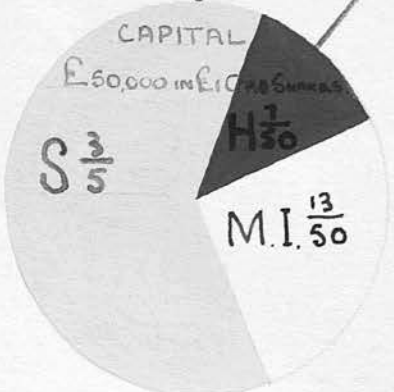


$\frac{7}{50}$ BOUGHT — 7/1/43



$\frac{3}{5}$ BOUGHT — 31/12/42

T



The Balance Sheets of a group at 31st December 1945 are as follows:-

ASSETS

	<u>H.</u>	<u>S.</u>	<u>T.</u>	<u>V.</u>
Property at cost.	£ 251,000	£ -	£ 30,000	£ 2,000
Plant at cost, less depreciation	130,000	20,000	8,000	4,500
Investment (Government Stock)	-	-	1,000	-
do. Subsidiaries	82,000	44,500	-	-
Stock.. .. .	178,000	40,000	14,000	9,000
Debtors	56,000	10,400	8,700	5,000
Subs' Current Accounts	6,500	-	500	-
Dividends Receivable.. .. .	4,500	-	-	-
Cash in Bank	9,000	100	500	1,000
Goodwill at cost.	-	10,000	7,000	-
	<u>£ 717,000</u>	<u>£125,000</u>	<u>£ 69,700</u>	<u>£21,500</u>

LIABILITIES

	<u>H.</u>	<u>S.</u>	<u>T.</u>	<u>V.</u>
Share Capital (in £1 Ordinary Shares) ..	£ 500,000	£100,000	£ 50,000	£15,000
Creditors	62,500	10,700	7,500	2,800
Amount due to H.. .. .	-	4,300	2,200	500
Reserve for inter-coy profit on stock ..	2,000	-	-	-
General Reserve.. .. .	100,000	-	7,000	2,000
Profit and Loss Account	52,500	2,500	3,000	1,200
Proposed Dividend	-	7,500	-	-
	<u>£ 717,000</u>	<u>£125,000</u>	<u>£ 69,700</u>	<u>£21,500</u>

Notes:

(1) Investments in Subsidiaries are as follows:-

	<u>Book Value</u>
<u>H.</u> 60,000 Ord. Shares ($\frac{6}{10}$ ths) in S bought ^{30th} April 1941	£62,000
7,000 do. ($\frac{7}{50}$ ths) in T bought 7th Jan. 1943	8,000
10,000 do. ($\frac{2}{3}$ rds) in V bought 30th June 1942	<u>12,000</u>
As per Balance Sheet of H.. ..	<u>£82,000</u>

H. has adopted the policy of continuing to credit to Investment Account, dividends received from Subsidiaries until all investments are stated at cost less the full relative proportions of the pre-acquisition revenue balances. This was completed before 31st December 1945. When acquiring shares in T, H accepted S's view regarding the valuation of T's Plant (see note 5).

<u>S.</u> 24,000 (now 30,000) Ord. Shs. ($\frac{3}{5}$ ths) in T. bought 31st December 1942, at cost	£ 38,000
5,000 Ord. Shs. ($\frac{1}{3}$ rd) in V. bought 30th June 1944, at cost. ..	<u>6,500</u>
As per Balance Sheet of S.. ..	<u>£ 44,500</u>

P.L. A/c. Gen. Res. Total

On 31st December 1942 the balances at credit of			
T were	£ 10,000	£ 15,000	£ 25,000
On 30th June 1944 the balances at credit of V were.. .. .	900	1,500	<u>2,400</u>

S. accepted H's view regarding the valuation of V's Property (see note 4) On 4th January 1943 T made a bonus issue of shares out of General Reserve by giving one new Ord. Share for every four held (General Reserve at 31:12:42 £15,000)/

(a) (Continued) -

S.1.	Revenue Account	Dr. £ 9,000	
	To Investment Account (in T.)		£ 9,000

(Being $\frac{3}{5}$ ths T's credit balance on Revenue Account £15,000 at 31:12:42 - pre-acquisition when S bought 30,000 shares $\frac{3}{5}$ ths in T.)

Note: T's credit balance of Revenue Account £25,000 at 31:12:42 is reduced by the bonus issue of shares on 1943 £10,000 in the calculation of the above pre-acquisition figure.

S.2.	Revenue Account	Dr. £ 800	
	To Investment Account (in V)		£ 800

(Being $\frac{1}{3}$ rd V's credit balance on Revenue Account £2,400 at 30:6:44 - pre-acquisition when S bought 5,000 shares ($\frac{1}{3}$ rd) in V.)

H.1.	Revenue Account	Dr. £ 500	
	To Stock Reserve		£ 500

(Being increase in reserve required by the group at 31:12:45 for inter-coy profits on stock)

(b) The Aggregation of the Adjusted Balance Sheets is:-ASSETS

	<u>Total</u>	<u>H.</u>	<u>S.</u>	<u>T.</u>	<u>V.</u>
Property.	£284,000	£251,000	£ -	£ 30,000	£ 3,000
Plant	162,690	130,000	20,000	8,190	4,500
Stock	241,000	178,000	40,000	14,000	9,000
Debtors.. .. .	80,100	56,000	10,400	8,700	5,000
Subsidiary's Current Account.	-	6,500	-	500	-
Dividends receivable		4,500			
Cash	10,600	9,000	100	500	1,000
Goodwill per Balance Sheets..	17,000	-	10,000	7,000	-
<u>Investments at Adjusted Cost:</u>					
In S 60,000 shares	62,000	62,000			
T 7,000 shares	8,000	8,000			
V 10,000 shares	12,000	12,000			
T 30,000 shares	29,000	-	29,000		
V 5,000 shares	5,700	-	5,700		
Government Stocks	1,000			1,000	
Revenue Account			7,300		
	<u>£913,090</u>	<u>£717,000</u>	<u>£122,500</u>	<u>£ 69,890</u>	<u>£22,500</u>

LIABILITIES

	<u>Total</u>	<u>H.</u>	<u>S.</u>	<u>T.</u>	<u>V.</u>
Share Capital.. .. .	£665,000	£500,000	£100,000	£ 50,000	£15,000
Creditors.	83,500	62,500	10,700	7,500	2,800
Due H	-	-	4,300	2,200	500
Stock Reserve.. .. .	2,500	2,500	-	-	-
Proposed Dividends.. .. .	3,000	-	7,500	-	-
Revenue Account	156,996	152,000	-	9,096	3,200
Capital Reserve	2,094	-	-	1,094	1,000
	<u>£913,090</u>	<u>£717,000</u>	<u>£122,500</u>	<u>£ 69,890</u>	<u>£22,500</u>

(c) The Consolidated Statement of Assets and Liabilities as at 31:12:45, is/ASSETS/

(c) The Consolidated Statement of Assets and Liabilities as at 31:12:45, is:-

ASSETS

Property	£284,000
Plant.. .. .	162,690
Stock, less reserve	238,500
Sundry Debtors	80,100
Investment (Government Securities)	1,000
Cash	10,600
Goodwill as per Balance Sheets	17,000
<u>Goodwill - Net Cost of Control to the Group:</u>	

By H.

	In S $\frac{6}{10}$ ths	In T $\frac{7}{50}$ ths	In V $\frac{2}{3}$ rds
Adjusted Cost	£ 62,000	£ 8,000	£ 12,000
<u>Less: Capital Reserve.</u>		153	667
		£ 7,847	£ 11,333
Par Value	60,000	7,000	10,000
	£ 2,000	£ 847	£ 1,333
		Dr. £ 4,180	

By S.

	In T $\frac{3}{5}$ ths	In V $\frac{1}{3}$ rd
Adjusted Cost	£ 29,000	£ 5,700
<u>Less: Capital Reserve.</u>	656	333
	£ 28,344	£ 5,367
Par	30,000	5,000
	Cr. £ 1,656	£ 367 Dr.
	£ 1,289 Cr.	

<u>Less: Min. Interests S $\frac{4}{10}$</u>	516	Cr. 773	3,407
			<u>£797,297</u>

LIABILITIES

Share Capital H.. .. .	£500,000
Sundry Creditors.	83,500
<u>Capital Reserve -</u>	
V	£ 1,000
To S (1/3rd).. .. .	£ 333
" H (2/3rds).	667
	<u>1,000</u>
T	£ 1,094
To S (3/5ths).	£ 656
" H (7/50ths)	153
" Min. Interests T 13/50ths.	285
	<u>1,094</u>
Revenue Account.	£156,996
<u>Less: Minority Interests:</u>	
T 13/50ths of £9,096	£ 2,365
S $\frac{4}{10}$ (S + $\frac{1}{3}$ V + $\frac{3}{5}$ T)	
" $\frac{4}{10}$ (7,300 Dr. + $\frac{3,200}{3}$ + $\frac{3}{5}$ x 9,096	
	Dr. 310
	<u>2,055</u>
	<u>154,941</u>

Forward £ 738,441

Minority Interests/

(c) (Continued) Liabilities -

Forward £738,441

Minority Interests:

	<u>4</u> S <u>10</u> ^{ths}	<u>13</u> T <u>50</u> ^{ths}	
Capital	£ 40,000	£ 13,000	
Capital Reserve.. .. .	-	285	
Proposed Dividend	3,000		
Revenue Account.. .. .	Dr. 310	2,365Cr	
Net Cost of Control	Cr. 516	-	
	<u>£ 43,206</u>	<u>£ 15,650</u>	58,856
			<u>£797,297</u>

Notes:

- (1) The Controllers of the group must determine how much of the Revenue Account £154,941 is to be transferred to Group General Reserve. As a minimum £100,000 (H's General Reserve) should be transferred. A mathematical calculation based on the post-acquisition General Reserves of the Subsidiaries - Revenue Account £154,941 is of course post-acquisition only - is:-

$$\begin{aligned}
 \text{General Reserve} &= H + \frac{6}{10} (S + \frac{1}{3} V + \frac{3}{5} T) + \frac{7}{50} T + \frac{2}{3} V. \\
 &= 100,000 + \frac{6}{10} \left(- + \frac{1}{3} (2,000 - 1,500) + \frac{3}{5} (7,000 - 5,000) \right) + \frac{7}{50} \times 7,000 \\
 &\qquad\qquad\qquad + \frac{2}{3} \times 2,000 \\
 &= 100,000 + \frac{6}{10} (166.6 + 1,200) + 980 + 1,333.3. \\
 &= 103,133
 \end{aligned}$$

On this basis Revenue Account is divisible

Group General Reserve per calculation.. .. .	£103,133
<u>Less: Additional depreciation charged to T in the Consolidated Statement i.e. T, 2. adjustment.. .. .</u>	<u>£ 904</u>

Proportion thereof falling to the group.

$\frac{7}{50}$ of 904 + $\left(\frac{3}{5} \times \frac{6}{10} \times 904\right)$ thro' S = $\frac{1}{2} \times 904$	<u>452</u>
<u>Group General Reserve ..</u>	<u>£102,681</u>
<u>Group Profit and Loss Account</u>	<u>52,260</u>
	<u>£154,941</u>

Observe that the amounts of the General Reserve of T and of V at the date that H bought shares in T & V are not required. All the reserve is post-acquisition from the group's view-point as H has written down the value of shares in T and in V by the full pre-acquisition balances.

- (2) As regards T's Bonus Issue of Shares in 1943, it should be noted that this was made entirely out of a pre-acquisition General Reserve so far as S is concerned. Accordingly the capitalisation in T's/financial books reduces the pre-acquisition revenue, Balance to be capitalised by S (see S.1.) for consolidation purposes.

Even in a case where the Bonus Issue has been made out of a General Reserve created after acquisition date, it would be quite in order to reduce the pre-acquisition revenue balance by the amount of the bonus. In this case the Subsidiary is capitalising profits and there is no need for the group to capitalise the amount again.

(3) Undervaluation of T's Plant -

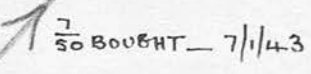
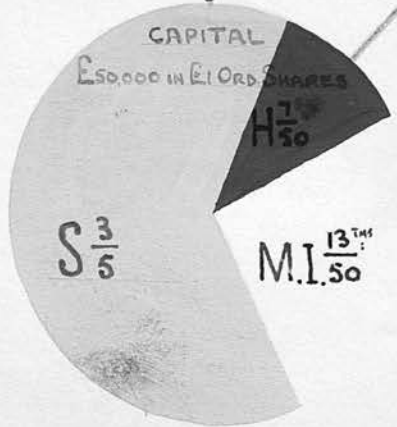
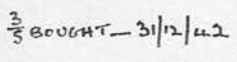
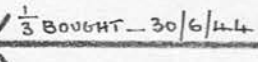
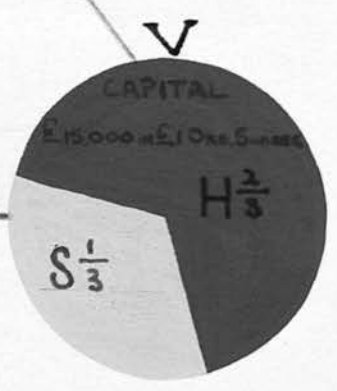
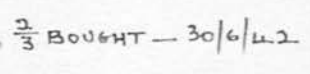
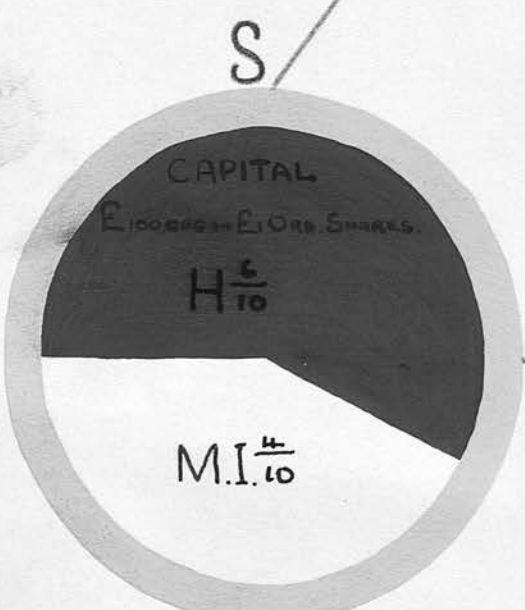
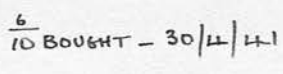
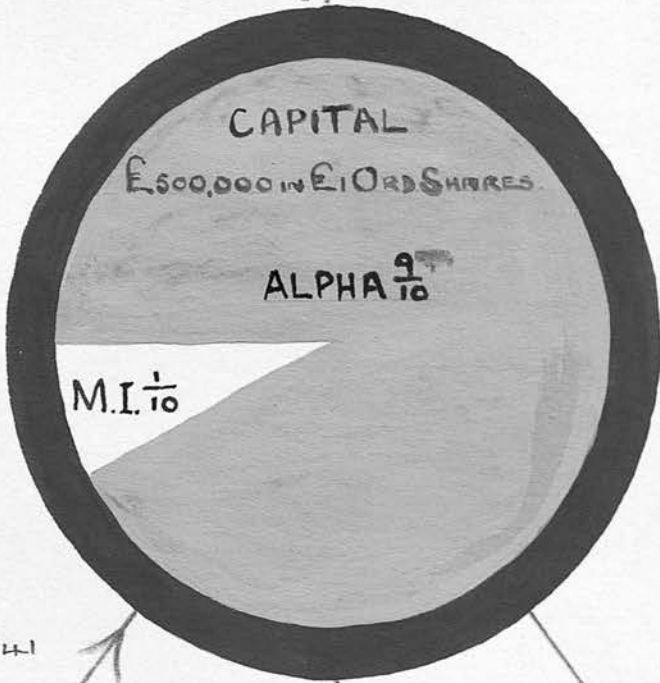
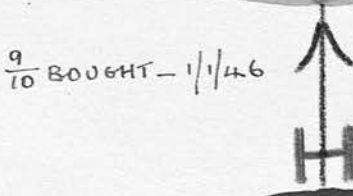
£1,500 when S bought $\frac{3}{5}$ ths T on 31:12:42, £1,500 when H bought $\frac{7}{50}$ ths T on 7:1:43 and £1,094 in the Consolidated Statement at 31:12:45.

T is not providing for any depreciation on the valuation difference and will never in point of fact do so. In theory S and H, having paid for the higher valuation of Plant in the price given for T's shares, should write down the valuation of "Investments in Subsidiary T" in their financial books by the appropriate proportion of depreciation on the plant valuation difference according to their financial interest in T. This is not being done in the financial books of S and H, accordingly the Net Cost of Control figure will increase each year (see Net Cost of Control figure on year later in example 41).

The writing down of "Investment in Subsidiary T" which should have been done is:-

In S's books.	10% depreciation on valuation difference	£1,500 for 1943	£150
	do.	do. £1,350 for 1944	135
	do.	do. £1,215 for 1945	<u>121</u>
			<u>£406</u>
S's share $\frac{3}{5}$ ths thereof.	£244	Group bears $\frac{6}{10}$ ths of this or ..	£146
In H's books	10% depreciation on valuation difference for 1943,4,5		£406.
	H's share $\frac{7}{50}$ ths thereof..	.. .. .	<u>57</u>
Increase in Net Cost of Control during 1943-45 due to this factor		..	<u>£203</u>

(4) This example is worked out in the form of Ledger Accounts in Appendix II.



Example 29(a) - Purchase of a Holding Company by another Company. Revaluation of Assets of the Sub-subsidiaries:

Alpha Ltd. acquired 450,000 Ordinary Shares of H. Ltd. in ex.29, at 1st January 1946. The purchase price £675,000 (30/- per share) was arrived at on the basis of the Consolidated Statement at 31st December 1945 (ex.29) but after making certain further adjustments, viz:-

- (1) Alpha considered V's Property worth £4,500
- (2) Alpha considered the Goodwill valuation of each company was -

	<u>Total Goodwill</u> as valued by <u>Alpha</u>	<u>Balance Sheet</u> <u>Value</u>	<u>Hidden</u> <u>Goodwill</u>	<u>Hidden</u> <u>Badwill</u>
V.	£ 3,000		£ 3,000	
T.	6,000	£ 7,000		£ 1,000
S.	13,333	10,000	3,333	
H.	93,000	-	93,000	

In the case of H and S the above revaluation figures by Alpha affect Alpha's view on the value of "Investments in Subsidiaries" appearing in the Balance Sheets of H and S.

Prepare a Consolidated Statement of the new group on the assumption that Alpha's Balance Sheet after purchase will be -

ASSETS

Investment in H. Ltd. 450,000 shares..	..	..	..	..	..	..	..	..	..	£ 675,000
Preliminary Expenses ..	..	..	..	..	..	..	..	..	..	40,000
Cash ..	..	..	..	..	..	..	..	..	..	35,000
										£ 750,000

LIABILITIES

Share Capital:

250,000 5% Preference Shares of £1 each..	..	..	..	..	..	..	..	..	..	£ 250,000
500,000 Ordinary Shares of £1 each..	..	..	..	..	..	..	..	..	..	500,000
										£ 750,000

SOLUTION

The purchase price of H's shares (30/-each) is a round figure and accordingly it is unlikely that at that price H's Goodwill will work out at exactly £93,000. The exact value of H's Goodwill computed on a basis of 30/- per share, is £93,065 arrived at thus:-

Total value of H Ltd and its Subsidiaries on the basis of 30/- per share. (500,000 shares) £ 750,000
Made up as follows -

Value of H. Ltd. and its Subsidiaries as per Consolidated Statement at 31.12.45.

Capital ..	..	..	..	..	..	..	..	..	..	£ 500,000
Revenue ..	..	..	..	..	..	..	..	..	..	154,941
										£ 654,941
									<u>Forward</u>	£ 750,000

Add: /

Forward £ 750,000

Forward .. £ 654,941

Add: Adjustments for re-valuation of V's and T's Assets by Alpha:

V. Property £4,500:

Valued in purchase price of V's shares by H & S at
£3,000 Increase of £1,500

$\frac{13}{15}$ th thereof (H's effective financial interest in V

is $\frac{2}{3}$ rd direct + $\frac{6}{10}$ th of $\frac{1}{3}$ rd = $\frac{13}{15}$ ths) £ 1,300

Goodwill £3,000:

Valued in purchase price of $\frac{2}{3}$ rd of V's shares by
H at £2,000 ($\frac{3}{2} \times 1,333$ - see Net Cost of Control
of V

by H in ex.29) and valued in purchase price of
 $\frac{1}{3}$ rd of V's shares by S at £1,100 ($\frac{3}{1} \times 367$ - see
net Cost of Control of V by S in ex. 29)

on $\frac{2}{3}$ rd £1,000 increase $\frac{2}{3}$ rd thereof. £ 667

on $\frac{1}{3}$ rd £1,900 increase, H's interest in

this is through S $\frac{6}{10}$ th of $\frac{1}{3}$ of 1,900 or 380 1,047

£ 2,347

T. Hidden Badwill £1,000:

Valued in purchase price of $\frac{3}{5}$ ths of T's shares
by S at £2,760 ($\frac{5}{3} \times 1,656$ - see Net Cost of

Control of T by S in ex. 29) but when H bought
 $\frac{7}{50}$ th T, T's Hidden Goodwill was valued at £6,050

($\frac{50}{7} \times 847$ - see Net Cost of Control of T by H.

On $\frac{3}{5}$ th £1,760 (decrease in Badwill) $\frac{3}{5}$ th thereof

£1,056 H's interest in this through S is $\frac{6}{10}$ th
of £1,056 or. £ 634

On $\frac{7}{50}$ th £7,050 (1,000 + 6,050 is increase

in Badwill) $\frac{7}{50}$ th thereof. . . minus .. 987 - 353 1,994

H's Goodwill £93,000 - but is balance/price or £ 656,935
93,065

750,000

Note: No adjustment is required in respect of Alpha's valuation of S's Hidden Goodwill £3,333, as this is unchanged from the valuation by H in purchasing $\frac{6}{10}$ ths of S's shares ($\frac{10}{6} \times 2,000$ - see Net Cost of Control of S by H, ex. 29 - = £3,333.

(a) The Adjustments required in each Company's Accounts are:-

V.1. Property	Dr £	2,500	
To Capital Reserve.			2,500
(Being increase in valuation of V's Property (£,4500 - £2,000 Balance Sheet) at 1:1:46 when Alpha acquired control of the group)			

T.1./

(a) (Continued)

T. 1.)									
T. 2.)									
S. 1.)	All as per ex. 29.								
S. 2.)									
H. 1.)									
Alpha 1.	Revenue Account	..	..	..	..	..	..	..	£139,447
	To Investment (in H.)	..	..	..	..	..	..	..	£139,447

(Being $\frac{9}{10}$ th H's true cr. balance on Revenue Account
 £154,941 at 1:1:46 - pre-acquisition when Alpha bought
 450,000 shares ($\frac{9}{10}$ th) in H.)

Note: The figure of £154,941 is taken from the Consolidated Statement in ex. 29. It could, of course, be worked out from the financial Account thus:-

$$H = H + \frac{6}{10} (S + \frac{1}{3} V + \frac{3}{5} T) + \frac{7}{50} T + \frac{2}{3} V$$

(for actual working see note 1 to solution)

(b) The Aggregation of the Adjusted Balance Sheets is:-ASSETS

	Total	Alpha	H	S	T	V
Property	£285,500	£ -	£251,000	£ -	£30,000	£ 4,500
Plant.	162,690	-	130,000	20,000	8,190	4,500
Stock.	241,000	-	178,000	40,000	14,000	9,000
Debtors	80,100	-	56,000	10,400	8,700	5,000
Subsidiaries Current Account	-	-	6,500	-	500	-
Dividends receivable. ..	-	-	4,500	-	-	-
Goodwill per Balance Sheets	17,000	-	-	10,000	7,000	-
Preliminary Expenses. ..	40,000	40,000	-	-	-	-
Cash.. .. .	45,600	35,000	9,000	100	500	1,000
<u>Investment at Adjusted Cost:</u>						
In S 60,000 shares. ..	62,000	-	62,000	-	-	-
In T 7,000 shares. ..	8,000	-	8,000	-	-	-
In V 10,000 shares. ..	12,000	-	12,000	-	-	-
In T 30,000 shares. ..	29,000	-	-	29,000	-	-
In V 5,000 shares. ..	5,700	-	-	5,700	-	-
In H 450,000 shares. ..	535,553	535,553	-	-	-	-
Government Stock	1,000	-	-	-	1,000	-
Revenue Account.	-	139,447	-	7,300	-	-
	<u>£1,525,143</u>	<u>£750,000</u>	<u>£717,000</u>	<u>£122,500</u>	<u>£69,890</u>	<u>£24,000</u>

LIABILITIES

Share Capital	£1,415,000	£750,000	£500,000	£100,000	£50,000	£15,000
Creditors.. .. .	83,500	-	62,500	10,700	7,500	2,800
Contra Accounts.	-	-	-	4,300	2,200	500
Stock Reserve	2,500	-	2,500	-	-	-
Proposed dividends	3,000	-	-	7,500	-	-
Revenue Account.	17,549	-	152,000	-	9,096	3,200
Capital Reserve.	3,594	-	-	-	1,094	2,500
	<u>£1,525,143</u>	<u>£750,000</u>	<u>£717,000</u>	<u>£122,500</u>	<u>£69,890</u>	<u>£24,000</u>

(c)/

(c) The Consolidated Statement of Assets, Liabilities is:-ASSETS

Property	£285,500
Plant.. .. .	162,690
Stock, less Reserve	238,500
Debtors	80,100
Investment - Government Stock	1,000
Cash	45,600
Preliminary Expenses.. .. .	40,000
Goodwill per Balance Sheets	17,000
<u>Goodwill - Net Cost of Control to the Group:</u>	

	By S.		By H.		By Alpha	
	In T $\frac{3}{5}$ th	In V $\frac{1}{3}$ rd	In S $\frac{6}{10}$	In T $\frac{7}{50}$	In V $\frac{2}{3}$	In H $\frac{9}{10}$
Adjusted Cost	£29,000	£5,700	£62,000	£8,000	£12,000	£535,553
<u>Less: Share of Cap. Res.</u>	656	833		153	1,667	
	£28,344	£4,867		£7,847	£10,333	
Par Value	30,000	5,000	60,000	7,000	10,000	450,000
			Dr. £ 2,000	£ 847	£ 333	£ 85,553
	Cr. £ 1,656	£ 133				
		£1,789 Cr.		£3,180 Dr.		
To H $\frac{6}{10}$ ths	£1,073			1,073 Cr.		
" Min Ints. S $\frac{4}{10}$ ths	716	1,789				
				£2,107 Dr.		
To Alpha $\frac{9}{10}$ ths.. .. .			£ 1,896			1,896
To Min.Ints.H $\frac{1}{10}$ th			211	2,107		87,449
						<u>£957,839</u>

LIABILITIES

Share Capital Alpha.	£750,000
Sundry Creditors.	83,500
Capital Reserve V	£ 2,500
To S ($\frac{1}{3}$ rd)	£ 833
To H ($\frac{2}{3}$ rds)	1,667
	<u>2,500</u>
T	£ 1,094
To S ($\frac{3}{5}$ ths)	£ 656
To H ($\frac{2}{5}$ th)	153
To Min. Ints. T $\frac{13}{50}$	285
	<u>1,094</u>
Revenue Account.. .. .	£17,549
<u>Less: Minority Interests:</u>	
T $\frac{13}{50}$ of 9,096	£ 2,365
S $\frac{4}{10}$ (S + $\frac{1}{3}$ V + $\frac{3}{5}$ T). .. .. .	..Dr. 310
H $\frac{1}{10}$ (H + $\frac{6}{10}$ S + $\frac{2}{3}$ V + $\frac{7}{50}$ T)	15,494
	<u>17,549</u>

Minority Interests/

Forward £ 833,500

LIABILITIES (Continued)

£833,500

Minority Interests:

	<u>H</u> $\frac{1}{10}$ th	<u>S</u> $\frac{4}{10}$ ths	<u>T</u> $\frac{13}{50}$ ths	
Share Capital	£ 50,000	£ 40,000	£ 13,000	
Capital Reserve.	-	-	285	
Proposed Dividends	-	3,000	-	
Revenue Account.	15,494	Dr. 310	2,365	
Net Cost of Control.. .. .	.Dr. 211	Cr. 716	-	
	£ 65,283	£ 43,406	£ 15,650	124,339
				£957,839

Notes:

1. As the new group has not traded as a group, there is no balance on Revenue Account in the Consolidated Statement. All profits up to 1:1:46 are capitalised. The Minority Interests H £15,494 is arrived at thus -

$$\begin{aligned}
 & \frac{1}{10} \left(H + \frac{6}{10} S + \frac{2}{3} V + \frac{7}{50} T \right) \\
 = & \frac{1}{10} \left\{ H + \frac{6}{10} \left(S + \frac{1}{3} V + \frac{3}{5} T \right) + \frac{2}{3} V + \frac{7}{50} T \right\} \\
 = & \frac{1}{10} \left\{ 152,000 + \frac{6}{10} \left(\text{Dr. } 7,300 + \frac{3}{5} \times 9,096 \right) + \frac{2}{3} \times 3,200 + \frac{7}{50} \times 9,096 \right\} \\
 = & \frac{1}{10} (152,000 + 465 \text{ Dr.} + 2,133 + 1,273) \\
 = & \frac{1}{10} \times 154,941 \\
 = & 15,494
 \end{aligned}$$

2. Owing to the proximity of dates the figures of the new group of Alpha and its Subsidiaries may be reconciled with the old group of H and its Subsidiaries (ex.29)

- (a) Goodwill - Net Cost of Control £87,449. This is composed of -

$\frac{9}{10}$ ths (Alpha's interest in H) of

(a) The Net Cost of Control per Consolidated Statement ex.29	£ 3,407
(b) H's Hidden Goodwill £93,000 ammended to exact figure of	93,065
(c) S's Hidden Goodwill £ 3,333 - unchanged from ex. 29	
(d) V's Hidden Goodwill difference per note above	1,047
	£ 97,519
(e) T's Hidden Badwill difference per note above	353
	£ 97,166
	$\frac{9}{10}$ ths thereof .. £ 87,449

The figure of £87,449 can be arrived at also by taking the necessary proportions of the re-valuation figure for Hidden Goodwill (or Badwill) adopted by Alpha, viz:-

H. £93,065	$\frac{9}{10}$ ths thereof	£ 83,759
S. £ 3,333 Hidden Goodwill	$\frac{9}{10}$ ths of $\frac{6}{10}$ ths thereof.. .. .	1,800
V. £ 3,000 Hidden Goodwill	$\frac{9}{10} \left(\frac{2}{3} \text{ of } 3,000 + \left(\frac{6}{10} \text{ths of } \frac{1}{3} \text{ of } £3,000 \right) \right)$ thro' S	2,340
		£ 87,899

Less/

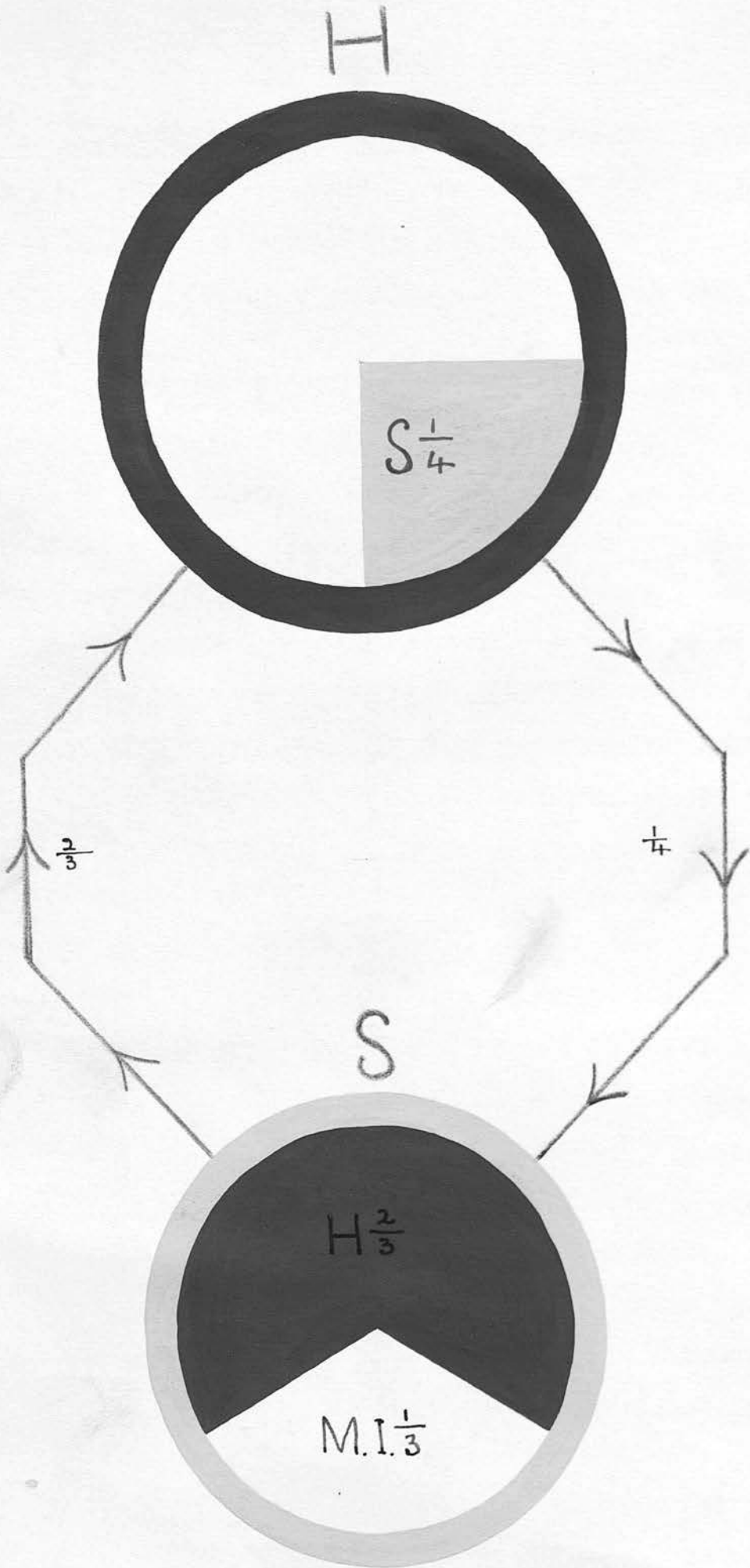
CHAPTER IX. Crossholdings.

Subsidiary owning shares in the Holding Company.

There is some doubt as to whether it is in order for a subsidiary to hold shares in the holding company as, in certain cases at any rate, such a situation when created appears equivalent to a company purchasing its own shares which amounts to a reduction of capital requiring Court sanction (Trevor v Whitworth 1887 12 App. Cas. 409). To take an extreme case, if a fully-owned subsidiary commenced buying shares in the holding company and continued buying until its holding was substantial, the legality of the transaction as a whole ^{would to be} appear [^] very doubtful. On the other hand, in practice, a company may be acquired by a large holding company, and as at the date of purchase, the new subsidiary may have amongst its assets as an investment of surplus cash, some shares in industrial public companies including shares in the holding company. There seems no good reason why, because of that investment in the holding company, the subsidiary should not be acquired, or, alternatively, why the subsidiary should be compelled thereafter to realise its holding in the holding company.

The fact is cross-holdings do exist in practice. They make the preparation of a Consolidated Statement a little more difficult. The subsidiary's profits falling to the holding company partly revert back to the subsidiary according to the latter's holding in the former. Of the amount returning, a proportion again goes back to the holding company and so on until the amount ultimately transferable is reduced to nil. These transfers affect the portion falling to be credited to the Minority Interests of the subsidiary as they take their share of each theoretical transfer. This is the only effect of the cross-holding from the group's point of view, i.e., if the subsidiary is fully-owned, the cross-holding does not affect the final consolidation figures of Revenue Account.

EXAMPLE — 30.



Example 30 - Subsidiary owning shares in the Holding Company - Division of Profits

H, a Holding Company where current Revenue Account balance is Cr. £10,000 ^{owns} 2/3rds of the Ordinary Capital of S, where current Revenue Account balance is Cr. £3,000. S, however, also owns 1/4 of the Ordinary Capital of H. All holdings have been held since incorporation.

If S declared all its profits as dividend, the Minority Interests would receive £1,000 (1/3rd) and H would receive £2,000 (2/3rds). If H declared as dividend its entire profits, including the £2,000 received from S, S would receive £3,000 (1/4 of 12,000). Now S would have a further £3,000 to distribute of which the Minority Interests would receive £1,000 (1/3rd) and H would receive £2,000 (2/3rds). Again H would have a further £2,000 to distribute of which S would receive £500 (1/4) and so on, thus:-

					S's Profits	Divisible M.I. 1/3	thus H 2/3	
As per Accounts	..	..	..	..	£ 3,000	£ 1,000	£ 2,000	(1)
From H (a)	..	..	..	..	£ 3,000	-	1,000	2,000 (2)
" " (b)	..	..	..	..	500	-	167	333 (3)
" " (c)	..	..	..	..	83	-	28	55 (4)
" " (d)	..	..	..	..	14	-	5	9 (5)
" " (e)	..	..	..	..	2	-	(say)	2 (6)
" " (f)	..	..	..	..	1	-	(say)	1 (7)
					<u>£ 6,600</u>	<u>£ 2,200</u>	<u>£ 4,400</u>	

					H's Profits	Group's Share	Divisible 1/4 to S	Thus
From S (1)	..	..	..	..	£ 2,000			
As per Accounts	..	..	..	..	<u>10,000</u>			
					<u>£ 12,000</u>	£ 9,000	£ 3,000	(a)
From S (2)	..	..	..	..	<u>£ 2,000</u>	1,500	500	(b)
(3)	..	..	..	..	<u>£ 333</u>	250	83	(c)
(4)	..	..	..	..	55	41	14	(d)
(5)	..	..	..	..	9	7	2	(e)
(6)	..	..	..	..	2	1 (say)	1	(f)
(7)	..	..	..	..	1	1 (say)	-	
						<u>£ 10,800</u>	<u>£ 3,600</u>	

The total profits £13,000 may be stated thus:-

S	..	..	..	..	..	..	£ 3,000
Add: Share from H	..	..	..	..	..	..	<u>3,600</u>
							£ 6,600
Less: Minority Interests S 1/3rd	..	..	..	..	..	..	<u>2,200</u>
						To H..	£ 4,400
H	..	..	..	..	..	..	<u>10,000</u>
							£ 14,400
Less: Share falling to S 1/4	..	..	..	..	..	..	<u>3,600</u>
Group's share of H and S profits	..	..	..	..	..	..	£ 10,800
Minority Interests S share of H and S profits	..	..	..	..	..	..	<u>2,200</u>
							<u>£ 13,000</u>

The/

The above arithmetical calculation is cumbersome unless the cross-holding is of small amount which will reduce the amount of the transfers very quickly. The better method is to compute the group's share £10,800 and that of the Minority Interests, by the use of elementary algebra.

In the above group each member's interest can be expressed thus:-

$$\text{H's true profits} = \text{own profits} + \frac{2}{3}\text{rds of S's true profits}$$

$$\text{S's true profits} = \text{own profits} + \frac{1}{4} \text{ of H's true profits}$$

Both H's and S's true profits are unknown.

Let $4x = \text{H's true profit}$) Note In selecting suitable multiples for X and Y regard
 Let $3y = \text{S's true profit}$) should be made to the smallest fraction of profit which
 each company has to divide. H's profits have to be
 divided into fourths (select 4) T's into thirds (select 3)

$$\text{Then } 4x = 10,000 + 2y \dots\dots\dots(1)$$

$$\text{and } 3y = 3,000 + x \dots\dots\dots(2)$$

These are simultaneous equations which can easily be solved by expressing x in terms of y in one equation, and substituting that value in the other, thus:-

$$\text{Taking (2) } 4x = 12y - 12,000$$

Substituting that value for $4x$ in (1)

$$12y - 12,000 = 10,000 + 2y$$

$$\therefore 10y = 22,000$$

$$y = 2,200$$

Substituting £2,200 for y in (1) x is found

$$4x = 10,000 + 4,400$$

$$x = 3,600$$

($\frac{5}{2}$ of $4x$)

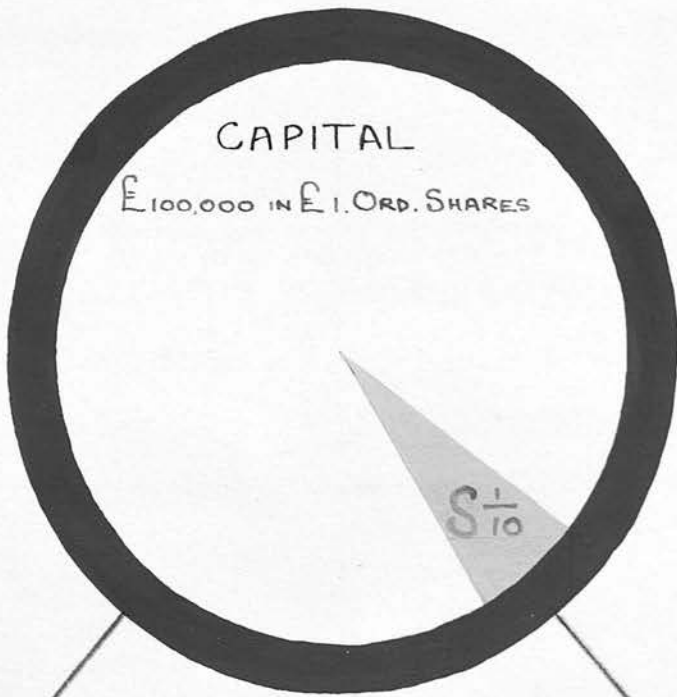
The group's share of the total profits is	$3x$ or .. ..	.. £ 10,800
The Minority Interests S share of the total profits is	y , or .. ..	.. <u>2,200</u>
	($\frac{1}{3}$ of $3y$)	
	<u>Total profits of H and S.</u>	.. <u>£ 13,000</u>

As similar equations can be expressed for any group, however complicated, the division of post-acquisition Revenue balances (Revenue Account) between the group and Minority Interests can always be arrived at by this method.

A Consolidated Statement of a group simply means a statement showing the position of the combine from the point of view of the shareholders of the holding company. Accordingly, when one of these shareholders is a member of the group, the par value of the shares held by that member, irrespective of whether the member is fully or partly-owned, is deducted from the share capital in the Consolidated Statement. The resultant figure for capital represents the shares held by what may be called "the outsiders" of the holding company, i.e. the share capital held by the personal shareholders of the holding company.

EXAMPLE - 31.

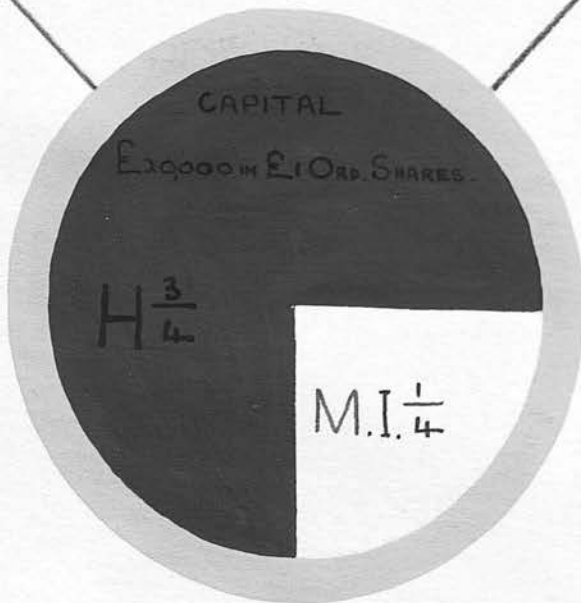
H



$\frac{3}{4}$ BOUGHT - 31/12/47

$\frac{1}{10}$ BOUGHT - 31/12/47

S



Example 31 - Subsidiary owning shares in Holding Company. Holdings bought on Balance Sheet date at Balance Sheet price.

The summarised Balance Sheets of H and S as at 31st December 1947, were:-

	<u>ASSETS</u>	<u>H</u>	<u>S</u>
Sundry Assets		<u>£120,500</u>	<u>£ 27,000</u>
<u>LIABILITIES</u>			
Share Capital (in £1 Ordinary Shares)		£100,000	£ 20,000
Creditors		10,500	1,000
Revenue Account		<u>10,000</u>	<u>6,000</u>
		<u>£120,500</u>	<u>£ 27,000</u>

If it is assumed "Sundry Assets" are fairly valued in the above, H's shares are worth 22/- each and S's 26/- each. If a purchase of shares took place on 31st December 1947 at these prices H buying $\frac{3}{4}$ of S, thereby making it a Subsidiary and S buying $\frac{1}{10}$ th of H, the Balance Sheets would be:-

	<u>ASSETS</u>	<u>H</u>	<u>S</u>
<u>Investments:</u>			
15,000 shares in S at cost 26/- each		£ 19,500	£ -
10,000 shares in H at cost 22/- each		-	11,000
Sundry Assets		<u>101,000</u>	<u>16,000</u>
		<u>£120,500</u>	<u>£ 27,000</u>
<u>LIABILITIES</u>			
Share Capital (in £1 Ordinary Shares)		£100,000	£ 20,000
Creditors		10,500	1,000
Revenue Account		<u>10,000</u>	<u>6,000</u>
		<u>£120,500</u>	<u>£ 27,000</u>

SOLUTION

As full and fair prices have been given for the shares and Consolidated Statement of the group should bring out Net Cost of Control at Nil. Further the shares of S are still worth 26/- and accordingly the figure for Minority Interests S should be £6,500 (5000 shares at 26/- each)

(a) The adjustments required in each company's accounts are:-

H (1) Revenue Account Dr £ 4,500
 To Investment Account (in S) £ 4,500
 (Being $\frac{3}{4}$ S's credit balance on Revenue Account on 31st December 1947 £6,000 - pre-acquisition - when H bought 15,000 shares in S ($\frac{3}{4}$))

← S(1) Revenue Account Dr £ 1,000
 To Investment Account (in H) £ 1,000
 (Being $\frac{1}{10}$ th H's credit balance on Revenue Account on 31st December 1947 £10,000- pre-acquisition- when S bought 10,000 shares in H ($\frac{1}{10}$ th))

(b) The aggregation of the adjusted Balance Sheets, is:-

	<u>ASSETS</u>	<u>Total</u>	<u>H</u>	<u>S</u>
<u>Investments at adjusted Cost:</u>				
In S 15,000 shares		£ 15,000	£ 15,000	
In H 10,000 shares		10,000	-	£ 10,000
Sundry Assets		<u>117,000</u>	<u>101,000</u>	<u>16,000</u>
		<u>£142,000</u>	<u>£116,000</u>	<u>£ 26,000</u>

LIABILITIES

Capital		£120,000	£100,000	£ 20,000
Creditors		11,500	10,500	1,000
Revenue Account		<u>10,500</u>	<u>5,500</u>	<u>5,000</u>
		<u>£142,000</u>	<u>£116,000</u>	<u>£ 26,000</u>

(c)/

ASSETS

Sundry Assets.. .. . £117,000
Goodwill - Net Cost of Control to the group:

	<u>By S In</u> <u>H 1/10th</u>	<u>By H In</u> <u>S $\frac{3}{4}$</u>	
Adjusted Cost.. .. .	£ 10,000	£ 15,000	
Par.. .. .	<u>10,000</u>	<u>15,000</u>	<u>£117,000</u>

LIABILITIES

Share Capital H			£100,000
<u>Less: Held by S</u>			<u>10,000</u>
			£ 90,000
Creditors.			11,500
Revenue Account		£ 10,500	
<u>Less: Minority Interests S (by algebra)</u>		<u>1,500</u>	9,000
<u>Minority Interests:</u>		<u>S $\frac{1}{4}$</u>	
Capital.		£ 5,000	
Revenue Account		<u>1,500</u>	<u>6,500</u>
			<u>£117,000</u>

Notes:

- (1) The share of Revenue Account falling to the Minority Interests £1,500 and to the group £9,000 is arrived at thus:-

Let $10x$ = H's true profits (i.e. own + $\frac{3}{4}$ S's true profits)
 Let $4y$ = S's true profits (i.e. own + $\frac{1}{10}$ th H's true profits)

Then $10x = 5,500 + 3y$ (1)

and $4y = 5,000 + x$ (2)

$\therefore 40y = 50,000 + 10x$

$\therefore 40y - 50,000 = 5,500 + 3y$

$\therefore y = 1,500$

and $x = 1,000$

Group's share $9x$	£ 9,000
Minority Interests S y	<u>1,500</u>
	<u>£ 10,500</u>

These figures are obviously correct if one considers the Original Balance Sheets of the two members before the exchange of shares took place

90,000 shares in H take $\frac{9}{10}$ ths Revenue Account	£ 9,000
5,000 shares in S take $\frac{1}{4}$ Revenue Account.. .. .	<u>1,500</u>

thus:-

- S The shareholders of 5,000 shares (now the Minority Interests) are entitled to $\frac{1}{4}$ of S's Revenue Balance of £4,000 as at 31st December 1947 and this will not be altered by the exchange of shares on 31st December 1947 (the same date) as the Revenue Balance of H at that date is not revenue to S but is paid for in the price given for H's shares.

shares

- H The personal shareholders of 90,000 (now the new "group" shareholders of H) take 9/10ths of H's revenue balance of £10,000 as at 31st December 1947. Again this is not increased by the purchase of S's Shares by H on 31st December 1947 since S's revenue balance is pre-acquisition and is paid for in the price given for the shares.
- (2) The figure for Minority Interests is £6,500 as was anticipated. This example therefore proves that even although a Subsidiary is partly-owned, the par value of all the Shares held by it in the H. Co. is deducted from Share Capital in the Consolidated Statement.

Capitalisation of the pre-acquisition revenue balance.(a) Gross-holding created on acquisition of the subsidiary.

In this case the subsidiary on the acquisition date by the holding company has already an Asset in its Balance Sheet representing an investment in the holding company. Now no group existed when this investment was originally purchased and accordingly it would be treated like an ordinary investment. If correct accounting principles have been adopted by the subsidiary in the past, it will already have credited to Investment Account in its books, dividends or portion thereof declared for a period prior to purchase. This is the normal procedure with regard to ordinary investments. An accrued dividend only is included in the purchase price of an ordinary investment. This is a very different situation from the case of an investment in a subsidiary where the purchaser can control the amount of the dividends to be paid in the future and is therefore primarily concerned with expected future profits. This distinction accounts for the higher price per share which a prospective purchaser is prepared to offer in the special circumstances where control of a company will pass into his hands if his offer is accepted. There are therefore two rules.

- (1) In the case of an ordinary investment, the purchase price includes only the expected dividend up to date of purchase, and -
- (2) In the case of an investment in a subsidiary, the purchase price includes the expected profits up to date of purchase.

It follows that in the Consolidated Statement of the new group, there is no question of the subsidiary capitalising its share of the holding company's Revenue Account balance at the purchase date. The balance on the holding company's Revenue Account at that earlier date is therefore of no moment.

At the later date when the holding company acquires control of the subsidiary, the interest purchased is not only an interest in the subsidiary but an interest in the holding company itself. The purchase price of the subsidiary's shares must be deemed to include not only the subsidiary's profits (or a proportion thereof, if it is /

it is a partly-owned subsidiary) up to purchase date, but also a proportion - it may be a very small proportion - of the holding company's own profits up to the same date.

In any subsequent Consolidated Statement the pre-acquisition revenue balance to be capitalised by the holding company which, by the purchase of shares in the subsidiary already holding shares in the holding company, has created a cross-holding in the new group, is easily calculated by ~~one~~ taking the appropriate share of the figure representing the true balance on Revenue Account of the subsidiary at the date of purchase, i.e. its own balance together with the subsidiary's share of the balance on Revenue Account of the holding company as at the same date. This is a straightforward "a plus b" computation; there is no question of the cross-holding otherwise affecting the calculation.

Ex. S. bought $\frac{1}{100}$ th of H's Ordinary Capital in 1930 when H had a credit balance on Revenue Account of £5,000. From dividends received in 1931 S. credited to Investment Account £30 representing the proportion declared for the period prior to purchase.

In 1947 H. bought $\frac{3}{4}$ ths of S's. Ordinary Capital when S's. books disclosed that S. had a credit balance on Revenue Account of £810 while it was estimated from H's. books that H's. credit balance on Revenue Account on that date was £7,000. H's. holding in S. is at cost in H's. books.

Solution: No group existed up to 1947 but, thereafter, in the preparation of the Consolidated Statement, the value of investments must be written down thus:-

(1) H. should write down the value of its holding in S. by £660. The adjustment is -	
Revenue Account	Dr. £660
To Investment Account (in S.)	£660
(being $\frac{3}{4}$ ths of S's. credit balance on Revenue Account in 1947 - pre-acquisition when H bought $\frac{3}{4}$ ths S.)	
S's. credit balance on Revenue Account per S's. books in 1947	£810
<u>Add:</u> $\frac{1}{100}$ th of H's. credit balance on Revenue Account per H's books in 1947	70
H's. share $\frac{3}{4}$ ths thereof	<u>£880</u>
<u>Less:</u> Dividends credited by holding company to Investment Account	nil
Amount to be capd. for consolidation purposes	<u>£660</u>

Note: The information regarding H's bal. on Rev. A/c (£5,000 in 1930) is not therefore required.

(b) /

(b) Cross-holding created on the date the subsidiary acquired the shares in the holding company.

In the converse circumstances when an existing subsidiary subsequently buys shares in the holding company and thus creates a cross-holding, the amount to be capitalised as the pre-acquisition balance by the holding company remains the same as that prior to the existence of the cross-holding, while the amount to be capitalised by the subsidiary is the relative proportion of the holding company's Revenue Account as adjusted for the holding company's share (revenue portion only) of the Revenue Account of the subsidiary as at the date the subsidiary purchased the shares in the holding company. The purchase of shares in a holding company by a subsidiary is not an ordinary investment but really amounts to a holding company indirectly purchasing its own shares.

Ex. H. bought $\frac{3}{4}$ ths of S's. Ordinary Capital in 1940 when S. had a credit balance on Revenue Account of £1,000. Subsequently in 1947 S. bought $\frac{1}{100}$ th of H's. Ordinary Capital when H. had a credit balance on Revenue Account of £9,850 and S. had a credit balance on Revenue Account of £1,200. All holdings are stated at cost in the books of H. and S.

Solution: In the Consolidated Statement prepared before and after the existence of the cross-holding, H. must capitalise £750, being $\frac{3}{4}$ ths of £1,000.

In the Consolidated Statement prepared after the existence of the cross-holding, S. must capitalise $\frac{1}{100}$ th of H's. true Revenue Account balance, i.e. $\frac{1}{100}$ th (H. + $\frac{3}{4}$ S.) = $\frac{1}{100}$ th of £10,000 made up thus

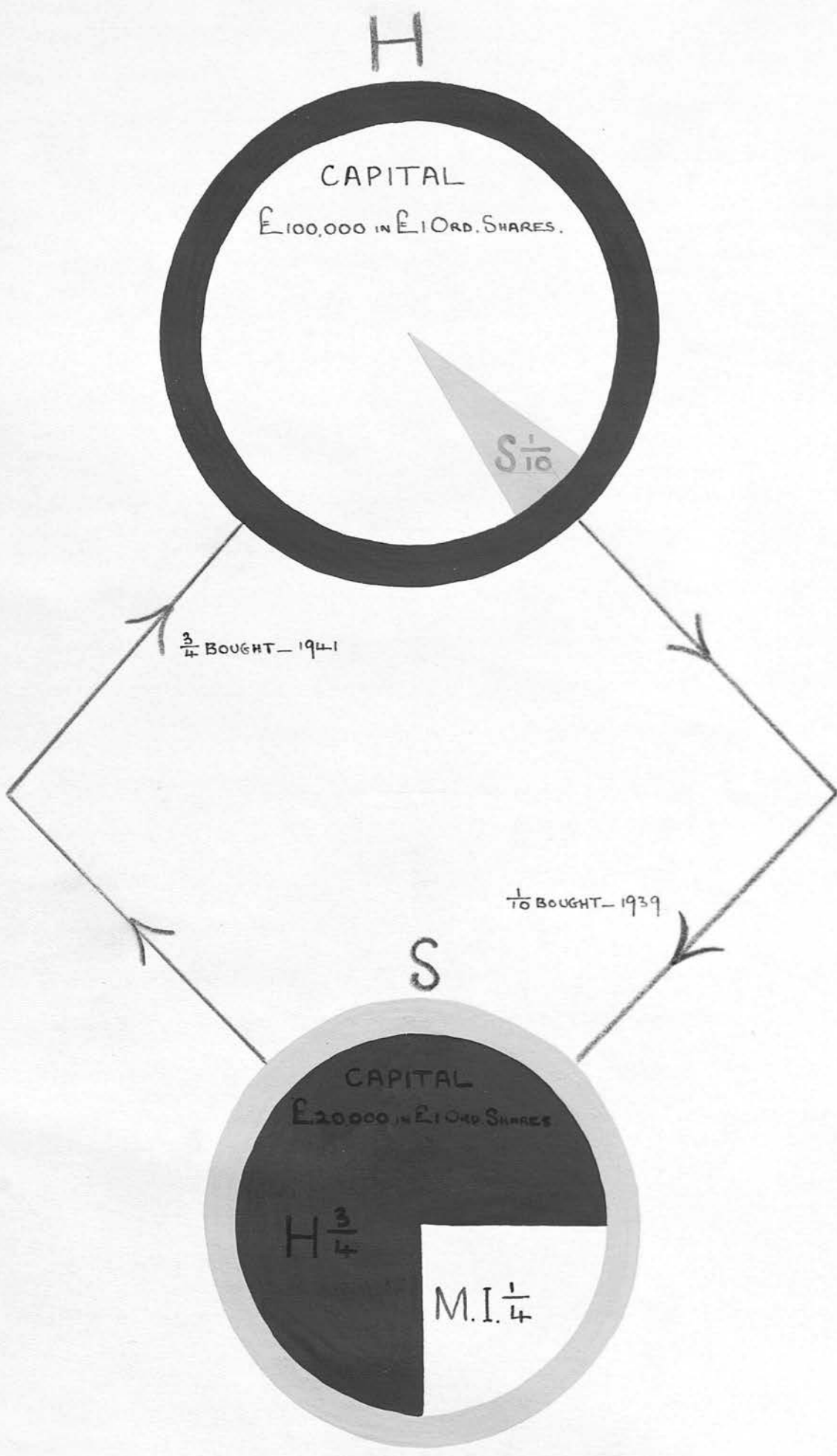
H's. Rev. A/c balance in 1947 is:	£9,850
<u>Add:</u> $\frac{3}{4}$ ths of S's. Rev. A/c balance in 1947	
$\frac{3}{4}$ ths of £1,200	<u>900</u>
	£10,750
 <u>Less:</u> $\frac{3}{4}$ ths of S's. Revenue Account balance in 1940 which should have been capitalised by H. $\frac{3}{4}$ ths of £1,000	 <u>750</u>
$\frac{1}{100}$ th thereof = £100	<u>£10,000</u>

Note: In this example, the shares are "at cost" in the financial books. If dividends had been credited to Investment Account, the amount thereof would reduce the amount of the actual consolidation adjustment.

Net Cost of Control.

In stating Net Cost of Control at cost to the group, it has already been shown that the Minority Interests of a subsidiary are allocated their shares in the Net Cost of Control figure of any sub-subsidiary which the subsidiary controls or in which the subsidiary holds shares. This arithmetical allocation has the effect of excluding all "hidden" Goodwill in the Minority Interests figure of the Consolidation Statement (see page VI.(4)). Similarly, where part of the Assets of a subsidiary is invested in the holding company, the Minority Interests of the subsidiary, whose assets are so invested, are allocated their share in what may be conveniently called the Net Cost of Control of the holding company. (Strictly speaking, of course, control of the holding company has not been acquired, but the term Net Cost of Control is used to cover the difference between Adjusted Cost of the shares (minus (or plus) a proportion of any Capital Reserve) and par value of an investment in any member of a group.) This share is calculated according to the principles used in arriving at the Minority Interests' share of Revenue Account, as the position of the Minority Interests in regard to the Net Cost of Control of the holding company by the subsidiary, and vice versa, is similar in principle to that of post-acquisition revenue balances of the two companies - the Minority Interests take a share of each theoretical transfer between the two members.

EXAMPLE - 32.



Example 32 - Subsidiary owning shares in Holding Company. Shares bought at different dates at market value. Dividends credited to Investment A/c.

The summarised Balance Sheets of a group at 31st December 1947, are:-

<u>ASSETS</u>											<u>H</u>	<u>S</u>
Sundry Assets..	..	..	..	..	..	..	..	..	..	..	£ 89,100	£ 15,000
Goodwill at cost	..	..	..	..	..	..	..	..	..	..	10,000	500
<u>Investments:</u>												
15,000 shares in S at cost..	..	..	..	..	..	..	..	..	..	..	18,000	-
10,000 shares in H at cost..	..	..	..	..	..	..	..	..	..	£ 11,350		
Less: Dividend credited in 1940	..	..	..	..	..	..	..	..	..	250		
											-	11,100
											£117,100	£ 26,600

<u>LIABILITIES</u>											<u>H</u>	<u>S</u>
Share Capital (in £1 Ordinary Shares)	..	..	..	..	..	..	..	..	..	..	£100,000	£ 20,000
Creditors.	..	..	..	..	..	..	..	..	..	..	10,500	1,000
Revenue Account	..	..	..	..	..	..	..	..	..	..	6,600	5,600
											£117,100	£ 26,600

Notes:

- (1) S acquired 1/10th of H in 1939
- (2) H acquired $\frac{3}{4}$ of S in 1941 when S's books showed a credit balance on Revenue Account of £600 — and H's books showed a credit balance on Revenue Account of £1,100.

SOLUTION

- (a) The Adjustments required in each company's accounts, are:-

S No adjustments required. The 10,000 shares held in H were purchased before the group was formed and can therefore be considered an Ordinary Investment

H (1) Revenue Account Dr. £532 $\frac{1}{2}$
 To Investment Account (in S).. .. . £532 $\frac{1}{2}$

(Being $\frac{3}{4}$ of S's credit balance on Revenue Account in 1941 pre-acquisition when H bought 15,000 shares in S $\frac{3}{4}$, made up thus:-

Credit balance per S's books in 1941.. .. . £ 600
 Add: 1/10th interests in H 1/10th of 1,100 110

£ 710

$\frac{3}{4}$ thereof £ 532 $\frac{1}{2}$

- (b) The aggregation of the adjusted Balance Sheets is -

<u>ASSETS</u>											<u>Total</u>	<u>H</u>	<u>S</u>
Sundry Assets..	..	..	..	..	..	..	..	..	..	..	£104,100	£ 89,100	£ 15,000
Goodwill..	..	..	..	..	..	..	..	..	..	..	10,500	10,000	500
<u>Investments at Adjusted Cost:</u>													
In S	15,000 shares	..	..	..	..	..	..	..	..	..	17,467 $\frac{1}{2}$	17,467 $\frac{1}{2}$	-
H	10,000 shares	..	..	..	..	..	..	..	..	..	11,100	-	11,100
											£143,167 $\frac{1}{2}$	£116,567 $\frac{1}{2}$	£ 26,600

LIABILITIES/

(b) Continued:

IX (13)

								<u>LIABILITIES</u>			Total	H	S
Capital.	..	..	..	..	..	..	..	£120,000	£100,000	£	20,000
Creditors	..	..	..	..	..	..	..	11,500	10,500		1,000
Revenue Account	..	..	..	..	..	..	..	<u>11,667½</u>	<u>6,067½</u>		<u>5,600</u>
								<u>£143,167½</u>	<u>£116,567½</u>		<u>£ 26,600</u>		

(c) The Consolidated Statement, is:-

<u>ASSETS</u>												
Sundry Assets	£104,100
Goodwill - per Balance Sheet	10,500
<u>Goodwill - Net Cost of Control to the group:</u>												
								<u>By S In</u>	<u>By H In</u>			
								<u>H 1/10th</u>	<u>S ¾</u>			
Adjusted Cost	£ 11,100	£ 17,467½			
Par	<u>10,000</u>	<u>15,000</u>			
								£ 1,100	£ 2,467½			
									£ 3,567½			
<u>Less: Minority Interests S (see below)</u>	..	..	..	..	..	..	..		<u>364</u>		<u>3,203½</u>	
											<u>£117,803½</u>	

<u>LIABILITIES</u>												
Share Capital H..	£100,000
<u>Less: Held by S</u>	<u>10,000</u>
											£ 90,000	
Sundry Creditors.	11,500
Revenue Account..	£ 11,667½
<u>Less: Minority Interests S (see below)</u>	<u>1,677½</u>
											9,990	
<u>Minority Interests:</u>												<u>S ¾</u>
Capital	£ 5,000
Revenue Account	1,677½
Net Cost of Control.	Dr. <u>364</u>
											<u>6,313½</u>	
											<u>£117,803½</u>	

Notes:

- (1) The share of Revenue Account and of Net Cost of Control falling to Minority Interests and to the group are both computed by algebra.

Revenue Account £11,667½

Let	10 x	=	H's true Revenue balance.
Let	4 y	=	S's true Revenue balance
	10 x	=	6,067½ + 3y .....(1)
and	4 y	=	5,600 + x .....(2)
	10 x	=	40y - 56,000
	37 y	=	62,067½
	y	=	1677.5
and	x	=	1,110

Group's share	9x	..	..	..	..	..	..	£ 9,990
Minority Interests S	y	..	..	..	..	..	..	<u>1,677½</u>
								<u>£ 11,667½</u>

Net Cost of Control/

(1) (Continued)

Net Cost of Control £3,567½

Let $10x$ = H's true share of Cost of Control
and $4y$ = S's true share of Cost of Control

$$\begin{aligned} 10x &= 2467\frac{1}{2} + 3y && \dots\dots\dots(1) \\ \text{and } 4y &= 11,000 + x && \dots\dots\dots(2) \\ 10x &= 40y - 11,000 \\ 37y &= 13,467\frac{1}{2} \\ y &= 363.99 \\ x &= 355.94 \end{aligned}$$

Group's share	9x	..	..	..	..	..	..	£	3,203½
Minority Interests S	y	..	..	..	..	..	..	£	364
									3,567½

(2) The Minority Interests S £6,313½ can be reconciled by independent calculation from the Balance Sheets, thus:-

Let $£40x$ = true value of S's business including its investment in H
Thus $30x$ = true value of H's holding in S
H's business is worth therefore. Share Capital + Revenue Account + true value of investment in S less Book value

$$\begin{aligned} &= 100,000 && + 6,600 + 30x - 18,000 \\ &= 88,600 && + 30x \end{aligned}$$

∴ 1/10th of H's business (10,000 shares held by S) is worth £(8,860 + 3x)

S business is therefore worth - Share Capital + Revenue Account + true value of investment in H, less Book Value.

$$\begin{aligned} \therefore 40x &= 20,000 + 5,600 + (8,860 + 3x) - 11,100 \\ 37x &= 23,360 \\ x &= \text{£}631.35135 \end{aligned}$$

∴ true value of S's business $40x$ is £25,254.054 (20,000 shares)
Minority Interests of S $10x$ = 6,313.513 (5,000 shares)
(which agrees with figure in Consolidation)

(3) The advantage of using the procedure - recommended throughout this book - of debiting Revenue Account of the H Company with the pre-acquisition Revenue Balance of the Subsidiary (see H(1) in foregoing example) - is that the adjusted revenue balance become entirely revenue from the group's view-point and can be divided up between the group and any Minority Interests (by the use of algebra to give effect to the cross-holdings). If this adjustment is not done in the Revenue Accounts of the Company which holds the shares but left unadjusted till a later stage in the process of consolidating - the conventional method given in most text books and used for demonstration purposes in examples 2 and 3 - the position is involved as Profit and Loss Account balances transferred to members are partly capital (the pre-acquisition proportion) and partly revenue (the post-acquisition proportion). The cross-holding makes the conventional method cumbersome and unnecessarily complicated.

Cross-holdings in subsidiaries themselves.

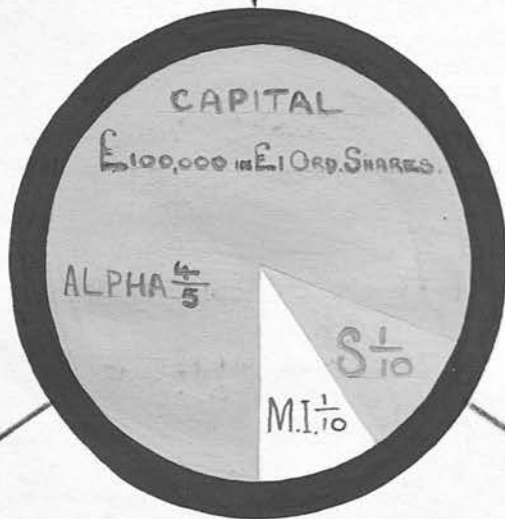
Cross-holdings between subsidiaries themselves, while a little uncommon, are sometimes met with in practice. Two companies may make an exchange of shares to promote closer co-operation and, thereafter, both these associated companies may be bought by a holding company. In the preparation of the subsequent Consolidated Statement the Cross-holding must be taken into account in the treatment of post-acquisition results of the new group. In the calculation of the associated companies' pre-acquisition revenue balances which require to be capitalised by the holding company, the question of taking ~~into account of~~ the Cross-holding ^{into account} depends on the time factor. If both the associated companies were purchased by the holding company on the same date, the Cross-holding would require to be taken into account in the determination of the pre-acquisition revenue balance of both associated companies. But if they were not bought on the same date, the Cross-holding would only be taken into account in arriving at the pre-acquisition revenue balance of the associated company which was purchased last. In the case of the associated company purchased first, the investment in the other associated company is an ordinary investment.

When a holding company acquires another holding company in which a Cross-holding exists, one must take the Cross-holding into account for the purpose of allocating the post-acquisition results and also of arriving at the pre-acquisition balance of the subsidiary.

ALPHA



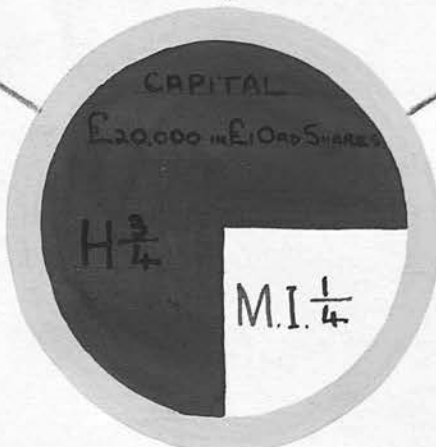
$\frac{3}{4}$ BOUGHT 31/12/47



$\frac{3}{4}$ BOUGHT 1941.

$\frac{1}{10}$ BOUGHT 1939.

S



Example 33 - Subsidiary owning shares in Sub-subsidiary and vice versa.

Let it be assumed that the group in the previous example was acquired by Alpha on 31st December 1947, Alpha purchasing 80,000 Ordinary Shares of H and the Balance Sheet of Alpha as at 31st December 1947, together with these of H and S as before, were -

	<u>ASSETS</u>								<u>Alpha</u>	<u>H</u>	<u>S</u>
Sundry Assets	£162,000	£ 89,100	£ 15,000
Goodwill	-	10,000	500
<u>Investments:</u>											
15,000 shares in S at cost	-	18,000	-
80,000 shares in H at cost	88,000	-	-
10,000 shares in H at cost	£ 11,350			
<u>Less: Dividend credited ..</u>	<u>250</u>	-	-	<u>11,100</u>
									<u>£250,000</u>	<u>£117,100</u>	<u>£ 26,600</u>

LIABILITIES

Share Capital (in £1 Ordinary Shares) .. .. .	..	..	..	..	..	..	..	..	£200,000	£100,000	£ 20,000
Creditors .. .. .	..	..	..	..	..	..	..	..	30,000	10,500	1,000
Revenue Account.. .. .	..	..	..	..	..	..	..	..	<u>20,000</u>	<u>6,600</u>	<u>5,600</u>
									<u>£250,000</u>	<u>£117,100</u>	<u>£ 26,600</u>

SOLUTION

(a) The Adjustments required in each company's accounts, are:-

S as in previous example.

H (1) As in previous example.

Alpha (1) Revenue Account Dr. £8,880
 To Investment Account (in H) £ 8,880

(Being 4/5ths H's true Revenue balance as at 31st December 1947 -
 pre-acquisition - when Alpha bought 80,000 shares in H 4/5ths, made up thus-

H's true Revenue Account balance 10x (per Note 1 on solution in previous
 example) Cr. £ 11,100

Alpha's share 4/5ths thereof £ 8,880

(b) The Aggregation of the adjusted Balance Sheets, is:-

	<u>ASSETS</u>								<u>Total</u>	<u>Alpha</u>	<u>H</u>	<u>S</u>
Sundry Assets	£266,100	£162,000	£ 89,100	£ 15,000
Goodwill per Balance Sheet.	10,500	-	10,000	500
<u>Investments at Adjusted Cost:</u>												
In H 80,000 shares..	79,120	79,120	-	-
S 15,000 shares..	17,467½	-	17,467½	-
H 10,000 shares..	<u>11,100</u>	-	-	<u>11,100</u>
									<u>£384,287½</u>	<u>£241,120</u>	<u>£116,567½</u>	<u>£ 26,600</u>

LIABILITIES

Capital .. .. .	..	..	..	..	..	..	..	..	£320,000	£200,000	£100,000	£ 20,000
Creditors .. .. .	..	..	..	..	..	..	..	..	41,500	£ 30,000	£ 10,500	1,000
Revenue Account.. .. .	..	..	..	..	..	..	..	..	<u>22,787½</u>	<u>11,120</u>	<u>6,067½</u>	<u>5,600</u>
									<u>£384,287½</u>	<u>£241,120</u>	<u>£116,567½</u>	<u>£ 26,600</u>

(c) The Consolidated Statement, is:-ASSETS

Sundry Assets.	£266,100
Goodwill per Balance Sheets.. . . .	10,500
<u>Goodwill - Net Cost of Control to the Group:</u>	

	By S H 1/10th	In S 3/4	By H In	By Alpha In H 4/5	
Adjusted Cost.	£ 11,100		£ 17,467½		£ 79,120
Par.	10,000		15,000		80,000
	£ 1,100		£ 2,467½		£ 880 Cr
					Dr. £3,567½
<u>Less: Minority Interests:</u>					
S (as before y).	£ 364				
H (x in previous example).					356
			720		
			£2,847½Dr		£ 880Cr
					1,967½
					<u>£278,567½</u>

LIABILITIES

Share Capital Alpha	£200,000	
Creditors.	41,500	
Revenue Account	£ 22,787½	
<u>Less: Minority Interests:</u>		
S (as before y)	£ 1,677½	
H (x in previous example)	1,110	
	<u>2,787½</u>	
	20,000	
<u>Minority Interests:</u>		
	H 1/10th	S ¼
Capital	£ 10,000	£ 5,000
Revenue Account	1,110	1,677½
Net Cost of Control.	Dr 356	364
	£ 10,754	£ 6,313½
		<u>17,067½</u>
		<u>£278,567½</u>

Notes:

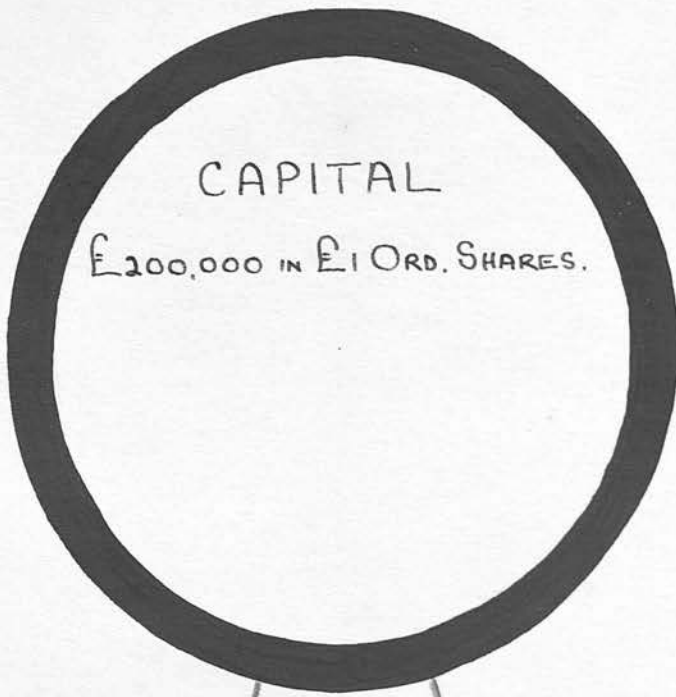
- As the cross-holding between H and S existed prior to Alpha's purchase of shares of H, H and S must be considered first to arrive at the true Revenue balance and true Cost of Control of each member.
- The Revenue Account balance in the Consolidated Statement £20,000 is exactly Alpha's credit balance on 31.12.47. This is correct as those of H and S are either capitalised as pre-acquisition or fall to the Minority Interests as the case may be; H and S provide no revenue to the new group up to 31st December 1947.
- The Minority Interests of H are 1/10th. H's share Capital is held thus:-

By Alpha (the Holding Co)	4/5ths	80,000 shares
By S (a Sub-subsidiary)	1/10th	10,000 shares
By Minority Interests	1/10th	<u>10,000 shares</u>
		<u>100,000</u>

The Minority Interests H therefore take 1/10th of the Revenue balance of H and 1/10th of the Net Cost of Control to H. These 1/10th shares are X in the relative equations in the previous example

EXAMPLES — 34 AND 43

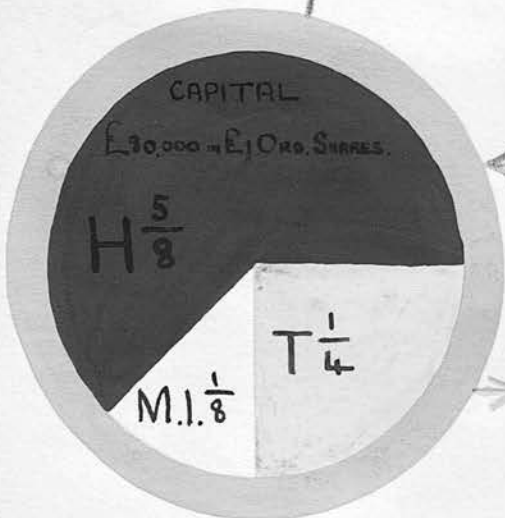
H



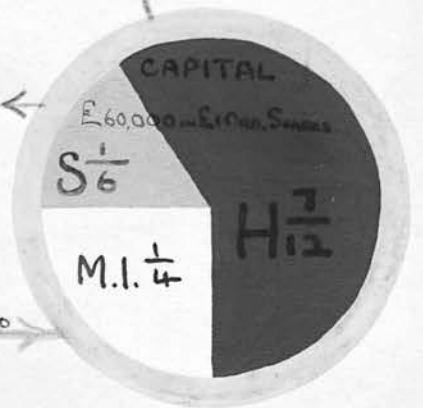
$\frac{5}{8}$ BOUGHT — 31/12/44

$\frac{7}{12}$ BOUGHT — 31/12/44

S



T



$\frac{1}{6}$ BOUGHT MANY YEARS AGO

$\frac{1}{4}$ BOUGHT MANY YEARS AGO

H.1. Revenue Account Dr. £8,600
 To Investment Account (in S.) £8,600
 (Being $\frac{5}{8}$ ths of S.'s true revenue balance at 31/12/44 -
 pre-acquisition when H. acquired 50,000 shares in S. ($\frac{5}{8}$ ths).

H.2. Revenue Account Dr. £16,590
 To Investment Account (in T.) £16,590
 (Being $\frac{7}{12}$ ths of T.'s true revenue balance at 31/12/44 -
 pre-acquisition when H. acquired 35,000 shares in T. ($\frac{7}{12}$ ths).

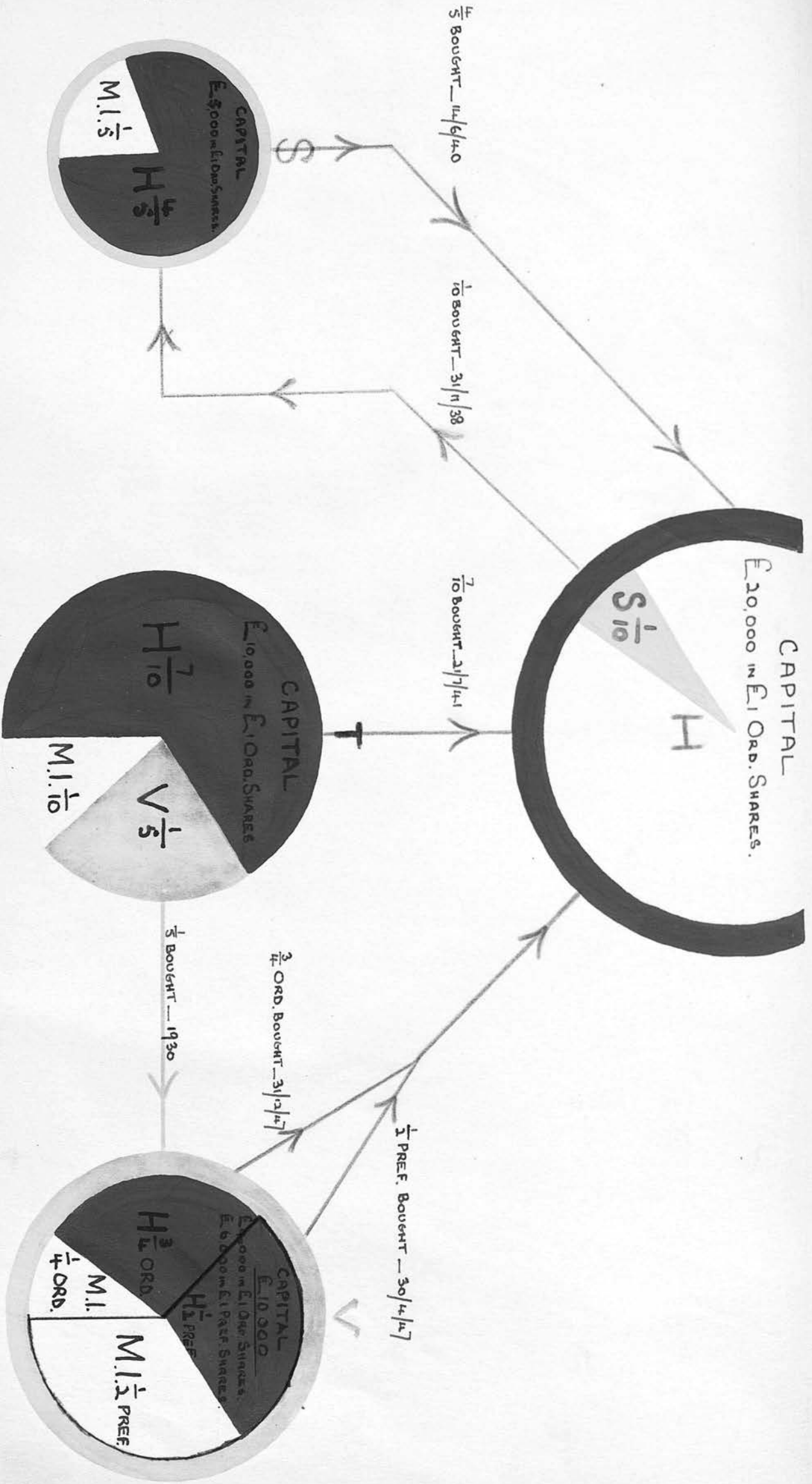
(b) The Aggregation of the adjusted Balance Sheets is:

<u>Assets</u>	<u>Total</u>	<u>H.</u>	<u>S.</u>	<u>T.</u>
Sundry Assets ..	£391,500	£237,500	£ 88,000	£ 66,000
Investments at cost less dividends credited;				
In T. ($\frac{1}{4}$ th) 10,000 shares	11,020		11,020	
In S. ($\frac{1}{4}$ th) 20,000 shares	25,000			25,000
Investments at adjusted cost:				
In T. ($\frac{7}{12}$ ths) 35,000 shares	35,910	35,910		
In S. ($\frac{5}{8}$ ths) 50,000 shares	51,400	51,400		
	£ 514,830	£324,810	£ 99,020	£ 91,000
	£ 514,830	£324,810	£ 99,020	£ 91,000
<u>Liabilities</u>				
Share Capital ..	£ 340,000	£200,000	£ 80,000	£ 60,000
Creditors ..	106,000	90,000	10,000	6,000
Revenue Account ..	68,830	34,810	9,020	25,000
	£ 514,830	£324,810	£ 99,020	£ 91,000
	£ 514,830	£324,810	£ 99,020	£ 91,000

(c) The Consolidated Statement of Assets and Liabilities at 31st December 1944 is

<u>Assets</u>				
Sundry Assets				£391,500
Goodwill - Net Cost of Control to the group				
	<u>By T.</u>	<u>By S.</u>	<u>By H.</u>	
	<u>in S. ($\frac{1}{4}$th)</u>	<u>in T. ($\frac{1}{5}$th)</u>	<u>In S. ($\frac{5}{8}$ths)</u>	<u>In T. ($\frac{7}{12}$ths)</u>
Adjusted Cost	£25,000	£11,020	£51,400	£35,910
Par	20,000	10,000	50,000	35,000
	£ 5,000	£ 1,020	£ 1,400	£ 910
Less:				
Minority Interests				
S. (see below)		242		
T. " "	1,371			
	£ 3,629	£ 778	£ 1,400	£ 910
	£ 3,629	£ 778	£ 1,400	£ 910
				£398,217
<u>Liabilities</u>				
Share Capital H.				£200,000
Creditors				106,000
Revenue Account, H. only				60,000
Minority Interests:				
	<u>In S. ($\frac{1}{8}$th)</u>	<u>In T. ($\frac{1}{4}$th)</u>		
Share Capital ..	£10,000	£15,000		
Revenue Account ..	1,720	7,110		
Net Cost of Control Dr.	242	1,371		
	£11,478	£20,739		32,217
	£11,478	£20,739		32,217
				£ 398,217

EXAMPLE — 35.



Group of 4 Members with simple cross-holding.

The summarised Balance Sheets of a Group at 31st December 1947 are -

	<u>Assets</u>			
	<u>H.</u>	<u>S.</u>	<u>T.</u>	<u>V.</u>
Sundry Assets	£10,800	£30,600	£15,000	£15,600
Goodwill at Cost.	1,000	2,000	-	-
Investments.	19,900	2,100	3,000	1,700
Profit and Loss Account	-	-	1,000	-
	<u>£31,700</u>	<u>£34,700</u>	<u>£19,000</u>	<u>£17,300</u>
	<u>Liabilities</u>			
Share Capital (in £1 Shares):				
Ordinary.. .. .	£20,000	£ 5,000	£10,000	£ 4,000
7½% Preference.	-	-	-	6,000
Debentures.. .. .	1,000	15,000	-	1,000
Creditors	4,400	12,700	9,000	3,300
Profit and Loss Account	6,300	2,000	-	3,000
	<u>£31,700</u>	<u>£34,700</u>	<u>£19,000</u>	<u>£17,300</u>

Notes.

1. The details of "Investments" are -

H. 4,000 Ordinary Shares ($\frac{4}{5}$ ths) in S.) Bought on 14th June 1940 when
 - at cost £ 5,200) S.'s credit balance on P.& L.
Less: Dividends credited.. .. . 900) A/c. was estimated at £1,000
 £ 4,300) and H.'s estimated at £5,000,

7,000 Ordinary Shares ($\frac{7}{10}$ ths) in T. (Bought on 21st July 1941 when
 at cost 5,600 (it was estimated T. had a
 (debit balance on P.& L.A/c.
 (of £700.

3,000 Ordinary Shares ($\frac{3}{4}$ ths) in V.
 at cost 7,000 Bought on 31st Dec. 1947.

3,000 Preference Shares ($\frac{1}{2}$) do. 3,000 Bought on 30th April 1947.
 (Preference Shares have a (V.'s 1947 Preference
 preference for dividend and dividend not yet declared.)
 capital.)

As per H.'s Balance Sheet .. £19,900

S. 2,000 ($\frac{1}{10}$ th) Ordinary Shares in H.
 at cost, less dividends credited £ 2,100 Bought on 30th November 1938.

T. £3,000 Debentures in S. at cost .. £ 3,000

V. 2,000 Ordinary Shares ($\frac{1}{5}$ th) in T.
 at cost, less dividends credited £ 1,700 Bought in 1930.

2. V.'s Preference Shares are non-cumulative. They enjoy a preference for dividend and capital, but have no further rights.

Solution.

(a) The adjustments required in each Company's Accounts are:

V.1. Revenue Account	Dr.	£ 450	
To Preference Dividend outstanding.. .. .			£ 450
(Being 1947 Preference Dividend accrued)			
H.1. Outstanding Dividends Receivable Account	Dr.	£ 225	
To Revenue Account			£ 150
Investment Account (in V.'s Pref.)			75
(Being 1947 Preference Dividend from V. in respect of 3,000 Preference Shares in V. bought by H. on 30th April 1947 ($\frac{1}{5}$ rd capitalised))			

H.2. /

H.2. Revenue Account	Dr.	£ 300	
To Investment Account (in S.)			£ 300
(Being proportion of S.'s credit balance on Revenue Account (pre-acquisition) at 14th June 1940 when H. bought 4,000 Ordinary Shares ($\frac{4}{5}$) in S., made up thus:			
Cr. balance at 14th June 1940, estimated from S.'s books		£1,000	
Add: $\frac{1}{10}$ th of H.'s Cr. balance on 14th June 1940 (S. holds $\frac{1}{10}$ of H.),			
$\frac{1}{10}$ th of £5,000		500	
		<u>£1,500</u>	
$\frac{4}{5}$ ths thereof falling to H.		£1,200	
Less: Dividend credited to Investment Account by H.		900	
		<u>£ 300</u>	
		<u>£ 300</u>	
H.3. Investment Account (in T.)	Dr.	£ 490	
To Revenue Account			£ 490
(Being $\frac{7}{10}$ ths T.'s debit balance on Revenue A/c., £700, on 21st July 1941 (pre-acquisition) when H. bought $\frac{7}{10}$ ths T.)			
H.4. Revenue Account	Dr.	£1,762 $\frac{1}{2}$	
To Investment Account (in V.)			£1,762 $\frac{1}{2}$
(Being $\frac{3}{4}$ ths V.'s credit balance on Revenue A/c., £2,350, on 31st Dec. 1947 (pre-acquisition) when H. bought $\frac{3}{4}$ ths of V.'s Ordinary Capital, made up thus:			
V.'s Cr. balance per Balance Sheet.		£3,000	
Less: Accrued Preference Dividend, V. for 1947		450	
		<u>£2,550</u>	
Less: $\frac{1}{5}$ th of T.'s debit balance, £1,000 (V. owns $\frac{1}{5}$ th T.) ..		200	
		<u>£2,350</u>	
$\frac{3}{4}$ ths thereof to H. ..		<u>£1,762$\frac{1}{2}$</u>	

Note: No pre-acquisition adjustment is required in respect of the 2,000 Ordinary Shares in H. held by S., and of the 2,000 Ordinary Shares in T. held by V. Both these holdings were ordinary investments existing before the Group was formed.

(b) The Aggregation of the adjusted Balance Sheets is:

	<u>Assets</u>				
	<u>Total</u>	<u>H.</u>	<u>S.</u>	<u>T.</u>	<u>V.</u>
Sundry Assets	£72,000	£10,800	£30,600	£15,000	£15,600
Goodwill, per Balance Sheets ..	3,000	1,000	2,000	-	-
Dividend Receivable outstanding.	-	225	-	-	-
Debentures.. .. .	-	-	-	3,000	-
<u>Investments at Adjusted Cost:</u>					
In S. 4,000 Shares.	4,000	4,000	-	-	-
" T. 7,000 "	6,090	6,090	-	-	-
" V. 3,000 Preference Shares	2,925	2,925	-	-	-
" V. 3,000 Ordinary " ..	5,237 $\frac{1}{2}$	5,237 $\frac{1}{2}$	-	-	-
" T. 2,000 Shares	1,700	-	-	-	1,700
" H. 2,000 "	2,100	-	2,100	-	-
Revenue Account.. .. .	-	-	-	1,000	-
	<u>£97,052$\frac{1}{2}$</u>	<u>£30,277$\frac{1}{2}$</u>	<u>£34,700</u>	<u>£19,000</u>	<u>£17,300</u>

Liabilities /

Note: As there is a cross-holding between H. and S. the Minority Interests are calculated by algebra, thus:

Revenue Account, £8,427 $\frac{1}{2}$

Let $10x$ = H.'s true share of Revenue Account

and $5y$ = S.'s " " " " " "

Then $10x$ = $H + \frac{4}{5}S + \frac{7}{10}T + \frac{3}{4}(V + \frac{1}{5}T)$

= $4,877\frac{1}{2} + 4y + \frac{7}{10}$ of Dr. 1,000 + $\frac{3}{4}(2,550 + \frac{1}{5}$ of Dr. 1,000)

= $4,877\frac{1}{2} + 4y - 700 + 1,762\frac{1}{2}$

∴ $10x = 5,940 + 4y$ (1)

and $5y = 2,000 + x$ (2)

∴ $5,940 + 4y = 50y - 20,000$

$-46y = -25,940$

∴ $y = 563.913$

and $x = 819.565$

Revenue Account is divisible -

Group (9x)	£ 7,376
Minority Interests:	
S. (y)	564
T.	Dr. 100
V.	587 $\frac{1}{2}$
	£ 8,427 $\frac{1}{2}$

Net Cost of Control, £1,127 $\frac{1}{2}$

Let $10x$ = H.'s true share of Cost of Control

and $5y$ = S.'s " " " " " "

$10x = 1,027\frac{1}{2} + 4y$ (1)

$5y = 100 + x$ (2)

$50y - 1,000 = 1,027\frac{1}{2} + 4y$

$y = 44.08$

$x = 120.4$

Net Cost of Control is divisible -

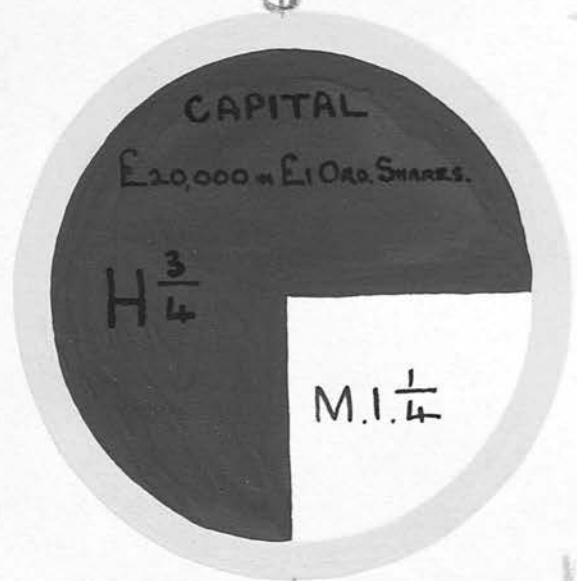
Group (9x)	£ 1,083 $\frac{1}{2}$
Minority Interests, S. (y)	44
	£ 1,127 $\frac{1}{2}$

EXAMPLES — 36 AND 37.

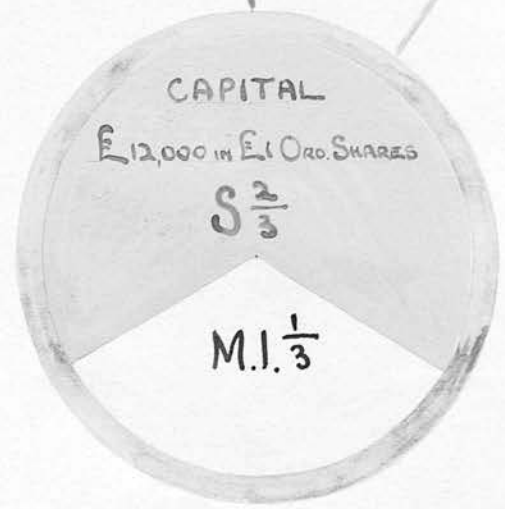
H



$\frac{3}{4}$ BOUGHT — 1942



$\frac{2}{3}$ BOUGHT — 1930



Example 36.

Sub-subsidiary acquiring shares in the Holding Company after the group is formed. All holdings at cost.

The summarised Balance Sheets of a group at 31st December 1946 were-

		<u>Assets</u>		
		H.	S.	T.
Sundry Assets	.. .. .	£111,000	£21,667	£ 9,000
<u>Investment at Cost</u>				
In S.	15,000 shares	19,000		
" T.	8,000 "		9,333	
" H.	5,000 "			6,000
		<u>£130,000</u>	<u>£31,000</u>	<u>£15,000</u>

Liabilities

Share Capital (in £1 Ordinary Shares)	..	£100,000	£20,000	£12,000
Creditors	.. .. .	20,000	6,000	2,000
Revenue Account	.. .. .	10,000	5,000	1,000
		<u>£130,000</u>	<u>£31,000</u>	<u>£15,000</u>

S. acquired $\frac{2}{3}$ rds of T. in 1930 when it was estimated from T's books that T's balance on Revenue Account was credit £2,800.
 H. acquired $\frac{3}{4}$ ths of S. in 1942 when it was estimated: ~~From T's books that T's balance on Revenue Account was credit £2,800.~~

(a) From S's books that S's balance on Rev. A/c was cr. £3,000
 (b) " T's. $\frac{1}{3}$ " " T's. " " " " " " cr. £1,600

T. acquired $\frac{2}{10}$ th of H. in 1943 when it was estimated -

(a) From H's books that H's bal. on Rev. A/c was cr. £8,450
 (b) " S's. " " S's. " " " " " " cr. £4,267
 (c) " T's. " " T's. " " " " " " cr. £ 800

Solution.

(a) The adjustments required in S. H. and T's. accounts in order to write down the cost of investments by the pre-acquisition balances, are -

S.1. Revenue Account Dr. £1867
 To Investment Account (in T.) £1867
 (Being $\frac{2}{3}$ T's. cr. balance on Rev. A/c in 1930
 £2,800 - pre-acqn. - when S. bought 8,000
 shs. in T. ($\frac{2}{3}$))

H.1. Revenue Account Dr. £1650
 To Investment Account (in S.) £1650
 (Being $\frac{3}{4}$ of S. credit balance in 1942 £2200 -
 pre-acqn. - when H. bought 15,000 shs.
 in S. ($\frac{3}{4}$ ths) made up thus:

Adjustment for T's. post-acquisition results 1930-1942	{	Less: $\frac{2}{3}$ of T's. Cr. balance 1930 which should have been capitalised (see S.1.)	£3,000	1,867
			£1,133	1,067
	{	Add: $\frac{2}{3}$ of T's. Cr. balance in 1942 £1600 falling to S.	1,067	£2,200
			£2,200	£2,200

T.1. /

Liabilities

Share Capital H.	£100,000		
<u>Less: Held by T.</u>	<u>5,000</u>		
		£ 95,000	
Creditors	28,000		
<u>Revenue Account</u>	<u>£12,033</u>		
<u>Less: Min. Ints.</u>			
T. see below	£ 371		
S. " "	<u>969</u>	<u>1,340</u>	10,693
<u>Minority Interests</u>			
Capital	£ 5,000	<u>£ 4,000</u>	
Revenue Account	969	371	
Net Cost of Control	Cr. <u>23</u>	<u>221</u>	Dr.
	<u>£ 5,992</u>	<u>4,150</u>	10,142
			<u>£ 143,835</u>

As there is a cross-holding between H. & T., the division of Revenue Account £12,033 and the Net Cost of Control Dr. £2,366, between the group and the Minority Interests of S. and T. is computed by algebra thus:

Revenue Account £12,033Net Cost of Control £2366 Dr

$$\begin{aligned}
 \text{Let } 20x &= \text{H's true share of revenue} \\
 \text{\& } 6y &= \text{T's " " " "} \\
 \therefore 20x &= H + \frac{3}{4}S + \frac{3}{4} \text{ of } \frac{2}{3}T. \\
 &= 8350 + \frac{3}{4}x \cdot 3133 + 3y \\
 \therefore 80x &= 33,400 + 9399 + 12y \quad (1) \\
 6y &= 550 + x \quad (2) \\
 \therefore 80x &= 42,799 + 1100 + 2x \\
 78x &= 43899 \\
 x &= 562.808 \\
 \text{\& } y &= 185.468
 \end{aligned}$$

Divisible thus:

$$\begin{aligned}
 \text{Group's share} & \dots 19x \quad \text{£10,693} \\
 \text{Min. Ints.} & \\
 \text{T.} & \dots \dots \dots 2y \quad 371 \\
 \text{S.} & \frac{1}{4}(3133 + 4y) = 16969 \\
 & \underline{\underline{\text{£ 12,033}}}
 \end{aligned}$$

$$\begin{aligned}
 \text{Let } 20x &= \text{H's true share of} \\
 & \text{Cost of Control} \\
 \text{\& } 6y &= \text{T's true share of} \\
 & \text{Cost of Control} \\
 \therefore 20x &= H + \frac{3}{4}S + \frac{3}{4} \text{ of } \frac{2}{3}T. \\
 &= 2350 + \frac{3}{4}(-534) + 3y \\
 \therefore 80x &= 9400 - 1602 + 12y \\
 6y &= 550 + x \\
 80x &= 7798 + 1100 + 2x \\
 78x &= 114.08 \\
 y &= 110.68
 \end{aligned}$$

Divisible thus:

$$\begin{aligned}
 \text{Group's share} & \dots 19x \quad \text{£2,168} \\
 \text{Min. Ints.} & \\
 \text{T.} & \dots \dots \dots 2y \quad 221 \\
 \text{S.} & \frac{1}{4}(-534 + 4y) \text{ Dr. } 23 \\
 & \underline{\underline{\text{£ 2,366}}}
 \end{aligned}$$

Example 37.

Sub-subsidiary acquiring shares in the Holding Company after the group is formed. Holdings at cost less pre-acquisition revenue balances in the books of the Holding Company and the Subsidiary.

The summarised Balance Sheets of a group as at 31st December 1946 were -

	<u>Assets</u>	H.	S.	T.
Sundry Assets		£111,000	£21,667	£ 9,000
<u>Investments</u>				
<u>At Cost less divds. credited.</u>				
In S. (15,000 shs.)		17,350		
" T. (8,000 ")			7,466	
<u>At Cost</u>				
In H. (5,000 shs.)				6,000
		<u>£128,350</u>	<u>£29,133</u>	<u>£15,000</u>
	<u>Liabilities</u>			
Share Capital (in £1 Ordinary Shares)		£100,000	£20,000	£12,000
Creditors		20,000	6,000	2,000
Revenue Account		8,350	3,133	1,000
		<u>£128,350</u>	<u>£29,133</u>	<u>£15,000</u>

Notes.

1. S. bought $\frac{2}{3}$ rds T. in 1930 when it was estimated that T's. balance on Revenue Account was cr. £2,800. S. credited to Investment Account dividends received from T. in 1930/31 to the extent of £1,867; this covers fully S's. share of T's. pre-acquisition balance ($\frac{2}{3}$ of 2800 = 1867)

2. H. bought $\frac{3}{4}$ ths S. in 1942 when it was estimated -

(a) from S's. books that S's. balance on Rev. A/c was cr. £1,133
 (b) " T's. " " T's. " " " " " " cr. £1,600

H. credited to Investment Account dividends received from S. in 1942 to the extent of £1,650; this covers fully H's. share of T's. pre-acquisition balance ($\frac{3}{4}$ of {S. 1133 + $\frac{2}{3}$ + T. 1600})
 $= \frac{3}{4} \times 2200$
 $= 1650$

3. T. acquired $\frac{1}{20}$ th of H. in 1943 when it was estimated -

(a) from H's. books that H's. balance on Rev. A/c was cr. £6800
 (b) " S's. " " S's. " " " " " " cr. 2400
 (c) " T's. " " T's. " " " " " " cr. 800

Solution./

Solution.

- (a) The adjustments required in the above Balance Sheets in order to write down the value of Investments to Adjusted Cost, are in T's. Accounts only.

T.1. Revenue Account Dr. £ 450
 To Investment Account (in H.) £ 450
 (Being $\frac{1}{20}$ th of H's. credit balance on
 Revenue Account in 1943 £9,000 -
 pre-acqn. - when T. bought 5,000
 shares in H. ($\frac{1}{20}$ th). The £9,000
 is arrived at thus:

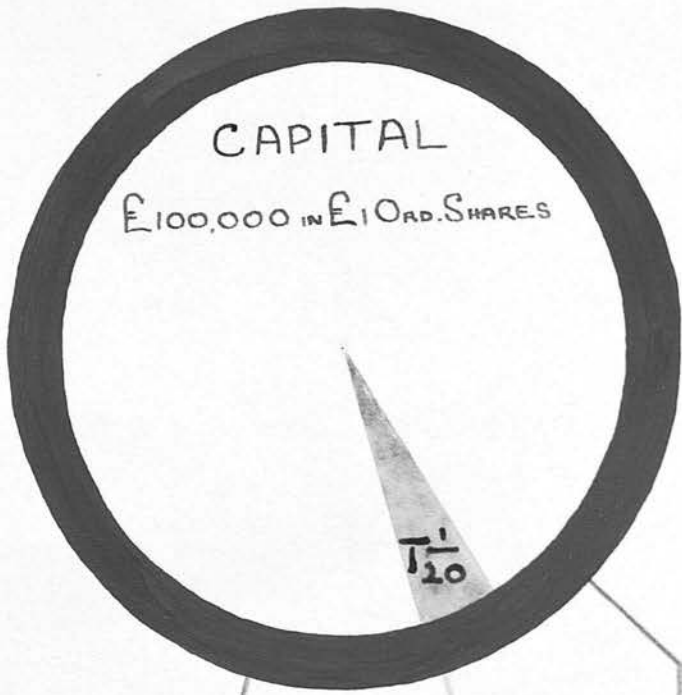
$$\begin{aligned} H. &= H. + \frac{3}{4} S. + \frac{3}{4} \times \frac{2}{3} T. \\ &= 6800 + \frac{3}{4} \times 2400 + \frac{1}{2} \times 800 \\ &= 9,000 \end{aligned}$$

- (b) & (c) The Aggregation of the adjusted Balance Sheets and the resultant Consolidated Statement is the same as the previous example. The figures and facts are the same except that H. and S. had written down the cost of Investments by the full pre-acquisition balances in their books. This procedure simplifies consolidation.

This example should be compared with example 20, which excludes a cross-holding but is otherwise similar.

EXAMPLES — 38 AND 42.

H

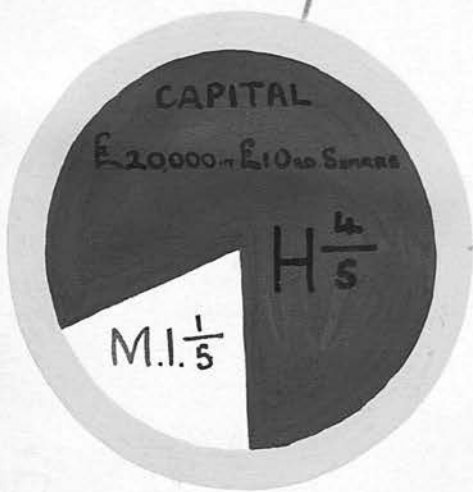


$\frac{4}{5}$ BOUGHT — 1941

$\frac{1}{20}$ BOUGHT — 1938

$\frac{1}{2}$ BOUGHT — 1940

S



$\frac{1}{4}$ BOUGHT — 1942



Example 38.

Sub-subsidiary holding shares in Holding Company prior to formation of the Group.
All holdings at cost less certain dividends credited. Further shares bought in
Sub-subsidiary after cross-holding existed.

The summarised Balance Sheets of a Group at 31st December 1943 are:

		<u>Assets</u>		
		<u>H.</u>	<u>S.</u>	<u>T.</u>
Sundry Assets	.. .. .	£108,000	£20,000	£10,000
<u>Investments:</u>				
In H. 5,000 Shares at cost less dividend £500.	.. .. .	-	-	7,000
" T. 6,000 " " " " " £600.	.. .. .	8,000	-	-
" S. 16,000 " " " " " " " " " "	.. .. .	14,000	-	-
" T. 3,000 " " " " " " " " " "	.. .. .	-	5,000	-
Revenue Account	.. .. .	-	1,000	-
		<u>£130,000</u>	<u>£26,000</u>	<u>£17,000</u>
		<u>Liabilities</u>		
Share Capital (in £1 Ordinary Shares).	.. .. .	£100,000	£20,000	£12,000
Creditors	.. .. .	20,000	6,000	2,000
Revenue Account	.. .. .	10,000	-	3,000
		<u>£130,000</u>	<u>£26,000</u>	<u>£17,000</u>

Notes.

- T. bought $\frac{1}{20}$ th of H. in 1938.
- H. bought $\frac{1}{2}$ of T. in 1940 when it was estimated -
 - from T.'s books that T.'s balance on Revenue Account was Cr. £1,800, and
 - " H.'s " " H.'s " " " " " " Cr. £12,000.
 By arrangement one of H.'s Directors became Chairman of T. immediately after the acquisition.
- H. bought $\frac{4}{5}$ ths of S. in 1941 when it was estimated from S.'s books that S.'s balance on Revenue Account was Dr. £1,250. H. considered S.'s Fixed Assets overvalued by £2,000; this was not adjusted in S.'s books.
- S. bought $\frac{1}{4}$ of T. in 1942 when it was estimated -
 - from T.'s books that T.'s balance on Revenue Account was Cr. £2,000.
 - " S.'s " " S.'s " " " " " " Cr. £1,200.
 - " H.'s " " H.'s " " " " " " Cr. £16,000.
- All dividends credited to Investment Account by H., S. and T. were received shortly after the acquisition of the holding.

Solution.

(a) The adjustments required in each Company's Accounts are -

T. No adjustment required. T.'s holding in H. is an ordinary investment existing before the formation of the Group.

H.(1) Revenue Account Dr. £ 600
 To Investment Account (in T.) £ 600

(Being portion of T.'s credit balance on Revenue Account - pre-acquisition - in respect of 6,000 Shares bought in T. by H. in 1940, made up thus:

T.'s balance per T.'s books in 1940 £1,800

Add: $\frac{1}{20}$ th of H.'s balance in 1940
 (5,000 shares held by T)

$\frac{1}{20}$ th of 12,000 600

£2,400

H.'s interest, $\frac{1}{2}$ thereof.. £1,200

Less: Dividend credited to Investment Account by H. 600

Balance to be capitalised. £ 600

H.(2) Investment Account (in S.) Dr. £1,000
 To Revenue Account £1,000
 (Being $\frac{4}{5}$ ths of S.'s debit balance on Revenue A/c.
 in 1941 (Dr. £1,250) - pre-acquisition - when
 H. bought 16,000 Shares in S. ($\frac{4}{5}$ ths).)

S.(1) Capital Reserve Dr. £2,000
 To Fixed Assets £2,000
 (Being over-valuation of S.'s Fixed Assets in
 1941 when H. acquired control of S.)

S.(2) Revenue Account Dr. £ 250
 To Investment Account (in T.) £ 250
 (Being portion of T.'s credit balance on Revenue
 A/c. - pre-acquisition - in respect of 3,000
 Shares bought in T. by S. in 1942, computed thus:

	H.	S.	T.
Revenue credit balance per books			
in 1942	£16,000	£1,200	£2,000
<u>Less: Amounts which should have been</u> capitalised prior thereto to adjust pre-acquisition balance			
H.(1) Dr. £600 and H.(2) Cr. £1,000	400 Cr.		
	<u>£16,400</u>	<u>£1,200</u>	<u>£2,000</u>

As T. owns $\frac{1}{20}$ th H. and H. has $\frac{1}{2}$ T. (and $\frac{4}{5}$ ths S.) a cross-holding
 existed in 1942, and T.'s true Revenue balance must be calculated
 by algebra.

Let $4x =$ T.'s true Revenue balance after receiving $\frac{1}{20}$ th from H.

$$\therefore 4x = T. + \frac{1}{20} (H. + \frac{4}{5} S. + \frac{1}{2} T.)$$

$$= 2,000 + \frac{1}{20} (16,400 + \frac{4}{5} \text{ of } 1,200 + 2x)$$

$$78x = 40,000 + 16,400 + 960$$

$$x = 735 \quad (\frac{1}{4} \text{th of T.'s Revenue balance in 1942})$$

$\frac{1}{4}$ th of T.'s true Revenue balance in 1942 falling to S.. £ 735
Less: Dividend credited to Investment A/c. by S. .. 485

Balance to be capitalised £ 250

b) The aggregation of the adjusted Balance Sheets is -

	<u>Assets</u>		H.	S.	T.
		<u>Total</u>			
Sundry Assets		£136,000	£108,000	£18,000	£10,000
<u>Investments at Adjusted Cost:</u>					
In H. $\frac{1}{20}$		7,000	-	-	7,000
" T. $\frac{1}{2}$		7,400	7,400	-	-
" S. $\frac{4}{5}$		15,000	15,000	-	-
" T. $\frac{1}{4}$		4,750	-	4,750	-
Revenue Account.. .. .		-	-	1,250	-
Capital Reserve.. .. .		2,000	-	2,000	-
		<u>£172,150</u>	<u>£130,400</u>	<u>£26,000</u>	<u>£17,000</u>
	<u>Liabilities</u>				
Capital		£132,000	£100,000	£20,000	£12,000
Creditors		28,000	20,000	6,000	2,000
Revenue Account.. .. .		12,150	10,400	-	3,000
		<u>£172,150</u>	<u>£130,400</u>	<u>£26,000</u>	<u>£17,000</u>

c) /

The division therefore is -

Group (19x) £ 11,321

Minority Interests:

T. (y) 899
 S. $\frac{1}{5}$ (- 1,250 + 899) 70 Dr.
y £ 12,150

Net Cost of Control, £5,750.

Let 20x = H.'s true share of Net Cost of Control

and 4y = T.'s " " " " " " "

$$\begin{aligned} \therefore 20x &= H. + \frac{4}{5} (S. + \frac{1}{4} T.) + \frac{1}{2} T. \\ &= 2,000 + \frac{4}{5} (1,750 + y) + 2y \end{aligned}$$

$$100x = 10,000 + 7,000 + 4y + 10y$$

$$100x = 17,000 + 14y \quad (1)$$

$$4y = 2,000 + x \quad (2)$$

$$400y = 200,000 + 100x$$

$$400y - 200,000 = 17,000 + 14y$$

$$386y = 217,000$$

$$y = 562.176$$

$$x = 248.70$$

The division therefore is -

Group (19x) £ 4,725

Minority Interests:

T. (y) 562
 S. $\frac{1}{5}$ (1,750 + 562) 463
y £ 5,750

Alternatively the calculation can be made by transferring the balances round the members until they are exhausted. Demonstration (taking Revenue Account):

	T.	To S. $\frac{1}{4}$	To H. $\frac{1}{2}$	M.I. $\frac{1}{4}$	S.	To H. $\frac{4}{5}$	M.I. $\frac{1}{5}$	H.	To Group	To T. $\frac{1}{20}$
Balance	£3,000			£ 750	£1,250	Dr.		£10,400		
		£ 750			750			1,500		
		<u>£1,500</u>			£ 500			£ 400	£ 100	Dr. 400
								<u>£11,500</u>		£10,925
										£ 575
From H.	£ 575			144						
		£ 144			144			£ 287		
			£ 287			£ 115	29 Cr.	115		
								<u>£ 402</u>	382	20
" "	£ 20			5				£ 10		
		£ 5			5			£ 4	1	4
			£ 10					<u>£ 14</u>		14
				<u>£ 899</u>				<u>£ 70</u>	Dr.	<u>£11,321</u>

(2) Attention is drawn to the calculation of the pre-acquisition balance capitalised in respect of an acquisition of shares made in a member in which a cross-holding already exists, S.(2).

CHAPTER X. Consolidated Profit and Loss Accounts.

While a Consolidated Statement of Assets and Liabilities discloses the financial position of the group as at a certain date, it does not show the amount of profit earned by the group since the date of the previous statement. If the directors or shareholders are to be properly informed of the earning capacity of the combine, a Consolidated Profit and Loss Account must be available and is indeed a vital supplement to any Consolidated Statement of Assets and Liabilities.

Interesting statistics such as the turnover of the group, the wages bill, etc., may be compiled by adding together the figures in the Profit and Loss Accounts of all members of the group. Such simple aggregation of Profit and Loss Accounts would not be a very useful guide; ^{it might} but ~~perhaps~~ even be misleading ~~one~~, ~~as to the prosperity of the group~~ from the point of view of the shareholders of the holding company. It might include, for example, the figures of a prosperous member ~~which might be~~ owned by the holding company only to the extent of 51% or even less in the case of a sub-subsidiary. What is required is a statement showing the trading profits which fall to the shareholders of the holding company for the year under review from all the members of the group. ^{N.L.} There are two methods of computation available. Firstly, group trading profits may be arrived at by aggregation of the proportions of trading profit of each member as distinct from total profits which will include dividends received from other members. In each company, the trading profit as shown in the accounts is adjusted for all Revenue Account matters which were dealt with in the preparation of the Consolidated Statement of Assets and Liabilities, such as inadequate depreciation, increases or decreases in reserves for unrealised profit on stock, and pre-acquisition earnings in the case of a newly-acquired subsidiary. The resultant figure is used in the aggregation when the /

the subsidiary is fully-owned, but if the subsidiary is partly-owned, only a proportion of it is taken according to the group's effective financial interest in the member. Thus the ^{proper} amount of trading profit of the subsidiaries and the holding company, falling to the shareholders of the holding company, is obtained.

The second method is to compute the group trading profit by a comparison of the balances on Group Profit and Loss Account as shown in the Consolidated Statements of Assets and Liabilities at the beginning and at the end of the period under review. If a balance at credit at the end exceeds a balance at credit at the beginning, the difference represents either -

- (a) the group net profit if no dividend has been paid during the period by the holding company.
- (b) the excess of group net profit over dividends paid by the holding company in the case where a dividend has been paid by the holding company.

The net profit of any group can ~~therefore~~ ^{thus} be ascertained and by the addition of all items debited in members' accounts which are appropriations of profits, the group trading profit is found. The procedure by this second method may be stated thus:

- (1) Ascertain the difference on the Group Profit and Loss Account balance as shown by the Consolidated Statements at the beginning and at the end of the period.
- (2) Adjustment of (1) in respect of any dividend debited in the financial accounts of the holding company will give the net profit or loss of the group for the period under review.
- (3) To arrive at the trading profit adjust the net profit (2) for appropriations of profit such as -
 - (a) All national taxation, Directors' Fees, etc., debited in the accounts of the holding company and of fully-owned subsidiaries, and a proportion of these charges in the accounts of each partly-owned subsidiary or sub-subsidiary - the proportion depending in each case on the effective financial interest that the main holding company has in each member.
 - (b) All transfers to the credit of General Reserve from the profits of the holding company and of fully-owned subsidiaries and a proportion of such transfers is partly-owned subsidiaries or sub-subsidiaries. Transfers from General Reserve would be treated similarly but in a negative way.

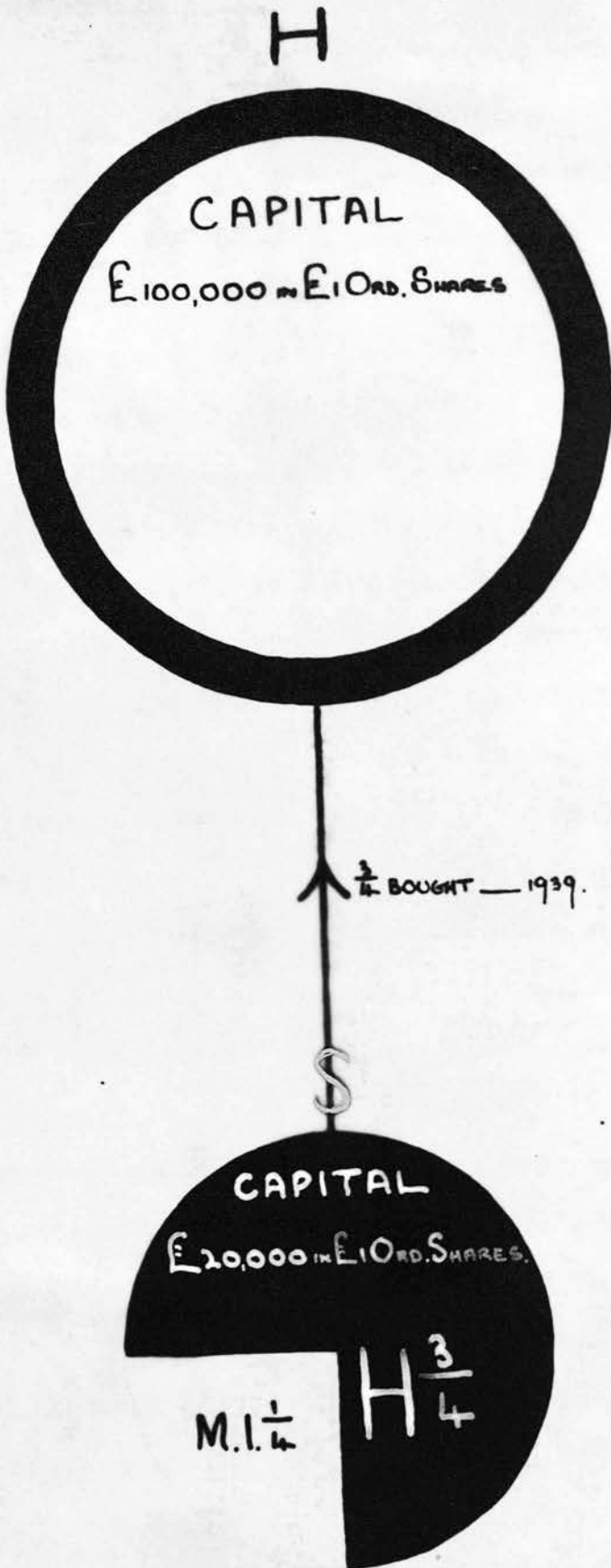
The distinction between the treatment of dividends paid on the one hand and national taxation, reserve adjustments, etc., on the other hand, should be noted. In the former, only dividends paid by the holding company are of moment as those paid by subsidiaries or sub-subsidiaries are merely cross-entries correctly proportional to the holding company's interest in each subsidiary.

Other adjustments may be necessary in order to arrive at a true trading profit. These include the separation of "windfalls" from ordinary receipts and the elimination of exceptional expenditure which should be stated separately in the profits statement. In the case of a subsidiary acquired during the year, only the post-acquisition profit is taken as revenue falling to the group, and in the adding back of expenses only those applicable to the post-acquisition period are dealt with.

The second method gives a Consolidated Appropriation Account. This is usually all that is required. It would be quite possible to apply the same principles to all Profit and Loss Account items and so prepare a detailed Group Profit and Loss Account, but the Account would have little practical value except perhaps in the case of a horizontal combine.

It is recommended that information regarding depreciation written off should also be disclosed. One may do this either by showing the amount of depreciation written off each asset in the Consolidated Statement of Assets and Liabilities ^{or} by showing an amount for depreciation as a debit in the Consolidated Profit and Loss Account. The former method is preferable since it will disclose the total depreciation written off in the aggregate value of the assets while the latter will disclose a lesser amount according to the proportion of the Minority Interests - the lesser amount representing the group's share only of the depreciation charged.

EXAMPLES — 11 and 39



A (4)

Example 39 - Consolidated Profit and Loss Account - group of two members. The Published Statement.

The summarised Balance Sheets of the same group as example 11, as at 31st December 1947, are:-

	<u>ASSETS</u>	
	<u>H</u>	<u>S</u>
Sundry Assets.	£111,150	£ 32,000
<u>Investments at Cost:</u>		
15,000 shares in S	22,850	
Goodwill at cost	1,000	4,500
	<u>£135,000</u>	<u>£ 36,500</u>

LIABILITIES

Share Capital (In £1 Ordinary shares)	£100,000	£ 20,000
Creditors	9,000	3,000
General Reserve	9,000	4,000
Profit and Loss Account.	17,000	9,500
	<u>£135,000</u>	<u>£ 36,500</u>

The summarised Profit and Loss Accounts for the year ended 31st December 1947, are -

By	Balance at credit at 1st January 1947	£ 13,000	£ 7,000
	Trading Profit.	7,500	6,000
	Dividend from S	1,500	-
		<u>£ 22,000</u>	<u>£ 13,000</u>
To	Dividends paid.	£ 4,000	£ 2,000
	National Taxation	600	900
	Directors' Fees	400	100
	Transfer to General Reserve	-	500
	Balance at credit at 31st December 1947.	17,000	9,500
		<u>£ 22,000</u>	<u>£ 13,000</u>

SOLUTION

- (a) The adjustments required are the same as those of last year - see example 11 - as there has been no change in the structure of the group during 1947.
- (b) The aggregation of the adjusted Balance Sheets is:-

	<u>ASSETS</u>	<u>Total</u>	<u>H</u>	<u>S</u>
Sundry Assets.		£143,150	£111,150	£ 32,000
Goodwill per Balance Sheets		5,500	1,000	4,500
<u>Investments at Adjusted Cost:</u>				
15,000 shares in S		15,350	15,350	-
		<u>£164,000</u>	<u>£127,500</u>	<u>£ 36,500</u>

LIABILITIES/

(b) Continued.

								<u>LIABILITIES</u>	<u>Total</u>	<u>H</u>	<u>S</u>
Share Capital	..	..	..	..	..	..	..	£120,000	£100,000	£ 20,000
Creditors	..	..	..	..	..	..	..	12,000	9,000	3,000
Revenue Account	..	..	..	..	..	..	..	32,000	18,500	13,500
								£164,000	£127,500	£ 36,500	

(c) The Consolidated Statement is:-

								<u>ASSETS</u>		
Sundry Assets	£143,150
Goodwill per Balance Sheets.	5,500
Goodwill - Net Cost of Control to H (as per last year)	350
										£149,000

								<u>LIABILITIES</u>		
Share Capital H	..	..	..	..	..	..	..	..	..	£100,000
Creditors	..	..	..	..	..	..	..	..	..	12,000
Revenue Account	..	..	..	..	..	..	..	..	£ 32,000	
<u>Less: Minority Interests</u> S $\frac{1}{4}$ of £13,500	..	..	..	..	..	..	..	..	3,375	28,625
<u>Minority Interests:</u>								<u>S $\frac{1}{4}$</u>		
Capital	..	..	..	..	..	..	..	..	£ 5,000	
Revenue Account.	..	..	..	..	..	..	..	..	3,375	8,375
										£149,000

Note:

To sub-divide Revenue Account between General Reserve and Profit and Loss Account, the mathematical calculation of the amount transferable to General Reserve on the same basis as last year, is -

$$\begin{aligned}
 \text{General Reserve} &= \text{H} + \frac{3}{4} \text{ S's created since acquisition.} \\
 &= 9,000 + \frac{3}{4} (4,000 - 2,000) \\
 &= 10,500
 \end{aligned}$$

The Sub-division is	General Reserve.	..	..	£10,500
	Profit & Loss Account	..	..	18,155
				£28,655

Statement of Group Profits - Year to 31st December 1947 -

								<u>FIRST METHOD</u>			
Trading Profit of H	..	..	..	..	..	..	..	..	..	£ 7,500
Do.	S	..	..	..	..	..	..	..	£ 6,000	
								$\frac{3}{4}$ thereof to group	4,500
								Group Trading Profit (1947)	£ 12,000

SECOND METHOD/

Example 40 - Consolidated Profit and Loss Account. Group of 3 members, 1 acquired during the year.

The summarised Balance Sheets of the same group as example 11 (H and S only), as at 31st December 1947, are:-

	<u>ASSETS</u>								<u>H</u>	<u>S</u>	<u>T</u>
Sundry Assets	£100,150	£ 32,000	£ 21,100
<u>Investments at Cost:</u>											
15,000 shares in S	22,850	-	-
8,000 shares in T	11,000	-	-
Goodwill at cost..	1,000	4,500	-
									<u>£135,000</u>	<u>£ 36,500</u>	<u>£ 21,100</u>

	<u>LIABILITIES</u>										
Share Capital (in £1 Ordinary shares)	£100,000	£ 20,000	£ 12,000
Creditors	9,000	3,000	4,000
General Reserve	9,000	4,000	-
Profit and Loss Account	17,000	9,500	5,100
									<u>£135,000</u>	<u>£ 36,500</u>	<u>£ 21,100</u>

The summarised Profit and Loss Accounts for the year ended 31:12:47, are:-

By Balance at credit at 1:1:46 .. .. .	..	..	..	..	..	..	..	..	£ 13,000	£ 7,000	£ 4,100
Trading Profit .. .. .	..	..	..	..	..	..	..	..	7,500	6,000	5,500
Dividend received from S. .. .. .	..	..	..	..	..	..	..	..	1,500	-	-
									<u>£ 22,000</u>	<u>£ 13,000</u>	<u>£ 9,600</u>
To Dividends paid. .. .. .	..	..	..	..	..	..	..	..	£ 4,000	£ 2,000	£ 3,000
National Taxation .. .. .	..	..	..	..	..	..	..	..	600	900	1,200
Directors' Fees .. .. .	..	..	..	..	..	..	..	..	400	100	300
Transfer to General Reserve .. .. .	..	..	..	..	..	..	..	..	-	500	-
Balance at credit at 31:12:47. .. .. .	..	..	..	..	..	..	..	..	17,000	9,500	5,100
									<u>£ 22,000</u>	<u>£ 13,000</u>	<u>£ 9,600</u>

H acquired 8,000 Ordinary shares in T on 30th September 1947 when it was estimated the balance at credit of T's Profit and Loss Account was £3,900, made up thus:-

Balance at credit at 31st December 1946 .. .. .	..	..	..	..	..	..	..	..	£ 4,100		
<u>Add:</u> Estimated Trading Profit to 30th September 1947 .. .. .	..	..	..	..	..	..	..	..	3,925		
											£ 8,025
<u>Less:</u> Dividend Paid (April 1947) .. .. .	..	..	..	..	..	..	..	..	£ 3,000		
National Taxation - 9 months.. .. .	..	..	..	..	..	..	..	..	900		
Directors' Fees. .. .. .	..	..	..	..	..	..	..	..	225		4,125
											<u>£ 3,900</u>
<u>Estimated credit balance at 30th September 1947 .. .. .</u>	..	..	..	..	..	..	..	..			<u>£ 3,900</u>

SOLUTION

(a) The adjustments to be made are the same as these made at 31st December 1946 (see example 11) with the addition of a further adjustment in respect of shares in T acquired by H during the year.

H (2) Revenue Account. .. .. .	..	..	..	..	..	..	..	..	£ 2,600		
To Investment Account (in T). .. .. .	..	..	..	..	..	..	..	..		£ 2,600	

(Being 2/3rds T's estimated credit balance on Revenue Account £3,900 at 30:9:47 - pre-acquisition - when H bought 8,000 shares in T (2/3rds).

(b)/

Ex. 41. Consolidated Profit and Loss Account - Group of 4 members (ex.29 one year later)

In the group given in ex.29, the following is the Profit and Loss Account for the year ended and Balance Sheet as at 31st December 1946 (one year later than in ex.2)

PROFIT and LOSS ACCOUNT

Cr.	<u>H</u>	<u>S</u>	<u>T</u>	<u>V</u>
By Balance at credit at 31st December 1945 ..	£ 52,500	£ 2,500	£ 3,000	£ 1,200
Dividends received -				
From S	6,000	-	-	-
" T	280	1,200	-	-
" V	500	250	-	-
Trading Profit	61,420	15,050	5,200	2,600
	<u>£120,700</u>	<u>£19,000</u>	<u>£ 8,200</u>	<u>£ 3,800</u>
Dr.				
To National Taxation.	£ 30,000	£ 6,800	£ 2,000	£ 800
Directors' Fees	2,000	500	200	250
Transfer to General Reserve.	10,000	-	-	500
Dividends Paid -				
H 8%.. .. .	40,000	-	-	-
S 10%.. .. .	-	10,000	-	-
T 4%.. .. .	-	-	2,000	-
V 5%.. .. .	-	-	-	750
Balance at credit at date	38,700	1,700	4,000	1,500
	<u>£120,700</u>	<u>£19,000</u>	<u>£8,200</u>	<u>£ 3,800</u>

BALANCE SHEET

ASSETS

	<u>H</u>	<u>S</u>	<u>T</u>	<u>V</u>
Property at Cost	£251,000	£ -	£30,000	£ 2,000
Plant at cost, less depreciation	120,000	18,000	7,400	4,050
Investments - Government Stocks	-	-	1,000	-
do. - in Subsidiary Companies	82,000	44,500	-	-
Stock.	180,000	41,000	16,000	8,000
Debtors	60,000	15,000	8,000	7,000
Subsidiary Company's Current Accounts	7,000	-	-	-
Dividends receivable.	6,000	-	-	-
Cash in Bank	10,000	200	600	950
Goodwill at cost	-	10,000	7,000	-
	<u>£716,000</u>	<u>£128,700</u>	<u>£70,000</u>	<u>£22,000</u>

LIA BILITIES

Share Capital	£500,000	£100,000	£50,000	£15,000
Sundry Creditors	65,000	12,000	7,000	3,000
Amount due to H.	-	5,000	2,000	-
Reserve for inter-coy profit on stock	2,300	-	-	-
General Reserve.	110,000	-	7,000	2,500
Profit and Loss Account	38,700	1,700	4,000	1,500
Proposed Dividends	-	10,000	-	-
	<u>£716,000</u>	<u>£128,700</u>	<u>£70,000</u>	<u>£22,000</u>

Notes:
1. (5)/

Ex. 41. (Continued) Notes:

- (1) - (5) As per ex. 29, except that in note (2) the proposed dividend S. for year to 31st December 1946 is 10% free of tax, and in note (3) the stock reserve is to be increased to £3,000 at 31st December 1946.
- (6) All dividends declared and received by the above companies are stated consistently (Gross - H. T. and V.; Free of tax - S) as between the members.

SOLUTION(a) The Adjustments required in each company's accounts are:-

V. 1. Same as in ex. 29

T. 1. Plant Account Dr. £ 985
 To Capital Reserve. £ 985

(Being current increase in valuation of T's Plant, i.e. increase on 31:12:42 (when S acquired control of T) of £1,500, less depreciation at 10% p.a. to 31:12:46 - see below)

	<u>In Financial</u> <u>A/cs of T.</u>	<u>In Consolidated Statement</u>	<u>Under-</u> <u>Valuation</u>
As at 31:12:45 see ex.29	£ 8,000	£ 7,096	£ 1,094
Less: Depreciation 1946	<u>600</u>	<u>710</u>	<u>109</u>
	<u>£ 7,400</u>	<u>£ 6,386</u>	<u>£ 985 - Undervaln.</u>

At 31:12:46 -
T.1. adjustment

Difference £1,014 -
additional depreciation required to
be provided for by the group - T.2.
adjustment.

T. 2. Revenue Account (Group General Reserve) Dr. £ 1,014
 To Plant Account £ 1,014

(Being additional depreciation required by the group since 31:12:42, i.e. the excess of 10% p.a. on book value, over the amount written off in T's books - see above)

S. 1.) Same as in ex. 29.

S. 2.)

H. 1. Revenue Account Dr. £ 700
 To Stock Reserve. £ 700

(Being increase in reserve required at 31:12:46, for inter-coy profit on stock)

(b) The Aggregation of the Adjusted Balance Sheets, is:-

<u>ASSETS</u>	<u>Total</u>	<u>H</u>	<u>S</u>	<u>T</u>	<u>V.</u>
Property.	£284,000	£251,000	£ -	£30,000	£ 3,000
Plant	149,421	120,000	18,000	7,371	4,050
Stock	245,000	180,000	41,000	16,000	8,000
Debtors.. .. .	90,000	60,000	15,000	8,000	7,000
Subsidiaries' Current Account	-	7,000	-	-	-
Dividends receivable	-	6,000	-	-	-
Goodwill per Balance Sheets..	17,000	-	10,000	7,000	-
Cash	11,750	10,000	200	600	950
<u>Investments at adjusted Cost:</u>					
In S. 60,000 shares	62,000	62,000	-	-	-
T. 7,000 shares	8,000	8,000	-	-	-
V. 10,000 shares	12,000	12,000	-	-	-
T. 30,000 shares	29,000	-	29,000	-	-
V. 5,000 shares	5,700	-	5,700	-	-
Government Stock.. ..	1,000	-	-	1,000	-
Revenue Account	-	-	8,100	-	-
	<u>£914,871</u>	<u>£716,000</u>	<u>£127,000</u>	<u>£69,971</u>	<u>£23,000</u>

LIABILITIES/

(b) (Continued)

LIABILITIES

	<u>Total</u>	<u>H</u>	<u>S</u>	<u>T</u>	<u>V</u>
Share Capital	£665,000	£500,000	£100,000	£50,000	£15,000
Creditors	87,000	65,000	12,000	7,000	3,000
Amounts due to H.	-	-	5,000	2,000	-
Stock Reserve	3,000	3,000	-	-	-
Proposed Dividend	4,000	-	10,000	-	-
Revenue Account.. .. .	153,886	148,000	-	9,986	4,000
Capital Reserve.. .. .	1,985	-	-	985	1,000
	<u>£914,871</u>	<u>£716,000</u>	<u>£127,000</u>	<u>£69,971</u>	<u>£23,000</u>

(c) The Consolidated Statement of Assets and Liabilities as at 31.12.46, is:-ASSETS

Property	£284,000
Plant	149,421
Stock, less Reserve	242,000
Sundry Debtors	90,000
Investment (Government Securities)	1,000
Cash	11,750
Goodwill per Balance Sheets.	17,000
<u>Goodwill Net Cost of Control to the Group:</u>	

	<u>By H.</u>		
	<u>In S $\frac{6}{10}$ths</u>	<u>In T $\frac{7}{50}$ths</u>	<u>In V $\frac{2}{3}$ths</u>
Adjusted Cost	£ 62,000	£ 8,000	£12,000
<u>Less: Capital Reserve.</u>	-	138	667
		£ 7,862	£11,333
Par Value	60,000	7,000	10,000
	<u>£ 2,000</u>	<u>£ 862</u>	<u>£ 1,333</u>
		Dr. £ 4,195	
	<u>By S</u>		
	<u>In T $\frac{3}{5}$ths</u>	<u>In V $\frac{1}{3}$rd</u>	
Adjusted Cost	£ 29,000	£ 5,700	
<u>Less: Capital Reserve...</u>	591	333	
	£ 28,409	£ 5,367	
Par Value	30,000	5,000	
	<u>Cr. £ 1,591</u>	<u>Dr. 367</u>	
		Cr£1,224	
<u>Less: Min. Interests S $\frac{4}{10}$ths</u>		<u>490</u>	<u>734</u>
			<u>3,461</u>
			<u>£798,632</u>

LIABILITIES/

Notes (Continued)

2. A comparison with the Consolidated Statement as at 31.12.45 (ex.29) shows that the Net Cost of Control figure has increased by £54 (3,461 - 3,407). This is due to depreciation for 1946 on the undervaluation of T's Plant which is referred to in note 3 to solution in ex.29. In neither H's nor S's financial books has any provision been made by a writing down of the asset "Investment in T" in respect of depreciation on the valuation difference. The effect of such a correct provision for 1946 would have been to keep the Net Cost of Control at the same figure in both Consolidated Statements. The correct provision is -

In S's financial books:

Depreciation on the valuation difference for 1946 - £109

S's share thereof $\frac{3}{5}$ ths or £65 of which the group bears $\frac{6}{10}$ ths or .. £ 39In H's financial books:

Depreciation on the valuation difference for 1946 - £109

H's share thereof $\frac{7}{50}$ ths or 15£ 54STATEMENT of GROUP PROFIT - Year to 31st December 19461st Method:

Trading Profit H	£ 61,420
<u>Less: Additional Stock Reserve Increase</u>	
1946	£700
1945	£500
	200
Trading Profit S £15,050	£ 61,220
$\frac{6}{10}$ ths thereof.	9,030
Trading Profit T £ 5,200	
Group's share thereof $\frac{1}{2}$ ($\frac{7}{50} + (\frac{6}{10} \times \frac{3}{5})$)	2,600
Trading Profit V £ 2,600	
Group's share thereof $\frac{13}{15}$ ($\frac{2}{3} + (\frac{6}{10} \text{ of } \frac{1}{3})$)	2,253
	<u>£ 75,103</u>

2nd Method:

Group Profit and Loss Account, Credit Balance per Consolidated Statement at 31st December 1946	£ 38,540
Group Profit and Loss Account, Credit Balance per Consolidated Statement at 31st December 1945 (ex.29)	52,260
	<u>Decrease</u> £ 13,720

Less:

H. Dividends	£ 40,000
National Taxation	30,000
Directors' Fees	2,000
Reserve Transfer	10,000
	<u>£ 82,000</u>
S. National Taxation £6,800	$\frac{6}{10}$ ths thereof. £ 4,080
Directors' Fees 500	" 300
	<u>4,380</u>
T. National Taxation £2,000	$\frac{1}{2}$ thereof £ 1,000
Directors' Fees .. 200	" 100
	<u>1,100</u>
V. National Taxation £ 800	$\frac{13}{15}$ ths thereof. £ 693
Directors' Fees 250	" 217
Reserve Transfer 500	" 433
	<u>1,343</u>
	<u>88,823</u>
	<u>£ 75,103</u>

Group's Trading Profit for 1946 .. £ 75,103

The 2nd method gives the figures for, a Consolidated Profit and Loss Account -

To National Taxation. ..	£35,773	By Balance at Credit at 31.12.45 ..	£52,260
Directors' Fees	2,617	Trading Profit falling to the group	75,103
Transfer to General Reserve	10,433		
Dividend paid by H	<u>40,000</u>		
	£88,823		
Balance at credit at date	<u>38,540</u>		
	<u>£127,363</u>		<u>£127,363</u>

Notes:

1. Only $\frac{13}{15}$ ths of V's figures are taken although V has itself no Minority Interests. One-third of V is, however, held by S and S is only $\frac{6}{10}$ ths owned by H. The group's effective financial interest in V is thus:-

$$\begin{aligned}
 & \frac{2}{3} + \left(\frac{6}{10} \text{ of } \frac{1}{3} \text{ through S} \right) \\
 = & \frac{20}{30} + \frac{6}{30} \\
 = & \frac{13}{15} \text{ths}
 \end{aligned}$$

2. Although not done in this Example, a good feature in consolidations is to show the amount of depreciation written off by the group. This may be done in either the Consolidated Profit and Loss Account which would then disclose the group's share of total depreciation, or better in the Consolidated Statement of Assets and Liabilities which would then show the aggregate amount written off each asset.

Example 42 - Consolidated Profit & Loss Account - Group of 3 members with a cross-holding:

Taking example No.38, the following is the Profit and Loss Account for the year ended and Balance Sheet as at 31st December 1944 (year later)

PROFIT and LOSS ACCOUNT for year ended 31st December 1944.

									<u>H</u>	<u>S</u>	<u>T</u>
By Balance at credit at 31st December 1943	..	..	..	..	..	..	..	..	£ 10,000	-	£ 3,000
Trading Profit	..	..	..	..	..	..	..	..	19,300	1,100	3,500
Dividends received											
From H 7½%	..	..	..	..	..	..	..	..	-	-	375
T 20%	..	..	..	..	..	..	..	..	1,200	600	-
									<u>£ 30,500</u>	<u>£ 1,700</u>	<u>£ 6,875</u>
To Balance at debit at 31st December 1943	..	..	..	..	..	..	..	..	£ -	£ 1,000	£ -
National Taxation	..	..	..	..	..	..	..	..	7,000	200	1,775
Dividends paid											
H 7½%	..	..	..	..	..	..	..	..	7,500	-	-
T 20%	..	..	..	..	..	..	..	..	-	-	2,400
Directors' Fees	..	..	..	..	..	..	..	..	1,000	-	200
Balance at credit at date	..	..	..	..	..	..	..	..	<u>15,000</u>	<u>500</u>	<u>2,500</u>
									<u>£ 30,500</u>	<u>£ 1,700</u>	<u>£ 6,875</u>

BALANCE SHEET

As at 31st December 1944

ASSETS

Sundry Assets	..	..	..	..	..	..	..	..	£118,000	£ 20,500	£ 10,500
Investments											
In H 5,000 shares	..	..	..	..	..	..	..	..	-	-	7,000
T 6,000 shares	..	..	..	..	..	..	..	..	8,000	-	-
S 16,000 shares	..	..	..	..	..	..	..	..	14,000	-	-
T 3,000 shares	..	..	..	..	..	..	..	..	-	5,000	-
									<u>£140,000</u>	<u>£ 25,500</u>	<u>£ 17,500</u>

LIABILITIES

Share Capital (in £1 Ord. shares)	..	..	..	..	..	..	..	..	£100,000	£ 20,000	£ 12,000
Creditors	..	..	..	..	..	..	..	..	25,000	5,000	3,000
Revenue Account	..	..	..	..	..	..	..	..	15,000	500	2,500
									<u>£140,000</u>	<u>£ 25,500</u>	<u>£ 17,500</u>

Notes:

The Balance Sheet valuations of Investments and the notes are the same as in example 38.

SOLUTION

(a) The adjustments required in each company's Accounts are the same as in example 38.

(b)/

Solution (Continued)

(b) The aggregation of the Adjusted Balance Sheets, is:-

							<u>ASSETS</u>			
							Total	H	S	T
Sundry Assets	..	..	..	..	..	..	£147,000	£118,000	£ 18,500	£ 10,500
Investments at adjusted cost:										
In H 5,000 shares..	..	..	..	..	..	..	7,000	-	-	7,000
T 6,000 shares..	..	..	..	..	..	..	7,400	7,400	-	-
S 16,000 shares..	..	..	..	..	..	..	15,000	15,000	-	-
T 3,000 shares..	..	..	..	..	..	..	4,750	-	4,750	-
Capital Reserve.	..	..	..	..	..	..	2,000	-	2,000	-
							<u>£183,150</u>	<u>£140,400</u>	<u>£ 25,250</u>	<u>£ 17,500</u>

LIABILITIES

Capital.	..	..	..	..	..	..	£132,000	£100,000	£ 20,000	£ 12,000
Creditors	..	..	..	..	..	..	33,000	25,000	5,000	3,000
Revenue Account	..	..	..	..	..	..	18,150	15,400	250	2,500
							<u>£183,150</u>	<u>£140,400</u>	<u>£ 25,250</u>	<u>£ 17,500</u>

(c) The Consolidated Statement of Assets and Liabilities as at 31st December 1944, is-ASSETS

Sundry Assets	..	..	..	..	..	..	..	..	..	..	£147,000
Goodwill - Net Cost of Control to group:											
As per last year..	..	..	..	..	..	..	..	..	..	..	<u>4,725</u>
											<u>£151,725</u>

LIABILITIES

Share Capital H (less held by T £5,000)	..	..	..	..	..	..	..	..	..	..	£ 95,000
Creditors	..	..	..	..	..	..	..	..	..	..	33,000
Revenue Account:	..	..	..	..	..	..	..	..	..	£ 18,150	
Less: Minority Interests	T	(see below)	..	..	..	..	..	..	£	850	
	S	(see below)	..	..	..	..	..	..	..	220	1,070
											<u>17,080</u>

Minority Interests:

		S 1/5th	T 1/4th	
Capital	£ 4,000
Revenue Account.	220
Capital Revenue, as per last year	Dr. 400
Net Cost of Control, as per last year	Dr. 463
				<u>£ 3,357</u>
				<u>£ 3,288</u>
				<u>6,645</u>

£151,725

As there is a direct cross-holding between H and T and also an indirect cross-holding through S, the share of the Revenue balances falling to the Minority Interests of S and T are calculated by algebra-

Revenue Account £18,150

Let $20x$ = H's true share of Revenue AccountLet $4y$ = T's true share of Revenue AccountThen $20x = H + \frac{4}{5}(S + \frac{1}{4}T) + \frac{1}{2}T$

$$20x = 15,400 + \frac{4}{5}(250 + y) + 2y$$

$$\therefore 100x = 77,000 + 1,000 + 4y + 10y$$

$$\therefore 100x = 78,000 + 14y \dots\dots(1)$$

and $4y = 2,500 + x \dots\dots(2)$

$$400y - 250,000 = 100x$$

$$\therefore 400y - 250,000 = 78,000 + 14y$$

$$\therefore 386y = 328,000$$

$$\therefore y = 849.74$$

and by substitution $x = 898.964$

The/

The division therefore is:-

X (19)

Minority Interests:	Group	19 x	£ 17,080
	T	y	850
	S	1/5th (250 + 850) y	220
			<u>£ 18,150</u>

Statement of group profit - Year to 31st December 1944:

1st METHOD

Trading Profits	H	per Accounts	.. .. .	£ 19,300
	S	per Accounts	.. .. .	1,100
	T	per Accounts	.. .. .	3,500
				<u>£ 23,900</u>

Group's share thereof as calculated by algebra (see below)	.. .. .	£ 22,278
Group Trading Profit 1944.	.. .. .	<u>22,278</u>

The algebraical calculation is:-

Let	20 x	=	H's true share of profits
"	4 y	=	T's do. do.
Then	20 x	=	H + 4/5ths (S + 1/4 T) + 1/2 T
	20 x	=	19,300 + 4/5ths (1,100 + y) + 2y
∴	100 x	=	96,500 + 4,400 + 4y + 10y
∴	100 x	=	100,900 + 14y .....(1)
and	4 y	=	3,500 + x .....(2)
∴	400 y	=	350,000 + 100 x
∴	400 y	=	350,000 + 100,900 + 14 y
			386 y = 450,900
	∴ y	=	1168.135
	x	=	1172.540

The division therefore is:-

Group's share.	.. .. .	19 x	£ 22,278
Minority Interests:			
	T	y	1,168
	S	1/5th (1,100 + 1,168) y	454
			<u>£ 23,900</u>

2nd METHOD

Profit and Loss Account. Credit balance per Consolidated Statement at 31st December 1944..	.. .. .	£ 17,080
Profit and Loss Account. Credit balance per Consolidated Statement at 31st December 1943 (see example 38)	.. .. .	11,321
		<u>Increase</u>
		£ 5,759

Add: Group's share of non-trading debits:

	H	S	T	Total Group's share thereof -(see below)
National Taxation..	£ 7,000	£ 200	£ 1,775	£ 8,975
Directors' Fees ..	1,000		200	1,200
				<u>£ 9,394</u>
Dividend paid by H.	.. .. .	.. .. .	.. .. .	£ 7,500
Less: Received by T (a member of the group).	.. .. .	.. .. .	.. .. .	<u>375</u>
				<u>7,125</u>
Group Trading Profit 1944	.. .. .	.. .. .	.. .. .	<u>£ 22,278</u>

CONSOLIDATED PROFIT and LOSS ACCOUNT/

CONSOLIDATED PROFIT and LOSS ACCOUNT

By	Balance at credit at 31st December 1943	..	..	..	..	..	..	..	..	£ 11,321
	Group Profit.	..	..	..	..	..	..	..	..	<u>22,278</u>
										<u>£ 33,599</u>
To	National Taxation..	..	..	..	..	..	..	..	..	£ 8,272
	Directors' Fees	..	..	..	..	..	..	..	..	1,122
	Dividend paid by Holding Company to members outside the group	..	..							7,125
	Balance at credit at 31st December 1944	..	..	..	..	..	..	..	..	<u>17,080</u>
										<u>£ 33,599</u>

As a cross-holding exists the group's share of National Taxation and Directors' Fees are calculated by algebra, thus:-

NATIONAL TAXATION

Let $20x = H$'s true share of charges
 " $4y = T$'s true share of charges
 Then $20x = H + \frac{4}{5}ths (S + \frac{1}{4}T) + \frac{1}{2} T$
 and $4y = T + x$
 $\therefore 20x = 7,000 + \frac{4}{5}ths (200 + y) + 2y$
 $\therefore 100x = 35,000 + 800 + 4y + 10y$
 $100x = 35,800 + 14y \dots\dots\dots(1)$
 and $4y = 1,775 + x \dots\dots\dots(2)$
 $\therefore 400y - 177,500 = 100x$
 $\therefore 400y - 177,500 = 35,800 + 14y$
 $\therefore 386y = 213,300$

$\therefore y = 552.591$

and by substitution $x = 436.364$

The Division therefore is:-

Group's share	19x	..	..	..	..	..	£ 8,272
Minority Interests							
	T	y	..	..	..	..	552
	S	$\frac{1}{5}th (200 + 553)$	..	..	..	..	<u>151</u>
		y					<u>£ 8,975</u>

DIRECTORS' FEES

$20x = 1,000 + \frac{4}{5}th y + 2y$
 $100x = 5,000 + 4y + 10y$
 $100x = 5,000 + 14y \dots\dots\dots(1)$
 and $4y = 200 + x \dots\dots\dots(2)$

$\therefore 400y - 20,000 = 100x$

$\therefore 400y - 20,000 = 5,000 + 14y$

$\therefore 386y = 25,000$

$\therefore y = 64.767$

and $x = 59.068$

The Division therefore is:-

Group's share.	19x	..	..	..	..	..	£ 1,122
Minority Interests							
	T	y	..	..	..	..	65
	S	$\frac{1}{5}th (65)$	..	..	..	..	<u>13</u>
							<u>£ 1,200</u>

Notes

1. Observe the equations used for any purpose are always the same for the same group.
2. As regards dividends to be added to the increase in Profit and Loss Account as at 1944 compared with 1943, in method (2) only the dividend paid by the Holding Company is considered (as in all previous examples) and only to the extent it has been paid to H's shareholders who are not members of the group. It is unnecessary to use algebra for this but ~~the~~ by doing so the same answer is given and the algebraical calculation may assist in the understanding of the matter.

$$\begin{array}{rcl}
 20x & = & 6,300 + \frac{4}{5}(-600 + y) + 2y \\
 100x & = & 31,500 - 2,400 + 4y + 10y \\
 100x & = & 29,100 + 14y \quad \dots\dots\dots(1) \\
 \text{and } 4y & = & 2,025 + x \quad \dots\dots\dots(2)
 \end{array}$$

$$\begin{array}{rcl}
 \therefore 400y - 202,500 & = & 100x \\
 \therefore 400y - 202,500 & = & 29,100 + 14y \\
 \therefore 386y & = & 231,600 \\
 y & = & 600 \text{ (exactly)} \\
 x & = & 375 \text{ (exactly)}
 \end{array}$$

The dividends are therefore divisible:-

Group	19x	=	£7,125	This is H's dividend £7,500 less paid to T £375 i.e. the dividend paid to H's shareholders excluding T a group member.
-------	-----	---	--------	--

Minority Interests				
T	y	=	600	This is the cash actually paid to T's outside shareholders when T declared the 20% dividend £2,400 i.e. $\frac{1}{4}$ of £2,400.

Do.	S	$\frac{1}{5}(-600 + 600)$	<u> </u>	-
		y	<u>£7,725</u>	

Example 43Consolidated Profit & Loss Account - Partly-owned Subsidiaries with a cross holding (Subsidiaries previously Associated Companies).

The Profit & Loss Accounts for the year ended and Balance Sheets as at 31st December 1945 of H.S. & T. in example 34 are:

Profit & Loss Accounts

	<u>H.</u>	<u>S.</u>	<u>T.</u>
By Balance at credit at 31/12/44 ..	£60,000	£ 9,020	£25,000
" Dividend from S. 10% on 20,000 shares ..			2,000
" " " T. 40% " 10,000 " ..		4,000	
<u>Note.</u>			
H. had credited dividends received from S. & T. to Investment A/c.			
" Trading Profit ..	30,000	7,000	9,000
	<u>£ 90,000</u>	<u>£20,020</u>	<u>£36,000</u>
To Dividends paid H. ..	£40,000		
" " " S. 10% ..		£ 8,000	
" " " T. 40% ..			£24,000
" National Taxation ..	9,000	3,620	4,800
" Directors' Fees ..	1,000	400	200
" Balance at credit at date ..	40,000	8,000	7,000
	<u>£90,000</u>	<u>£20,020</u>	<u>£36,000</u>

Balance Sheets

<u>Assets</u>	<u>H.</u>	<u>S.</u>	<u>T.</u>
Sundry Assets ..	£231,500	£87,980	£49,000
Investments at cost less dividends credited:			
In T. (1/6th) 10,000 shares ..		11,020	
" S. (1/4th) 20,000 shares ..			25,000
" S. (3/8ths) 50,000 shares less dividend £5,000 ..	55,000		
" T. (7/12ths) 35,000 shares less dividend credited £14,000 ..	38,500		
	<u>£325,000</u>	<u>£99,000</u>	<u>£74,000</u>
<u>Liabilities</u>			
Share Capital (in £1 Ordinary Shares) ..	£200,000	£80,000	£60,000
Creditors ..	85,000	11,000	7,000
Revenue Accounts ..	40,000	8,000	7,000
	<u>£325,000</u>	<u>£99,000</u>	<u>£74,000</u>

Solution:

(a) The adjustments required in each Company's Accounts are

S. & T. - No adjustment (as in last year see example 34)		
H. 1. Revenue Account	Dr. £3,600	
To Investment Account (in S.)		£3,600
(Being pre-acquisition revenue balance per example 34 £8,600 less dividend £5,000 credited by H to Investment Account)		

H. 2./

H.2. Revenue Account ..	Dr. £2,590	
To Investment Account (in T.)		£2,590
(Being pre-acquisition revenue balance per example 3/4 £16,590 less dividend £14,000 credited by H. to Investment Account).		

(b) The Aggregation of the Adjusted Balance Sheets is

<u>Assets</u>	<u>Total</u>	<u>H.</u>	<u>S.</u>	<u>T.</u>
Sundry Assets ..	£368,480	£231,500	£87,980	£49,000
Investments at cost less divid: ends credited:				
In T. (1/6th) 10,000 shares	11,020		11,020	
" S. (1/4th) 20,000 shares	25,000			25,000
Investments at adjusted cost:				
In S. (3/8ths) 50,000 shares	51,400	51,400		
" T. (7/12ths) 35,000 shs.	35,910	35,910		
	<u>£491,810</u>	<u>£318,810</u>	<u>£99,000</u>	<u>£74,000</u>
<u>Liabilities</u>				
Share Capital ..	£340,000	£200,000	£80,000	£60,000
Creditors ..	103,000	85,000	11,000	7,000
Revenue Account ..	48,810	33,810	8,000	7,000
	<u>£491,810</u>	<u>£318,810</u>	<u>£99,000</u>	<u>£74,000</u>

(c) The Consolidated Statement of Assets and Liabilities is

<u>Assets</u>		
Sundry Assets ..	..	£368,480
Goodwill - Net Cost of Control to the group (as per last year) ..	..	6,717
		<u>£375,197</u>
<u>Liabilities</u>		
Share Capital H. ..	..	£200,000
Creditors ..	..	103,000
Revenue Account ..	£48,810	
<u>Less; Minority Interests</u>		
S. see below	£1,196	
T. " "	2,348	3,544
		45,266
<u>Minority Interests</u>		
	<u>In S. 3/8th</u>	<u>In T. 1/4th</u>
Capital	£10,000	£15,000
Revenue Account	1,196	2,348
Net Cost of Control (as last year) Dr.	242	1,371
	<u>£10,954</u>	<u>£15,977</u>
		<u>26,931</u>
		<u>£375,197</u>

Notes/

Statement of Group Trading Profits for 19451st Method

H.'s Trading Profit	..	..	£30,000
S.'s " " £7,000 group's share (see below)			6,543
T.'s " " £9,000 " " " "			5,543
<u>Group Trading Profit for 1945</u>			<u>£42,086</u>

2nd Method

Group Revenue Account - balance at 31/12/45 per Consolidated Statement	..	..	£45,266
Group Revenue Account - balance at 31/12/44 per Consolidated Statement	..	..	60,000
<u>Decrease</u>			<u>£14,734</u>

Less:

Non-trading debits

Dividend paid H. only	..	£40,000	
National Taxation H.	..	£9,000	
S. £3,620) group's share			
T. 4,800) see below		<u>6,356</u>	15,356
		<u>£8,420</u>	
Directors' Fees H.		£1,000	
S. £400) group's share			
T. 200) see below		<u>464</u>	1,464
		<u>£500</u>	<u>56,820</u>
<u>Group Trading Profit for 1945</u>			<u>£42,086</u>

The second method gives the figures for a Consolidated Profit and Loss Account.

Note

The above shares are calculated by algebra using 8x and 12y as in the previous equations thus:

<u>Trading Profit</u>	<u>National Taxation</u>	<u>Fees</u>
$8x = 7000 + 2y \dots(1)$	$8x = 3620 + 2y \dots(1)$	$8x = 400 + 2y \dots(1)$
$12y = 9000 + 2x \dots(2)$	$12y = 4800 + 2x \dots(2)$	$12y = 200 + 2x \dots(2)$
$\therefore y = 934.78$	$\therefore y = 496.09$	$\therefore y = 26.09$
$x = 1108.57$	$x = 576.52$	$x = 56.52$

The division therefore is:-

Group's share T. 7y	£6,543	£3,473	£182
" " S. 5x	5,543	2,883	282
	<u>£12,086</u>	<u>£6,356</u>	<u>£464</u>

Minority Interests

T. 5y	2,804	1,488	80
S. x	1,110	576	56
Total S. and T.	<u>£16,000</u>	<u>£8,420</u>	<u>£600</u>

CHAPTER XI. Preference Shares of Subsidiaries in Consolidated Statements.

Many companies have part of their Share Capital in Preference Shares. The rights of Preference Shares depend on the company's Memorandum and Articles of Association. As regards profits, the articles may grant them a fixed dividend of so much per cent per annum and nothing more, in priority to a distribution to other capital. This dividend may be either payable as regards each year out of profits of that year only (generally preference shares of this type are called non-cumulative), or payable for each year out of profits if sufficiently available, with a right where profits of any year are insufficient to pay the preference dividend in full, to make good the deficiency out of profits of subsequent years (preference shares of this type are called cumulative). In addition, after receiving this preference dividend they may be entitled to a further participation in profits after a certain percentage has been paid to another class or other classes of shares. (Preference Shares with this further right are called Participating Preference Shares).

As regards repayment of capital in event of liquidation, the articles may or may not give to the preference shareholders a repayment of their share capital with or without arrears of dividend, in priority to repayment of capital to other classes of shares. Further, after the par value of all share capital is repaid in a winding up, the articles may or may not give the preference shares a right to participate in any surplus assets.

Where the articles are silent on certain points, the rights of Preference Capital are determined by the decisions of case law. The most important of these have laid down that a preference shareholder is not entitled on any winding up to a prior right to repayment of capital unless the articles of the company make provision therefor (London India Rubber Co., 1866, 5. Eq. 519; Re Madame /

⊗

In this Chapter various types of Preference Shares are dealt with and while some of these types are not commonly found, the principles given apply to cases of share capital structure where there are preferred—ordinary shares deferred-ordinary shares etc.

Madame Tussaud & Sons Ltd. (1927) 1 Ch. 657) and that his "preference" is confined prima facie, to a preference dividend. It has also been held that the dividend is considered cumulative where the articles declared that the preference shares are to be entitled to a specified rate per cent (Henry v Great Northern Railway Company 1 De G. and J. 606; Webb v Earle, 1875, 20 Eq. 556; Foster v Coles 22 T.L. R. 555). As regards participation in surplus assets after repayment of all share capital at par, it has been held that -

- (a) in the absence of provisions in the articles, the Ordinary Shareholders are entitled to all surplus assets attributable to revenue profits (Will v United Lankat Plantations Company Ltd. 1914, A.C.11).
- & (b) unless the articles expressly negative the right of the Preference shareholder to participate, Ordinary and Preference Capital share proportionately in surplus assets attributable to capital profits (In re Wm. Metcalfe & Sons (1933) 1 Ch. 142; re Madame Tussaud & Sons (1927) 1 Ch. 657; re Fraser & Chalmers Ltd. (1919) 2 Ch. 114), Macfarlane (1936) S.L.T. 106.)

In the preparation of Consolidated Statements of a group which includes a member or members with Preference Capital the exact rights of this class must be ascertained but in the determination of how such rights are to be treated one must keep in view that the statement is being prepared on the basis of a going concern.

⊗ Preference Shares with a preference for capital and with no further right to share in Surplus Assets in a winding-up.

This is a common type of Preference Share and presents little difficulty in the preparation of the Consolidated Statement. Provided that there are sufficient profits, the preference dividend up to the date of the Balance Sheet is accrued when the accounts of the Company with such preference capital are being adjusted (Dr. Revenue Account; Cr. Outstanding Preference Dividend Account). When the holding company or another member of the group holds some or all of these Preference Shares, then the Preference dividend receivable up to the Balance Sheet date should be accrued when the accounts of that member are being adjusted (Dr. Accrued Dividends Receivable /

Receivable Account; Cr. Revenue Account). During the process of consolidation this latter accrual, an asset, will form a contra against the liability of the other member. The balance remaining (if any) will represent the accrued dividend due to outside shareholders and will appear under Minority Interests or if preferred under a separate heading as a cash liability of the group. Examples of this type of Preference Share are given elsewhere (see examples 14, 24, 27 and 35) and there is no need to reiterate them here.

In the application in practice of theoretical principles, it should be noted that, for simplicity, in all the examples in this treatise, Preference dividends have been accrued gross, whereas in practice it will generally be found that the balance of Profit and Loss Account represents a net surplus available to the shareholders after adequate provision has been made for all national taxation, and accordingly Preference dividends may require to be accrued net during the process of consolidation.

Preference Shares with a preference for capital and with a further right to share in Surplus Assets, after the Ordinary Shares have received par in a winding-up.

With this type of Preference Share, the adjustment of the revenue side is straightforward for the Consolidated Statement is prepared on the basis of a going concern and the preference shares have an interest in the subsidiary's profits only to the extent of the fixed preference dividend up to the Balance Sheet date.

The capital aspect requires more careful and detailed consideration. If a subsidiary with this type of Preference Capital has a Capital Reserve in its Balance Sheet, this reserve is not available for distribution as dividend and for consolidation purposes, it should therefore be divided between the Preference Capital and the Ordinary Capital according to the amounts of the respective capitals. In theory the Capital Reserve is represented by the Surplus Assets which would be divided similarly on a winding /

winding up. Now during the process of consolidation, a Capital Reserve can arise to a subsidiary, i.e. where the Net Cost of Control of a sub-subsidiary results in a credit balance, and it must be determined whether this created capital reserve should be treated similar to a Capital Reserve in the Balance Sheet of the subsidiary and be divided between Preference and Ordinary Capital.

A credit balance on Net Cost of Control of a company can be accounted for by four main reasons which may be inter-mixed in any one case.

- (1) Owing to a general over-valuation of the book value of the sub-subsidiary's fixed assets.

This over-valuation although known to the purchasers of the sub-subsidiary and taken into account in fixing the fair price of the shares, cannot be always earmarked specifically to the individual assets. In these circumstances the Consolidated Statement can only be prepared without the normal adjustment for an over-valuation being made, and a credit balance on Net Cost of Control is likely to arise as a result. (The normal adjustment referred to is - dr. Capital Reserve Account and cr. the Asset concerned - the Capital Reserve being transferred after aggregation of the adjusted Balance Sheets to the Minority Interests and to the subsidiary holding the shares and so affects the figure of adjusted cost of these shares see page VI.34).

- (2) Through an over-valuation of the book value of Goodwill of the sub-subsidiary (or through the existence of "Badwill".)

This is not adjusted in the same way as an over-valuation of a specific fixed asset such as Property, Plant, etc., but Goodwill or "Badwill" reflected in the purchase price of the shares is shown separately in a Consolidated Statement at cost to the group so far as acquired. A credit balance on the Net Cost of Control to the subsidiary which holds the shares can therefore emerge from this factor.

- (3) Owing to anticipated post-acquisition losses of the sub-subsidiary.

If the subsidiary purchasing the shares in the sub-subsidiary, makes a reduction in its offer to cover anticipated future losses, a credit balance on Net Cost of Control of the sub-subsidiary may well arise.

- (4) Through shares being acquired at a bargain price.

In the first three eventualities it seems clear that the "paper" surplus arising to the subsidiary in a credit balance on the Net Cost of Control of a sub-subsidiary, is not analagous to a Capital /

Capital Reserve existing in the subsidiary's Balance Sheet. Indeed from a practical point of view at any particular date there may be no real surplus at all. It is considered therefore that a created Capital Reserve arising to a subsidiary during the process of consolidation should not be allocated between Ordinary Capital and Preference Capital of this type, but should be regarded as the concern of the Ordinary shareholders only. Even in the fourth case, the same principle applies for the surplus is a "paper" profit which is unlikely to bear any relation to the eventual realisation profit or loss on the sale of the shares in, (or on the liquidation of) the sub-subsidiary at some distant date. While a realisation profit would become a Capital Reserve in the Balance Sheet of the subsidiary, a realisation loss would be probably written off against Profit and Loss Account of the subsidiary and would thus be borne by the Ordinary Shareholders only. It is true that the sale of the shares in, or liquidation of, the sub-subsidiary may not be contemplated at any particular consolidation date, but the eventual result does have some bearing on the point. In any event, an example will show that adverse future trading results of the sub-subsidiary may reduce or nullify the "paper" profit made on acquisition date.

Ex. S. Ltd. is a subsidiary of a group. S's Ordinary Capital is all held by the holding company. S's Preference Capital is of the type under discussion and is all held by outsiders. In 1945 S. acquired all the Ordinary Shares (10,000 shares of £1 each) of T. Ltd. at a bargain price of 21/- per share. On acquisition date T. had a credit balance on Revenue Account of £2,500.

In the Consolidated Statement of the group, the Net Cost of Control of T. the sub-subsidiary, to S. would be £2,000 made up thus:-

Cost /

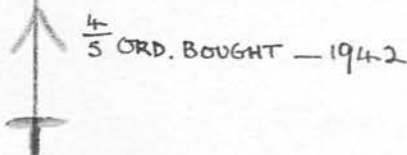
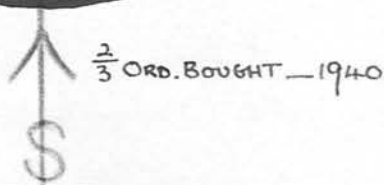
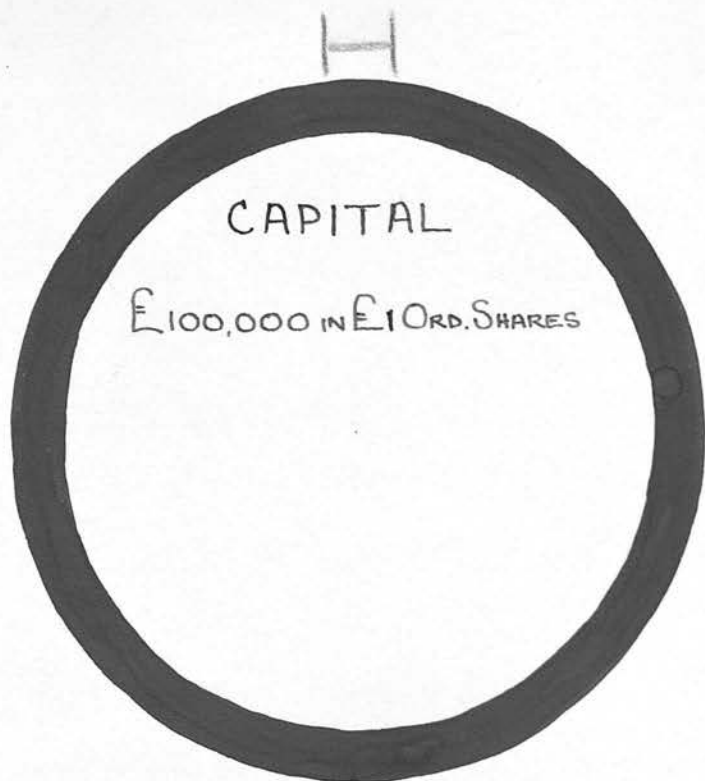
	By S in T
Cost Price 10,000 Ord. Shs. in T at 21/- each . .	£10,500
<u>Less:</u> Pre-acqn. cr. bal. on T's Rev. A/c at acqn. date	2,500
Adjusted Cost . .	£ 8,000
Par value	10,000
Net C. of C. of T to S ("Paper" profit" on acqn.)	£ 2,000 cr.

T's trading results in the future may well vary. If, say in 1946/47 T was incurring losses and at 31st December, 1947, had a debit balance on Revenue Account of £3,000, it is clear that the "paper" profit made by S on acquisition is more than lost. In the Consolidated Statement of the group as at 31st December, 1947, the net post-acquisition loss of T, £5,000, would be debited to S's Revenue Account and would be borne probably by S's Ordinary Shares only. A fair set off to this revenue burden would be the allocation to the Ordinary Shareholders only, of the "paper" capital profit made on acquisition and still arising in the process of consolidation at 31st December, 1947. There is, of course, no direct contra - one is a revenue loss, the other a capital profit - the point is that in fairness ~~it seems that~~ both these items should apply to S's Ordinary Shareholders only.

While one can visualise cases where the "paper" profit made on acquisition date appears ^{still} to exist, or even to be increased as measured in terms of real value, on a future consolidation date, as a general rule it is inexpedient to make any allocation to Preference Shares of such a "paper" profit arising perhaps many years ago. It is considered the better practice simply to put a note on the Consolidated Statement as follows -

"The Preference Shares of a subsidiary, all of which are held by outsiders, have a preference for capital and a further right to rank pari passu in the Surplus Assets in a winding up. The above Consolidated Statement is prepared without taking into account these further rights, as liquidation of any member of the group is not contemplated. The Preference Shares are valued at par, plus accrued dividends, and this valuation appears under the heading 'Minority Interests'".

EXAMPLE — 44.



Example 44 - Pref. Shares having a pref. for Capital and ranking pari passu with Ord. Shares in the Surplus Assets after the Ord. Shares have received par. Sub and Sub-sub. with such Pref. Shares and with credit balances on Revenue Account.

The summarised Balance Sheets of a group, as at 31st December 1943, are:-

	<u>ASSETS</u>	<u>H</u>	<u>S</u>	<u>T</u>
Sundry Assets.		£103,000	£ 26,150	£ 19,600
<u>Investments at Cost:</u>				
10,000 Ord. Shares in S		17,000	-	-
8,000 Ord. Shares in T		-	9,500	-
		£120,000	£ 35,650	£ 19,600

LIABILITIES

Ord. Capital (in £1 shares)	£100,000	£ 15,000	£ 10,000
5% Non-cum. Pref. Capital (in £1 shares)	-	5,000	2,000
		£ 20,000	£ 12,000
Capital Reserve	-	5,000	-
Creditors	9,000	2,000	2,500
Revenue Account	11,000	8,650	5,100
	£120,000	£ 35,650	£ 19,600

H acquired 2/3rds of S in 1940 when S had a credit balance on Revenue Account of £9,000 and a credit balance on Capital Reserve Account of £5,000.

S acquired 4/5ths of T in 1942 when T had a credit balance on Revenue Account of £3,000.

Both the above balances are adjusted for the Pref. Dividend outstanding at the relative acquisition date.

The Pref. Dividend in both companies is "free of tax" and unpaid for 1943. The Pref. Shares of S and T have a pref. for capital and rank pari passu with the Ord. Shares in the surplus Assets on any winding up after the Ord. shares have received par.

SOLUTION

(a) The adjustment required in each company's Accounts are:-

T 1.	Revenue Account	Dr. £100	
	To Pref. Dividend outstanding Account		£ 100
	(Being accrual of 1943 Pref. Dividend)		
S 1.	Revenue Account	Dr. £250	
	To Pref. Dividend outstanding Account		£ 250
	(Being accrual of 1943 Pref. Dividend)		
S 2.	Revenue Account	Dr. £2,400	
	To Investment Account (in T)		£2,400
	(Being 4/5ths T's Cr. balance on Revenue Account £3,000 in 1942 - pre-acquisition - when S bought 8,000 Ord. Shares in T (4/5ths))		
H 1.	Revenue Account	Dr. £6,000	
	To Investment Account (in S)		£6,000
	(Being 2/3rds S's Cr. balance on Revenue Account £9,000/- pre-acquisition when H bought 10,000 Ord. Shares in S (2/3rds))		

(b) The aggregation of the Adjusted Balance Sheets, is:- /

(b) The aggregation of the Adjusted Balance Sheets is:-

<u>ASSETS</u>	<u>Total</u>	<u>H</u>	<u>S</u>	<u>T</u>
Sundry Assets	£148,750	£103,000	£ 26,150	£ 19,600
Investments at Adjusted Cost -				
In S 10,000 Ord. Shares.. .. .	11,000	11,000	-	-
In T 8,000 Ord. Shares.. .. .	7,100	-	7,100	-
	<u>£166,850</u>	<u>£114,000</u>	<u>£ 33,250</u>	<u>£ 19,600</u>
<u>LIABILITIES</u>				
Ord. Capital	£125,000	£100,000	£ 15,000	£ 10,000
Pref. Capital	7,000	-	5,000	2,000
Capital Reserve.. .. .	5,000	-	5,000	-
Creditors.. .. .	13,500	9,000	2,000	2,500
Pref. Dividend Outstanding	350	-	250	100
Revenue Account	16,000	5,000	6,000	5,000
	<u>£166,850</u>	<u>£114,000</u>	<u>£ 33,250</u>	<u>£ 19,600</u>

(c) The Consolidated Statement is:-

<u>ASSETS</u>			
Sundry Assets			£148,750
Net Cost of Control to the group:			
		By S in T 4/5	By H in S 2/3
Adjusted Cost	£ 7,100		£ 11,000
Less: Share of Capital Reserve. ($\frac{1}{2}$ of £5,000)..	-		2,500
Par	8,000		£ 8,500 10,000
Less: Minority Interests S Ord 1/3rd	£ 900cr 300		£ 1,500cr. -
	£ 600		£ 1,500
Capital Reserve. ..			<u>£ 2,100</u>

Note: The Pref. Shares of the Sub and Sub-sub, all of which are held by outside shareholders, have a pref. for capital and a further right to rank pari passu with the Ord. Shares in surplus assets on a winding up. The above Consolidated Statement has been prepared on the basis of taking into account these further rights only to the extent they exist in the form of a Capital Reserve in the Balance Sheet of the Sub. The Pref. Shares are valued at par, plus accrued Pref. Dividend plus a share of the Capital Reserve and this valuation appears under the heading of M.I.

<u>LIABILITIES</u>			<u>£148,750</u>
Share Capital H.			£100,000
Creditors.. .. .			13,500
Capital Reserve S			£ 5,000
Less: Minority Interests S Pref $\frac{1}{4}$..	£ 1,250		
" S Ord. $\frac{1}{4}$..	1,250		2,500
			<u>£ 2,500</u>
To H (transferred to Adjusted Cost of Shares in S)			<u>2,100</u>
Capital Reserve Net Cost of Control to the group			<u>2,100</u>
		Forward	<u>£115,600</u>

(c) Liabilities (Continued)

	<u>Forward</u>	£115,600
Revenue Account	£ 16,000	
<u>Less: Minority Interests:</u>		
T 1/5th of £5,000	£ 1,000	
S 1/3rd of (6,000 + 4/5ths x 5,000)	<u>3,333</u>	<u>4,333</u>
		11,667

Minority Interests:

	<u>S Ord 1/3</u>	<u>S Pref.</u>	<u>T Ord 1/5</u>	<u>T Pref.</u>	
Capital	£ 5,000	£ 5,000	£ 2,000	£ 2,000	
Capital Reserve	1,250	1,250	-	-	
Revenue Account	3,333	-	1,000	-	
Pref. Dividend outstanding	-	250	-	100	
Net Cost of Control of T	<u>Cr. 300</u>	-	-	-	
	<u>£ 9,883</u>	<u>£ 6,500</u>	<u>£ 3,000</u>	<u>£ 2,100</u>	<u>21,483</u>
					<u>£148,750</u>

Notes:

- (1) Observe that while the Preference shares of S take a $\frac{1}{4}$ share of the Capital Reserve in S's Balance Sheet £5,000, the Capital Reserve arising on the Net Cost of Control of T (Cr.£900) is allocated to S's Ordinary Shareholders only. (Group 2/3rds; Minority Interests 1/3rd).
- (2) The Minority Interests can be independently verified from an examination of the original Balance Sheets.

T's Preference shares are worth par £2,000 + 1943 Dividend £100. .. £ 2,100

T's Ordinary shares are worth 30/- each, thus:-

Sundry Assets	£ 19,600
<u>Less: Creditors</u>	£ 2,500
Preference shares and accrued dividend	<u>2,100</u>
	<u>4,600</u>

Value of 10,000 Ord. Shares (30/- each) £ 15,000

2,000 Ordinary shares at 30/- each 3,000
 S's Preference shares are worth par £5,000 + 1943 dividend £250 + $\frac{1}{4}$ Capital Reserve Account $\frac{1}{4}$ of £5,000 6,500

S's Ordinary shares are worth £2.1.2 $\frac{1}{2}$ d each, thus:-

Sundry Assets	£ 26,150
8,000 Ordinary shares in T at T's Balance Sheet price 30/-ea.	<u>12,000</u>
	£ 38,150
<u>Less: Creditors</u>	£ 2,000
Preference Shares of S (as above)	<u>6,500</u>
	<u>8,500</u>

Value of 15,000 Ordinary Shares (£2.1.2 $\frac{1}{2}$ d each) £ 29,650

5,000 Ordinary shares at £2.1.2 $\frac{1}{2}$ d each 9,883

As per Consolidated Statement £ 21,483

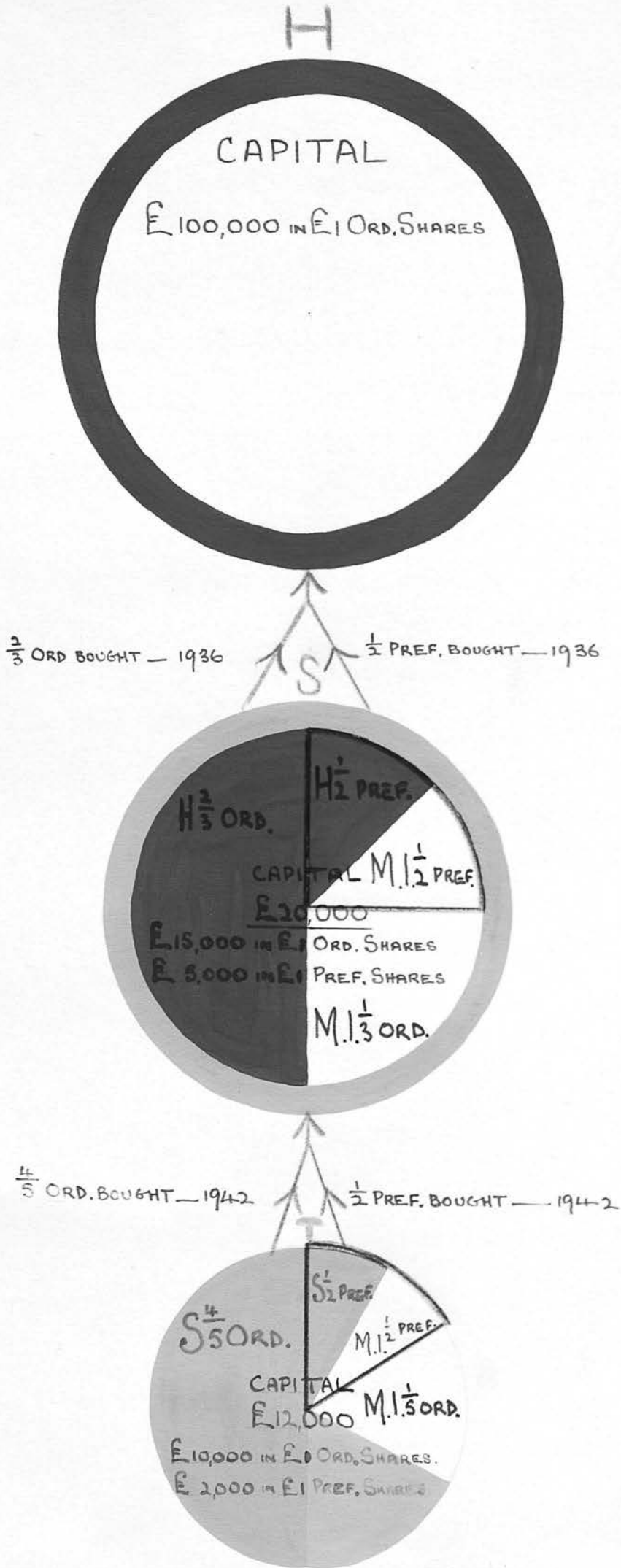
A group may purchase a non-profit earning competitor company with the intention of winding it up at an early date. A credit balance arising during the process of consolidation in the Net Cost of Control of this company is available -

- (a) To meet any trading losses of the company until the winding up date.
- (b) To meet the eventual loss on realisation of the Assets.

Necessary corollaries as regards the application of (a) are that the post-acquisition loss was anticipated and allowed for in the price when the purchase of the shares was made, and that the loss is only applied to an extent which leaves a sufficient credit balance on Net Cost of Control to deal adequately with (b).

Preference Shares which enjoy a preference for capital and which exist in such a competitor company will be valued at par unless the debit balance on its Profit and Loss Account is so very large that even the Preference Shares are unlikely to receive par at the forthcoming liquidation.

EXAMPLE 5 — 45 AND 51.



Example 45 - Sub and Sub-sub with Pref. and Ord. Shares held by group members.
Pref Shares with a pref. for Capital and ranking pari passu with
Ord. Shs. in Surplus Assets after the Ord. Shares have received
par. Sub-sub about to be liquidated.

The summarised Balance Sheets of a group as at 31st December 1943, are:-

	<u>ASSETS</u>	<u>H</u>	<u>S</u>	<u>T</u>
Sundry Assets.. .. .		£100,500	£ 32,000	£ 9,500
<u>Investments:</u>				
10,000 Ord. Shares in S at cost		17,000	-	-
8,000 Ord. Shares in T at cost		-	3,000	-
1,000 Pref. shares in T at cost		-	650	-
2,500 Pref. shares in S at cost, less dividend credited. ..		2,500	-	-
Revenue Account.. .. .		-	-	5,000
		<u>£120,000</u>	<u>£ 35,650</u>	<u>£ 14,500</u>

LIABILITIES

Ordinary Capital (in £1 shares)	£100,000	£ 15,000	£ 10,000
5% Non-Cum. Pref. Capital (In £1 shares)	-	5,000	2,000
		£ 20,000	£ 12,000
Sundry Creditors	9,000	2,000	2,500
Revenue Account	11,000	13,650	-
	<u>£120,000</u>	<u>£ 35,650</u>	<u>£ 14,500</u>

H acquired 2/3rds Ord. and 1/2 Pref. Shs. in S in 1936 when S had a Cr. balance on Revenue Account of £9,000 after charging the Pref. dividend.

S acquired 4/5ths Ord. and 1/2 Pref. Shs. in T in 1942 when T had a Dr. balance on Revenue Account of £3,000 Dr. T Ltd. was a competitor of the group and was trading at a loss. S bought T's shares expecting losses to continue and intends winding up T at an early date.

The Pref. Dividends of S and T are "free of tax" and unpaid for 1943. The Pref. Shares of S and T have a pref. for capital and also rank pari passu with the Ord. Cap. in the surplus Assets, after the Ord. Capital have received par, in a winding up.

SOLUTION

(a) The adjustments required in each company's Accounts are:

H 1.	Revenue Account	Dr. £6,000	
	To Investment Account (in S)		£6,000
	(Being 2/3rds S's credit balance on Revenue Account in 1936, £9,000 - pre-acquisition - when H bought 10,000 Ord. Shares in S (2/3rds).		
H 2.	Outstanding Dividends Receivable Account ..	Dr. £ 125	
	To Revenue Account		£ 125
	(Being accrual ^{of} 1943 Pref. Dividend - 5% on £2,500 - due by S to H.		

Note: As regards the Pref. Shares held by H in S it is assumed that the dividend credited to Investment Account covered the full period up to date of purchase in 1936.

S 1	Revenue Account	Dr. £ 250	
	To Outstanding Pref. Dividend Account ..		£ 250
	(Being accrual of 1943 Pref. Dividend)		
S 2	Investment Account (in T)	Dr. £2,400	
	To Revenue Account		£2,400
	(Being 4/5ths of T's debit balance on Revenue Account £3,000 in 1942 - pre-acquisition - when S bought 8,000 Ord. Shares in T 4/5ths).		

(b)/

(b) The Aggregation of the Adjusted Balance Sheets, is:-

XI (12)

<u>ASSETS</u>						<u>Total</u>	<u>H</u>	<u>S</u>	<u>T</u>
Sundry Assets..	..	..	..	..	..	£142,000	£100,500	£ 32,000	£ 9,500
<u>Investments at Adjusted Cost:</u>									
10,000 Ord. Shares in S	..	..	..	..	..	11,000	11,000	-	-
8,000 Ord. Shares in T	..	..	..	..	..	5,400	-	5,400	-
1,000 Pref. Shares in T	..	..	..	..	..	650	-	650	-
2,500 Pref. Shares in S	..	..	..	..	..	2,500	2,500	-	-
Dividends receivable outstanding	..	..	..	..	..	-	125	-	-
Revenue Account	..	..	..	..	..	-	-	-	5,000
						<u>£161,550</u>	<u>£114,125</u>	<u>£ 38,050</u>	<u>£ 14,500</u>

LIABILITIES

Ord. Capital ..	..	..	..	..	..	£125,000	£100,000	£ 15,000	£ 10,000
Pref. Capital..	..	..	..	..	..	7,000	-	5,000	2,000
Creditors. ..	..	..	..	..	..	13,500	9,000	2,000	2,500
Preference Dividends outstanding	..	..	..	..	..	125	-	250	-
Revenue Account	..	..	..	..	..	15,925	5,125	15,800	-
						<u>£161,550</u>	<u>£114,125</u>	<u>£ 38,050</u>	<u>£ 14,500</u>

(c) The Consolidated Statement is:-ASSETS

Sundry Assets..	..	..	..	..	..	..	..	..	..	£142,000
<u>Goodwill - Net Cost of Control to the group:</u>										

	By S in T		By H in S		Cr. £	Cr.	Dr.	£	-	1,000
	Ord. 4/5	Pref. 1/2	Ord. 2/3	Pref. 1/2						
Adjusted Cost..	£ 5,400	£ 650	£ 11,000	£ 2,500						
Par..	8,000	1,000	10,000	2,500						
Cr. £ 2,600 Cr. 350 Dr. 1,000 £ - 1,000										
£ 2,950 Cr.										
<u>Less: Post-acquisition loss of T 4/5ths of £2,000 ..</u>		1,600								
£ 1,350										
<u>Less: Minority Interests S Ord. 1/3rd</u>		450								
<u>£ 900 to Reserve per contra.</u>										

Note: The Pref. shares of the Sub and Sub-sub, one-half of which are held by outside shareholders, have a pref. for capital and a further right to share with the Ord. Shares in the surplus assets in any winding up. The Consolidated statement is prepared without giving effect to a possible sharing in the surplus assets of the Sub. as winding up is not contemplated. In the case of the Sub-sub which is about to be wound up, it is unlikely that there will be any surplus assets to divide. The Pref. Shares in the Sub-sub are, however, likely to receive par.

£143,000LIABILITIES/

LIABILITIES

Share Capital H	£100,000
Creditors.	13,500
Reserve to meet loss on realisation of T	900
<u>Revenue Account:</u>	
T.. .. .	Dr.£ 5,000
<u>Less: Minority Interests T Ord. 1/5th.</u>	1,000
	Dr.£ 4,000
<u>Less: S's share of T post-acquisition loss transferred to Net Cost of Control</u>	1,600
	To S.. .. Dr.£ 2,400
S.. .. .	15,800
	£ 13,400
<u>Less: Minority Interests S Ord. 1/3rd</u>	4,467
	To H.. .. £ 8,933
H.. .. .	5,125
	<u>14,058</u>

Minority Interests:

	S Ord 1/3	S Pref 1/2	T Ord 1/5	T Pref 1/2	
Capital.. .. .	£ 5,000	£ 2,500	£ 2,000	£ 1,000	
Pref. Dividend outstanding	-	125	-	-	
Revenue Account	4,467	-	Dr 1,000	-	
Net Cost of Control of T .. Cr.	450	-	-	-	
	<u>£ 9,917</u>	<u>£ 2,625</u>	<u>£ 1,000</u>	<u>£ 1,000</u>	<u>14,542</u>
					<u>£143,000</u>

Notes in Solution:

- (1) T's Pref. Shares, having a pref. for capital do not share in T's debit/^{balance} on Rev. A/c. No provision has been made for T's 1943 Pref. Dividend as there are no profits and the dividend is non-cumulative .
- (2) Observe in the Revenue Account £2,400 of T's Dr. Balance is transferred to S. This ~~represents~~ T's post-acquisition Dr balance which has already been credited to S's Revenue Account (see S.2) The net balance of S £13,400 is S's own profits only (£13,650 less Pref. Dividend £250)
- (3) The Minority Interests can be reconciled independently from a perusal of T's and B's Balance Sheets.

T's Pref. Shares are worth par having a Pref. for capital -	1,000 shares at £1 .	..£ 1,000
T's Ord. Shares are worth 10/- each per T's Balance Sheet -	2,000 shares at 10/-	.. 1,000
S's Pref. Shs. are worth par + accrued 1943 dividend -	2,500 Pref. Shares..	.. 2,625
S's Ord. Shares are worth £1.19.8d thus:-		
Sundry Assets	£ 32,000	
8,000 Ord. Shares in T at 10/- each ..	4,000	
1,000 Pref. do. at £1 each ..	1,000	
	<u>£ 37,000</u>	
<u>Less: Creditors</u>	£ 2,000	
Pref. Capital +		
Dividend	<u>5,250</u>	<u>7,250</u>

Total Value of 15,000 Ord. Shs. (£1.19.8d each) £ 29,750

50,000 Ord. Shs. at £1. 19. 8d. 9,917

As per Consolidated Statement £14,542

Preference Shares with no preference for capital, but ranking pari passu with Ordinary Shares in any winding-up.

- (a) Subsidiary expected to continue trading as an active member of the group.

Treatment of Revenue Account.

The subsidiary's Preference Capital of this special type has an interest in a credit balance on Revenue Account to the extent of the accrued Preference dividend up to the Balance Sheet date. A debit balance on Revenue Account falls solely on the Ordinary Shares in the normal case.

On first thoughts it might appear that in the Consolidated Statement a debit balance should be allocated between the Preference Capital and the Ordinary Capital according to the amounts of the respective capitals because, if the subsidiary was wound up, a debit balance on Revenue Account would suggest a deficiency of assets and neither the Preference or Ordinary Shareholders would receive par but something less. The same repayment of capital would be made to each class of share, that is to say with par values of £1, the repayment to each class might be, ^{say,} 16/- per share.

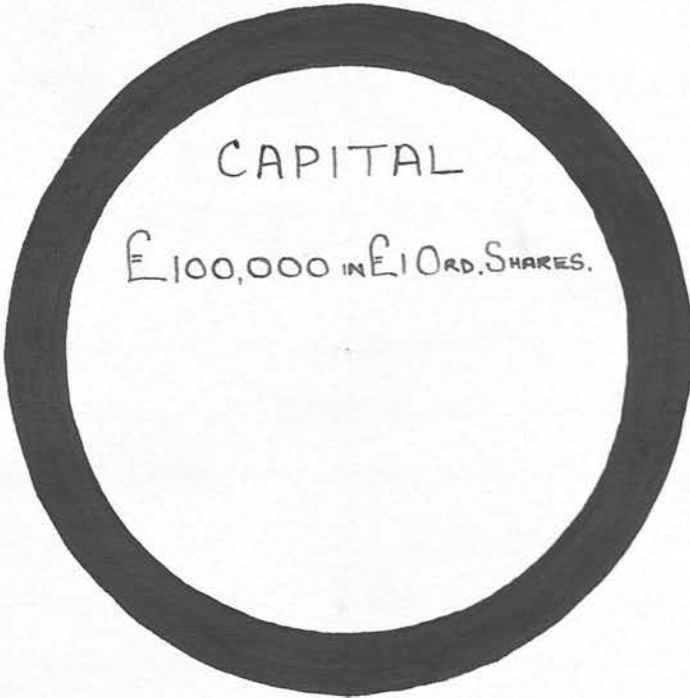
Further consideration, however, will show that such an allocation is not sound. Considering that the subsidiary is continuing to trade as an active member of the group, one can say that a debit balance on Revenue Account at any date may well be wiped out by subsequent profits and so the debit balance will in fact be borne by the Ordinary shareholders, for dividends otherwise payable to them out of current profits will be reduced by the old losses. Accordingly, the correct consolidation procedure to adopt is to charge a debit balance to Ordinary shareholders only, except in the abnormal case where the debit balance is so very large that the subsidiary is about to be wound up. This case is discussed under heading (b) later in this section. In the case of a debit balance at acquisition date, one should again regard this as the concern of the /

the Ordinary shareholders since the subsidiary purchased is likely to be re-organised by the group and put on a profit-earning basis in the future. The debit balance will be wiped out and the Preference Shares will then be worth their full par value.

A suitable footnote should appear on the Consolidated Statement where a subsidiary has a debit balance on Revenue Account and this has been allocated to the Ordinary shareholders only as suggested. Appropriate wording might be "Certain Preference Shares of a subsidiary, all of which belong to outside shareholders, have no preference for capital but rank pari passu with the Ordinary Shares in a winding up. The subsidiary has a debit balance of £ - on Profit and Loss Account at the above date. In the Consolidated Statement no account has been taken of the possibility of these Preference Shares bearing a proportion of the debit balance of that subsidiary as a winding-up is not contemplated. These Preference Shares are valued at par under the heading 'Minority Interests.'"

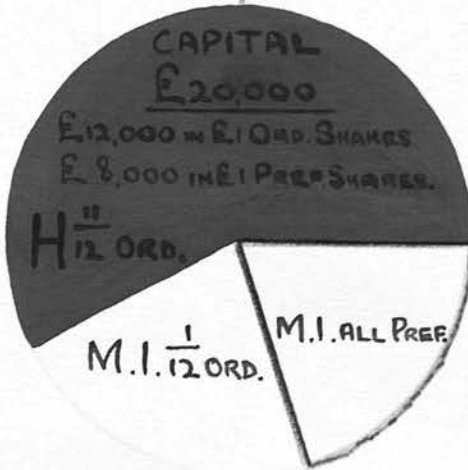
EXAMPLE — 46

H



↑ $\frac{11}{12}$ ORD BOUGHT — 31/12/43

S



Example 46 - Sub with Pref. Shares having no preference for capital but ranking pari passu with Ord. Shares in a winding up. Sub. with debit balance on Revenue Account bought for the purpose of becoming an active member of the group.

The Summarised Balance Sheets of a group, as at 31st December 1943, are:-

	<u>ASSETS</u>	<u>H</u>	<u>S</u>
Sundry Assets		£109,375	£ 22,800
Investment at cost -			
11,000 Ord. Shares in S at 17/6d each		9,625	-
Revenue Account.. .. .		-	1,200
		<u>£119,000</u>	<u>£ 24,000</u>
	<u>LIABILITIES</u>		
Ordinary Capital (in £1 shares).		£100,000	£ 12,000
5% Non. Cum. Pref. Capital (in £1 shares).		-	8,000
			£ 20,000
Creditors		9,000	4,000
Revenue Account.. .. .		10,000	-
		<u>£119,000</u>	<u>£ 24,000</u>

H bought 11,000 Ord. Shares in S on 31st December 1943. The Pref. Shares of S have no preference for capital, but rank pari passu with the Ord. Shares in any winding up. H intends to reorganise S and make it a profit earning-member of the group.

SOLUTION

(a) The Adjustment required in H's Accounts, is:-

H (1) Investment Account (in S)	Dr. £1,100
To Revenue Account	£1,100
(Being 11/12ths S's Revenue Account Dr. balance at 31.12.43 £1,200 - pre-acquisition - when H bought 11,000 Ord. Shares in S (11/12ths))	

(b) The aggregation of the adjusted Balance Sheets, is:-

	<u>ASSETS</u>	<u>Total</u>	<u>H</u>	<u>S</u>
Sundry Assets		£132,175	£109,375	£ 22,800
Investment at adjusted cost:				
11,000 Ord. Shares in S		10,725	10,725	-
Revenue Account		-	-	1,200
		<u>£142,900</u>	<u>£120,100</u>	<u>£ 24,000</u>
	<u>LIABILITIES</u>			
Ord. Share Capital		£112,000	£100,000	£ 12,000
Pref. Share Capital		8,000	-	8,000
Creditors		13,000	9,000	4,000
Revenue Account		9,900	11,100	-
		<u>£142,900</u>	<u>£120,100</u>	<u>£ 24,000</u>

(c)/

ASSETS

Sundry Assets.	£132,175
<u>Net Cost of Control of S:</u>	
	By H
	in S 11
	<u>12</u>
Adjusted Cost	£ 10,725
Par	<u>11,000</u>
	<u>Capital Reserve.. Cr. £ 275</u>

Note: The Pref. shares of the Sub, all of which belong to outside shareholders have no Preference for capital but rank pari passu with the Ord. shares on a winding up. The Sub. has a debit balance on Profit and Loss Account of £1,200 at the above date and no account has been taken of the possibility of these Pref. Shares sharing to the extent of £480 in this Dr. balance on a winding up. The Pref. shares are included under M.I. at par.

£132,175LIABILITIES

Share Capital H	£100,000
Creditors	13,000
Revenue Account	£ 9,900
<u>Less: To Min. Ints. S. Ord 1/12th of Dr. £1,200..</u>	<u>Dr. 100</u>
Capital Reserve - Net Cost of Control to group	275
<u>Minority Interests:</u>	
	S.Ord $\frac{1}{12}$ S. Pref.
Capital.	£ 1,000 £ 8,000
Revenue Account .. .. .	..Dr. 100 -
	<u>£ 900 £ 8,000</u>

£132,175

Note: S's Pref. Share Capital has not borne a share of the debit balance on S's Profit and Loss Account although on a winding up it is unlikely that the pref. shares would realise par. The reason why S's Ord. Shares bear all the £1,200 debit balance in the above solution is that, since it is the intention of the group to reorganise S and put it on a profit earning basis, the whole debit balance will fall ~~in fact~~ on S's Ord. Shares.

[in that event]

Treatment of Capital Reserve.

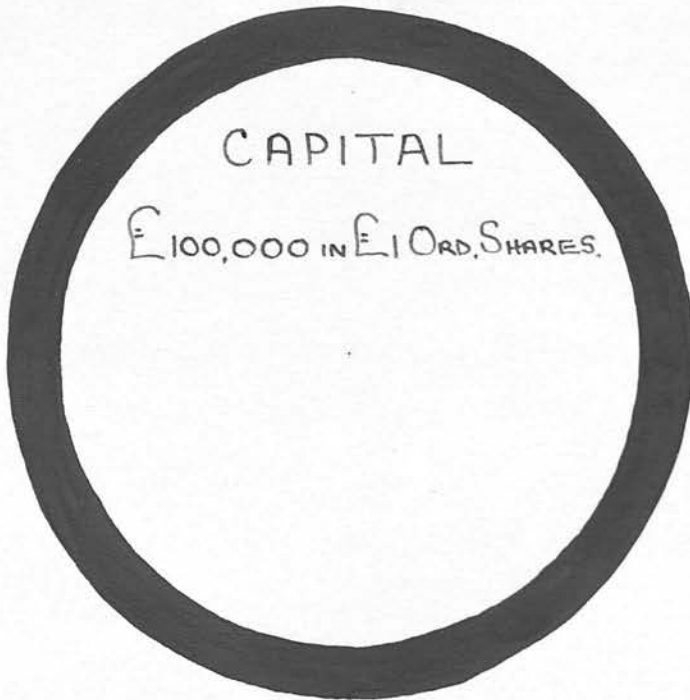
Where the Subsidiary has Preference Shares of the type under discussion, a Capital Reserve existing in the Balance Sheet of a Subsidiary and a created Capital Reserve arising to the Subsidiary in the Net Cost of Control of a Sub-subsidiary are both treated according to the principles already laid down where Capital Reserves exist in a Subsidiary which has Preference Shares with a preference for Capital and with a further right on a winding up to share in the Surplus Assets after the Ordinary Shares have received par (see page XI, 3). The principles to adopt during the process of consolidation are therefore -

- (a) Capital Reserve in Balance Sheet of a subsidiary - allocate to Subsidiary's Preference and Ordinary Capital pari passu.
- (b) Created Capital Reserve arising to a Subsidiary in the credit balance on Net Cost of Control of a Sub-subsidiary - allocate to Subsidiary's Ordinary Capital only.

In all cases a suitable footnote should appear in the Consolidated Statement.

EXAMPLE — 47.

H



↑ $\frac{2}{3}$ ORD. BOUGHT YEARS AGO.
\$



↑ $\frac{5}{6}$ BOUGHT YEARS AGO.



Example 47 - Sub. with Pref. shares having no preference for capital but ranking pari passu with Ord. Shares in a winding up Sub. holding shares in a Sub-sub, the latter with a debit balance on Revenue Account:

The summarised Balance Sheets of a group as at 31st December 1943 are:-

								<u>ASSETS</u>		
								<u>H</u>	<u>S</u>	<u>T</u>
Sundry Assets	..	..	..	..	..	..	..	£124,000	£ 19,000	£ 14,500
<u>Investments at cost, less dividends credited:</u>										
10,000 Ord. Shares In S	..	..	..	..	..	..	..	11,000	-	-
10,000 Ord. Shares in T	..	..	..	..	..	..	..	-	8,000	-
Revenue Account	..	..	..	..	..	..	..	-	-	1,500
								<u>£135,000</u>	<u>£ 27,000</u>	<u>£ 16,000</u>

								<u>LIABILITIES</u>		
Ord. Capital (in £1 Ord. Shares)	..	..	..	..	..	..	..	£100,000	£ 15,000	£ 12,000
5% Non-cum. Pref. Capital (in £1 shares)	..	..	..	..	..	..	..	-	5,000	-
									£ 20,000	
Creditors	..	..	..	..	..	..	..	25,000	5,100	4,000
Revenue Account	..	..	..	..	..	..	..	10,000	1,900	-
								<u>£135,000</u>	<u>£ 27,000</u>	<u>£ 16,000</u>

H and S bought their holdings in S and T respectively many years ago and the dividends credited to Investment Account cover the pre-acquisition Revenue balance in both cases. The Pref. shares of S have no preference for capital but rank pari passu with the Ord. Shares in any winding up. S's Pref. dividend for 1943 has not been paid.

SOLUTION

- (a) No adjustments are required as all shares are valued at Adjusted Cost in the Balance Sheets.
- (b) The aggregation of the adjusted Balance Sheets is unnecessary.
- (c) The Consolidated Statement of Assets and Liabilities is:-

								<u>ASSETS</u>	
Sundry Assets	..	..	..	..	..	..	..	£157,500	
<u>Net Cost of Control to the group:</u>								<u>By S in</u>	<u>By H in</u>
								<u>T 10/12</u>	<u>S 2/3rds</u>
Adjusted Cost	..	..	..	..	..	..	..	£ 8,000	£ 11,000
Par	..	..	..	..	..	..	..	10,000	10,000
								Cr.£ 2,000	Dr 1,000
<u>Less: Min. Interests S Ord. 1/3rd</u>								<u>667</u>	
								£ 1,333	
								<u>1,000</u>	
<u>Capital Reserve</u>								<u>£ 333</u>	

Note: The Pref. Shares of a Sub, all of which belong to outside shareholders have no preference for capital but rank pari passu with the Ord. Shares in a winding up. The above Consolidated Statement takes no account of a share in the surplus assets which might fall to these Pref. Shares as a winding up of the Sub. is not contemplated.

£157,500

LIABILITIES

(c) Continued.

LIABILITIES

Share Capital H	£100,000
Creditors.	34,100
Capital Reserve - Net Cost of Control to the group	333

Revenue Account:

T.. .. .	Dr. £ 1,500
<u>Less: Minority Interests T 1/6th.</u>	<u>250</u>

To S .. Dr. £ 1,250

S.. .. .	£ 1,900
<u>Less: Pref. dividend to Minority Interests.</u>	<u>250</u>
	<u>1,650</u>

<u>Less: Minority Interests S. Ord. 1/3rd</u>	Cr. £ 400
	<u>133</u>

To H £ 267

H.. .. .	<u>10,000</u>	10,267
----------	---------------	--------

Minority Interests:

	S Pref.	S. Ord. 1/3rd.	T. Ord. 1/6th.	
Capital.	£ 5,000	£ 5,000	£ 2,000	
Revenue Account	250	133	Dr. 250	
Net Cost of Control of T	-	667	-	
	<u>£ 5,250</u>	<u>£ 5,800</u>	<u>£ 1,750</u>	<u>12,800</u>
				<u>£157,500</u>

Notes:

1. The Capital Reserve of £2,000 arising to S in the Net Cost of Control of T is not allocated proportionately to S's Pref. Capital although S's Pref. Capital would share in a Capital reserve due to a profit on sale of all T's shares by S. The above "paper" profit is unlikely to bear any relation to the eventual realisation profit. Indeed on the face of it, it is doubtful if S could sell its holding in T at book value (16/- per share) for T's shares valued on T's current Balance Sheet are only worth 17/6d per share and T is apparently incurring losses. The "paper" profit is shared by S's Ordinary shares only and they bear the full share of the debit balance on T's Revenue Account falling to S. Further S's Ord. shares would bear any realisation loss of the holding in T as that loss would be debited to S's Profit and Loss Account

2. S's Minority Interests Ord. £5,800 can be reconciled from an examination of S's Balance Sheet thus:-

S. Sundry Assets	£ 19,000
Shares in T at T's Balance Sheet price 10,000 shares at 17/6d each	<u>8,750</u>

£ 27,750

<u>Less: Creditors.</u>	£ 5,100
S's Pref. Capital plus accrued dividend.	<u>5,250</u>
	<u>10,350</u>

Balance Sheet value of S's Ordinary Shares £ 17,400

1/3rd thereof to Minority Interests £ 5,800

(b) Subsidiary not expected to trade in the future as an active member of the group.

Treatment of Revenue Account.

A business in competition with the trading activities of the group, may be brought up by the group with the intention of closing down that new subsidiary as soon as practicable. When consolidating the accounts of the new group one may take the view that the individual figures of the new subsidiary should be left out of account altogether and the investment shown in total as a special item under a separate heading in the Consolidated Statement, thus "Investment in the purchase of a controlling interest in a competitor company pending liquidation." After realisation a loss can be regarded as the cost of eliminating competition and charged over a period of years against the profits of the members which held the investment. If there is a profit on realisation then so much the better for the group. This ~~simple~~ method has much in its favour but the alternative of treating the new subsidiary, until realised, in the same way as any other subsidiary, may be desirable especially in cases where ~~prior to liquidation of the new subsidiary,~~ it may take a year or two for the group to take over its trade and organisation or where, although liquidation seems likely, definite decision on the matter will depend on the trading results of the next few years.

It may be ~~then~~ ^{decided} that such a subsidiary is to be treated like an ordinary subsidiary for the purposes of the Consolidated Statement. Where the subsidiary has Preference shares with no preference for capital but ranking pari passu with Ordinary Shares in any winding up, the allocation of a debit balance on Revenue Account differs from that suggested in the case where the new subsidiary is to be considered an active member of the group. A debit balance on Revenue Account at any date should be allocated proportionately between the Preference Capital and the Ordinary Capital since each will /

will bear their share of the expected deficiency of assets at the forthcoming liquidation.

A credit balance on Revenue Account is easily dealt with, for the Preference Shares are not interested in it apart from the accrued Preference dividend to date, and until liquidation intervenes, the remaining balance on Revenue Account can be allocated entirely to Ordinary shareholders.

An explanatory note on the face of the Consolidated Statement is desirable in all these cases.

Creditors	12,000
Revenue Account	4,800
	16,800

I was a previous competitor of T. on 31st December 1948 and intends to close down at an early date. The Preference Shares rank pari passu with the Ordinary Shares

(a) The adjustment required is as follows:-

Investment Account	12,000
To Revenue Account	4,800

(Using proportion of debit balance of Revenue Account at pre-acquisition, when it would be 12,000/16,800 = 71.43% up thus:-

S's debit balance on Revenue account at pre-acquisition	12,000
Less: borne by S's Preference Shares	4,800
Balance falling on T's Ordinary Shares	7,200

(b) The aggregation of the adjusted

Example 48 /

Sundry Assets	100,000
<u>Net Cost of Control of H:</u>	
Adjusted Cost	100,000
Par	100,000
Notes	

Example 48 - Subsidiary with Preference shares having no preference for capital but ranking pari passu with Ordinary shares in a winding up. Subsidiary with large debit balance on Revenue Account, bought by the H. Company with the intention to liquidate the Subsidiary.

The summarised Balance Sheets of a group as at 31st December 1943 are:-

	<u>ASSETS</u>	<u>H</u>	<u>S</u>
Sundry Assets.. .. .		£112,125	£ 16,500
<u>Investment at Cost:</u>			
11,000 Ordinary shares in S at 12/6d each.. .. .		6,875	-
Revenue Account		-	7,500
		£119,000	£ 24,000
<u>LIABILITIES</u>			
Ordinary Capital (in £1 Ordinary Shares)		£100,000	£ 12,000
5% Non-cumulative Preference Capital (in £1 Ordinary shares)		-	8,000
			£ 20,000
Creditors.		9,000	4,000
Revenue Account		10,000	-
		£119,000	£ 24,000

S was a previous competitor of H. H bought 11,000 Ordinary shares in S on 31st December 1943 and intends to close down the business of S and wind up the company at an early date. The Preference Shares of S have no preference for capital but rank pari passu with the Ordinary Shares in any winding up.

SOLUTION

(a) The adjustment required in H's Accounts, is:-

Investment Account	Dr. £4,125	
To Revenue Account		£4,125

(Being proportion of debit balance on S's Revenue Account at 31:12:43 £7,500 - pre-acquisition, when H bought 11,000 Ordinary Shares in S (11/12ths) made up thus:-

S's debit balance on Revenue Account at 31:12:43	Dr.£ 7,500	
<u>Less:</u> Borne by S's Preference Shares 2/20ths		3,000
<u>Balance falling to S's Ordinary Shares. ..</u>		£ 4,500
<u>11/12ths thereof. ..</u>		£ 4,125

(b) The aggregation of the adjusted Balance Sheets is hardly necessary.

(c) The Consolidated Statement of Assets and Liabilities is:-

	<u>ASSETS</u>		
Sundry Assets.. .. .			£128,625
<u>Net Cost of Control of S:</u>		<u>By H in</u>	
		<u>S 11/12</u>	
Adjusted Cost		£ 11,000	
Par		11,000	

Note/ Forward £128,625

EXAMPLE — 49.

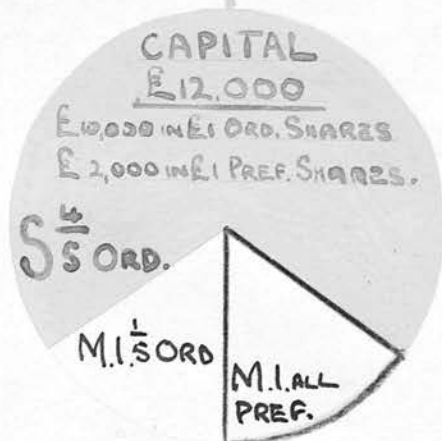
H



↑ $\frac{2}{3}$ ORD. BOUGHT — 1936
\$



↑ $\frac{4}{5}$ ORD. BOUGHT — 31/12/43



Example 49 - Sub and Sub-sub with Pref. Shares having no pref. for capital but ranking pari passu with Ord. Shares in a winding up. Sub-sub with large debit balance bought at Balance Sheet price by the Sub with the intention of winding up the Sub-sub.

The summarised Balance Sheets of a group as at 31st December 1943, are:-

		<u>ASSETS</u>		
		<u>H.</u>	<u>S.</u>	<u>T.</u>
Sundry Assets .. .. .	.. .. .	£103,000	£ 30,983	£ 9,500
<u>Investments at cost:</u>				
10,000 Ord. Shares in S. .. .. .	.. .. .	17,000		
8,000 Ord. Shares in T. (11/8d) .. .. .	.. .. .		4,667	
Revenue Account,.. .. .	.. .. .			5,000
		<u>£120,000</u>	<u>£ 35,650</u>	<u>£ 14,500</u>

		<u>LIABILITIES</u>		
Ordinary Capital (in £1 shares).. .. .	.. .. .	£100,000	£ 15,000	£ 10,000
5% Non-Cum Pref. Capital (in £1 shares) .. .. .	.. .. .		5,000	2,000
			£ 20,000	£ 12,000
Creditors, .. .. .	.. .. .	9,000	2,000	2,500
Revenue Account,.. .. .	.. .. .	11,000	13,650	
		<u>£120,000</u>	<u>£ 35,650</u>	<u>£ 14,500</u>

H. acquired 2/3rds of S. in 1936 when S. had a credit balance on Revenue Account of £9,000 available for Ordinary Shareholders.
 S. acquired 4/5ths of T. on 31st December 1943. T. was a previous competitor of the group and S. intends to liquidate T. at an early date.

The Pref. Dividends of both S. & T. is "free of tax" and unpaid for 1943. The Preference shares of S. and T. have no preference for capital and rank pari passu with the Ordinary Shares in any winding up.

SOLUTION

(a) The adjustments required in each Company's Accounts are:

H. 1 Revenue Account Dr. £ 6,000
 To Investment Account in S. £ 6,000

(Being 2/3rds S's credit balance on Revenue Account £9,000 in 1936, pre-acquisition when H. bought 10,000 Ordinary Shares in S. (2/3rds))

S. 1 Revenue Account Dr. £ 250
 To Outstanding Preference Dividend Account, £ 250

(Being S's Preference dividend accrued for 1943).

S. 2 Investment Account (in T) Dr. £ 3,333
 To Revenue Account £ 3,333

(Being portion of T's debit balance on Revenue Account on 31st December 1943 - pre-acquisition when S. bought 8,000 Ordinary Shares in T. (4/5ths) made up thus:

T's debit balance on Revenue Account at 31/12/43, Dr.	£ 5,000
Less: Borne by Preference Shares (1/6th,)	833
	<u>£ 4,167</u>

S's share 4/5ths thereof, £ 3,333

(b)/

(b) The aggregation of the adjusted Balance Sheet is:

<u>ASSETS</u>				
	<u>Total</u>	<u>H.</u>	<u>S.</u>	<u>T.</u>
Sundry Assets,	£ 143,483	£ 103,000	£ 30,983	£ 9,500
<u>Investments at Adjusted Cost:</u>				
In S. 10,000 Ordinary Shares,	11,000	11,000		
T. 8,000 Ordinary Shares,	8,000		8,000	
Revenue Account,				5,000
	<u>£ 162,483</u>	<u>£ 114,000</u>	<u>£ 38,983</u>	<u>£ 14,500</u>

LIABILITIES

Ordinary Capital,	£ 125,000	£ 100,000	£ 15,000	£ 10,000
Preference Capital,	7,000	-	5,000	2,000
Creditors,	13,500	9,000	2,000	2,500
Preference Dividend Account, ..	250	-	250	-
Revenue Account,	16,733	5,000	16,733	-
	<u>£ 162,483</u>	<u>£ 114,000</u>	<u>£ 38,983</u>	<u>£ 14,500</u>

(c) The Consolidated Statement is:

<u>ASSETS</u>				
Sundry Assets				£ 143,483
<u>Goodwill - Net Cost of Control to the Group</u>				
	<u>By S in T 4/5ths</u>	<u>By H in S 2/3rds</u>		
Adjusted Cost	£ 8,000	£ 11,000		
Par	8,000	10,000		
	<u>£ -</u>	<u>£ 1,000</u>		1,000

Note: The Preference Shares of the Sub. and the Sub-sub, all of which are held by outside shareholders, have no preference for capital but rank pari passu with the Ordinary Shares in any winding up. The above Consolidated Statement is prepared on the basis of taking into account only a share of the deficiency of assets, as represented by the debit balance on Revenue Account, which will be borne by the Preference Shareholders of the Sub-sub, which is about to be wound up.

£ 144,483

LIABILITIES

Share Capital H.				£ 100,000
Creditors				13,500
<u>Revenue Account</u>				
T			Dr. £ 5,000	
<u>Less: Borne by Preference Shares 1/6 Minority Interest</u>			833	
			£ 4,167	
<u>Less: Minority Interest S. Ordinary 1/5 of £4,167 Dr.</u>			834	
		To S	£ 3,333	
S			16,733	
			Cr. £ 13,400	
<u>Less: Minority Interest S. Ordinary 1/3rd.</u>			4,467	
		To H	£ 8,933	
H			5,000	13,933
Minority Interests/			<u>Forward..</u>	<u>£ 127,433</u>

Forward .. £ 127,433

Minority Interests

	S Ord. $\frac{1}{3}$	S. Pref.	T Ord. $\frac{1}{5}$	T Pref.	
Capital	£ 5,000	£ 5,000	£ 2,000	£ 2,000	
Dividends Outstanding.	-	250	-	-	
Revenue Account. ..	4,467	-	834 Dr.	833 Dr.	
	<u>£ 9,467</u>	<u>£ 5,250</u>	<u>£ 1,166</u>	<u>£ 1,167</u>	<u>17,050</u>
					<u>£ 144,483</u>

Notes on Solution

(1) As S bought the Ordinary Shares in T at T's Balance Sheet price 11/8d per share the Net Cost of Control of T is nil. The Preference and Ordinary Shares of T held by Minority Interests are both also valued at 11/8d per share (2,000 Shares @ 11/8 £1,167) which is T's Balance Sheet valuation.

(2) T's 1943 Preference Dividend is not provided for as T is trading at a loss and the Dividend is non cumulative.

(3) The Revenue Account £13,933 can be arrived at by considering the Revenue Balances of each company from the group's viewpoint.

H. £11,000 group entitled to entire balance	£ 11,000
S. £13,650 reduced by 1943 Preference Dividend of £250	£ 13,400
<u>Less: Pre-acquisition credit balance, which is not revenue to the group.. .. .</u>	<u>9,000</u>
	<u>£ 4,400</u>
2/3rds thereof falling to the group.. .. .	2,933
T. £5,000 Dr. - all pre-acquisition shares, bought 31st December 1943	<u>NIL</u>
As per Consolidated Statement	<u>£ 13,933</u>

(4) This is a theoretical example. It is considered that the Statement gives a fair financial picture of the group. It establishes the point that where Preference Shares have no preference for capital but rank pari passu with Ordinary Shares in a winding up, a credit balance on Revenue Account falls entirely to Ordinary Shares (see S) apart from the Preference Dividend, while a debit balance on Revenue Account falls to be apportioned between the Preference and Ordinary Shares according to the amount of Capital in each class (see T) provided the Preference Shares will undoubtedly have to bear that share owing to the fact that the company is about to be liquidated.

Treatment of Capital Reserve.

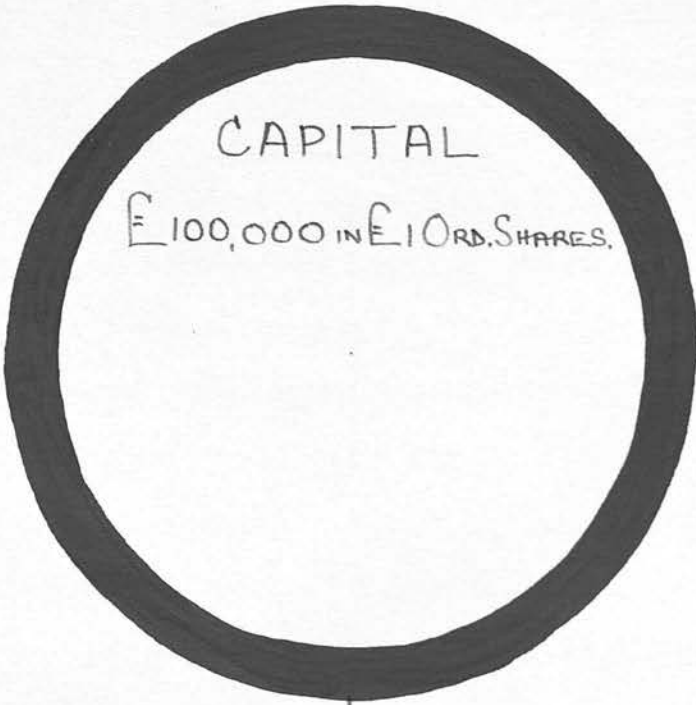
Where a subsidiary has Preference Shares of the type under discussion and holds shares in a sub-subsidiary which is bought up with the idea of alleviating competition and which is to be closed down and liquidated shortly, the credit balance on the Net Cost of Control of the sub-subsidiary cannot be considered a surplus available for allocation pari passu between the Preference and Ordinary Capital of the subsidiary. This is a temporary surplus which may be required to meet the loss on realisation of the sub-subsidiary, and it should be allocated in the interval to the Ordinary Shares only of the subsidiary. The group share should appear as a special reserve on the liability side of the Consolidated Statement under the heading "Reserve for probable loss on realisation of subsidiary." It is thus kept distinct and separate from the Net Cost of Control of subsidiaries which are active members of the group.

When a non-prosperous company is purchased by the group with the intention of winding up that new subsidiary at an early date, the treatment of any post-acquisition loss requires a little further consideration. It has already been pointed out that if this new subsidiary has Preference Capital of the type under discussion, the current debit balance on Revenue Account will be allocated proportionately to Preference and Ordinary Capital. As regards the member of the group which hold the shares in the new subsidiary, its share of a post-acquisition loss may be debited to Revenue Account. ^{such share} Alternatively, ~~it~~ may be applied against, and up to a certain amount of, a credit balance on the Net Cost of Control of the new subsidiary in cases where the loss was anticipated, and a reduction made for it in the offer to purchase the shares. It would not be prudent to set off losses against the credit balance on the Net Cost of Control if the surplus remaining thereafter ~~to~~ ~~meet the loss on realisation of Assets,~~ appeared insufficient from a practical point of view ~~in any particular case,~~ to meet the loss on realisation of Assets.

Example 50 /

EXAMPLE — 50

H



↑ $\frac{2}{3}$ ORD. BOUGHT YEARS AGO
\$



↑ $\frac{5}{6}$ BOUGHT — 31/3/43
T



Subsidiary with Preference Shares having no preference for Capital but ranking pari passu with Ordinary Shares in a winding up. Recent purchase of control of a competitor by the Subsidiary with the intention of liquidating the competitor Coy. which is trading at a loss.

The summarised Balance Sheets of a group, as at 31st December 1943 are:-

		<u>Assets</u>		
		<u>H.</u>	<u>S.</u>	<u>T.</u>
Sundry Assets	.. .. .	£ 124,000	£ 23,250	£ 10,000
<u>Investments:</u>				
10,000 Shares in S. at cost less Divds. credited	.. .. .	11,000		
10,000 Ord. Shares in T. at cost (7/6dea.)			3,750	
Revenue Account	.. .. .			6,000
		£ 135,000	£ 27,000	£ 16,000

		<u>LIABILITIES</u>		
Ordinary Share Capital (in £1 Shares)	..	£ 100,000	£ 15,000	£ 12,000
5% Non. Cum. Pref. Cap. (Do.)	..		5,000	
			£ 20,000	
Creditors	.. .. .	25,000	5,100	4,000
Revenue Account	.. .. .	10,000	1,900	-
		£ 135,000	£ 27,000	£ 16,000

H. bought 10,000 Ord. Shrs. in S. many years ago and the divids. credited to Investment Account cover S's pre-acquisition Rev. balance.

S. bought 10,000 Ord. Shrs. in T. on 31st March 1943 when it was estimated T. had a debit balance on Rev. A/c of £4,200.

T. was a competitor of the group and S. decided to purchase T. and wind up T. as soon as practical. In the interval S. considered T. would continue to trade at a loss. S's. Preference Shares have no preference for Capital but rank pari passu with the Ord. Shrs. in a winding up. S's Pref. Divd. for 1943 is outstanding.

Solution:

(a) The adjustments required in each Company's Accounts are:-

S. (1) Revenue Account Dr. £ 250
 To Outstanding Pref. Divd. A/c. £ 250
 (Being accrual of 1943 Pref. Divd.)

S. (2) Invest, A/c. in T. Dr. £3,500
 To Revenue Account 3,500
 (Being 5/6ths of T.'s debit balance on Rev. A/c. £4,200 at 31/3/43 - pre acquisition when S. bought 10,000 Ord. Shares in T. (5/6ths Ord.).)

(b) The aggregation of the adjusted Balance Sheets is -

		<u>ASSETS</u>			
		<u>Total</u>	<u>H.</u>	<u>S.</u>	<u>T.</u>
Sundry Assets	.. .. .	£157,250	£124,000	£ 23,250	£ 10,000
<u>Investments at adjusted cost:</u>					
10,000 Ord. Shares in S.	..	11,000	11,000		
10,000 " " " T.	..	7,250		7,250	
Revenue Account	.. .. .				6,000
		£175,500	£135,000	£ 30,500	£ 16,000

LIABILITIES /

LIABILITIES

	Total	H.	S.	T.
Ord. Capital	£127,000	£100,000	£ 15,000	£ 12,000
Pref. Capital.. ..	5,000		5,000	
Creditors	34,100	25,000	5,100	4,000
Dividend o/s	250		250	
Revenue Account	9,150	10,000	5,150	-
	<u>£175,500</u>	<u>£135,000</u>	<u>£ 30,500</u>	<u>£ 16,000</u>

(c) The Consolidated Statement is:-

ASSETS

Sundry Assets £157,250
Goodwill - Net Cost of Control to the Group:

	By S. in T. 5/6ths	By H. in S. 2/3rds	
Adjusted Cost	£ 7,250	£ 11,000	
Par.	<u>10,000</u>	<u>10,000</u>	
	Cr. £ 2,750	Dr. £ 1,000	£ 1,000
Less: Share of T's post-acquisition loss falling to S. and anticipated by S. 2/3rds of (6,000 - 4,200)	<u>1,500</u>		
	£ 1,250		
Less: Min. Ints. S. Ord. 1/3rd	<u>417</u>		
Reserve per contra.	<u>£ 833</u>		

Note: The Pref. Shares of a Subsidiary, all of which are held by outside Shareholders, have no preference for Capital but rank pari passu with the Ord. Shares on a winding up. The above Consolidated Statement takes no account of a share in the surplus (or deficiency) of Assets which might fall to these Pref. Shares as an winding up is not contemplated.
 [immediate]

£158,250

LIABILITIES

Share Capital H. £100,000
 Creditors 34,100
 Reserve for loss on realisation of T. 833

Revenue Account:

T.	Dr. £ 6,000	
Less: Min. Ints. T. 1/6th	<u>1,000</u>	
	To S. Dr. £ 5,000	
Less: Post acquisition loss set off against reserve created on purchase of T. 5/6ths of 1,800 Dr.	<u>1,500</u>	
	Dr. £ 3,500	
S.	<u>5,150</u>	
	£ 1,650	
Less: Min. Ints. S. Ord. 1/3rd	<u>550</u>	
	To H. £ 1,100	
H.	<u>10,000</u>	11,100

Minority Interests:

	S. Pref.	S. Ord. 1/3rd	T. Ord. 1/6th	
Capital.. ..	£ 5,000	£ 5,000	£ 2,000	
Revenue A/c...	250	550	1,000 Dr.	
Net cost of Control of T.		<u>417</u>		
	<u>£ 5,250</u>	<u>£ 5,967</u>	<u>£ 1,000</u>	12,217
				<u>£ 158,250</u>

Notes: (1) The Minority Interests S. Ordinary can be reconciled by an independent examination of S's Balance Sheet.

Sundry Assets.. .. .	£ 23,250	
10,000 Ord. Shares in T. at T's Balance Sheet price (10/- each),	<u>5,000</u>	
		£ 28,250
<u>Less: Creditors</u>	£ 5,100	
Pref. Shrs. plus accrued Dividend	<u>5,250</u>	<u>10,350</u>
Value of S's Ord. Shares.		<u>£ 17,900</u>
Minority Interests 1/3rd thereof		<u>£5,967</u>

(2) S's 5/6ths share of T's post acquisition loss (5/6ths of £1,800 = £1,500) being anticipated by S. and allowed in the purchase price of T's Ord. Shares (7/6d each) may be set off legitimately against the Capital Reserve arising in the net Cost of Control of T. £2,750. After the set off there remains a reserve of £1,250 which is divisible amongst S's Ord. Shareholders (Minority Interests 1/3rd Group 2/3rds). The Group's share is shown under a separate heading in the Consolidated Statement as a reserve to meet the loss on realisation of T. at an early date and T's trading losses to that date. If in point of fact these two losses exceed the reserve, then the net loss falling to S. will be charged to S's Profit and Loss Account when a net Profit would become a Capital Reserve in future Balance Sheets of S. and in preparing Consolidated Statements thereafter the Pref. Shares of S. would be allocated their share. But, until it is definitely known that a profit on realisation will emerge, the Capital Reserve arising in the Net Cost of Control should not be allocated to the Pref. Shares of S. - there is no certainty that any profits will be made on realisation.

An alternative solution would be to consolidate Coys. H. and S. only and show as an Asset the Investment in T. This would be quite satisfactory where the competitor Coy. purchased was to be immediately realised. Any loss on realisation would represent the cost to the Group for the removal of the competitor.

Consolidated Statement of H. and S. only

<u>ASSETS</u>		<u>H.</u>	<u>S.</u>	
Sundry Assets		£124,000	+ £23,250	£ 147,250
Goodwill - Net Cost of Control of S. as before,				1,000
Investment at cost, pending realisation				<u>3,750</u>
<u>Note: The Group have a 2/3rds interest in the above investment. It represents a purchase of a competitor Coy. which is about to be wound up.</u>				
				<u>£ 152,000</u>
<u>LIABILITIES</u>				
Share Capital H.				£ 100,000
Creditors		£25,000	+ £5,100	30,100
Revenue Account (as before)				11,100
Minority Interests:		<u>S. Pref.</u>	<u>S. Ord 1/3rd</u>	
Capital.. .. .		£5,000	£ 5,000	
Rev. Account.. ..		<u>250</u>	<u>550</u>	
		<u>£5,250</u>	<u>£5,550</u>	10,800
				<u>£ 152,000</u>

Subsidiary and Sub-Subsidiary with Preference and Ordinary Shares held by group members. Preference Shares with no preference for Capital but ranking pari passu with Ordinary Shares in a winding up. Sub-Subsidiary about to be liquidated.

Balance Sheet and facts as per Example 45 except that the Pref. Shares of S. and T. have no preference for Capital but rank pari passu with Ord. Shares in any winding up.

Solution:

(a) The adjustments required in each Company's Accounts are:

H. 1)
H. 2) as per Example 45.
S. 1)

S. 2 Investment A/c (in T. Ord) .. Dr. £2,000
To Revenue A/c £2,000

(Being proportion of T's debit balance on Rev. Account £3,000 in 1942 - pre-acquisition - when S. bought 8,000 Ord. Shs. in T. (4/5ths) made up thus:-

Debit Balance of T. in 1942 Dr. £3,000

Less: To be borne by T's Pref. Shs
1/6th 500

£2,500

4/5ths thereof to S. .. £2,000

S. 3 Investment A/c (in T. Pref.) Dr. £ 250
To Rev. A/c £ 250

(Being proportion of T's debit balance on Rev. A/c £3,000 in 1942 which will be borne by 1,000 Pref. Shares held by S. - pre-acquisition - when S. bought 1,000 Pref. Shrs. in T. (1/2) made up thus:-

Debit balance of T. in 1942. .. Dr. £3,000

1/6th thereof borne by Pref. Shs.. Dr. £500

1/2 thereof to S. .. Dr. £250

(b) The aggregation of the adjusted Balance Sheets is:

	<u>ASSETS</u>			
	<u>Total</u>	<u>H.</u>	<u>S.</u>	<u>T.</u>
Sundry Assets	£142,000	£100,500	£32,000	£ 9,500
<u>Investments at adjusted Cost</u>				
10,000 Ord. Shs. in S.	11,000	11,000		
8,000 " " in T.	5,000		5,000	
1,000 Pref. Shs. in T.	900		900	
2,500 " " in S.	2,500	2,500		
Dividends receivable o/s.	-	125		
Revenue Account	-			5,000
	<u>£161,400</u>	<u>£114,125</u>	<u>£37,900</u>	<u>£14,500</u>

	<u>LIABILITIES</u>			
Ord. Capital	£125,000	£100,000	£ 15,000	£10,000
Pref. Capital	7,000	-	5,000	2,000
Creditors	13,500	9,000	2,000	2,500
Dividends payable o/s..	125	-	250	
Revenue Account	15,775	5,125	15,650	-
	<u>£161,400</u>	<u>£114,125</u>	<u>£ 37,900</u>	<u>£14,500</u>

(c) The/

(c) The Consolidated Statement is:

<u>ASSETS</u>				
Sundry Assets				£142,000
<u>Goodwill - Net Cost of Control to the Group:</u>				
	<u>By S. in T.</u>		<u>By H. in S.</u>	
	<u>Ord. 4/5ths</u>	<u>Pref. 1/2</u>	<u>Ord. 2/3rds</u>	<u>Pref 1/2</u>
Adjusted Cost ..	£ 5,000	£ 900	£11,000	£2,500
Par.	<u>8,000</u>	<u>1,000</u>	<u>10,000</u>	<u>2,500</u>
	<u>£ 3,000 Cr. £ 100 Cr.</u>		<u>£ 1,000 Dr.</u>	<u>-</u>
	<u>£3,100 Cr.</u>			1,000
<u>Less: Share of Post-</u>				
<u>acquisition Loss of T.</u>		<u>1,500</u>		
				£1,600
<u>Less: Min. Ints. S. Ord. 1/3</u>		<u>533</u>		
<u>Reserve per Contra ..</u>		<u>£1,067</u>		
				<u>£143,000</u>

Note: The Pref. Shares of the Sub. and the Sub-sub, one half of which are held by outside Shareholders, have no pref. for Capital but should rank pari passu with Ord. Shs. on a winding up. The above Consolidated Statement is prepared on the basis of taking into account only a share of the deficiency of Assets, as represented by the debit balance on Rev. A/c, which will be borne by the Pref. Shareholders of the Sub-sub, which is about to be wound up.

<u>LIABILITIES</u>				
Share Capital H.				£100,000
Creditors				13,500
<u>Revenue Account: ..</u>				<u>£15,775</u>
<u>Less: Min. Ints:</u>				
	T. Pref 1/12th of Dr. £5,000,	Dr. £ 417		
	T. Ord. 1/6th of Dr. £5,000,	Dr. 833		
	S. Ord. 1/3rd of Cr. £13,400,	Cr. <u>4,467</u>	<u>3,217</u>	
	(£13,650 - £250)		<u>£12,558</u>	
<u>Add: Post-acquisition loss</u> £2,000 of T. falling				
to S. and set off against Reserve at				
purchase date,				
1,000 Pref. Shs. bear 1/12th ..	£ 167			
8,000 Ord. Shs. bear 8/12ths ..	<u>1,333</u>		<u>1,500</u>	
				14,058
<u>Minority Interests:</u>				
	<u>S. Ord. 1/3</u>	<u>S. Pref. 1/2</u>	<u>T. Ord. 1/5th</u>	<u>T. Pref. 1/2</u>
Capital ..	£5,000	£2,500	£2,000	£1,000
Pref. Dividend..		125		
Revenue A/c ..	4,467		833 Dr.	417 Dr.
<u>Net Cost of Control</u>				
of T.	Cr. <u>533</u>			
	<u>£10,000</u>	<u>£2,625</u>	<u>£1,167</u>	<u>£ 583</u>
				14,375
<u>Reserve to meet loss on realisation of T.</u>				<u>1,067</u>
				<u>£143,000</u>

Notes on Solution

(1)/

Notes on Solution

- (1) The Min. Interests can be calculated independently for the Balance Sheet of S. and T.

T's Pref. Shares, having no preference in a winding up, are worth 11/8d each. 1,000 Pref. Shares at 11/8d each .. £ 583

T.'s Ord. Shares are worth 11/8d each $\left(\frac{7,000}{12,000} \times £1 \right)$
2,000 Ord. Shares at 11/8d each .. 1,167

S's Pref. Shares are worth par plus accrued 1943 Divd.
2,500 Pref. Shares 2,625

S's Ord. Shares are worth £2 each arrived at thus:

Sundry Assets.. .. .	£32,000
Invest. in T. 8,000 Ord. Shs. @ 11/8d..	4,667
1,000 Pref. Shs @ 11/8d..	<u>583</u>
	£37,250

<u>Less: Creditors</u>	£2,000
S's. Pref. Cap. + 1943	
Pref. Divd... .. .	<u>5,250</u>
	<u>7,250</u>

Value of 15,000 Ord. Shs. (£2 each)	<u>£30,000</u>
-------------------------------------	----------------

5,000 Ord. Shs. in S. at £2 each ..	<u>10,000</u>
	<u>£14,375</u>

- (2) A comparison with the solution of example 45 where the Pref. Shares had a preference for Capital is interesting. The balance at credit of Revenue Account of the Group £14,058 is the same for the two solutions.

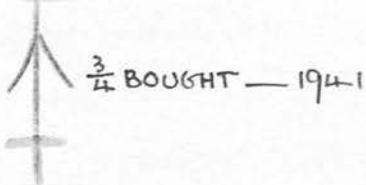
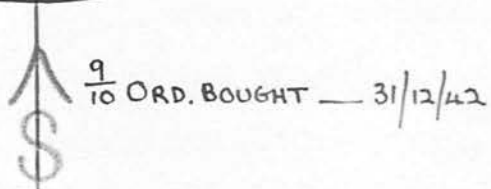
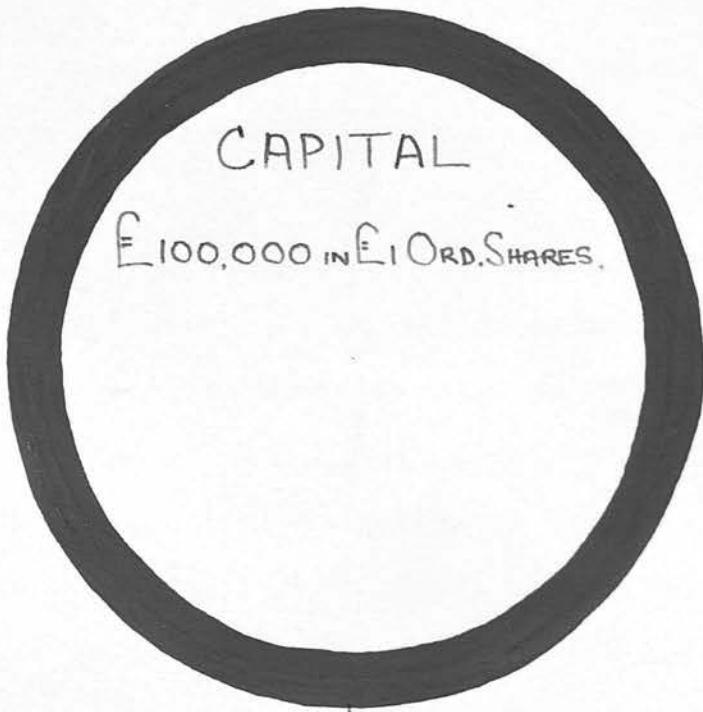
In this section an outline has been given of the incorporation in a Consolidated Statement of a new subsidiary which is ~~about~~ to be wound up and where a particular type of Preference Share is found to exist either in the new subsidiary or in the member which holds the shares. The principles given may also apply to an old subsidiary which is incurring losses to such an extent that the group has under consideration a restriction of its activities, by the closing down of the subsidiary altogether. This might mean a change of method of treating the subsidiary and in these circumstances a suitable explanatory note on the face of the Consolidated Statement would be desirable. In many cases, however, it may be preferable to make no change in the method of treating the subsidiary but delay adjustment until the subsidiary is wound up, say, in the following year, after which the subsidiary will no longer be a member of the group.

Participating Preference Shares.

The capital aspect of this type of Preference Share is the same as a Preference Share without participating right in surplus profits. The only new point is the allocation of the revenue balance. A credit balance on Revenue Account of a subsidiary with Participating Preference Shares, should be adjusted in the normal way, for any profits falling to, or losses chargeable against, that subsidiary ^{in respect of} ~~from~~ shares held in another member. The adjusted revenue balance should then be allocated between Participating Preference and Ordinary Shares, etc., according to their rights, as if the full revenue (Profit and Loss Account and General Reserve) was distributed as dividend. On the other hand, a debit balance on Revenue Account falls entirely to the Ordinary Shares.

EXAMPLE — 52.

H



The summarised Balance Sheets of a Group as at 31st December 1944 are:-

		<u>ASSETS</u>		
		H.	S.	T.
Sundry Assets		£105,000	£26,000	£17,000
<u>Investments at cost:</u>				
18,000 Ord. Shares in S...		22,000		
9,000 " " " T...			13,000	
		<u>£127,000</u>	<u>£39,000</u>	<u>£17,000</u>
		<u>LIABILITIES</u>		
Share Capital in £1 Ord. Shares.. .. .		£100,000	£20,000	£12,000
" 5% Participating Pref. Shrs.			10,000	
Sundry Creditors		20,000	5,000	2,000
Revenue Account		7,000	4,000	3,000
		<u>£127,000</u>	<u>£39,000</u>	<u>£17,000</u>

Notes:

- (1) S's. Participating Pref. Shs. have a preference for Capital and no share in surplus Assets on any winding up. They have a preference for Dividend at 5% (non-cumulative) and are further entitled to 1% for every 2% paid to the Ord. Shareholders in excess of an Ord. Divd. of 10%. The Pref. Shs. have received their Divd. up to 31st Dec. 1943.
- (2) S. bought $\frac{3}{4}$ ths T. (9,000 Shs.) in 1941 when T. had a Cr. balance on Revenue Account of £1,000.
- (3) H. bought 9/10ths S. (18,000 Ord. Shs.) on 31st Dec. 1942 when S. had a Credit balance on Revenue Account of £2,800 and when T. had a Credit balance on Revenue Account of £1,600.

Solution:

(a) The adjustments required in each Company's Accounts are:-

S. (1) Revenue Account	Dr. £750	
To Investment A/c (in T.) ..		£750
(Being $\frac{3}{4}$ ths T's Rev. A/c. balance in 1941 (Cr. £1,000) pre-acquisition when S. bought 9,000 Ord. Shs. in T. ($\frac{3}{4}$ ths).		
H. (1) Revenue Account	Dr. £2,340	
To Investment A/c. (in S.) ..		£2,340
(Being 9/10ths S's true Rev. A/c balance on 31st Dec. 1942 falling to the Ord. Shs. - pre-acquisition - when H. bought 18,000 Ord. Shs. in S. (9/10ths) made up thus:-		
S's Cr. Balance on Rev. A/c. at 31/12/42 per		
Accounts		£ 2,800
and $\frac{3}{4}$ ths T's. Do. Do. Do.		
$\frac{3}{4}$ of £1,600		<u>1,200</u>
		£ 4,000
<u>Less:</u> $\frac{3}{4}$ ths T's Cr. balance on Rev. A/c. in 1941 which shd. have been Capd. by S. (see S.1)		<u>750</u>
S's free Revenue Balance at 31/12/42		£ 3,250

<u>Divisible thus:</u>	<u>Pref.</u>	<u>Ord.</u>
5% Pref. Dividend	£ 500	
10% Ord. Dividend		£2,000
Balance £750 divisible in ratio of 1:4 (Pref. and Ord. respectively)*	<u>150</u>	<u>600</u>
	<u>£ 650</u>	<u>£2,600</u>
9/10ths of Balance falling to Ord. Shares S.		<u>£ 2,340</u>

* Note: The ratio of 1:4 is due to the difference in Capital, viz:
2% on Ordinary, £20,000 and
1% on Preference £10,000.

(b)/

(b) The aggregation of the adjusted Balance Sheets is:-

<u>ASSETS</u>				
	<u>Total</u>	<u>H.</u>	<u>S.</u>	<u>T.</u>
Sundry Assets	£148,000	£105,000	£26,000	£17,000
<u>Investments at adjusted Cost:</u>				
In S. 18,000 Ord. ..	19,660	19,660		
T. 9,000 " ..	12,250		12,250	
	£179,910	£124,660	£38,250	£17,000
	£179,910	£124,660	£38,250	£17,000

<u>LIABILITIES</u>				
<u>Share Capital:</u>				
Ordinary	£132,000	£100,000	£20,000	£12,000
Part. Preference ..	10,000	-	10,000	-
Creditors	27,000	20,000	5,000	2,000
Rev. Account.. ..	10,910	4,660	3,250	3,000
	£179,910	£124,660	£38,250	£17,000
	£179,910	£124,660	£38,250	£17,000

(c) The Consolidated Statement is:-

<u>ASSETS</u>				
Sundry Assets				£148,000
<u>Goodwill - Net Cost of Control to the Group:</u>				
	<u>By S. in T. 3/4ths</u>	<u>By H. in S. 9/10ths</u>		
Adjusted Cost,	£12,250	£19,660		
Par	9,000	18,000		
	£ 3,250	£ 1,660		
<u>Less: To Min. Ints.</u>				
S. 1/10th,	325			
	£ 2,925	£ 1,660		4,585
				£152,585
				£152,585

<u>LIABILITIES</u>				
Share Capital H.				£100,000
Sundry Creditors				27,000
<u>Revenue Account:</u>				
T.			£3,000	
To Min. Ints. T. 1/4 ..			750	
		To S.	£2,250	
S.			3,250	
			£5,500	
<u>Divisible thus:-</u>				
		<u>Part. Pref.</u>	<u>Ord.</u>	
5% Pref.		£ 500		
10% Ord.			£2,000	
Balance £3,000 in ratio 1:4 ..		600	2,400	
		£1,100	£4,400	
To Min. Ints. S. ..		£1,100	£440	1,540
			To H.	£3,960
H.				4,660
				8,620
<u>Minority Interests:</u>				
	<u>S. Part. Pref.</u>	<u>S. Ord. 1/10th</u>	<u>T. Ord. 1/4th</u>	
Capital	£10,000	£2,000	£3,000	
Revenue A/c ..	1,100	440	750	
Net Cost of Control to T. ..		Dr. 325		
	£11,100	£2,115	£3,750	16,965
				£152,585

Note: Observe the allocation of S's Rev. A/c after receiving its share from T. between the Part. Pref. Shares and the Ord. Shares. The allocation is made as if all S's free revenue was distributed as Divd. and is required not only at the date of the Consolidated Statement but also at 31.12.42 in order to determine the pre-acquisition balance (when H. bought shares in S.).

The effect of Preference Shares being cumulative.

In the Consolidated Statement the only difficulty which arises is the treatment of arrears of Preference dividend due by a subsidiary. If the subsidiary has any balance at credit of Revenue Account (Profit and Loss Account and General Reserve) as shown in its legal Balance Sheet, the arrears should be debited for consolidation purposes, but only to the extent of reducing the credit balance to nil. Where, owing to shares held in other members, profits fall to the subsidiary for consolidation purposes, these are also available to meet such Preference dividend arrears. Where there is ~~is~~ a debit balance on Revenue Account the arrears can only be ignored. In any case, a note of the outstanding cumulative preference dividend, so far as not provided for in the Consolidated Statement, should appear as a footnote to the Consolidated Statement.

Deferred Shares.

The Share Capital of a subsidiary may include Deferred (or Founder's) Shares which have an interest in the balance of the profits of the company. The feature of such shares is that they take a large share of any surplus profits earned by the company in comparison to their small nominal value. Sometimes the dividend payable to Ordinary Capital is restricted to so much per cent and the Deferred Capital takes the balance of the profits. It may be, however, that the profits of the company, after meeting the Preference dividend, are divisible in some ratio between the Ordinary and Deferred Capital. For example, the Articles may stipulate that for every half per cent paid to the Ordinary Capital over, say, a cumulative ordinary dividend of $7\frac{1}{2}$ per cent per annum, the Deferred Shares are entitled to a sum equal to, say, 1% on the Ordinary Capital. In such a case, the rate of dividend paid to deferred shares would depend not only on the rate of dividend paid to Ordinary shareholders but also on the relative amounts of the Ordinary and Deferred Share Capital. Another common arrangement is that Deferred Shares are /

entitled to, say, 10 per cent of the surplus profits of any year after meeting a cumulative dividend of, say, $7\frac{1}{2}$ per cent on all the other paid-up capital.

In the preparation of the Consolidated Statement, where one of the subsidiaries has Deferred Shares, the revenue of the sub-subsidiary should be treated as if the full Revenue Account balance (Profit and Loss Account and General Reserve) was distributed as dividends. By the expression "the full Revenue Account balance" is meant the adjusted Revenue Account of the subsidiary plus (or minus) the share of profits (or losses) falling to that subsidiary from shares held in another member, e.g. a sub-subsidiary.

Ex. S. Ltd. is a subsidiary whose issued Share Capital is -

10,000 5% Cumulative preference shares of £1 each	£10,000
4,000 Ordinary Shares of £1 each	4,000
10,000 Deferred " " 1/- each	500
	£14,500

The Preference dividend due annually on 28th February has been paid up to the previous year (31/12/46).

The Ordinary Shares are entitled to a cumulative $7\frac{1}{2}$ per cent dividend in priority to a distribution to the Deferred Shares. For every half per cent paid over $7\frac{1}{2}$ per cent per annum to the Ordinary Shares, the Deferred Shares are entitled to a dividend represented by an amount equivalent to 1 per cent on the Ordinary Capital.

At 31st December, 1947, the balances at credit of the Revenue Accounts, before providing for the 1947 Preference dividend were:-

General Reserve . . .	£500	<u>Note:</u> There are no arrears of the cumulative $7\frac{1}{2}$ % Ordinary Dividend as at 31/12/46.
Profit & Loss A/c . .	900	
	£1400	

The Preference shares have no vote unless the Preference dividend is in arrears. The Deferred and Ordinary Shares have one vote /

vote each per share.

Case 1. H. Ltd. acquired 8,000 Deferred Shares in S. when S. was incorporated.

In the Consolidated Statement of H. and its subsidiaries at 31st December, 1947, the revenue figures of S. would be treated as follows:-

Cr. bal. at 31/12/47 (Gen. Res. and P. & L. A/c) . . .	£1,400	
<u>Less:</u> Pref. div. for 1947	£500	
7½% on Ord. Cap. for 1947	300	800
		<hr/>
Bal. divisible between Ordinary and Deferred Capital		£ 600

Theoretically divisible thus:- (Def. Cap. receives double the sum paid to Ord. Cap.)

Ord. Cap. $\frac{1}{3}$ (equivalent to an extra 5% making 12½%)	£200	
Def. " $\frac{2}{3}$ (equivalent to 80% divd. on Def. Cap.)	400	£ 600

Group Rev. A/c takes $\frac{4}{5}$ ths of £400 £ 320

Min. Ints. S.

Def. Pref. Cap. takes	£500	
Ord. " "	500	
Def. " $\frac{1}{5}$ th "	80	1080
		<hr/>
		£1400

Case 2. H. purchased 8,000 Def. Shs. in S. on 30th Sept. 1941 when the balances on S's. Rev. A/c were:-

Gen. Res.	£450	
P. & L. A/c	330	
	<hr/>	
	£780	

Investment Account in H's. books was as follows:-

Cost of 8,000 Def. Shs. in S. bought on 30th Sept. 1941	£900	
<u>Less:</u> Divds. received credited to Invest. A/c	40	
	<hr/>	
Balance at 31st Dec. 1947	£ 860	

In /

In the Consolidated Statement of the group at 31st December, 1947, the figures regarding S. would be treated as follows:-

(a) <u>Goodwill - Net C. of C. of S.</u>	By H. in S. $\frac{4}{5}$ ths Def.	
Cost, less divds. credited	£860	
<u>Less: Pre-acqn. profits</u>		
$\frac{4}{5}$ ths of £120 (see below) £96		
<u>Less: Divds. credited already to cap.</u>	<u>40</u>	<u>56</u>
		£804
Par	<u>400</u>	<u>£404</u>

Note: The pre-acqn. profit is calculated thus:-

Rev. bal. at 30/9/41	cr. £780
<u>Less: Pref. divd. 9 mths. to 30/9/41</u>	£375
7½% on Ord. Cap. for " "	<u>225</u> <u>600</u>
Bal. divisible between Ord. and Def. Cap.	£180

Theoretically divisible thus:-

Ord. Cap. $\frac{1}{3}$ rd	£ 60	
Def. " $\frac{2}{3}$ rds	<u>120</u>	<u>£180</u>

(b) Group Rev. A/c

Sh. of S's. current Rev. A/c as in Case 1	£320
<u>Less: Bal. of pre-acqn. profits capd.</u>	<u>56</u> <u>£264</u>

(c) Min. Ints. S.

	<u>S. Pref.</u>	<u>S. Ord.</u>	<u>S. Def. $\frac{1}{5}$</u>
Sh. Cap.	£10,000	£ 4,000	£ 100
Rev. A/c	<u>500</u>	<u>500</u>	<u>80</u>
	<u>£10,500</u>	<u>£ 4,500</u>	<u>£ 180</u>
			£15,180

Reconciliation

	<u>In the financial A/c</u>	<u>In the Cons.^d St.^t</u>
Sh. Cap.	£14,500 cr.	Min. Ints. £15,180 cr.
Rev. A/cs	<u>1,400 cr.</u>	Group Rev. A/cs <u>264 cr.</u>
	£15,900	£15,444
<u>Less: Investment A/c</u>	<u>860 dr.</u>	<u>Less: Goodwill</u>
	<u>£15,040</u>	Net C. of C. of S. <u>404 dr.</u>
		<u>£15,040</u>

Where there is a debit balance on Revenue Account the position is more obscure. As a general rule a debit balance should be divided between Ordinary and Deferred Capital in the ratio they share in the "surplus" profits, that is to say in the above example in the ratio of 1 to 2. This principle is based on the fact that one is justified in assuming that the existing debit balance may well be wiped out by future profits and after the arrears of the Cumulative Preference Dividend, and the arrears of the cumulative $7\frac{1}{2}$ per cent on the Ordinary Capital are met, it is the parties interested in the surplus profits remaining who will in fact bear the full burden of the previous losses. In any allocation of a debit balance on Revenue Account, care must be taken, however, to restrict, if necessary, the amount allocated to the Deferred Capital, to the nominal amount of the Deferred Capital, since a shareholder cannot lose more than his Capital as a result of adverse trading results. (Preference Shares will bear no share of a debit balance on Revenue Account unless the debit balance is so large that it exceeds the nominal value of the Ordinary and Deferred Capital (£4,500 in the above example).

So far as the treatment of Capital Reserves are concerned the Articles will state the rights of Deferred Shares and the same principles apply as these outlined in the earlier sections of this chapter which deal with various types of Preference Shares.

Sections of the Companies Act 1947

Definition of a Subsidiary

The Shareholding in the Parent Company

The Rights of Shareholders

Auditors' Report in Subsidiary Companies

Sections of the Companies Act 1947 relative to Holding Companies:

- 13 Contents of balance sheet and profit and loss account.
- 14 Obligation to lay group accounts before holding company.
- 15 Form of group accounts.
- 16 Contents of group accounts.
- 17 Financial year of holding company and subsidiary.
- 18 Meaning of "holding company" and "subsidiary."
- 19 Directors' report.
- 20 General provision as to liability of directors for defective accounts.
- 21 Signature and copies of accounts.
- 22 Extension of rights and duties of auditors.
- 25 Construction of references to documents annexed to accounts.
- 38 Particulars in accounts of directors' salaries, pensions, etc.
- 39 Particulars in accounts of loans to officers.

First Schedule - Accounts

- Part I - General provisions as to balance sheet and profit and loss account.
- Part II - Special provisions where the company is a Holding or Subsidiary Company.
- Part III - Exceptions for special classes of company.
- Part IV. - Interpretation of Schedule.

Second Schedule - Matters to be expressly stated in auditors' report.

Third Schedule - Conditions as to interests in shares and debentures of exempt private company.

Sections of the Companies Act 1929 relative to Holding Companies:

- 1 Definition of a Subsidiary (section 127).
- 2 The Shareholding in the Subsidiaries (section 125; section 124(1)).
- 3 The Revenue from Subsidiaries (section 126 (1)).
- 4 Auditors' Report in Subsidiaries (section 126 (2), (3) and (4)).

General Example 29 - Group of 4 members:

The Balance Sheets of a group at 31st December 1945 are as follows:-

<u>ASSETS</u>								<u>H</u>	<u>S</u>	<u>T</u>	<u>V</u>
Property at cost	..	..	..	..	..	..	£251,000	£ -	£ 30,000	£ 2,000
Plant at cost, less depreciation	..	..	..	..	..	..	130,000	20,000	8,000	4,500
Investment (Government Stock)	..	..	..	..	..	..	-	-	1,000	-
do. Subsidiaries	..	..	..	..	..	..	82,000	44,500	-	-
Stock	..	..	..	..	..	..	178,000	40,000	14,000	9,000
Debtors	..	..	..	..	..	..	56,000	10,400	8,700	5,000
Subsidiary's Current Accounts	..	..	..	..	..	..	6,500	-	500	-
Dividend Receivable	..	..	..	..	..	..	4,500	-	-	-
Cash in Bank	..	..	..	..	..	..	9,000	100	500	1,000
Goodwill at cost	..	..	..	..	..	..	-	10,000	7,000	-
							<u>£717,000</u>	<u>£125,000</u>	<u>£ 69,700</u>	<u>£21,500</u>	

<u>LIABILITIES</u>								<u>H</u>	<u>S</u>	<u>T</u>	<u>V</u>
Share Capital (in £1 Ordinary Shares)	..	..	..	..	..	..	£500,000	£100,000	£ 50,000	£15,000
Creditors	..	..	..	..	..	..	62,500	10,700	7,500	2,800
Amount due to H	..	..	..	..	..	..	-	4,300	2,200	500
Reserve for inter-cpy profit on stock	..	..	..	..	..	..	2,000	-	-	-
General Reserve	..	..	..	..	..	..	100,000	-	7,000	2,000
Profit and Loss Account	..	..	..	..	..	..	52,500	2,500	3,000	1,200
Proposed Dividend	..	..	..	..	..	..	-	7,500	-	-
							<u>£717,000</u>	<u>£125,000</u>	<u>£ 69,700</u>	<u>£21,500</u>	

Notes:(1) Investments in Subsidiaries are as follows:-

	<u>Book Value</u>
H 60,000 Ord. Shares (6/10ths) in S bought 30th April 1941	£62,000
7,000 do. (7/50ths) in T bought 7th January 1943	8,000
10,000 do. (2/3rds) in V bought 30th June 1942	12,000
<u>As per Balance Sheet of H</u>	<u>£82,000</u>

H has adopted the policy of continuing to credit to Investment Account, dividends received from Subsidiaries until all investments are stated at cost less the full relative proportions of the pre-acquisition revenue balances. This was completed before 31st December 1945. When acquiring shares in T, H accepted S's view regarding the valuation of T's Plant (see note 5).

S 24,000 (now 30,000) Ord. Shares (3/5ths) in T bought 31st December 1942, at cost	£ 38,000
5,000 Ord. Shares (1/3rd) in V bought 30th June 1944, at cost	6,500
<u>As per Balance Sheet of S</u>	<u>£ 44,500</u>

	<u>P.L.A/c</u>	<u>Gen.Res</u>	<u>Total</u>
On 31st December 1942 the balances at credit of T were	£ 10,000	£ 15,000	£ 25,000
On 30th June 1944 the balances at credit of V were	900	1500	2,400

S accepted H's view regarding the valuation of V's Property (see note 4)

On 4th January 1943 T made a bonus issue of shares out of General Reserve by giving one new Ord. Share for every four held (General Reserve at 31:12:42 £15,000)/

Notes (1) (Contd.)

£15,000). This increased T's issued capital from £40,000 to £50,000 and S's holding in T from 24,000 shares to 30,000.

- (2) The proposed dividend S £7,500 represents an Ordinary dividend of $7\frac{1}{2}\%$ (free of tax) declared by S for the year ended 31st December 1945, but not paid until 20th January 1946. H's share thereof £4,500 is shown as an Asset of H.
- (3) The reserve in H's Balance Sheet for inter-coy profits on stocks £2,000 is found inadequate and is computed for the purpose of the reserve required in the Consolidated Statement at 31st December 1945 at a figure of £2,500.
- (4) V's Property is re-valued at £3,000 by H on 30th June 1942 when H acquired control of V. V's accounts were not adjusted for this. There have been no additions since 1942.
- (5) On 31st December 1942 when S acquired control of T, S re-valued T's Plant at £10,000. The book-value on 31st December 1942 was £8,500. Additions since were £1,000 on 31st December 1944. S considered T's Plant should be depreciated by 10% p.a. In T's Accounts the practice is to write off round figures for depreciation according to the amount of profits earned each year. 10% depreciation is the rate of depreciation to be adopted for consolidation purposes.

Example 41 - The following is the Profit and Loss Accounts for the year ended and Balance Sheets as at 31st December 1946 (1 year later)

PROFIT and LOSS ACCOUNT

	<u>H</u>	<u>S</u>	<u>T</u>	<u>V</u>
Balance at 31:12:45	£ 52,500	£ 2,500	£ 3,000	£ 1,200
Dividends Received From S	6,000	-	-	-
" T	280	1,200	-	-
" V	500	250	-	-
Trading Profit	£1,420	15,050	5,200	2,600
	£120,700	£ 19,000	£ 8,200	£ 3,800
National Taxation.. .. .	£ 30,000	£ 6,800	£ 2,000	£ 800
Directors' Fees	2,000	500	200	250
Transferred to General Reserve	10,000	-	-	500
Dividends paid H 8%	40,000	-	-	-
S 10%	-	10,000	-	-
T 4%	-	-	2000	-
V 5%	-	-	-	750
Balance at credit at date	38,700	1,700	4,000	1,500
	£120,700	£ 19,000	£ 8,200	£ 3,800

BALANCE SHEET

ASSETS

Property at cost	£251,000	£ -	£ 30,000	£ 2,000
Plant at cost less depreciation	120,000	18,000	7,400	4,050
Investment - Government Stock	-	-	1,000	-
Investment • Subsidiary.	82,000	44,500	-	-
Stock	180,000	41,000	16,000	8,000
Debtors.. .. .	60,000	15,000	8,000	7,000
Subsidiary's Current Accounts	7,000	-	-	-
Dividends receivable	6,000	-	-	-
Cash in Bank.. .. .	10,000	200	600	950
Goodwill at cost	-	10,000	7,000	-
	£716,000	£128,700	£ 70,000	£ 22,000

LIABILITIES

Share Capital.	£500,000	£100,000	£ 50,000	£ 15,000
Creditors	65,000	12,000	7,000	3,000
Amount due to H	-	5,000	2,000	-
Reserve for inter-coy profits on stock.	2,300	-	-	-
General Reserve	110,000	-	7,000	2,500
Profit and Loss Account.	38,700	1,700	4,000	1,500
Proposed Dividends.	-	10,000	-	-
	£716,000	£128,700	£ 70,000	£ 22,000

Notes:

- (1)-(5) As per example 29 except that in Note(2) the proposed dividend S for year to 31:12:46 is 10% free of tax and in note (3) Stock Reserve is to be increased to £3,000 at 31:12:46.
- (6) All dividends declared and received by the above coys are stated consistently (Gross H. T and V; Free of tax S) as between the members.

SOLUTIONSTATEMENT of T's PLANT

	<u>In Financial</u> <u>A/cs. of T.</u>	<u>In the Consolidated Statement</u> <u>(10% Depreciation)</u>	<u>Under-</u> <u>valuation</u>
Value at acquisition date 31:12:42	£ 8,500	£ 10,000	£ 1,500
Depreciation 1943		850	150
Depreciation 1944		7,650 765	1,350 135
Additions 31:12:44		6,885 1,000	1,215
Depreciation 1945		7,885 789	121
Value at 31:12:45	8,000	£ 7,096	£ 1,094 Undervaluation at 31:12:45(T.1.)
		£8,190 = Value in Consolidated Statement 31:12:45	
		Difference £904 additional depreciation required up to 31:12:45 (T.2)	
Depreciation 1946	600	710	109
	£ 7,400	£ 6,386	£ 985 Undervaluation at 31:12:46(T.1.)
		Difference £1,014 additional depreciation required up to 31:12:46 (T.2)	
		£7,371 Value in Consolidated Statement 31:12:46	

CONSOLIDATION JOURNALV's SECTION

31:12:45	Property Account.	Dr. £1,000	
(1)	To Capital Reserve.		£1,000
	(Being increase in valuation of V's Property on 30:6:42 when H acquired control of V)		
31:12:46	as above -	no change	

T's SECTION

31:12:45	Plant Account	Dr. £1,094	
(1)	To Capital Reserve.		£1,094
	(Being current increase in valuation of T's Plant i.e. increase on 31:12:42 when S acquired control of T £1,500, less depreciation at 10% p.a. to 31:12:45)		
31:12:45	Revenue Account.. . . .	£904	
(2)	To Plant Account		£904
	(Being additional depreciation required by group since 31:12:42 i.e. the excess of 10% p.a. on book value over amount written off in T's books)		
31:12:46	Plant Account	Dr. £985	
(1)	To Capital Reserve.		£985
	(Being current increase in valuation of T's Plant i.e. increase on 31:12:42 £1,500, less depreciation at 10% p.a. to 31:12:46)		
(2)	Revenue Account.. . . .	£1,014	
	To Plant Account		£1,014
	(Being additional depreciation required by group since 31:12:42 i.e. the excess of 10% p.a. on book value over the amount written off in T's books)		

S's SECTION

31:12:45	Revenue Account.. . . .	Dr. £9,000	
(1)	To Investment Account (in T).		£9,000
	(Being 3/5ths T's cr. balance on Revenue Account £15,000 at 31:12:42 - pre-acquisition - when S bought 30,000 shares (3/5ths) in T)		
(2)	Revenue Account.. . . .	Dr. £800	
	To Investment Account (in V)		£800
	(Being 1/3rd V's cr. balance on Revenue Account £2,400 at 30:6:44 - pre-acquisition - when S bought 5,000 shares (1/3rd) in V.)		
31:12:46	(1) and (2) as	(1) and (2) at 31:12:45.	

H's SECTION

31:12:45	Revenue Account.. . . .	Dr. £500	
(1)	To Stock Reserve		£500
	(Being increase in reserve required at 31:12:45 for inter-company profits on stock)		

31:12:46/

CONSOLIDATION LEDGERV's SECTIONPROPERTY ACCOUNT

						<u>Dr.</u>	<u>Cr.</u>
31.12.45	To Balance per Balance Sheet	..	..	..	..	£ 2,000	
	Increase (re-valuation)..	..	..	..	..	1,000	
	By Transferred to Consolidation Section	..	..	..			£ 3,000
31.12.46	To Balance per Balance Sheet	..	..	..	..	£ 2,000	
	Increase (re-valuation)..	..	..	..	..	1,000	
	By Transferred to Consolidation Section	..	..	..			£ 3,000

SUNDRY ASSETS ACCOUNT

31.12.45	To Balance per Balance Sheet - Plant..	..	..	..		£ 4,500	
	Stock..	..	..	..		9,000	
	Debtors	..	..	..		5,000	
	Cash in Bank	..	..	..		1,000	
	By Transferred to Consolidation Section	..	..	..			£ 4,500
	do.	do.	..	..	..		9,000
	do.	do.	..	..	..		5,000
	do.	do.	..	..	..		1,000
31.12.46	To Balance per Balance Sheet - Plant..	..	..	..		£ 4,050	
	Stock..	..	..	..		8,000	
	Debtors	..	..	..		7,000	
	Bank ..	..	..	..		950	
	By Transferred to Consolidation Section	..	..	..			£ 4,050
	do.	do.	..	..	..		8,000
	do.	do.	..	..	..		7,000
	do.	do.	..	..	..		950

INTER-GROUP INDEBTEDNESS

31.12.45	By Balance per Balance Sheet	..	..	..	..		£ 500
	To Transferred to Consolidation Section	..	..	..		£ 500	

REVENUE ACCOUNT

31.12.45	By Balance per Balance Sheet - General Reserve..	..					£ 2,000
	Profit and Loss Account						1,200
	To Transferred to Consolidation Section	..	..	..		£ 3,200	
31.12.46	By Balance per Balance Sheet - General Reserve..	..					£ 2,500
	Profit and Loss Account						1,500
	To Transferred to Consolidation Section	..	..	..		£ 4,000	

SUNDRY LIABILITIES ACCOUNT/

V's SECTION (Contd.) -SUNDRY LIABILITIES ACCOUNT

		<u>Dr.</u>	<u>Cr.</u>
31.12.45	By Balance per Balance Sheet - Share Capital		£ 15,000
	Creditors		2,800
	To Transferred to Consolidation Sec.- H 10,000 + S 5,000	£ 15,000	
	do. do.	2,800	
<hr/>			
31.12.46	By Balance per Balance Sheet - Share Capital		£ 15,000
	Creditors		3,000
	To Transferred to Consolidation Sec.-H 10,000 + S 5,000	£ 15,000	
	do. do.	3,000	
<hr/>			

CAPITAL RESERVE ACCOUNT

31.12.45	By Increase in value of Property		J £ 1,000
	To Transferred to Consolidation Section - S 333 + H 667	£ 1,000	
<hr/>			
31.12.46	By Increase in value of Property		J£ 1,000
	To Transferred to Consolidation Section - S 333 + H 667	£ 1,000	
<hr/>			

T's SECTIONPLANT ACCOUNT

31.12.45	To Balance per Balance Sheet	£ 8,000	
	Current Increase (re-valuation)	J 1,094	
	By Additional Depreciation written off		J£ 904
	Transferred to Consolidation Section		8,190
<hr/>			
31.12.46	To Balance per Balance Sheet	£ 7,400	
	Current Increase (re-valuation)	J 985	
	By Additional Depreciation written off		J£ 1,014
	Transferred to Consolidation Section		7,371
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SUNDRY ASSETS ACCOUNT

31.12.45	To Balance per Balance Sheet - Property	£ 30,000	
	Investment.. ..	1,000	
	Stock	14,000	
	Debtors	8,700	
	Cash in Bank	500	
	Goodwill	7,000	
	By Transferred to Consolidation Section		£ 30,000
	do. do.		1,000
	do. do.		14,000
	do. do.		8,700
	do. do.		500
	do. do.		7,000
<hr/>			

31.12.46/

T's SECTION (Continued) -

SUNDRY ASSETS ACCOUNT (Contd.) -

	<u>Dr.</u>	<u>Cr.</u>
31.12.46 To Balance per Balance Sheet - Property	£ 30,000	
Investment.. .. .	1,000	
Stock.. .. .	16,000	
Debtors	8,000	
Cash in Bank	600	
Goodwill	7,000	
By Transferred to Consolidation Section		£ 30,000
do. do. do. do. do. do. do. do. do. do. do. do. do. do. do.		1,000
		16,000
		8,000
		600
		7,000

INTER-GROUP INDEBTEDNESS

31.12.45 By Balance per Balance Sheet		£ 2,200
To Balance per Balance Sheet	£ 500	
Transferred to Consolidation Section	1,700	
31.12.46 By Balance per Balance Sheet		£ 2,000
To Transferred to Consolidation Section	£ 2,000	

SUNDRY LIABILITIES ACCOUNT

31.12.45 By Balance per Balance Sheet - Share Capital		£ 50,000
Creditors		7,500
To Transferred to Consolidation Section - H.	£ 7,000	
do. do. S.	30,000	
do. do. Minority Interests	13,000	
do. do.	7,500	
31.12.46 By Balance per Balance Sheet - Share Capital		£ 50,000
Creditors		7,000
To Transferred to Consolidation Section - H.	£ 7,000	
do. do. S.	30,000	
do. do. M.I.	13,000	
do. do.	7,000	

REVENUE ACCOUNT

31.12.45 By Balance per Balance Sheet - General Reserve.. .. .		£ 7,000
Profit and Loss Account		3,000
To Depreciation on Plant	J£ 904	
Transferred to Consolidation Section	9,096	
31.12.46 By Balance per Balance Sheet - General Reserve.. .. .		£ 7,000
Profit and Loss Account		4,000
To Depreciation on Plant	J£ 1,014	
Transferred to Consolidation Section	9,986	

CAPITAL RESERVE ACCOUNT/

T's SECTION (Contd.) -CAPITAL RESERVE ACCOUNT

		<u>Dr.</u>	<u>Cr.</u>
31.12.45	By Increase in value of Plant		J£ 1,094
	To Transferred to Consolidation Section - S.	£ 656	
		H.	153
		M.I... ..	285
		<u>£ 1,094</u>	<u>£ 1,094</u>
31.12.46	By Increase in value of Plant		J£ 985
	To Transferred to Consolidation Section - S.	£ 591	
		H.	138
		M.I... ..	256
		<u>£ 985</u>	<u>£ 985</u>

S's SECTIONSUNDRY ASSETS ACCOUNT

31.12.45	To Balance per Balance Sheet - Plant.. .. .	£ 20,000	
		Stock.. .. .	40,000
		Debtors	10,400
		Cash in Bank	100
		Goodwill	10,000
	By Transferred to Consolidation Section		£ 20,000
	do. do.		40,000
	do. do.		10,400
	do. do.		100
	do. do.		10,000
31.12.46	To Balance per Balance Sheet - Plant.. .. .	£ 18,000	
		Stock.. .. .	41,000
		Debtors	15,000
		Cash in Bank	200
		Goodwill	10,000
	By Transferred to Consolidation Section		£ 18,000
	do. do.		41,000
	do. do.		15,000
	do. do.		200
	do. do.		10,000

INVESTMENT in SUBSIDIARY

31.12.45	To Balance per Balance Sheet - 30,000 Shares in T. ..	£ 38,000	
	do. do. - 5,000 Shares in V. ..	6,500	
	By Revenue Account - pre-acquisition balance		J£ 9,000
	Transferred to Consolidation Section (In T).. ..		29,000
	Revenue Account - pre-acquisition balance		J 800
	Transferred to Consolidation Section (In V).. ..		5,700
31.12.46	As above - no change.		

INTER-GROUP INDEBTEDNESS/

S's SECTION (Contd.) -INTER-GROUP INDEBTEDNESS

	<u>Dr.</u>	<u>Cr.</u>
31.12.45 By Balance per Balance Sheet		£ 4,300
To Transferred to Consolidation Section	£ 4,300	
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31.12.46 By Balance per Balance Sheet		£ 5,000
To Transferred to Consolidation Section	£ 5,000	
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SUNDRY LIABILITIES

31.12.45 By Balance per Balance Sheet - Share Capital		£100,000
Creditors		10,700
Proposed Dividends		7,500
To Transferred to Consolidation Section - H.	£ 60,000	
do. do. - Minority Ints.	40,000	
do. do.	10,700	
do. do.	7,500	
<hr/>		
31.12.46 By Balance per Balance Sheet - Share Capital		£100,000
Creditors		12,000
Proposed dividends		10,000
To Transferred to Consolidation Section - H.	£ 60,000	
do. do. - Minority Ints.	40,000	
do. do.	12,000	
do. do.	10,000	
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REVENUE ACCOUNT

31.12.45 By Balance per Balance Sheet and Profit and Loss Account		£ 2,500
Transferred to Consolidation Section		7,300
To Investment Account - pre-acquisition balance written off		
In T... .. J£	9,000	
In V... .. J	800	
<hr/>		
31.12.46 By Balance per Balance Sheet and Profit and Loss Account		£ 1,700
Transferred to Consolidation Section		8,100
To Investment Account - pre-acquisition balance written off		
In T... .. J£	9,000	
In V... .. J	800	
<hr/>		

H.'s SECTIONSUNDRY ASSETS ACCOUNT

31.12.45 To Balance per Balance Sheet - Property		£251,000
Plant.. .. .		130,000
Stock.. .. .		178,000
Debtors		56,000
Dividends receivable.. .. .		4,500
Cash		9,000
By Transferred to Consolidation Section		£251,000
do. do.		130,000
do. do.		178,000
do. do.		56,000
do. do.		4,500
do. do.		9,000
<hr/>		
31.12.46/		

H's SECTION (Contd.) -

SUNDRY ASSETS ACCOUNT (Contd.) -

	<u>Dr.</u>	<u>Cr.</u>
31.12.46 To Balance per Balance Sheet - Property	£251,000	
Plant.. .. .	120,000	
Stock.. .. .	180,000	
Debtors	60,000	
Dividends receivable.. .. .	6,000	
Cash in Bank	10,000	
By Transferred to Consolidation Section		£251,000
do. do.		120,000
do. do.		180,000
do. do.		60,000
do. do.		6,000
do. do.		10,000

INVESTMENT in SUBSIDIARIES

31.12.45 To Balance per Balance Sheet - 60,000 Shares in S ..	£ 62,000	
7,000 Shares in T ..	8,000	
10,000 Shares in V. ..	12,000	
By Transferred to Consolidation Section		£ 62,000
do. do.		8,000
do. do.		12,000

31.12.46 As above - no change.

INTER-GROUP INDEBTEDNESS

31.12.45 To Balance per Balance Sheet	£ 6,500	
By Transferred to Consolidation Section		£ 6,500
31.12.46 To Balance per Balance Sheet	£ 7,000	
By Transferred to Consolidation Section		£ 7,000

STOCK RESERVE ACCOUNT

31.12.45 By Balance per Balance Sheet		£ 2,000
Revenue Account increase in reserve		J 500
To Transferred to Consolidation Section	£ 2,500	
31.12.46 By Balance per Balance Sheet		£ 2,300
Revenue Account increase in reserve		J 700
To Transferred to Consolidation Section	£ 3,000	

REVENUE ACCOUNT

31.12.45 By Balance per Balance Sheet - General Reserve.. ..		£100,000
Profit and Loss Account		52,500
To Stock Reserve Account (increase)	£ 500	
Transferred to Consolidation Section	152,000	
31.12.46 By Balance per Balance Sheet - General Reserve.. ..		£110,000
Profit and Loss Account		38,700
To Stock Reserve Account (increase)	£ 700	
Transferred to Consolidation Section	148,000	

SUNDRY LIABILITIES/

AGGREGATION and CONSOLIDATED SECTION (Contd.) -SUNDRY DEBTORS ACCOUNT

											<u>Dr.</u>	<u>Cr.</u>
31.12.45	To V.	..	..	..	..	..	..	..	..	..	£ 5,000	
	T.	..	..	..	..	..	..	..	..	..	8,700	
	S.	..	..	..	..	..	..	..	..	..	10,400	
	H.	..	..	..	..	..	..	..	..	..	56,000	
	By Transferred to Consolidated Statement	..	..	..	..	..	..	..	..	..		£ 80,100
31.12.46	To V.	..	..	..	..	..	..	..	..	..	£ 7,000	
	T.	..	..	..	..	..	..	..	..	..	8,000	
	S.	..	..	..	..	..	..	..	..	..	15,000	
	H.	..	..	..	..	..	..	..	..	..	60,000	
	By Transferred to Consolidated Statement	..	..	..	..	..	..	..	..	..		£ 90,000

INTER-GROUP INDEBTEDNESS

31.12.45	By V.	..	..	..	..	..	..	..	..	..		£ 500
	T.	..	..	..	..	..	..	..	..	..		1,700
	S.	..	..	..	..	..	..	..	..	..		4,300
	To H.	..	..	..	..	..	..	..	..	..	£ 6,500	
31.12.46	By T.	..	..	..	..	..	..	..	..	..		£2,000
	S.	..	..	..	..	..	..	..	..	..		5,000
	To H.	..	..	..	..	..	..	..	..	..	£ 7,000	

INVESTMENTS (Government Securities)

31.12.45	To T.	..	..	..	..	..	..	..	..	..	£ 1,000	
	By Transferred to Consolidated Statement	..	..	..	..	..	..	..	..	..		£ 1,000
31.12.46	As above - no change.											

CASH in BANK ACCOUNT

31.12.45	To V.	..	..	..	..	..	..	..	..	..	£ 1,000	
	T.	..	..	..	..	..	..	..	..	..	500	
	S.	..	..	..	..	..	..	..	..	..	100	
	H.	..	..	..	..	..	..	..	..	..	9,000	
	By Transferred to Consolidated Statement	..	..	..	..	..	..	..	..	..		£ 10,600
31.12.46	To V.	..	..	..	..	..	..	..	..	..	£ 950	
	T.	..	..	..	..	..	..	..	..	..	600	
	S.	..	..	..	..	..	..	..	..	..	200	
	H.	..	..	..	..	..	..	..	..	..	10,000	
	By Transferred to Consolidated Statement	..	..	..	..	..	..	..	..	..		£ 11,750

GOODWILL per BALANCE SHEET

31.12.45	To T.	..	..	..	..	..	..	..	..	..	£ 7,000	
	S.	..	..	..	..	..	..	..	..	..	10,000	
	By Transferred to Consolidated Statement	..	..	..	..	..	..	..	..	..		£ 17,000
31.12.46	As above - no change.											

SUNDRY CREDITORS/

AGGREGATION and CONSOLIDATION SECTION (Contd.) -SUNDRY CREDITORS

		<u>Dr.</u>	<u>Cr.</u>
31.12.45	By V.		£ 2,800
	T.		7,500
	S.		10,700
	H.		62,500
	To Transferred to Consolidated Statement	£ 83,500	
31.12.46	By V.		£ 3,000
	T.		7,000
	S.		12,000
	H.		65,000
	To Transferred to Consolidated Statement	£ 87,000	

PROPOSED DIVIDENDS

31.12.45	By S.		£ 7,500
	To H. (receivable from S.)	£ 4,500	
	Transferred to Minority Interest (4/10ths)	3,000	
31.12.46	By S.		£ 10,000
	To H.	£ 6,000	
	Transferred to Minority Interest (4/10ths)	4,000	

NET COST of CONTROL - As at 31.12.45(a) BY S.

By Share of T's Capital Reserve (3/5ths)		£ 656
Par Value (Share Capital Accounts T.)		30,000
Share of V's Capital Reserve (1/3rd)		333
Par Value (Share Capital Account V.)		5,000
To 30,000 Shares held in T. 3/5ths (at adjusted cost)	£ 29,000	
5,000 Shares held in V. 1/3rd (at adjusted cost)	5,700	
Balance carried down	1,289	
	£ 35,989	£ 35,989
By Balance brought down		£ 1,289
To Transferred to - Minority Interest S. 4/10ths	£ 516	
H. 6/10ths	773	

(b) BY H.

To 60,000 Shares held in S. 6/10ths (at adjusted cost)	£ 62,000	
7,000 Shares held at T. 7/50ths (at adjusted cost)	8,000	
10,000 Shares held in V. 2/3rds (at adjusted cost)	12,000	
By Par Value (Share Capital Account S.)		£ 60,000
Par Value (Share Capital Account T.)		7,000
Share of T's Capital Reserve 7/50ths		153
Par Value (Share Capital Account V.)		10,000
Share of V's Capital Reserve (2/3rds)		667
Balance carried down		4,180
	£ 82,000	£ 82,000

To Balance/

AGGREGATION and CONSOLIDATION SECTION (Contd.) -

NET COST of CONTROL - as at 31.12.45 (Contd.) -

		(b) <u>H.</u> (contd.)		<u>Dr.</u>	<u>Cr.</u>
To Balance brought down	£ 4,180	
By H's share of S's Net Cost of Control (Cr. Balance)		£ 773
Balance transferred to Consolidated Statement		<u>3,407</u>
<u>As at 31.12.46</u>					
		(a) <u>BY S.</u>			
By Share of T's Capital Reserve 3/5ths		£ 591
Par Value (Share Capital Account T.)		30,000
Share of V's Capital Reserve 1/3rd		333
Par Value		5,000
To 30,000 Shares held in T. (3/5ths) at adjusted cost	£ 29,000	
5,000 Shares held in V. (1/3rd) at adjusted cost	5,700	
Balance carried down	1,224	
				<u>£ 35,924</u>	<u>£ 35,924</u>
By Balance brought down		£ 1,224
To Transferred to Minority Interest S. 4/10ths	£ 490	
H. 6/10ths	734	

		(b) <u>BY H.</u>			
To 60,000 Shares held in S. 6/10ths at adjusted cost..	£ 62,000	
7,000 Shares held in T. 7/50ths at adjusted cost..	8,000	
10,000 Shares held in V. 2/3rds at adjusted cost..	12,000	
By Par Value Share Capital Account S.		£ 60,000
Par Value Share Capital Account T.		7,000
Share of T's Capital Reserve		138
Par Value Share Capital Account V.		10,000
Share of V's Capital Reserve		667
Balance carried down		<u>4,195</u>
				<u>£ 82,000</u>	<u>£ 82,000</u>
To Balance brought down	£ 4,195	
By Share of S's Net Cost of Control (Cr. balance)		£ 734
Balance transferred to Consolidated Statement		<u>3,461</u>

REVENUE ACCOUNT - Year to 31.12.45

		(a) <u>V.</u>			
By Transferred from V's Section		£ 3,200
To Transferred to S. 1/3rd	£ 1,067	
Transferred to H. 2/3rds	2,133	
(b) <u>T.</u>					
By Transferred from T's Section		£ 9,096
To Transferred to S. 3/5ths..	£ 5,458	
H. 7/50ths	1,273	
Minority Interest T. 13/50ths..	2,365	

(c)/

AGGREGATION and CONSOLIDATION SECTION (Contd.) -

REVENUE ACCOUNT - Year to 31.12.45 - (Contd.) -

	(c)	<u>S.</u>						<u>Dr.</u>	<u>Cr.</u>
To Transferred from S's Section (Dr. balance)	£ 7,300	
By Transferred from V. above 1/3rd		£ 1,067
Transferred from T. above 3/5ths		5,458
<u>Balance is divisible:</u>									
H. 6/10ths	£ 465	
Minority Interest S. 4/10ths	<u>310</u>	<u>775</u>

	(d)	<u>H.</u>							
To Transferred from S. above (dr. balance) (6/10ths)	£ 465	
Balance transferred to Consolidated Statement	154,941	
By Transferred from H's Section		£152,000
Transferred from V. above (2/3rds)		2,133
T. above (7/50ths)		<u>1,273</u>
								<u>£155,406</u>	<u>£155,406</u>

Year to 31.12.46

	(a)	<u>V.</u>							
By Transferred from V's Section		£ 4,000
To Transferred to S. 1/3rd	£ 1,333	
H. 2/3rd	<u>2,667</u>	

	(b)	<u>T.</u>							
By Transferred from T's Section		£ 9,986
To Transferred to S. 3/5ths	£ 5,992	
H. 7/50ths	1,398	
M.I. T. 13/50ths	<u>2,596</u>	

	(c)	<u>S.</u>							
To Transferred from S's Section (Dr. balance)	£ 8,100	
By Transferred from V. above 1/3rd		£ 1,333
T. above 3/5ths		<u>5,992</u>
<u>Balance divisible:</u>									
H. 6/10ths	£ 465	
M.I. S. 4/10ths	<u>310</u>	<u>775</u>

	(d)	<u>H.</u>							
By Transferred from H's Section		£148,000
V. above 2/3rds		2,667
T. above 7/50ths		<u>1,398</u>
To Transferred from S. above 6/10ths (Dr. balance)	£ 465	
Balance transferred to Consolidated Statement	<u>151,600</u>	

MINORITY INTERESTS/

AGGREGATION and CONSOLIDATION SECTION (Contd.) -MINORITY INTERESTS as at 31.12.45

						<u>Dr.</u>	<u>Cr.</u>
(a) <u>T. 13/50ths</u>							
To	Transferred to Consolidated Statement	..	..	..	..	£ 15,650	
By	Transferred from T's Share Capital..	..	..	..	..		£ 13,000
	Transferred from T's Capital Reserve	..	..	..	..		285
	Transferred from T's Revenue Account	..	..	..	..		2,365
(b) <u>S. 4/10ths</u>							
By	Transferred from S's Share Capital..	..	..	..	..		£ 40,000
	Transferred from Net Cost of Control (Cr. balance)	..	..	..	..		516
	Transferred from Proposed Dividends	..	..	..	..		3,000
To	Transferred from Revenue Account (Dr. balance)	..	..	..	..	£ 310	
	Transferred to Consolidated Statement	..	..	..	..	43,206	
						£ 43,516	£ 43,516

As at 31.12.46

(a) <u>T. 13/50ths</u>							
By	Transferred from T's Share Capital	..	..	..	..		£ 13,000
	Transferred from T's Capital Reserve	..	..	..	..		256
	Transferred from T's Revenue Account	..	..	..	..		2,596
To	Transferred to Consolidated Statement	..	..	..	..	£ 15,852	
(b) <u>S. 4/10ths</u>							
By	Transferred from S's Share Capital..	..	..	..	..		£ 40,000
	Net Cost on Control (Cr. balance)..	..	..	..	..		490
	Proposed Dividends..	..	..	..	..		4,000
To	Transferred from S's Revenue Account (Dr. balance)	..	..	..	..	£ 310	
	Transferred to Consolidated Statement	..	..	..	..	44,180	
						£ 44,490	£ 44,490

SHARE CAPITAL ACCOUNT

31.12.45	By	Transferred from H.	..	..	..	..	£500,000
	To	Transferred to Consolidated Statement	..	..	..	..	£500,000
31.12.46	As above - no change.							

Appendix III

Summary of full procedure of Consolidation.

Apart from the special treatment of the Net Cost of Control of a sub-subsidiary and of the pre-acquisition revenue balance of a subsidiary which holds shares in a sub-subsidiary, the Consolidated Statements of a group which includes a sub-subsidiary, are prepared by the application of the principles as used in the case of a simple group. In order that the reader may orientate his thoughts on the whole subject at this point, a summary of the full recommended procedure is given.

Summary of full procedure

(a) Adjustments to be made in each member's legal Balance Sheet.

Note: Members should be dealt with in a convenient order, which will be found to be according to acquisition dates. The accounts of the 1st member purchased should be adjusted in the first place, followed by the adjustment of the accounts of the 2nd member purchased and so on.

- (1) The items included under the various headings of each member's Balance Sheet should be examined and figures transferred and headings altered so that all accounts are stated on a uniform basis. Thus, like will be added to like, when the adjusted Balance Sheets are aggregated.
- (2) The Profit and Loss Account and General Reserve balances should be slumped under the heading "Revenue Account".
- (3) All Preference dividends due to date should be accrued (less tax, of course). Where any Preference Shares are held by other members, the amount receivable should be accrued and will form a contra item.

Contra Items.

- (4) Amounts due to or by other members, which items may be included in the legal Balance Sheet under Debtors, Creditors, Loans, Bills Receivable or Payable, Dividends outstanding, etc., should be shown under separate headings. Such amounts should be agreed with those shown by other members.

(5) Where Preference and/or Ordinary Dividends receivable from or payable to other members, are accrued in either Balance Sheet, adjustment should be made so that the treatment is consistent in all adjusted Balance Sheets. This is carried out either by the writing back of all accruals or by the accruing of the dividends where necessary; the latter method should be adopted for Preference Dividends so that the adjusted Revenue Account balance invariably represents a balance which falls ~~entirely~~ to Ordinary shareholders only. The figures for accrued dividend should be stated in the adjusted Balance Sheet either all gross without deduction of tax, or all net.

Adjustment of Assets.

(6) Where fixed assets are re-valued by a member when acquiring control, the assets should be written up or written down in the Balance Sheet of the member which owns the assets; the corresponding entry is a credit or debit to a Capital Reserve Account. It is immaterial whether this adjustment results in a net credit or net debit balance on Capital Reserve Account. The balance on Capital Reserve Account appears in the adjusted Balance Sheet and is dealt with at a later stage. The amount of the adjustment is the current over or under-valuation (called the valuation difference) at the date of the Consolidated Statement. This applies to wasting assets. The current valuation difference will be the original difference at acquisition date less depreciation to date at the rate written off by the group on the relative asset.

(7) Depreciation adjustments necessary owing to inadequate or excessive depreciation written off in the books of a member should be adjusted by a debit or credit to Revenue Account of the member which owns the asset. (Depreciation on the valuation difference /

difference under (6) above, is not adjusted in the Revenue Account. It is dealt with by taking the current valuation difference at the date of the Consolidated Statement as mentioned under (6) above. The amount of the consolidation adjusting entry will therefore decrease each year).

- (8) Where floating assets are re-valued by a member when acquiring control, no adjustment should be made during the process of consolidation except in the one case where at acquisition date there is an under-valuation which has since been corrected in the financial books of the subsidiary by an increase of profits. In this case the holding company's account should be adjusted by a debit to Revenue Account and a credit to "Investment in subsidiary" by the amount of the under-valuation.
- (9) Unrealised profit on stock from the group's viewpoint, sold by one member and on hand at Balance Sheet date to the purchasing member, should be provided for by the creation of a stock reserve by the holding company and a corresponding debit to the Reserve Account of the holding company, unless the rights of Minority Interests may be affected ^{in which case} ~~where~~ profit requires to be written off in total in the particular subsidiary's accounts.
- (10) Investments in other members, irrespective of the size of the holding, should be adjusted consistently throughout to what has been called "Adjusted Cost" which is cost price adjusted for the relative proportion of all pre-acquisition revenue balances. The corresponding entry is a debit (pre-acquisition profits) or a credit (pre-acquisition losses) to the Revenue Account of the member holding the shares.

Where shares have been written down in value by appropriations from a member's own profits, the shares should be written up so as to /

to appear at "Adjusted Cost". The corresponding entry is a credit to Special Reserve Account.

(b) Aggregation of the Adjusted Balance Sheets.

The Balance Sheets as adjusted (1 - 10 above) should be stated in columnar form and each balanced. After the cancellation of the contra items, the Balance Sheets should be aggregated. Additional headings such as "Cash (or Goods) in Transit" may be required. The question of whether the members are fully or partly owned is ignored in this aggregation.

(c) Compilation of the Consolidated Statement from the Aggregation of Adjusted Balance Sheets.

The adjustments carried out at this stage are (a) to give the Minority Interests their share of any subsidiary or sub-subsidiary and (b) to set off the "Adjusted Cost" of shareholdings against par value and so arrive at the Net Cost of Control to the group.

(a) Minority Interests. / ^{M.I.} (1) Share Capital. The Share Capital held by outside shareholders in each company is transferred to Minority Interests.

(2) Capital Reserve. The Minority Interests of each member with a Capital Reserve, should be allocated their share of any debit or credit balance on Capital Reserve and the balance transferred to the member entitled thereto by the writing up (debit balance on Capital Reserve) or writing down (credit balance on Capital Reserve) of the "Adjusted Cost" of the shares held.

(3) Revenue Account. The Minority Interests of each member should be allotted their proportion of the member's adjusted Revenue Account balance after taking into account the share of any other member's adjusted Revenue Account, falling to that member (e.g. when a subsidiary holds shares in a sub-subsidiary).

(4) Net Cost of Control. The Minority Interests of a subsidiary which holds shares in another member, are allocated their share of the Net Cost of Control of that other member (see below).

(b) Net /

- (b) Net Cost of Control to the group. The value of shares held in other members by each member, as already adjusted for pre-acquisition revenue balances (A.10 above) and Capital Reserve (C.2 above) is set off against par value in each case; the difference, Net Cost of Control by each member, is shared where necessary with the Minority Interests of the member which holds the shares. The balance of the Net Cost of Control of each member to the holding company gives in the aggregate the Net Cost of Control to the group. In the Consolidated Statement this is shown as Goodwill, if a debit balance, and as Capital Reserve, if a credit balance.

After these adjustments the only Share Capital not dealt with is that of the principal holding company. This is the group's Share Capital in the Consolidated Statement. The other figures in the Consolidated Statement are taken direct from the aggregation.

Thus the draft Consolidated Statement is arrived at. One further later adjustment is to split the Revenue Account between General Reserve and Profit and Loss Account according to the wishes of the controllers of the group. Depreciation adjustments debited to Revenue Account should be charged to General Reserve, while those credited to Revenue Account should be shown under "Special Reserve created from depreciation written off in the financial books by members in excess of group requirements."

It might be well to emphasize the features of a Consolidated Statement prepared according to the above principles.

- (1) Revenue Account, (Profit and Loss Account, General and Special Reserve).

This represents the undistributed profits of the holding company together with the relative proportions of those of subsidiaries and sub-subsidiaries, since the acquisition dates only.

- (2) Minority Interests.

This is the share of the Net Assets in the adjusted Balance Sheets of the subsidiary or sub-subsidiary which belong to members outside the group. The figure includes Goodwill only in so far as it appears as an asset in the Balance Sheet of the member - all "hidden" Goodwill of subsidiaries and sub-subsidiaries is excluded. On the other hand where assets /

assets such as Property, Plant, etc., have been re-valued, these re-valuation figures appear in the Adjusted Balance Sheets and the Minority Interests are affected.

(3) Net Cost of Control to the group.

This is the actual cost to the group of "hidden" Goodwill or "Badwill" of all subsidiaries. It is the excess of the purchase price of the shares, as adjusted for asset re-valuation, and pre-acquisition revenue balances, over par value in so far as the burden falls on the group, i. e. only to the extent that the shares in subsidiaries and sub-subsidiaries have been effectively acquired.