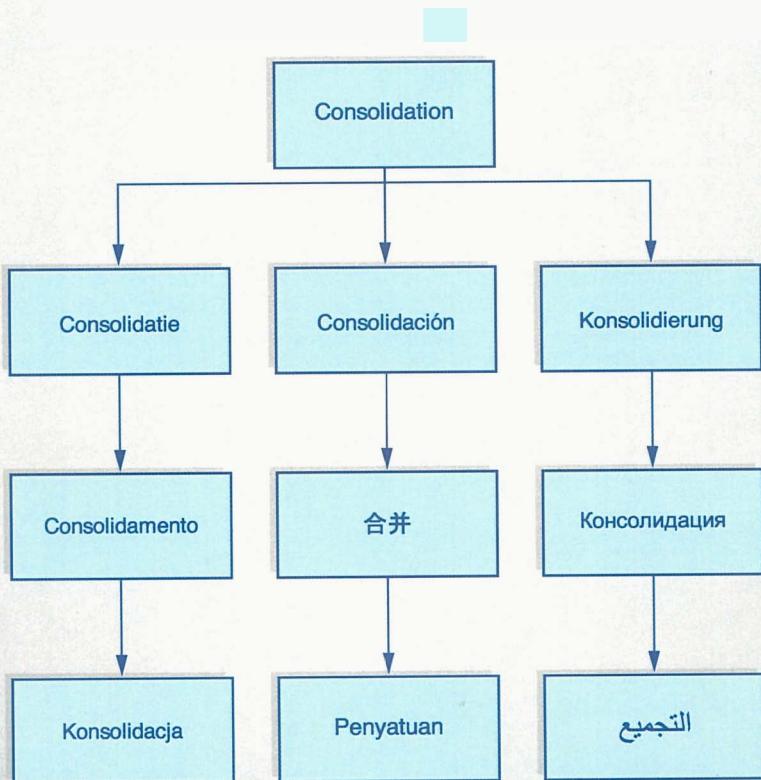


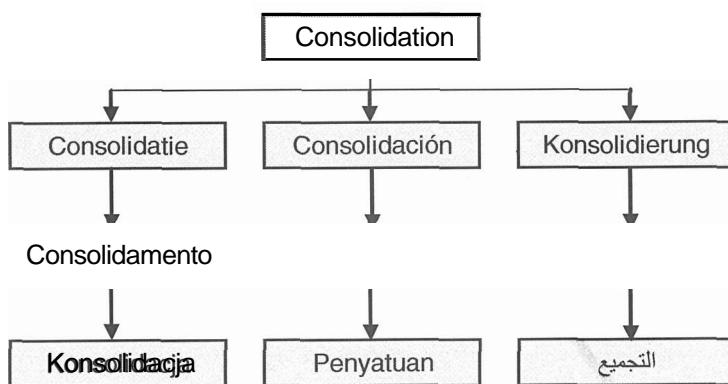
DIRECT CONSOLIDATION

Consolidate your expertise



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Consolidate Your Expertise



ALLEN WHITE



First published 2016

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ISBN 978 - 99959 - 0 - 210 - 0

It is a pleasure for me to thank the teams of consolidators of a significant number of groups with whom I had a close collaboration which allowed me to bring the necessary methodology to a difficult technique.

The author

BART 1

ONCE UPON A TIME

... THE

CONSOLIDATION

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This introduction takes a look at consolidation over the past decades. It includes some anecdotes which marked the pioneering adventure of the first groups.

Our look at the past reveals an extraordinary evolution, primarily resulting from information technology and the culture of groups rather than from consolidation accounting principles themselves.

We conclude our overview with an attempt to imagine how consolidation and the environment in which it is carried out may continue to change in the future.

Why consolidate accounts?

History shows that by the end of the 19th century companies, primarily established in the United States, were organising in groups. They were called conglomerates at the time.

It soon became apparent how difficult it was to get an economic and financial picture of these groups of companies as a single entity. This was the difficulty faced by the financial world at the time.

Many questions arose as to how to handle, interpret and even obtain information given:

- The diverse activities of the companies
- The variety of currencies used by the countries where they were located
- The level of control or absence of control over the companies
- The range of accounting rules applied to individual accounts
- The many transactions between the companies which partially hid their actual performance outside the group.

In other words, rules soon became necessary.

1 The slow evolution of consolidation requirements

While the first holding companies, true economic conglomerates present in the international sphere, were already appearing in the second half of the 19th century, it took until 1904 for consolidated accounts to be put on the

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agenda of the first international accounting congress. Publications on the topic first appeared in the United States in 1918.

It took Europe much longer to become aware of the usefulness of these publications. Great Britain took the lead over other European countries and issued rules for consolidated account publication in 1939, but only made them compulsory much later with a 'Companies Act' in 1948.

In France, despite studies and some concrete proposals from 1954 on, a first decree was issued in 1967 which, however, only provided for the possibility of attaching consolidated accounts to the ordinary accounts of holding companies.

It wouldn't be right to leave out the international actions organised in parallel with these converging national rules, particularly in the 1970s. We should note that:

- In 1973, the International Accounting Standards Committee (IASC), representing the main accounting organisations of a large number of countries, issued Standard number 3 which stated that a parent company must publish consolidated accounts.
- The United Nations, within a commission of international companies founded in 1974, expressed its wish to see the ordinary accounts of large groups completed by consolidated accounts.
- And, lastly, in 1976, the OECD (Organisation for Economic Cooperation and Development) issued recommendations on the publication of consolidated information as part of its declaration on international investments and multinational companies.

However, it took until June 13, 1983 for the 7th European Directive on consolidated accounts to appear, which asked for its implementation in all Member States before January 1st, 1988 and to publish consolidated accounts applicable, however, to the fiscal period beginning after January 1st, 1990.

This was the legislative framework in which the first consolidations were done.

1.1 The 1970s: The pencil and eraser age

If a historian had to describe the consolidations done by the pioneering holding companies which chose to publish their consolidated accounts at the end of the 1960s, they would refer to it as the pencil and eraser age.

Personal computers didn't exist and spreadsheets were unheard of. Consolidation principles were not yet sufficiently well mastered to give rise to specialised software.

At most, some consolidators used accounting programs (no one talked about software at the time and even less about software packages) in which they piled company accounts as long entries of asset debits to liabilities credits and, when they were able to, via a screen. At the time, punch cards were still very much used as a data entry medium.

Office calculators were an indispensable tool both for currency exchanges (the euro didn't exist yet!) and for establishing all of the elimination entries.

It's easy to see why, with these types of tools, the production of consolidated accounts and notes to the accounts could only be done on a very flexible schedule, especially if the extent of the group's perimeter rendered it somewhat complex.

Some readers will maybe remember that, at the time, there were already some "groups of groups" among the many quite large groups. They were real economic octopi present internationally and in nearly every business area.

These "super groups" are worth spending a little time on, and one in particular, for which we had the extraordinary opportunity to develop a consolidation system.

It consisted of nearly 2000 companies, split into about 20 subgroups. The latter were in turn treated as holdings because they were sometimes listed on several stock exchanges and, therefore, required to publish consolidated accounts before the parent company to which they reported.

How did this "super group" proceed?

The consolidator at the time used large format, pre-printed sheets of paper with columns like today's spreadsheets.

The accounts of the sub-groups appeared in successive columns and were followed by adjustments and eliminations. Of course, each sub-group had previously done its own consolidation in its own way.

Any errors or late amount changes required the use of an eraser and a significant amount of time for recalculations. At the end of the consolidation, its complexity was measured by the number of pencils and erasers used.

As for the schedule, the group published its consolidated accounts in October of the following year.

One cultural point should be noted: most annual reports at this time first presented the parent company's statutory accounts and the consolidated accounts appeared in the last pages of the appendix.

This presentation underscored their perceived importance at the time.

In fact, a very small audience among board members, banks and financial analysts could boast of fully understanding the contents of the amalgamated figures whose real usefulness was often questioned.

1.2 The 1980s: The beginnings of the computer age

The inconvenience of consolidation work and the late schedule couldn't remain in place for long. There were still no personal computers at the beginning of the 1980s, but some computer companies, forerunners of future software vendors, took on the challenge and began to provide solutions.

The largest groups quickly showed an interest in the new software. It isn't hard to understand why! One software company came to the forefront in France in the early 1980s with its consolidation software.

Two functions stood out. On one hand, its concept of modularity covered the current "Segment Information" required by IFRS standards when a group is active in different fields. On the other, the innovative software ran on a Singer mini-computer, the well-known sewing machine manufacturer of the time...

While the functionality of this consolidation software quickly won over large groups, technical support was a major concern. It wasn't long before the software was completely rewritten in COBOL to run on an IBM 370 mainframe at service bureaus.

This was a significant step forward for the groups at the time.

They now had software that handled all of the calculations inherent to consolidation. What is more, it was possible to enter adjustments online via terminals. So everything was perfect?

Not really.

The working method of service bureaus at the time consisted in collecting information during the day, processing it at night and sending the printed reports early the following day by taxi or courier.

In practice, a last adjustment sent at 10 AM had to wait for the arrival of several kilos of paper (listings) the next morning in which the consolidator

sometimes noticed that the debits and credits for an adjustment had to be inverted!

It wasn't until 1985 that the first consolidation software for the Personal Computers made its appearance. This was a real gamble given that the PC XT had 64 K of RAM and used 360 Kb diskettes. It was quickly followed by the PC AT with the first hard drive (30 Mb).

They were incredibly more powerful!

The software of this decade already included the concept of flows. Traditional currency conversions and eliminations were handled correctly. However, functionalities to easily document consolidated shareholders' equity and the cash flow statement had obvious shortcomings or were missing altogether. It should be noted that the learning curve was far from being met at the time and many Auditors had to finish the technical work themselves.

One other significant shortcoming was the lack of a consolidation bundle integrated with the software. The technology available didn't allow for it yet and groups created paper bundles which they sent to their companies. The bundles were often close to a hundred pages long.

Their use was inconvenient in several ways.

First, the large documents weren't personalised with the figures of each company, making justification of the figures sent for the previous consolidation somewhat precarious.

Next, if entries were made by hand, the inclusion of the items in the consolidation software also required manual entry.

Lastly, the intrinsic inconsistencies between the bundle tables weren't detected at source, but only much too late at the consolidating company level, without any real possibility of getting a quick correction. Email exchanges were not yet available.

While consolidation software was a great improvement over pencil and eraser, poor data quality and drawn-out schedules were challenges for the following years.

3 The 1990s: The search for a miracle solution

In the majority of European Community member states, the start of this decade coincided with the requirement for groups of a certain size to produce

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consolidated accounts. This was a major cultural shock for many which were very ill-prepared to meet this requirement.

Why?

Many of the groups discovered that they were groups; they had been used to thinking company by company, ignoring the less important ones and not always including all of their transactions.

Consolidation is rooted in each and every held company, regardless of where it is located in the world. There are so many organisational issues, appeals to authority, rules to be communicated.

The scouring effects of consolidation also disturbed many of these secretive groups: intra-group results are eliminated, dividends are eliminated, intercompany turnover is eliminated...

What remains of the accounts?

Then, the groups, which had very complex structures, often for tax purposes, became aware of the transparency the technique gradually resulted in.

In addition, the requirement involved new costs for specialised staff, software, account approvals by Auditors and closer supervision of the companies in the perimeter.

This was the state of mind with which many groups set out on this new adventure.

During the first years of the decade, a dozen consolidation software companies were competing in this niche market. The number of groups responding to the consolidation requirement was limited but highly concentrated geographically.

This highly competitive environment quickly led to the development of the functionality missing in the software, particularly a decentralised consolidation bundle, consisting of software and data that could be sent to the companies of the perimeter.

It should be noticed, however, that at the beginning of the decade there was no email and information exchange between companies was done via telecommunications lines (modem) and, more often, by courier.

What was being exchanged? Essentially, 1.4Mb floppies in an envelope!

One anecdote we remember is about a company that had carefully sealed an envelope with staples before sending it. The staples went right through the diskette!

More seriously, however, two events had a significant impact on the second half of the decade.

The first was technological. It confirmed the definitive advent of Windows, the internet and email exchanges as the new environment in which software would operate and dialogue.

It was truly a revolution in convenience and effectiveness, particularly when it came to information exchanges with the companies in the perimeter.

The second revolution was functional. It attempted to integrate reporting functionality into first generation software, known as statutory consolidation software.

Many groups gradually realised how difficult it was to reconcile the figures produced by statutory consolidation with those created following a projected fiscal period, often by different departments.

The approaches were based on different software. Specialised software was used for statutory consolidation and Lotus (followed by Excel) was often used for reporting. Staff often came up through different training channels with more or less detailed-oriented information systems, with complete or partial perimeters, based on different frequencies, etc. In other words, two different figures universes coexisted in the groups.

Recognising this, software companies reacted very quickly and launched the concept of "unified consolidation".

Did the decade end with a miracle product? Not really.

The software developed primarily by European companies with a Latin culture tended to offer functionally complete statutory consolidation software with a few reporting functions which were deemed to be insufficient.

The software developed by Anglo-Saxon companies provided excellent reporting functionality but was relatively incomplete in terms of statutory functionality where everything had to be set up with parameters. American groups, which often had vast perimeters, had much simpler tree structures with fully owned companies.

The market was clearly moving toward a unified solution. However, vendor culture resulted in software that was either more heavily biased toward statutory consolidation or to reporting.

Unified consolidation didn't perfectly match market expectations at the end of the decade.

1.4 The 2000s: Y2K and IFRS

The turn of the century (Y2K in the English-language media of the time) disappointed many journalists looking for a sensational story because the long-anticipated bug didn't negatively affect accounting systems and the performance of consolidation software packages received high marks.

Another much more critical deadline awaited listed groups in 2005: the implementation of IFRS standards to apply to all public companies belonging to member states of the European Community.

The goal was infinitely praiseworthy given that the decision removed the haziness of the 7th Directive of 1983.

By setting standards for all Member States, Europe was making consolidated accounts comparable from the standpoint of both content and form for companies in similar lines of business, regardless of the Member State they were located in. Hadn't the United States applied the same approach throughout its states and with US Gaap for quite some time already?

Was the European goal achieved after a few years of IFRS? The answer isn't straightforward.

From a content standpoint, IFRS is voluminous, changing and interpreted, making it difficult to implement uniformly across listed companies.

We have often come across qualified or even very different opinions on a similar situation, sometimes from two partners of the same firm.

From the standpoint of form, some states like Belgium, Luxembourg, France, Italy and Poland have imposed a national publication standard for statutory accounts for many years now.

When the first consolidated accounts were published, groups found it normal to follow a recommended scheme... which didn't exist and has never been proposed by Member States.

With the advent of IFRS, each group created their own publication standards. Items that didn't appear explicitly on a balance sheet or income statement could be put in an attached table or in a note.

It was up to the reader to find the information...

The general, overriding feeling after a few years with IFRS standards is revealed in the following comments:

- The figures published hide a very high degree of technicality, to such an extent that consolidators sometimes wonder if external observers are able to interpret them correctly
- It's very debatable how well the objective of effective rule harmonisation is being met
- The structure of the notes to the accounts means that they are not entirely comparable
- An uneven skill level is found both in consolidation professionals and Auditors who sometimes find it difficult to stay abreast of shifting interpretations of IFRS rules.

The advent of IFRS clearly created competition. The leaders adopted IFRS standards, leaving no other options available and, sometimes, with a feeling of duty, whereas the other, unlisted groups in the pack wanted to retain national standards for a long time even though some of them did decide to break away.

As for consolidation software packages, they adjusted to the IFRS requirements and the impact on functional changes turned out to be minor.

Why?

Because the move to IFRS standards, with a few exceptions, didn't involve the mechanics of consolidation per se, but rather the content of the statutory accounts of each company in the consolidation scope.

During all of these years, the market maintained the confusion between IFRS as a consolidation problem and IFRS as an accounting issue.

Software packages were impacted in terms of their parameters (chart of accounts, appendices), but not in their intrinsic functionality, or if so, only marginally.

Did the software evolve over the decade?

The main direction taken was again based on technology changes dictated by an increasing need to produce more reliable data faster.

Revisiting or developing consolidation software couldn't be done without immediately integrating a web approach, with all of the accesses and portability that it presupposes.

Not only did the traditional consolidation bundle make way to direct access to a centralised system by each company, consolidation functions themselves

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become accessible from any internet entry point, anywhere in the world and at any time.

This approach, confirmed by Cloud Computing, tends to make the location of both data and the software used to process them invisible to users, and to improve performance.

By the end of the decade, consolidators could finally do their work at any time of the night or day, from anywhere, even on holidays, and on the device of their choice, including a smartphone!

This was huge progress since the time of the first service bureau consolidations in the early 1980s.

Did unified consolidation finally fulfil its potential ten years later? There were clear convergences in functionality thanks to the comfort provided by tools increasingly in the public domain and also thanks to the expression of needs by groups which were becoming more uniform. Consolidation was bound to become a strategic planning tool rather than a simple picture of the past.

2 **What can we expect in the future?**

It would be very ambitious and risky on our side to consider the future of consolidation using the "crystal ball" approach. It would inevitably lead to some daydreaming.

We'll approach the topic more realistically, taking into account different aspects of consolidation which still leave room for potential improvements in time and resource savings over the coming years.

2.1 The structure of the data to consolidate and its processing in consolidation

It's surprising to note that, virtually since the beginning of the 1980s, the information required for statutory consolidation has been presented in the same format, essentially:

- Account balances
- The detail of the balance of some of the accounts (financial investments and intercompanies mainly)
- Variation items (flows)

- Analytical dimensions of certain account balances.

This is the case for different software packages from a given vendor and in the software of their competitors, sometimes even in very different locations.

To such an extent that some software companies went as far as using the same coding as competing software on the pretext of providing greater convenience for their clients.

In our opinion, this clearly means that there is currently convergence in the approach because it perfectly meets consolidation requirements.

As a result, we don't see any significant improvement in data structure in the foreseeable future.

Basic consolidation processing (eliminations) hasn't changed very much either since the early days of consolidation in the 1980s. There are, however, variations in some countries, but the best software on the market has included them as parameters.

In this case too, and strictly in terms of statutory consolidation, the learning curve is becoming asymptotic and, therefore, we don't expect any revolutionary change in processing. Of course, we aren't immune to a complete, though highly unlikely, reworking with new principles the legislators may come up with.

In conclusion, and to confirm these comments, execution times for consolidation processing are now measured in minutes, even for groups with hundreds of companies in their perimeter. This is no longer an area for consolidation optimisation in the future.

2.2 The reconciliation of inter-company balances: is there hope?

We feel that it is necessary to address briefly an area that has historically been a weak link in the consolidation process, that is, the reconciliation of inter-company balances.

We have identified several invariable aspects of consolidation over the past forty years:

- Regardless of the size of their perimeter, a majority of groups have an abnormally high number of unreconciled inter-company transactions which are recorded at a critical time in the process, that is, too late.

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- This often leads to big meetings during which, after giving out the bad grades, consolidation managers and their counterparts leave after agreeing to new and promising measures that are complied with during the next consolidation period, before old habits return.
- Over the past four decades, the resources implemented to improve this situation have relied on setting up information flows, first using paper forms, then with spreadsheets and via email exchanges. Everyone inspects their own inter-company positions with their partners, although most of them are already correct. This is a waste of time resources.
- With the arrival of ERP software and the resulting high degree of group centralisation, it was reasonable to expect greater effectiveness in the intercompany area. It enables transactions recorded in the accounting of a company related to another company of the same group to be automatically allocated in the accounts of that partner. What happens in practice is quite different: either groups don't acquire that option or they don't use it.

The hope that such situation develops positively in the future once again will find its sources in new technologies.

Some software companies have developed inter-company balance reconciliation software based on internet communication properties combined with web software functionality that removes all geographical and time constraints.

In practice, from the standpoint of principles, this means that:

- All of the companies of a perimeter enter their intercompany positions via the web
- Information can be provided freely according to the level of detail available (balances or transaction amounts)
- Companies can carry the reconciliation process at any time without any intervention from the consolidation managers and therefore understand the extent of their mutual disagreements
- Reconciliation is deemed completed, with an explanation provided for residual differences, at a time decided by the group.

For the first time in forty years of dealing with the intercompany issue, not only do benefits appear important, but they are imbedded in the long run.

The right tool exists today. Groups must become aware of the benefits of making an investment in this respect, despite the overwhelming feeling of contributing to accounting errors in their companies and to an activity which is, when all is said and done, not directly profitable.

Yet, this step must be taken to ensure optimisation of the consolidation process!

2.3 IFRS and Local Gaap

One of the main reasons for the technical difficulties arising from the consolidation process has always been the discontinuous nature of the process. Contrary to the accounting process, which is based on the transfer of balances brought forward, changes in currency rates, percentages, consolidation methods and entries/exits of companies from the perimeter are all discontinuities that have always made the consolidator's task difficult.

IFRS standards added another discontinuity to the process in 2005 in that the accounts included are, in principle, established based on local standards whereas consolidated accounts must be created using IFRS standards.

Legislators will have to take some difficult decisions sooner or later, which in our opinion are inevitable, to deal with contradictory situations. Let's take a closer look at this.

First, we don't think it's normal that a parent company establishes its statutory accounts in local standards and that, in the same annual report, its consolidated accounts are published according to IFRS standards.

Next, maintaining local standards for group companies implies adjustments in the consolidation to ensure that they comply to IFRS standards. This is a twofold difficulty.

Either IFRS adjustments remain centralised with the parent company without necessarily having sufficient information to manage them correctly, or IFRS adjustments are decentralised in the group's companies with the ensuing risks for misunderstandings and difficulties due to the fact that their management isn't integrated. There is a deterioration of the quality of information in either case.

Stepping back, it becomes clear that over time the worldwide accounting rules underpinning consolidations will erase both national practices and the disparities between listed and non listed groups.

2.4 Statutory consolidation and reporting: unified consolidation

Since the 1990s, most groups have tried more or less successfully to unify their statutory accounting and their reporting within the same software, often with barely concealed uneasiness, in order to more easily reconcile projections and reality.

Although consolidation software now handles this dual difficulty fairly well... the unease subsists.

We believe that the issue is not at the software level, but with the groups which don't necessarily work with the objectivity and rigour required because resources have to be allocated to reconcile figures from different sources. Is this the case?

A few observations will provide a better illustration than a long explanation of the true difficulties that groups we recently met with, consciously or unconsciously, create for themselves:

- Statutory consolidation provides each company with the consolidation method it needs, but reporting has sometimes a preference for proportional integration of the entire perimeter
- In reporting, local currency charges and income for the month are translated using a rate for the month then accumulated whereas in statutory consolidation these same amounts are first accumulated in local currency then translated using an average annual rate. The two transactions are obviously not commutative and this surprises some people!
- Reporting doesn't include all of the statutory consolidation adjustments, and some reporting adjustments are ignored by statutory consolidation
- Reporting frequently uses aggregates whereas statutory consolidation requires more detail. Is this a reason to work with two different chart of accounts?
- The perimeters of statutory consolidation and reporting are not always identical
- Reporting uses business units. In this case, does grouping the business units of a legal entity really provide the same figures as used at the statutory consolidation level?

- Statutory consolidation is established according to IFRS rules, but certain companies in the perimeter use non-IFRS standards for their forecasts
- While statutory consolidation applies the usual rules rigorously, notably the calculation of third-party interest and currency conversion differences, reporting doesn't always include this level of detail.

So, can statutory consolidation and reporting be reconciled?

As surprising as it may seem, there are many examples of this type.

The challenge for unified consolidation over the coming years is no longer to improve consolidation software. What sophisticated solution could software provide to such irrational situations?

Once again, whether we are talking about statutory consolidation or reporting, or both in a unified vision, it isn't up to the software to unify. The information system must provide unified structure, content and processing.

This is a matter for group organisation, a major change in habits and cultural changes. It is no longer a purely technical problem which makes it much more difficult.

However, success will result from this change in mentality.

2.5 Group structure

The difficulty of a statutory consolidation is determined by the complexity of the group's structure, that is, several group and third-party shareholders in the companies of the perimeter, the existence of crossed-participations between companies, companies owning their own shares or shares in the consolidating company, etc.

This type of structure was common in the 1970s, particularly in family-held companies, less in listed companies and major groups.

Software had to handle these complex structures very early on and the best provided lasting solutions.

However, the requirements of statutory consolidation, backed by Auditor recommendations, led groups to avoid such complex structures. There is now a growing realisation that it's best to make things simpler whenever possible.

Contrary to the time when the legislator required that companies, notably limited responsibility French companies, have seven shareholders, we now often come across international company legal forms that allow for a single shareholder.

This is the trend we have seen and which will continue given the requirements for transparency demanded over the past years.

On the other hand, despite efforts to simplify, major international groups have hundreds of companies in their perimeters. For these large conglomerates, the consolidation problem results from the many sub-groups that must sometimes also establish consolidated accounts, often using different standards than the one of the consolidating holding company.

This is a challenge all international consolidation software packages will have to deal with correctly.

2.6 Financial communication

Whether for a press release, the creation of a document for the Board of Directors, the creation of an annual report or an exchange of financial data with external organisations, we have seen that these tasks still take up a disproportionate amount of time in the overall consolidation schedule.

There are reasons for this. We should note that:

- Most software creates highly accurate reports required by consolidation professionals and Auditors, but neglects the 'financial communication' aspect which requires a high degree of quality, synthesis and customisation.
- Although software now provides interfacing tools to avoid having to recopy information which is always risky and time consuming, many groups don't use them. The reason for this is that many different tools have to be juggled and integrated which requires greater technical than accounting skills. People therefore tend to avoid the task.
- In addition, the development of an automatic interface between the database containing the consolidation information and what the market more and more often calls the 'financial book' is a long and difficult task. It is therefore expensive and the continuity of the book's format isn't assured. Another reason not to tackle it.

In the long run, however, as a result of its position on the critical consolidation schedule path, financial communication in the broadest sense

must be backed by easy-to-use functionality integrated in the consolidation software.

Significant improvements by consolidation software vendors are expected in this area in the short term.

2.7 Impact of future technological changes on consolidation

In the 1970s, it wasn't easy to imagine what changes would occur in information technology and what impact they would have on an activity as specialised as consolidation.

Forty years later, admiration and surprise dominate. In fact:

- Since the era of mainframe computers, apparently powerful because of their size and the infrastructure sheltering them, we have moved to computers on our desktops which are much more powerful both in terms of calculation capacity and memory.
- Isolated users, depending on the post office to exchange information, are now exchanging the same information at the speed of light regardless of where they are located.
- Technology has moved from the punched card, the 24-line, 80-character screen and listings with 132 lines to extraordinary convenience and ergonomics via the pixel, mouse and copy/paste.
- When will we finally decide to give a Nobel Prize to a universal software package like Excel although it's merely a calculation tool?

What innovations can we expect? It's a very difficult question.

All of the capacities are available today to ensure that consolidation processing times are expressed in minutes, information exchange times in seconds and access to information is possible at all times with an excellent level of reliability. This means that future improvements will gradually become imperceptible to humans.

It's very possible that technology will evolve toward voice and tactile communication between users and their consolidation software, thereby providing greater comfort, but there will be a very marginal impact on process optimisation.

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As for functional changes, the past has shown us a great degree of convergence between the approaches of competing software packages, a sure sign that the solutions developed are meeting needs.

It's probably a shame that no consolidation expert systems have appeared for statutory consolidation, whose principles change very little but which requires a high level of expertise. These systems use a knowledge base to guide users in their search for a solution by asking a series of questions based on previous answers.

These expert systems could also help consolidators with IFRS, in particular by formulating suggestions and arguments for given situations which, as we know, are wide open to interpretation.

If IFRS is used by an increasing number of groups, there could be an economic challenge in the coming years that could lead to competition between this type of expert system and the traditional consultancy approach.

3 Conclusion

Let's just have a look around in our today's world:

- In so many international airports, there are trains without drivers
- Most parts of a car are assembled together by robots and since so many years robots are painting these cars, with almost no human intervention
- When you need cash, you go to the cash dispenser with a « plastic card » and you get your money at any time of the day, without any human contact
- In a very short term, activities like accounting, fiscal advices and legal contracts will be produced by expert systems.

So many other examples could be listed in so many different areas.

These forty years of experience cumulated by all the actors of the consolidation have progressively leaded to a mature and deep knowledge of the mechanisms of that activity.

In parallel, technology on both processing and exchange of information has brought a high level of synergy that wasn't expected at the very beginning of the consolidation adventure.

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The challenge in a few years will be to make the consolidation process more and more automated with less and less human interaction because not only a fast close will be considered as a "minimum".

Having consolidated information available at any time with the necessary accuracy will become a must.

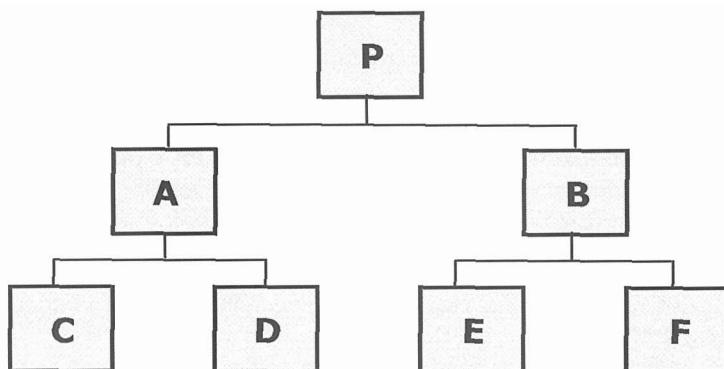
Robotisation of consolidation is probably the next step, we expect it or not.

PART 2

BASICS OF

CONSOLIDATION

TECHNIQUES



1 THE ECONOMICAL, FINANCIAL AND LEGAL CONTEXT OF THE CONSOLIDATION

1.1 Groups of companies

If a company is endowed with an appropriate legal and economic autonomy, it is however rare that this autonomy brings the necessary elements for its deployment.

A diversification of competence, products, a geographical expansion lead most of the time the company to look for alliances with other companies.

Practically, we notice that an alliance can range from a simple commercial representation to the take over of control of a company with the aim of influencing in a decisive way its management.

Among the alliances most classically met in our economical landscape, we shall mention, in an increasing order of dependence:

- The not conventional commercial connection by which quite naturally one company C1 depends on a company C2, one being the main customer of the other one
- The conventional commercial connection, by which a company C1 grants to a company C2 the commercial representation of its products, in order to sell them on a new market for example
- The "physical person" connection who constitutes a subtle shape of discreet dependence between several companies, each owned, mainly most of the time, by the same physical person. These companies present between them no visible link, especially as there is absence of a holding company
- The financial connection, finally, more classic, is characterized by owning shares in the capital of another company.

As soon as one of these connections exists in a long-lasting way between two or several companies, we agree to consider the latter as being a part of the same group.

In the scope of this book, we shall consider a group of companies in the most natural way by supposing the existence of a parent company owning shares of

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other companies, which are supposed to belong to the same group. All these notions will be reviewed with more details in the following chapters.

1.2 Financial consolidation statements

In this context of group where several companies act in close dependence, the activity of one is so influenced by another that the appreciation of a single company has a restrictive nature. It seems then more natural to build up an opinion not on an isolated company but either on the parent company or on all individual companies belonging to the group.

For an external observer, the only available information can be found in the statutory annual accounts reports of every individual company. Two approaches can be considered from then on:

- Either we consider only the parent company statutory accounts as better image of the group
- Or we consider the statutory accounts of all the companies of the group, including those of the parent company.

The first approach presents three major inconveniences:

- First, it supposes that the book values of the financial participations reflect faithfully the value of every owned company, which is not generally the case. Such an owned company sees its own capital evolving depending on its profits generated at the end of every year while the financial participations booked in the parent company accounts do not generally record that evolution
- Then, it supposes that the profit of every company appears in the financial products of the parent company, in the form of received dividends. It is clear that, in the majority of the cases, the share dividends paid by a company reflects only partially the profit which is generated during the previous year
- Finally, it masks any vision on companies owned indirectly by the parent company, because these do not simply appear in its accounts, neither in terms of participations nor in terms of received dividends.

The second approach consists in considering the statutory annual accounts of each company and to accumulate them with those of the parent company. Here also the inconveniences are of importance:

- The annual accounts of foreign companies lead straightaway to wonder as for the choice of adequate exchange rates to be applied to these foreign currency accounts.
In particular how to handle the balance sheet accounts which, from a period to the other one do not evolve, but fluctuate by the only phenomenon of different exchange rates.
- Inevitable duplications appear, because of simple accumulation, between receivables which the group owns on itself, between purchases which it concluded with himself and come to inflate artificially its total of assets, liabilities, its revenues and expenses
- Dividends, before being paid, belongs to the result of a company but are booked, next year, in the financial income of the shareholders of that company
- Finally let us point out that it seems at least abnormal that the accounts of company not controlled by the parent company are considered on the same foot as those of a company controlled by that parent company.

Both approaches were considered, none gives satisfaction. How to associate to a group of companies a significant, homogeneous economic picture as if the group was considered itself as a unique company dealing only with the outside world?

These deficiencies led the financial world to develop a new technique of "valuation" of groups, basic rules of which are universally adopted today: the consolidation of accounts.

1.3 Consolidation: Useful information?

There is almost one century between the first ideas of consolidation and the laws. What to say about that?

On one hand, the consolidation is a technique of information and not a technique of management, even if it gives very often an original and interesting picture on its own group.

We understand from then on the lack of haste of the groups to be consolidated, especially in the situations where an effective internal management reporting exists. Nevertheless, we notice that the most important groups, with strong structure and strong organization very often preceded the legal regulations.

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Smaller groups, in an expectation position, waiting the laws in order to avoid unnecessary costs, were taking some risks by being in a position not to be able to produce consolidated figures in a short delay.

On the other hand, it is necessary to recognize that the standards published both at the international and the national level have a lack of precision. Confronted to these vague recommendations, the small and medium size groups, sometimes incompetent in front of their often complex legal and economic structure are a little disorientated.

Anyway, today the consolidated financial statements are not anymore a fashion.

If more and more groups anticipate the legal requirements, it is to be able to bring more complete information than the statutory accounts of the parent company would bring.

Among the consumers of this type of information, we meet:

- The customers and the suppliers of the group who try to know better their partner
- The Bankers who want to appreciate needs in financing but also the attached risks
- The financial analysts who try to estimate the financial health of the group
- The world of the financial specialists cannot ignore this technique
- The competitors who try to identify better the group
- And finally labour unions and more particularly works councils, as informants to the company staffs.

A public composed of so many observers who, gradually, adapt their approaches to consolidated information and, with the legal organizations, creates an irreversible evolution.

2 CONSOLIDATION: A STEP BY STEP PROCESS

The consolidation process is a mix of lots of calculations, sometimes difficult situations to solve when group structure is changing, organization issues with correspondents, located all over the world, that sometimes you have even

never met, deadline issues to provide correct information just in time and so many people around you like CFO, Auditors, Bankers,... asking for information before you feel confident with it.

Facing such situation, keep in mind two key points during the consolidation process: Organization and Rigor.

We can define seven steps to achieve a consolidation.

Step 1: Identify the companies to include in the consolidation scope

Step 2: Collect the information from each company correctly and in time

Step 3: Translate all the information received into the consolidation currency

Step 4: Identify all intercompany differences and ask for explanations

Step 5: Book all necessary consolidation adjustments depending on group situation and consolidation rules

Step 6: Process all necessary eliminations to get a consolidated set of information

Step 7: Report consolidated figures to all addressees.

All along these steps, validation will be necessary and sometimes, reaching the end of the process, it may happen that previous steps will be revisited.

Such process implies a "spiral effect" until all reports show a consistency.

We propose now to give some additional information for each of these seven steps hereunder.

2.1 Step I: Identify the companies to include in the consolidation scope

A group is just a set of companies. Most of them remain unchanged, some others disappear because of a disposal or a merge, some new companies are entering the consolidation scope and the level of control in some companies may also change because of acquisitions or disposals of shares, implying a change in consolidation methods.

It is highly recommended that the persons in charge of a consolidation remain informed of all events of this type, all along the year, because of the impact on the consolidated figures.

PART 2 BASICS OF CONSOLIDATION TECHNIQUES

For each individual company,

- Calculate the control percentage owned by the group
- Consequently, adapt if necessary, its consolidation method
- Calculate the indirect financial percentage.

These notions will be completely defined in the next chapter but keep already in mind that a control percentage is necessary to fix the consolidation method and all calculations on equity are processed with the financial percentage.

Of course, we also recommend defining a materiality level for new companies to enter the consolidation scope. Be careful about the fact that a small company expected to have a weak contribution to consolidated figures should remain outside the consolidation scope. Very often, small companies are responsible for planning issues.

2.2 Step 2: Collect the information from each company correctly and in time

The information needed for a consolidation may depend on the reference (Local Gaap or IFRS) but also on what the Board, Auditors, Bankers are expecting.

In any case, there is a minimal set of information required for each company, which consists in

- A balance sheet and its P&L
- A detail of the financial investment accounts in other companies of the consolidation scope, including explanations on the evolution of such accounts
- Intercompany positions which consist of transactions made by the company with all other companies and that are still open in the balance
- Flows on all balance sheet accounts, which consist in explaining the evolution of these accounts between opening and closing dates.

That information is usually collected by the mean of what is called a "consolidation bundle", usually a spreadsheet or a web solution.

We will not give a full description of such a consolidation bundle here but let's limit us to some important points.

- A bundle should be personalized to each company. This means that last closing period figures will be present without possibilities to update them because they have been used and audited in the previous consolidation.
- A spreadsheet bundle very often consists in a quite large number of sheets in a workbook. Most of these sheets are linked together via formulas and macros. On the top of these sheets we find a set of validation rules. Experience shows that companies are asking the more complete and severe validation rules as possible. Why? Because when they send the consolidation bundle to the consolidation department, they are sure the information reaches the expected level of quality.
- A consolidation bundle should contain figures in local currencies. It is not advisable to ask companies to translate themselves their local currency figures into consolidation currency. Year after year, that translation is becoming more and more difficult. It should remain the responsibility of the consolidation office.
- When the evaluation rules of the group differ from the local rules, and this is very often the situation with IFRS, the question arises to know who is booking the necessary adjustments to comply with the group rules. The recommended position is to apply the 'push down' approach and to ask the company to book these adjustments. Very often, the company is not allowed to book these adjustments directly in its local accounting. So it is helpful to develop a consolidation bundle including the possibility to receive these adjustments. The consolidation bundle then presents a '3 columns' structure: column 1 for Local Gaap amounts, column 2 for impact of adjustments and column 3 which is the addition of the two first columns. This last column is usually the one that is consolidated (adjusted amounts).

2.3 Step 3: Translate all the information received into the consolidation currency

Although most of the consolidation software are processing this step automatically, we will provide all details of this difficult process in a dedicated chapter.

The important thing to notice is that after currency translation, all figures are now in a same currency and we could add them together. The picture we would get would be far away from an expected consolidated picture.

2.4 Step 4: Identify all intercompany differences and ask for explanations

After this step of translation currency we advise to analyse the intercompany positions of each company with all the others in order to check if they agree or not.

Let's keep in mind that what consolidated accounts have to show is the activity of a set of companies, the group, with the outside world, as if all these companies would have been considered as a single one.

That's the reason why consolidation process requires to eliminate receivables with payables, turnover with corresponding expenses,... but, of course, that elimination will correctly work if both amounts are equal.

Experience shows that it is not very often the case for some acceptable reasons but also for some unacceptable reasons. That's why we process this step just after the currency translation in order to give some time to each company to discuss between each other and to come back to the consolidation office with an updated or explained situation.

2.5 Step 5: Book all necessary consolidation adjustments depending on group situation and consolidation rules

This step is certainly the most important one in the consolidation process because of its human contribution. But for how long? It requires knowledge of all important events happening during the consolidation period and having a potential impact on consolidated figures: acquisitions and disposals of companies, capital increase, merge of companies, change in consolidation method, ...

This step requires also a deep knowledge on the content of individual Local Gaap accounts in order to evaluate what has to be adjusted to comply with group rules of consolidation. And finally, a certain number of internal transactions between companies must be correctly detected because they also need to be adjusted.

Speaking about consolidation adjustments, we usually define three categories of adjustments:

- First category: "Compliance to evaluation rules" adjustments

- Second category: "Elimination of internal transactions" adjustments
- Third category: "Technical" adjustments.

Let's give an example of each of these three categories.

First category example: "Compliance to evaluation rules" adjustments

For some fiscal reasons, a company A depreciates a fixed asset over 5 years but the group rules specify to depreciate this asset over 10 years.

What is the impact in the consolidation?

- First we have to reverse the statutory depreciation based over 5 years
- Book a new depreciation based over 10 years
- Calculate deferred taxes (certainly if IFRS)

and don't forget to check at each consolidation that the asset being adjusted is still in the account of the company!

Second category example: "Elimination of internal transactions" adjustments

A company A sells to company B an asset, for a price of 120. This asset is booked in company A accounts for a value of 100. Consequently, A shows a group profit of 20 and the asset is suddenly revaluated by 20 in the group accounts.

This transaction leads to a non economical conclusion. Indeed, because of a group transaction, an asset is revaluated and the group profit is increased.

This is a kind of situation that a consolidation office has to detect and to adjust consequently. A good consolidation bundle is necessary.

What is the impact in the consolidation?

In company A accounts, eliminate the group profit that has not been realized with the outside world.

In company B accounts, reverse the statutory depreciation based on an unaccepted value in consolidation, eliminate the profit booked in the acquired asset and depreciate the new value of that asset (same economical life time?).

Third category example: 'Technical" adjustments

This category of adjustments is easy to define. If, for a certain event, an adjustment is not booked, there will be for sure a technical mistake in the consolidation.

Amongst the events, we can state all group structure changes like acquisitions, disposals, increase in capital, ...

What is the impact in the consolidation?

We consider the parent company acquiring 100% of a new company for a price of 100. Equity of the acquired company is 80.

There will be a goodwill of 20, which is the difference between the acquisition price of 100 and 100% of the equity of 80.

In parent company, we have to book a goodwill of 20 and, depending on the evaluation rules, to depreciate this goodwill or to book an impairment on this goodwill.

Of course, before calculating the goodwill, we have to adjust the accounts of the acquired company to make them compliant with the group rules.

Most of the time, consolidation adjustments remain in the consolidation accounting for a long period of time. That means these adjustments need to be well documented because one should check if the corresponding statutory amount still corresponds to the effect of the adjustment.

2.6 Step 6: Process all necessary eliminations to get a consolidated set of information

The consolidation can be considered as an extension of each individual statutory accounting. All consolidation adjustments are in fact journal entries that cannot be booked in statutory accounts.

Once all consolidation adjustments have been booked, we still have a balance sheet, a P&L, flows, notes to the accounts, ... but some of the amounts have been adjusted.

If the consolidation adjustments require a human brain, eliminations can be processed automatically by all consolidation software. Here are the different steps.

- For each global integration company, we calculate the minority interests in the equity and reclassify the amount on the Minority interests account
- For each equity method company, we eliminate 100% of all assets and liabilities accounts, excepted equity which is eliminated for the percentage which doesn't belong to the group
- For each proportional integration company, all balance sheet and P&L accounts are eliminated for 50%, which is the normal percentage used
- For all companies we eliminate intercompany positions, which have been eventually adjusted at step 3
- Finally, we eliminate group part of equity and financial investment in order to calculate the consolidated reserves of each company.

All these concepts will be largely explained in the next chapters.

2.7 Step 7: Report consolidated figures to all addressees

There are different sets of reports when consolidation process is reaching the end, mainly four sets.

- First set consists in reports that are used internally by the consolidation office. These reports, quite technical, are necessary to validate the whole consistency of the consolidated set of information.
- A second set of reports consists in providing summarized consolidated data to the management and the Board. The presentation will be much more pleasant than technical.
- A third set of reports needs to bring answers to Auditors questions. We recommend to ask Auditors not only which content they need but also on which support: paper, spreadsheet, direct access in a "read only" mode to the consolidation software. Keep in mind that auditing a consolidation can be as complicated as producing the consolidated figures.
- Finally, there are a number of addressees that also need a summarized information. Amongst them, there will be financial analysts, Bankers, financial newspapers for public companies, unions, important customers or suppliers, ...

We know, by developing this step by step approach, we give the feeling that the consolidation process is something quite linear by starting with step 1 and finishing with step 7. That is partly true, but when reaching the technical set of reports, we can find an important number of mistakes making mandatory to revisit the whole process in order to improve the consistency of the figures.

This is what we mentioned earlier as a "spiral effect".

3 CONTROL AND FINANCIAL PERCENTAGES

Within the consolidation process, two percentages are used. We first need to know the control percentage owned by the group in each individual company, which is the basic information to determine the consolidation method that will be associated to each of these companies.

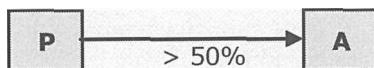
On the other hand, we also need to know the financial percentage owned directly and indirectly in each company of the consolidation scope, which is used to calculate group part in equity and in the profit. This financial percentage can be compared to the part of dividends that a group finally can expect to receive from these companies.

3.1 The control percentage

Control could be defined as follows: "control of a company means the power by law or by fact to influence the description of the appointment of the directors or managers or to influence the company's management orientation".

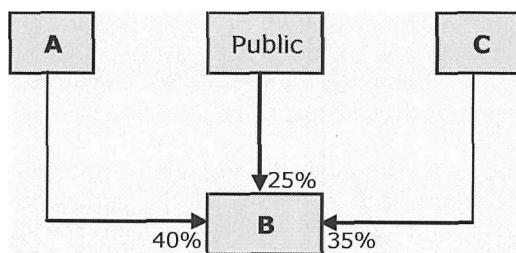
Therefore, two types of controls exist: legal control and the de facto control.

The legal control exists when one company owns more than 50% of the voting rights attached to the shares representing the capital of another company. This also means that it holds a majority on the Board of Directors. The presumption of legal control is irrefutable.



Control de facto exists when, because of the shareholding structure or agreements between shareholders, a company with less than 50% of the voting rights may still exercise control over the subsidiary.

For example: Company A owns 40% of a listed company B and 25% of the capital is owned by public shareholders. We assume that they are never present at general meetings. The rest of the shares (35%) are owned by a company C. When voting, there will only be 75% of the capital represented. In this case, the percentage of voting rights owned by company A in company B is 53% ($40\% / 75\%$), and therefore company A will be able to appoint the majority of the directors of the subsidiary. The control presumption is refutable.



When determining the power of control, one should take into account two elements:

- Shares directly held by the parent company and
- Shares indirectly held by the parent, i.e. via subsidiaries. In this case, the percentage of control of the subsidiary adds to that of the parent.

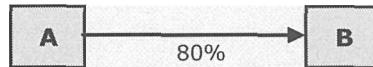
The word 'control' is very important because there are multiple levels of control, and the level of control will determine how to consolidate. There are three different situations of controls that will induce the related consolidation method.

The exclusive control

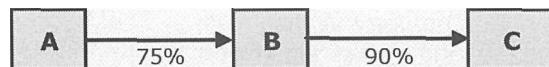
Exclusive control is the control exercised by a company either on its own (direct control), either with one or more of its subsidiaries (indirect control). A company is considered to be a subsidiary when the parent owns more than 50% of shares of the owned company.

PART 2 BASICS OF CONSOLIDATION TECHNIQUES

An example of direct and exclusive control: Company A owns 80% in company B.



An example of indirect control: Company A owns 75% in company B which owns 90% in company C. In this case, company A has also exclusive control over C via B.



It may happen that a parent company has directly and indirectly control at the same time. We then add the percentages.

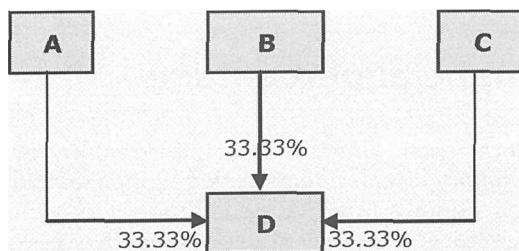
In the case of sole control, consolidation is, in principle, done via the global integration method.

The joint control

Under joint control should be understood the supervision to which a limited number of partners carry out together, when they agreed that the orientation management decisions could be taken by their mutual agreement control. Joint subsidiary, means the company in respect of which this joint control exists.

Joint control means that there is control between different companies, who made a convention about sharing business rules in common.

Example: Three airlines companies (A, B and C) which decide to create a common catering service in a HUB (D):

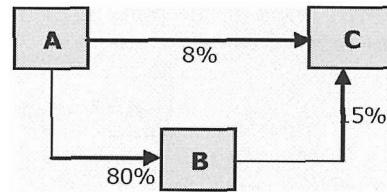


In the case of joint control, consolidation is, in principle, done via the proportional method.

Significant influence

We speak of significant influence when a parent company, directly and/or indirectly, holds investments in the capital of another company, forming together a percentage of detention between a commonly accepted range of 20% and 50%. In this case, it is common to refer to the company as an *associated company* instead of a subsidiary.

Example: Company A owns 80% in company B and 8% in company C, company B owns 15% in company C. Company A has sole control in company B and A has significant influence on company C because it holds a control percentage of 23%.

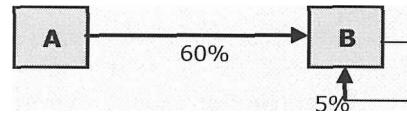


When there is a significant influence, the consolidation method to be used is the equity method.

Treasury shares

A corporation, or its affiliates, could hold its own shares (known as Treasury shares). To determine the percentage of control, these shares must be subtracted from the total of shares of the company.

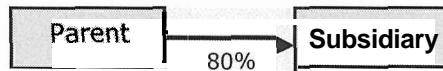
Example: Company A owns 60% of the capital company B which owns 5% of its own shares. To calculate powers of control, one must first subtract 5% own shares of the total available voting rights: $100\% -$



$5\% = 95\%$, and then calculate the relationship between what company A owns in company B and the recalculated percentage ($60\% / 95\% = 63\%$). The effective control power is 63%.

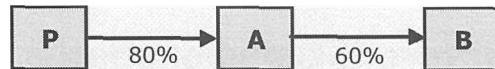
3.2 The financial percentage

In the most general case, when the parent company owns directly 80% of shares in a subsidiary, each share being supposed to give a right to a dividend, we speak about a financial percentage. Of course, most of the time, that financial percentage is equal to the direct control percentage.



PART 2 BASICS OF CONSOLIDATION TECHNIQUES

In more general group structures, subsidiaries can have participations in other subsidiaries, as in the following example

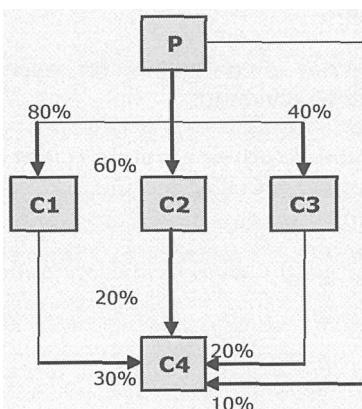


where the indirect financial percentage in company B is $48\% = 80\% * 60\%$ but the indirect control percentage in company B still remains at 60% because company A is controlled by the parent company P at 80%.

Confusion must be avoided between an indirect percentage of 48%, which is less than 50%, and a control percentage of 60%.

Moreover, we can define the indirect percentage as the multiplication of direct percentages along the path starting at parent company and going to the considered subsidiary.

Some group structures may bring some difficulties like the following one because there can exist several paths from parent company to a subsidiary.



Indeed, the indirect financial percentage in company C4 is calculated as follows

- Path 1 : P -> C1 -> C4 : $80\% * 30\% = 24\%$
- Path 2 : P -> C2 -> C4 : $60\% * 20\% = 12\%$
- Path 3 : P -> C3 -> C4 : $40\% * 20\% = 8\%$
- Path 4 : P -> C4 : 10%

giving a total indirect financial percentage of $24\% + 12\% + 8\% + 10\% = 54\%$.

3.3 When different types of shares represent the capital of a company

We strongly advise for each individual company of the consolidation scope to get the following information:

- The types and number of shares representing the capital ;
- For each individual shareholders, the types and number of shares owned.

Let's explain this on the basis of the following example.

We consider a company C whose capital is represented by:

- 1000 shares of type 1 conferring, for each share, one voting right and a right to dividends
- 1000 shares of type 2 conferring, for each share, a double voting right, but no right to dividends
- 1000 shares of type 3 with non-voting rights and right to dividends

giving 3000 shares issued.

Let's suppose there is a single shareholder, namely the parent company P that owns:

- 1000 shares of type 1
- 400 shares of type 2
- 700 shares of type 3

giving 2100 shares owned.

The control percentage of company P in company C is calculated as follows:

$$\frac{1000 * 1 + 400 * 2 + 700 * 0}{1000 * 1 + 1000 * 2 + 1000 * 0} = \frac{1800}{3000} = 60\%$$

which is the ratio between owned voting rights and issued voting rights.

PART 2 BASICS OF CONSOLIDATION TECHNIQUES

In practice, it is recommended not to limit to these arithmetical considerations.

One should also consider in particular

- The existence of a shareholder's agreement by which a majority shareholder abandons his voting rights for the minority shareholder. It will be for example the case when the majority shareholder plays a strictly financial role. In such situation, the choice is to maintain the control in the hands of the founding shareholder who, in most cases, is the person knowing about the technical products.
- The existence of a de facto control as far as the minority shareholder is almost alone in front of absent shareholders during general annual meetings. Such situations take then the priority with regard to the arithmetical calculation explained above.

The direct financial percentages is given by the following ratio

$$\frac{1000 * 1 + 400 * 0 + 700 * 1}{1000 * 1 + 1000 * 0 + 1000 * 1} = \frac{1700}{2000} = 85\%$$

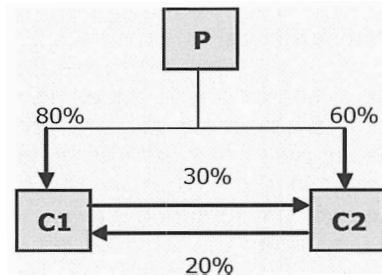
In such situation of various types of shares, direct financial percentage and direct control percentage may not be equal.

3.4 Some groups with more complex structures

By complex structures, we basically think of following both situations

- Company A owns shares of company B and company B owns shares of company A. We than speak about "crossed participations"
- Company A owns shares of the parent company.

Let's consider each of these two situations on the basis of an example.

Group with crossed participations

The control percentage in company C1 is 100% because the remaining 20% owned by C2 can be taken into account, C2 obviously being controlled by the group at 60%.

If we keep in mind the basic principle to be applied for the financial percentage of company C1, we just have to inventory all paths starting at P and arriving in C1, multiply the percentages along each path and then add them together.

At a first glance, we would say there are two paths, namely P \rightarrow C1 giving 80% and P \rightarrow C2 \rightarrow C1 giving $60\% * 20\% = 12\%$, and we would say the indirect financial percentage is 92%. That's not correct!

Here is the correct answer with (nearly) all the paths.

We first identify an infinite set of paths starting from P and ending at C1

| | | |
|--------|----------------------------|---------|
| Path 1 | P - C1 | 80% |
| Path 2 | P - C1 - C2 - C1 | 4.8% |
| Path 3 | P - C1 - C2 - C1 - C2 - C1 | 0.288% |
| Path 4 | P - ... | ... |
| | | 85.088% |

but there is also a second set of paths, different from the first one, starting from P and ending in C1 via C2, giving

| | | |
|--------|---------------------------------|---------|
| Path 1 | P - C2 - C1 | 12% |
| Path 2 | P - C2 - C1 - C2 - C1 | 0.72% |
| Path 3 | P - C2 - C1 - C2 - C1 - C2 - C1 | 0.043% |
| Path 4 | P - ... | ... |
| | | 12.763% |

PART 2 BASICS OF CONSOLIDATION TECHNIQUES

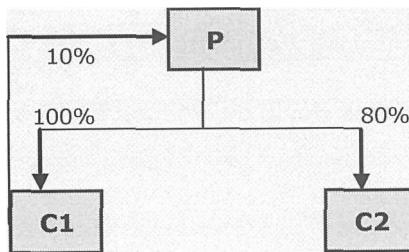
The indirect financial percentage is then **97.851%** instead of the 92% calculated above.

The difference is important and the following question arises: "What if we forget some paths?". The answer is quite clear: the group financial percentage is lower than what it is expected to be and the difference with regard to 100% is given to the 3rd Parties. So, that means that the Group part in Equity and in profit is less and not correct.

Of course, as soon as the mistake has been identified, a correction must be applied. Speaking about financial percentage, this mistake has an impact on the consolidated reserves of the concerned company. If the difference is material, a comment will be added to the notes of the consolidated accounts.

A company owns shares of the parent company

In this group, company C1 owns 10% of shares of parent company P.



If we apply the same principles of calculation of the indirect financial percentage of C1, we would find the following

| | | 100% |
|--------|--------------------------|------|
| Path 2 | M - C1 - M - C1 | 10% |
| Path 3 | M - C1 - M - C1 - M - C1 | 1% |
| Path 4 | M - ... | 111% |

which makes obviously no sense.

In fact, there is a limitation in this calculation rule. It works when subsidiaries own no shares of the parent company, otherwise a different approach must be defined.

The 10% participation from C1 into P must just be ignored when applying the calculation.

Let's look at the accounts of company S.

| C1 | | |
|--------------|-----|-----------------|
| Invest. In P | 50 | Capital 200 |
| | | Reserves 150 |
| | | Result 50 |
| Assets | 650 | Liabilities 300 |
| Total | 700 | Total 700 |

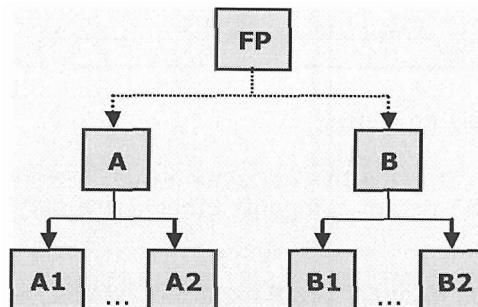
Depending on consolidation rules, one option consists simply in reclassifying that investment of 50 into "Owned shares" (Local Gaap). Another option consists in reclassifying that investment directly into the reserves, which is compliant with IFRS rules.

| C1 | | |
|--------------|------|-----------------|
| Invest. In P | 50 | Capital 200 |
| | (50) | Reserves 150 |
| Assets | 650 | Result 50 |
| Owned shares | 50 | Liabilities 300 |
| Total | 700 | Total 700 |

Under IFRS rules, investments would be credited by 50 and reserves debited by 50.

Consortium structures

We consider two groups of companies A and B without any financial links between A and B, neither between subsidiaries of A with subsidiaries of B. At this point we speak about two independent groups, except the fact that the Boards of A and B consist in majority of the same physical persons. So we can conclude that groups A and B are no so independent that they are looking like.



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We are faced to a 'consortium' and depending on local regulations, some countries make mandatory the publication of consolidated accounts for such structure.

How to proceed in such situation?

It is necessary to introduce what we call a "fictitious parent company" (FP) because a parent company must be unique within a consolidation scope. But what will be the balance sheet of FP? On liabilities side, we just add together the issued capital of A and B and on the assets side, we book Investment accounts on A and B with the corresponding capital amounts.

Once such construction is achieved, the consortium comes back to a classical structure with no problem to be consolidated the way we know.

3.5 Control percentage – Financial percentage

The percentage of control

The notion of percentage of control has already been widely commented here above. It is recalled that the control percentage determines the consolidation method. Therefore, it must be calculated for each company and for each consolidation.

The following table lists the basic principles that are to be applied to each individual company:

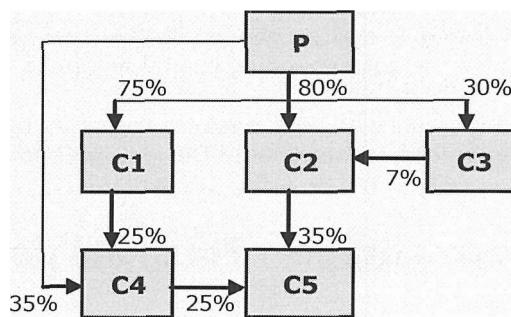
| Control percentage | Level of control | Consolidation method |
|---|--------------------------|---|
| >50% | Exclusive control | Global integration |
| 50% with existence of another shareholder with whom control is shared (*) | Joint control | Proportional Integration (or equity method if IFRS) |
| ≥20% and <50% | Significant influence | Equity method |
| < 20% | No significant influence | Not consolidated |

(*) May also occur with more than two shareholders. The essence here is that the control is shared between a limited number of shareholders.

Please note that exceptions are always possible, though one must comply with the requirements of the reference framework that was chosen for the

purpose of drawing up the consolidated accounts, whether it's Local Gaap or IFRS.

Let's suppose we have to consolidate the following group. First step consists in calculating the control percentage applying to each company of the consolidation scope. Then, on the basis of the table presented above, we attach to each of these companies its consolidation method.



We then calculate the indirect financial percentage in each company.

Calculation of the control percentages

- C1 is controlled at 75%
- C2 is controlled at 80% because P does not control C3 and therefore the 7% must be ignored
- C3 is not controlled because $30\% < 50\%$
- C4 is controlled because we have $35\% (P \rightarrow C4) + 25\% (C1 \text{ which is controlled by } P)$. The total control percentage is 60%
- C5 is controlled at $60\% = 35\% (C2 \text{ which is controlled by } P) + 25\% (C4 \text{ which is controlled } \rightarrow C5)$.

Attachment of a consolidation method to each company

- C1 is controlled at 75% : Global integration method
- C2 is controlled at 80% : Global integration method
- C3 is not controlled (30%) : Equity method
- C4 is controlled at 60% : Global integration method

PART 2 BASICS OF CONSOLIDATION TECHNIQUES

- C5 is controlled at 60% : Global integration method.

Calculation of the indirect financial percentages:

- For C1 : 75% owned directly by the parent company
- For C2 : 82.1% which is calculated along two paths
 - Path 1 : 80% owned directly by the parent company
 - Path 2 : P -> C3 -> C2 : $30\% * 7\% = 2.1\%$
- For C3 : 30% owned directly by the parent company
- For C4 : 53.75% which is calculated along two paths
 - Path 1 : 35% owned directly by the parent company
 - Path 2 : P -> C1 -> C4 : $75\% * 25\% = 18.75\%$
- For C5 : 42.1725% which is calculated along four paths
 - Path 1 : P -> C4 -> C5) : $35\% * 25\% = 8.75\%$
 - Path 2 : P -> C1 -> C4 -> C5) : $75\% * 25\% * 25\% = 4.6875\%$
 - Path 3 : P -> C2 -> C5) : $80\% * 35\% = 28\%$
 - Path 4 : P -> C3 -> C2 -> C5) : $30\% * 7\% * 35\% = 0.735\%$

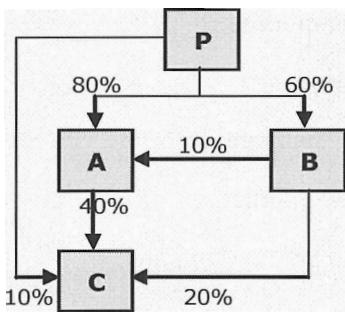
3.6 Algorithm to calculate indirect financial percentages in complex group structures

Mathematics and graphs theory in particular bring an interesting contribution to a difficult situation in consolidation. Indeed, whatever complex can be the structure of a group, there exists an algorithm that calculates the indirect financial percentages.

Most of consolidation software provide this function but for groups with a limited number of companies, it is also quite easy to develop that algorithm in a spreadsheet as we explain hereunder.

We will give the explanation on the basis of the following group structure.

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The answer we want to get through the algorithm is $86\% = 80\% + 60\% * 10\%$ for A, 60% for B and $56.4\% = 80\%*40\% + 60\%*10\%*40\% + 60\%*20\% + 10\%$ for C.

We first build a matrix with direct percentages between companies. Let's call D that matrix.

| | P | A | B | C |
|---|---|-----|-----|-----|
| P | 0 | 0.8 | 0.6 | 0.1 |
| A | 0 | 0 | 0 | 0.4 |
| B | 0 | 0.1 | 0 | 0.2 |
| C | 0 | 0 | 0 | 0 |

For instance, company B owns $20\% = 0.2$ in company C.

We then define the unit matrix called I with 1 on the diagonal and 0 in all the other cells

| | | | |
|---|---|---|---|
| 1 | 0 | 0 | 0 |
| 0 | 1 | 0 | 0 |
| 0 | 0 | 1 | 0 |
| 0 | 0 | 0 | 1 |

and calculate $I - D$ in order to get

| | | | |
|---|------|------|------|
| 1 | -0.8 | -0.6 | -0.1 |
| 0 | 1 | 0 | -0.4 |
| 0 | -0.1 | 1 | -0.2 |
| 0 | 0 | 0 | 1 |

Now, this matrix has to be inverted. It is a function provided by Microsoft Excel ©. We get $\text{INV}(I - D)$

| | | | |
|---|------|-----|------|
| 1 | 0.86 | 0.6 | 0.56 |
| 0 | 1 | 0 | 0.4 |
| 0 | 0.1 | 1 | 0.24 |
| 0 | 0 | 0 | 1 |

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Using the Excel syntax, each cell of this matrix is defined as follows

=INDEX(INVERSE(A:B);LINE,COL)

where "A:B" is the range defining the matrix to be inverted. "LINE" is the line number and "COL" is the column number of the cell in the output matrix.

Finally, we calculate the product of both matrices D and INV(I - D) which gives the expected result.

| | P | A | B | C |
|---|---|------|-----|------|
| P | 0 | 0.86 | 0.6 | 0.56 |
| A | 0 | 0 | 0 | 0.4 |
| B | 0 | 0.1 | 0 | 0.24 |
| C | 0 | 0 | 0 | 0 |

This again is easy to calculate in Excel by using the following syntax for each cell of the output matrix

=INDEX(MMULT(A:B;C:D);LINE;COL)

where "A:B" is the range of the matrix D, "C:D" is the range of the inverse matrix we just calculated and "LINE" and "COL" are the line and the column number of the corresponding cell of the final matrix.

Of course, we are interested only in the first line of that matrix which gives the indirect percentages from P in all other subsidiaries. For instance, we see indeed that P owns indirectly 60% in B.

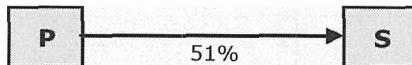
This algorithm works for any structure of any size. Crossed participations or cycle of participations (A → B → C → A) are also accepted. The only restriction is that a subsidiary cannot own shares of the parent company. If so, that link must be ignored.

4 THE CONSOLIDATION METHODS

4 . Global integration method

According to the global integration method, assets, liabilities, income and expenses of the owned company will be added to elements of the same type of the parent company. Minority interests (or interests of third parties or not controlling interests) will be calculated on the result and equity of those subsidiaries for which the indirect financial percentage is less than 100%.

Example



| | | P | | S | |
|---------------|-------|-------------|-------|----------|-----|
| Investments S | 120 | Capital | 500 | Capital | 200 |
| | | Reserves | 300 | Reserves | 150 |
| | | Result | 100 | Result | 50 |
| Assets | 1,030 | Liabilities | 250 | Assets | 700 |
| Total | 1,150 | Total | 1,150 | Total | 700 |
| Expenses | 900 | Income | 1,000 | Expenses | 550 |
| Result | 100 | | | Result | 50 |
| | | | | | |

| P + S | | | |
|------------------|---------------------|--------|-------|
| | Capital | 500 | |
| | Reserves | 300 | |
| | Result | 100 | |
| | Conso. reserves (S) | 84 | |
| Assets | Minority int. | 196 | |
| 1,730 | Liabilities | 550 | |
| Total | Total | 1,730 | |
| Expenses | 1,450 | Income | 1,600 |
| Result | 150 | | |
| Minor. int. res. | 24.5 | | |
| Group res. | 125.5 | | |

Explanation

For the Assets and Liabilities accounts, they are added up to 100%.

PART 2 BASICS OF CONSOLIDATION TECHNIQUES

Equity of P remains unchanged.

However the equity of S is integrated in proportion to the financial percentage:

- Capital = capital of company P
- Reserves = reserves of company P
- Result = result of company P
- Consolidated reserves (S) = $84 = 51\% \times [200+150+50] - 120$ (investment in S owned by P)
- Minority interests (S) = $196 = 49\% \times [200+150+50]$

In the Profit and Loss account, the Income and the Expenses are fully integrated (it does not include a possible intercompany problem in the example above).

As regards to the result, it is divided between Group part and Minority interests part:

- Minority interests result = $24.5 = 49\% * 50$
- Group result = 100 (Result of P) + $25.5 = 51\% * 50 = 125.5$

There is a more accounting way to get the consolidated figures, as explained hereunder.

| | P | S | P (1) | S (2) | S (3) | S (4) | Consolidation |
|---------------|-------|-----|-------|-------|-------|-------|---------------|
| Investments S | 120 | | (120) | | | | 0 |
| Assets | 1,030 | 700 | | | | | 1,730 |
| Link account | | | 120 | | | | 0 |
| Total Assets | 1,150 | 700 | 0 | 0 | 0 | (120) | 1,730 |

| | P | S | P (1) | S (2) | S (3) | S (4) | Consolidation |
|---------------------|-------|-----|-------|--------|--------|-------|---------------|
| Capital | 500 | 200 | | (98) | (102) | | 500 |
| Reserves | 300 | 150 | | (73.5) | (76.5) | | 300 |
| Result | 100 | 50 | | (24.5) | (25.5) | | 100 |
| Conso. reserves (S) | | | | 196 | 204 | | 84 |
| Minority int. | | | | | | (120) | 196 |
| Liabilities | 250 | 300 | | | | | 550 |
| Total Liabilities | 1,150 | 700 | 0 | 0 | 0 | 1120) | 1,730 |

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| | P | S | P(1) | S (2) | S (3) | S (4) | Consolidation |
|--------------------|-------|-----|------|-------|-------|-------|---------------|
| Income | 1,000 | 600 | | | | | 1,600 |
| Expenses | 900 | 550 | | | | | 1,450 |
| Result | 100 | 50 | | | | | 150 |
| 3rd Parties result | | | | | | | 24.5 |
| Group result | | | | | | | 125.5 |

It looks more like a spreadsheet approach with adjustments booked in each company.

We start first with the statutory accounts of each company, one company per column and then

- Column P (1) eliminates the investments on S by reclassifying them on a Link account
- Column S (2) reclassify 49% of Minority interests from equity to the corresponding Minority interests account
- Column S (3) eliminates the 51% group part of equity and reclassifies it on the consolidated reserves. At this point, equity of S is fully eliminated
- Column S (4) consists in booking in S on the Link account the opposite value of the investments on S. The counterpart is booked on Consolidated reserves.

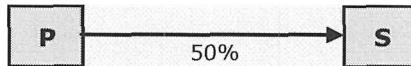
Consolidated accounts are represented in the last column on the right, which consists in a simple horizontal addition of all amounts.

Of course, consolidated value of the Link account is zero by construction and we can see that the Consolidated reserves are obtained by adding 204 which is the group part of equity and (120) which is the value of the investment on S in P accounts.

4.2 Proportional integration method

According to the method of proportional integration, the Assets, Liabilities, Expenses and Income of a joint subsidiary are included in the consolidated financial statements in proportion to the percentage held by the parent company.

Example



PART 2 BASICS OF CONSOLIDATION TECHNIQUES

| | | P | | S | |
|---------------|-----|----------|-----|----------|-----|
| Investments S | 120 | Capital | 500 | Capital | 200 |
| | | Reserves | 300 | Reserves | 150 |
| | | Result | 100 | Result | 50 |

| | | | | | |
|--------|-------|-------------|-------|--------|-----|
| Assets | 1,030 | Liabilities | 250 | Assets | 700 |
| Total | 1,150 | Total | 1,150 | Total | 700 |

| | | P + S | |
|--------|-------|---------------------|-------|
| | | Capital | 500 |
| | | Reserves | 300 |
| | | Result | 100 |
| | | Conso. reserves (S) | 80 |
| | | Minority int. | 0 |
| Assets | 1,380 | Liabilities | 400 |
| Total | 1,380 | Total | 1,380 |

| | | | |
|------------------|-------|--------|-------|
| Expenses | 1,175 | Income | 1,300 |
| Result | 125 | | |
| Minor. int. res. | 0 | | |
| Group result | 125 | | |

Explanation

At the balance sheet, the major difference compared to the global integration comes because the Assets and Liabilities of S are integrated in proportion to the financial percentage held. Therefore:

- The Capital, the Reserves and the Result of P are integrated at 100 %
- The Capital, the Reserves and the Result of S are integrated at 50% to calculate the Consolidated reserves = $80 = 50\% * [200+150+50] - 120$ (investment of S in P)
- The Assets of S are integrated at 50% and the Assets of P at 100 % = $[50\% * 700] + [100\% * 1030] = 1380$
- The Liabilities of S are integrated at 50% and the Liabilities of P at 100 % = $[50\% * 300] + [100\% * 250] = 400$

For the Profit and Loss account, the accounts of S are integrated in proportion to the financial percentage:

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- The Expenses of S are integrated at 50% and P at 100 % = [50% * 550] + [100% * 900] = 1175
- The Income of S are integrated at 50% and P at 100 % = [50% * 600] + [100% * 1000] = 1300
- The Result of S is integrated at 50% and P at 100 % = [50% * 50] + [100% * 100] = 125

Let's consider now the accounting approach for this proportional consolidation method.

| | P | S | P (1) | S (2) | S (3) | S (4) | Consolidation |
|---------------|-------|-----|-------|-------|-------|-------|---------------|
| Investments S | 120 | | (120) | | | | 0 |
| Assets | 1,030 | 700 | | (350) | | | 1,380 |
| Link account | | | 120 | | | (120) | 0 |
| Total Assets | 1,150 | 700 | 0 | (350) | 0 | (120) | 1,380 |

| | P | S | P (1) | S (2) | S (3) | S (4) | Consolidation |
|--------------------|-------|-----|-------|-------|-------|-------|---------------|
| Capital | 500 | 200 | | (100) | (100) | | 500 |
| Reserves | 300 | 150 | | (75) | (75) | | 300 |
| Result | 100 | 50 | | (25) | (25) | | 100 |
| Conso. reserves(S) | | | | 200 | | (120) | 80 |
| Minority int. | | | | | | | |
| | P | S | P (1) | S (2) | S (3) | S (4) | Consolidation |
| Income | 1,000 | 600 | | (300) | | | 1,300 |
| Expenses | 900 | 550 | | (275) | | | 1,175 |
| Result | 100 | 50 | 0 | (25) | 0 | 0 | 125 |
| 3rd Parties result | | | | | | | 0 |
| Group result | | | | | | | 125 |

Again, we start with the statutory accounts of each companies and then

Column P (1) eliminates the investments in P accounts, just as we did for the global integration method

- Column S (2) eliminates the 50% of Assets, Liabilities, Income and Expenses which cannot be integrated in the consolidated accounts
- Column S (3) eliminates the 50% of equity and reclassify the total amount on the Consolidated reserves

Column S (4) processes the investment via the Link account in the same way as before.

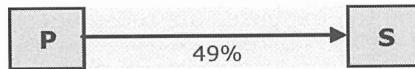
The consolidated figures are just the one obtained by horizontal addition.

4.3 The equity method

An investment consolidated with the equity method is recorded in the consolidated balance sheet for the part held in the share capital of the owned company, including the result of the year.

There are therefore, not as in the other two methods, additions of the Assets and Liabilities with the parent company. This makes sense given the fact that the Assets and Liabilities of the company consolidated via equity method are, by definition, not controlled.

Example



| Investments S | | 120 | Capital Reserves | | S | |
|---------------|-------|-------|---------------------|--|---------------------|-----|
| Assets | Total | 1,030 | Liabilities | | Capital Reserves | 200 |
| | | | | | Result | -- |
| | | | | | | |
| | | | | | | |
| Assets | Total | 700 | Liabilities | | Capital Reserves | 300 |
| Total | | 700 | Total | | Total | 700 |

| Expenses | 900 | Income | 1,000 | Expenses | 550 | Income | 600 |
|----------|-----|--------|-------|----------|-----|--------|-----|
| Result | 100 | | | Result | 50 | | |

| P + S | |
|-------------------|---------------------|
| | Capital |
| | Reserves |
| Equity value of S | 196 |
| | Result |
| | Conso. reserves (S) |
| Assets | 1,030 |
| Total | 1,226 |
| | Minority int. |
| | Liabilities |
| | 250 |
| | Total |
| | 1,226 |
| | |
| Expenses | 900 |
| Result | 124.5 |
| Minor. int. res. | 0 |
| Group res. | 124.5 |
| | Income |
| | Profit from Equity |
| | cies |
| | 24.5 |

Explanation

In the equity method, the investment that company P owns in company S is "upgraded" to the part owned in the equity of S.

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In the consolidated balance sheet:

- The Capital, the Reserves and the Result are those of company P
- The Consolidated reserves are equal to $76 = 49\% * (200 + 150 + 50) - 120$
- The Assets and Liabilities are those of company P
- Investments are upgraded and reclassified under the heading "Equity value of Equity method companies" = $196 = 49\% * (200 + 150 + 50)$

In the profit and loss account:

- The Income and the Expenses are those of company P
- Is incorporated under the heading "Profit from Equity companies" the result of S, attributable to P = $24.5 = 49\% * 50$ (result of S)
- In return, this has an impact on the result of the Group $124.5 = 100$ (result of P) + 24.5

In a more general situation where there could exist equity companies making losses and others making profits, the final consolidated P&L will present separately "Profits from Equity companies" and "Losses from Equity companies". This is a mandatory presentation required by all consolidations rules.

For those who have to produce a consolidated cash flow statement, notice that the result of S which is incorporated in the accounts of P is not a cash item.

Let's now present the accounting approach.

| | P | S | P (1) | S (2) | S (3) | S (4) | Consolidation |
|-------------------|-------|-----|-------|-------|-------|-------|---------------|
| Investments S | 120 | | (120) | | | | 0 |
| Equity value of S | | | | 196 | | | 196 |
| Assets | 1,030 | 700 | 120 | (700) | | | 1,030 |
| Link account | | | | | (120) | | 0 |
| Total Assets | 1,150 | 700 | 0 | (504) | 0 | (120) | 1,226 |

| | P | S | P (1) | S (2) | S (3) | S (4) | Consolidation |
|---------------------|-------|-----|-------|--------|--------|-------|---------------|
| Capital | 500 | 200 | | (102) | (98) | | 500 |
| Reserves | 300 | 150 | | (76.5) | (73.5) | | 300 |
| Result | 100 | 50 | | (25.5) | (24.5) | | 100 |
| Conso. reserves (S) | | | | | 196 | | 76 |
| Minority int. | | | | | (120) | | 0 |
| Liabilities | 250 | 300 | | (300) | | | 250 |
| Total Liabilities | 1,150 | 700 | 0 | (504) | 0 | (120) | 1,226 |

| | P | S | P (1) | S (2) | S (3) | S (4) | Consolidation |
|----------------------------|-------|-----|-------|--------|-------|-------|---------------|
| Income | 1,000 | 600 | | (600) | | | 1,000 |
| Profit from Equity invest. | | | | 25 | | | 24.5 |
| Expenses | 900 | 550 | | (550) | | | 900 |
| Result | 100 | 50 | 0 | (25.5) | 0 | 0 | 124.5 |
| 3rd Parties result | | | | | | | 0 |
| Group result | | | | | | | 124.5 |

- Column P (1) eliminates the investment on S via the Link account
- Column S (2) eliminates all accounts that cannot be integrated in the consolidated accounts, that means all Assets, Liabilities excepted the Equity for which the group must keep its 49%, Income and Expenses. Of course, as each column represents an adjustment, it must be in balance and for the balance sheet, we book the "Equity value of S" account which is 49% * Equity of S.
- Column S (3) eliminates the group part in equity
- Column S (4) processes the investment via the Link account in the same way as before.

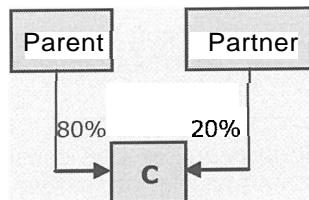
4.4 Consolidated reserves of a company

Consolidated reserves are the difference between the indirect percentage held in the equity of a subsidiary and the value of the investment that the parent company owns on this subsidiary.

Consolidated reserves = financial indirect % * equity of S - Investment in P

Example

In this example, parent company creates a company C with a Partner, contributing to 80% and 20% to the capital respectively.



The following accounts show that at the end of Year 1, company C makes a profit of 50 and a gross dividend of 20 is paid to the shareholders. At the end

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of year 2, company C makes a profit of 40. Here are the accounts of parent and C companies.

| Parent | | | C at creation date (Year 1) | | |
|---------------|-------|-------------|-----------------------------|-------------|-----|
| Investments S | 160 | Capital | 500 | Capital | 200 |
| | | Reserves | 300 | Reserves | 0 |
| | | Result | 100 | Result | 0 |
| Assets | 1,030 | Liabilities | 250 | Liabilities | 0 |
| Total | 1,190 | Total | 1,150 | Total | 200 |

We will calculate successively the consolidated reserves of company C at creation date, at the end of year 1 and at the end of year 2 by applying three times the same formula.

At creation date, consolidated reserves are $0 = 80\% * 200 - 160$.

At the end of Year 1, consolidated reserves = $40 = 80\% * [200 + 50] - 160$, which is just the group profit of Year 1 [$80\% * 50$].

| C at the end of year 1 | | |
|------------------------|----------|-------------|
| | Capital | |
| | Reserves | |
| | Result | |
| Assets | 550 | Liabilities |
| Total | 550 | Total |

At the end of Year 2, consolidated reserves = $56 = 80\% * [200 + 30 + 40] - 160$.

| C at the end of year 2 | | |
|------------------------|----------|-------------|
| | Capital | 200 |
| | Reserves | 30 |
| | Result | 40 |
| Assets | 670 | Liabilities |
| Total | 670 | Total |

The meaning of the 56 is the addition of the Year 1 and Year 2 profits for 40 and 32, minus the group dividends = $16 = 80\% * 20$.

So we can state that the consolidated reserves are just the accumulation of the group part in the result made each year by company C, less the dividends that are possibly paid during the same period.

That is also the reason why, at creation date, the consolidated reserves are zero, because no profit is made at that date.

After a certain number of years, we can also confirm that if the consolidated reserves are positive, the net contribution of the company in the group account is certainly a profit.

That specific account that appears in the consolidated accounts must be considered indeed as reserves just like other reserves accounts, because it is accumulation of non distributed results of each company.

4.5 Comparison between the different consolidation methods

In this chapter, we have considered two companies P and S, P owning S with 51%, 50% and 49% successively. For each of these percentages, we have then applied the corresponding consolidation method to statutory accounts which have been maintained identical.

What is the effect of these consolidation methods on the same figures? The answer can be found in the following presentation.

| | Global integration | Proportional integration | Equity method |
|-------------------|--------------------|--------------------------|---------------|
| Investments S | 0 | 0 | 0 |
| Equity value of S | | | 196 |
| Assets | 1,730 | 1,380 | 1,030 |
| Link account | 0 | 0 | 0 |
| Total Assets | 1,730 | 1,380 | 1,226 |

| | Global integration | Proportional integration | Equity method |
|---------------------|--------------------|--------------------------|---------------|
| Capital | 500 | 500 | 500 |
| Reserves | 300 | 300 | 300 |
| Result | 100 | 100 | 100 |
| Conso. reserves (S) | 84 | 80 | 76 |
| Minority int. | 196 | 0 | 0 |
| Liabilities | 550 | 400 | 250 |
| Total Liabilities | 1,730 | 1,380 | 1,226 |

| | Global integration | Proportional integration | Equity method |
|-------------------------|--------------------|--------------------------|---------------|
| Income | 1,600 | 1,300 | 1,000 |
| Profit from Equity cies | | | 24.5 |
| Expenses | 1,450 | 1,175 | 900 |
| Result | 150 | 125 | 124.5 |
| 3rd Parties result | 24.5 | 0.0 | 0.0 |
| Group result | 125.5 | 125.0 | 124.5 |

We can see that the total of the consolidated balance sheet decreases the same time the group is decreasing its level of control on company C.

The group equity which is equal to the addition of Capital, Reserves, Result and Consolidated reserves would have been the same if the percentage itself

would have remained unchanged. That means the Group equity does not depend on the consolidation method.

Of course, this becomes not true if we take into account the Minority interests which can be considered as equity (not debts!).

In particular, the consolidated reserves of S are showing a difference of **4** which is due to the effect of the percentage variation of 1% on its equity.

Finally, the contribution of S in the group profit is also decreasing because of the 1%. That means the profit doesn't depend on the consolidation method neither.

4.6 The value of a company from a consolidation point of view

The objective of this section is certainly not to give a magic formula for the value of a company. There are so many different values depending on so many various elements that we would be completely out of the subject of this book. In fact, we just want to focus on two values amongst so many others.

A first and basic value of an investment in a company A corresponds to the amount booked in parent company P accounts. That amount generally represents the historical acquisition price of the shares, which usually remains unchanged through the time. When P decides to sell these shares, the gain on disposal is just the difference between the selling price and the book value.

From the consolidation point of view, the value of company A is the part of the equity owned by P in A. We speak about the 'equity value' which will apply to any company, whenever its consolidation method is. For instance, the equity value of a 80% owned company, consolidated by the global consolidation method, is just 80% of its equity.

That means also, supposing company A is making profits each year without paying dividends, that the equity is increasing and so does the 80% equity value.

Let's summarize what we just said in the following formulas

$$\text{Equity value of A} = \text{Financial \%} * \text{Equity of A}$$

which could be rewritten as

$$\begin{aligned}\text{Equity value of A} &= \text{Investment in A} + \text{Financial \%} * \text{Equity of A} \\ &\quad - \text{Investment in A}\end{aligned}$$

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and if we put the following brackets

$$\text{Equity value of A} = \text{Investment in A} + [\text{Financial \%} * \text{Equity of A} - \text{Investment in A}]$$

we can write

$$\text{Equity value of A} = \text{Investment in A} + \text{Consolidated reserves of A}$$

This formula shows very clearly that the difference between the statutory value of A in P accounts and the equity value is equal to the consolidated reserves of A. This is not surprising because in consolidation, we show a company A whose value is increasing year after year depending on its profits.

In statutory accounts of P, the value is frozen.

The important consequence of these considerations is the fact that, for instance, if the selling price of a company is 100 and the statutory book value in P is 80, the gain on disposal is 20. If we suppose the equity value of A is 120, there is a loss on disposal of 20 in consolidation. And this is normal, because between the acquisition of A and its disposal, we have shown in consolidation a company becoming more and more "rich" or valuable.

These considerations explained here will be reminded when we will consider the adjustments needed to process a disposal of a company out of the consolidation scope.

But, at this moment, don't get confused when we speak about the equity value of a company, even if this company is not consolidated by the equity method. This is just a wording convention.

THE CONSOLIDATION TECHNIQUES

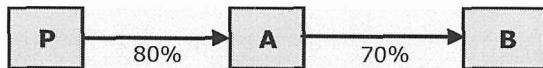
The structure of a group is often complicated by the fact that not only the parent company owns subsidiaries but that some subsidiaries can own shares in other subsidiaries. A question arises then on how to consolidate such groups. There are basically two techniques to consolidate such groups:

- The consolidation by stage.
- The direct consolidation.

5.1 The technique of stage consolidation

This technique consists in consolidating each company by the company that owns the company directly and thus consolidate up step by step, from bottom to top.

Example



In this structure we first consider A and B as a group where A is playing the role of the parent company. We already know how to consolidate these two companies. Let's call "A+B" the consolidated figures of this subgroup. We then consolidate P and A+B to achieve the complete consolidation.

Here are the statutory balance sheets of these companies

| P | | | |
|---------------|-----|-------------------------------|-----|
| Investments A | 160 | Capital Reserves Result | 500 |
| Assets | 640 | Liabilities | 120 |
| Total | 800 | Total | 800 |

| | | | |
|---------------|-----|-------------------------------|-----|
| Investments B | 100 | Capital Reserves Result | |
| Assets | 400 | Liabilities | 120 |
| Total | 500 | Total | 300 |

| B | | | |
|----------|-----|-------------------------------|-----|
| | | Capital Reserves Result | 100 |
| Assets | 360 | Liabilities | 200 |
| Total | 360 | Total | 360 |

Explanations

In step 1, we consolidate B with the global integration method in A and with a percentage of 70%:

- The Capital, the Reserves and the Result come from company A
- Consolidated reserves on B = $12 = 70\% * [100 + 50 + 10] - 100$

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- Minority interests on B = $48 = 30\% * [100+50+10]$
- Assets and Liabilities accounts come from the addition of A and B for 100 %.

Here is the consolidated balance sheet of A+B

| A + B | | |
|-------------------|--------|-------------|
| | Assets | Liabilities |
| | Total | Total |
| | | |
| Capital | 200 | |
| Reserves | 150 | |
| Result | 30 | |
| Conso. Res. (B) | 12 | |
| Minor. Inter. (B) | 48 | |
| | 760 | 320 |
| | Total | Total |
| | 760 | 760 |

In step 2, we consolidate, by global integration, the A+B level in company P:

- The Capital, the Reserves and the Result come from company P
- Consolidated reserves of A+B = $153.6 = 80\% * [200+150+30+12] - 160$
- Minority interests on A+B = $126.4 = 20\% * [200+150+30+12] + 48$
- Assets and Liabilities accounts come from the addition of P and A+B at 100 %.

Here is the final consolidated balance sheet for this group.

| P + (A + B) | | |
|---------------------|--------|-------------|
| | Assets | Liabilities |
| | Total | Total |
| | | |
| Capital | 500 | |
| Reserves | 150 | |
| Result | 30 | |
| Conso. Res (A+B) | 153.6 | |
| Minor. Inter. (A+B) | 126.4 | |
| | 1,400 | 440 |
| | Total | Total |
| | 1,400 | 1,400 |

We notice that the consolidated reserves calculated for B at the first level are considered as an equity account on which we apply the 80%.

On the Minority interests side, the 48 calculated on the first level have to be added at 100% to the calculation of Minority interests in the next level.

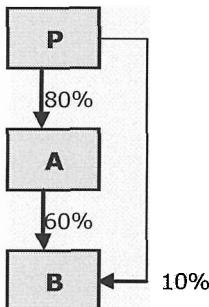
DIRECT CONSOLIDATION

Moreover, the 20% Minority interests at the final level also applies on the equity of A+B, including the 12 consolidated reserves of B.

Is this consolidation technique efficient in any group structure?

If we suppose a larger group with a simple tree structure, the answer would be yes because we could consolidate the whole group starting at the bottom and consider two companies at a time. We would finally reach the top parent company after making a certain number of consolidations of two companies each time.

Nevertheless, some problems could arise if, for instance, the group structure is the following.



Applying the step by step approach, we would first consolidate A+B and then P+(A+B), giving a consolidated balance sheet in which we would still have a "Financial investment in B" account for a certain amount.

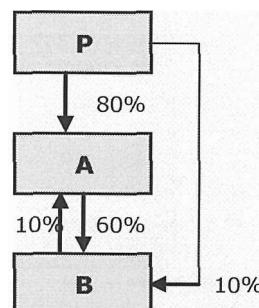
This amount must be eliminated against 10% of the equity of B. And this situation could become serious if, for instance, A is supposed to be a company located on another continent, A making its own consolidation, with its own adjustments.

A+B would become a kind of a black box and we would bet that the final consolidated accounts would be achieved with great difficulties and loss of time because of the additional information needed.

And for those who still believe that the stage consolidation is a helpful technique, let consider this final example.

We see that company B owns shares of company A which makes quite impossible to determine a stage in such structure.

The stage consolidation technique becomes inefficient in such structure.



5.2 The direct consolidation technique

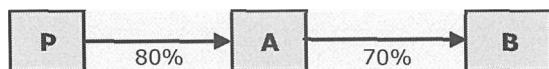
This technique is used to reduce the complexity of the group structure, to the so-called simple "rake" structure, where each company is directly consolidated by the parent company based on the indirect financial percentage held by the group in the company.

With this technique, consolidation is done in one step because all companies, regardless of their position in the group structure, are consolidated at once.

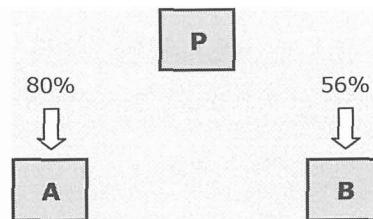
The last structure considered in the previous section, with crossed participations, would be consolidated without problems.

Let's explain how to use the direct consolidation technique on the basis of the same example

We remind here the group structure



which is transformed into a kind of a "rake" structure just as if each company would be owned directly by the parent company.



Of course, this transformation brings a new difficulty: the calculation of indirect financial percentages sometimes in quite complex structures, which could include crossed participations. We will come back to that subject at the end of this chapter.

For the moment, we just associate to each company its indirect financial percentage which is 80% for A and $56\% = 80\% * 70\%$ for B.

We consider the same balance sheets as above but this time we produce the final consolidated balance sheet of our example in a single process.

| P + A + B | | |
|------------------|-------------------|-------------|
| | Capital | 500 |
| | Reserves | 150 |
| | Result | 30 |
| | Conso. Res. (A) | 144 |
| | Conso. Res. (B) | 9.6 |
| | Minor. Inter. (A) | 56 |
| | Minor. Inter. (B) | 70.4 |
| Assets | 1,400 | Liabilities |
| Total | 1,400 | Total 1,400 |

Explanations

From this consolidation technique there is only one step: both A and B are consolidated by global integration directly with P:

- The Capital, the Reserves and the Result come from company P
- The Consolidated reserves of A = $144 = 80\% * [200 + 150 + 30] - 160$.
- The Consolidated reserves of B = $9.6 = 56\% * [100 + 50 + 10] - 80\% * 100$ where $56\% = 80\% * 70\%$ = indirect financial percentage in B
- Minority interests of A = $56 = 20\% * [200 + 150 + 30 - 100]$
- Minority interests of B = $70.4 = 44\% * [100 + 50 + 10]$
- Assets and Liabilities of P, A and B are added together at 100 %.

Two additional explanations are necessary.

Firstly we have to extend our definition of the consolidated reserves, which becomes "the indirect financial percentage in equity minus the indirect percentage of the shareholder in the investment owned". That's the reason why we apply 80% on the value of 100.

Secondly, we also have to extend the definition of the Minority interests calculation, which becomes "the Minority interests percentage in equity minus the same percentage in investments the concerned company has booked in its assets". This value is called the 'net equity value'. This is the reason why we find the term $-20\% * 100$.

We would summarize the approach by confirming that the direct technique is fully efficient with regard to any complex group structure if we take into account the three following issues

- Be able to calculate the indirect financial percentage
- Don't forget to take into account the indirect percentage of the shareholder when eliminating the investment in the consolidated reserves calculation
- Don't forget to calculate Minority interests in the net equity value as being equal to the equity minus the investments

5.3 Why applying a percentage on the investments when eliminating them?

We can start the explanation by going back to the stage technique and consider the calculation of the consolidated reserves of company B, company A being temporarily the parent company.

The consolidated reserves of B were calculated as

$$70\% * [100 + 50 + 10] - 100 = 12$$

One stage higher, we calculated the consolidated reserves of A+B as

$$80\% * [200 + 150 + 30 + 12] - 160 = 153.6$$

Let's now replace the amount of 12 by the previous formula to get

$$80\% * [380 + [70\% * 160 - 100]] - 160 = 153.6$$

in which we have added together the statutory equity of each company to keep the formula more readable.

We now make the following arrangement based on simple algebra rules

$$\begin{aligned} & 80\% * [380 + [70\% * 160 - 100]] - 160 = 153.6 \\ & = [80\% * 380 - 160] + [80\% * 70\% * 160 - 80\% * 100] = 153.6 \\ & = [80\% * 380 - 160] + [56\% * 160 - 80\% * 100] = 153.6 \end{aligned}$$

The two terms between [] can be identified as the consolidated reserves of A calculated by the direct technique and the second term is the consolidated reserves of B.

This proves the equivalence of the two approaches and we can state that $CR(A+B) = CR(A) + CR(B)$ where CR means Consolidated Reserves.

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Moreover, the left hand side of the equality is based on the stage consolidation while the right hand side is based on the direct technique.

A similar approach can be developed for the Minority interests.

Again, let's start with the Minority interests calculated by the stage technique which were 20% of A+B equity

$$20\% * [200 + 150 + 30 + 12] = 20\% * [380 + 12]$$

where 12 is the consolidated reserves of B calculated as $70\% * [100+50+10] - 100 = 70\% * 160 - 100$.

Let's replace again the 12 in the previous formula, giving

$$\begin{aligned} 20\% * [380 + 12] &= 20\% * [380 + [70\% * 160 - 100]] \\ &= 20\% * 380 + 14\% * 160 - 20\% * 100 \\ &= 20\% * [380 - 100] + 14\% * 160 \end{aligned}$$

and so we find the term $20\% * 100$ which is the part of Minority interests in the investment owned by A. Moreover the 14% are called the indirect Minority interests in company B.

THE CURRENCY TRANSLATION

6 . Currency translation principles

Groups often have subsidiaries in foreign countries, meaning that the individual accounts of these subsidiaries are then booked in foreign currency. It may happen that a parent company is located in a geographical area completely different than the majority of subsidiaries. Then it seems normal that the consolidated financial statement is expressed in the currency of the majority of the subsidiaries.

More often however, it is the currency of the parent company that is used as consolidating currency.

Following IFRS rules, the currency defined for each subsidiary is the functional currency, which is the main currency, used for business transactions. That functional currency can be different from the legal currency used for the statutory accounts.

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The statutory accounts of subsidiaries must then be translated into the currency of the parent company which is also called the consolidation currency.

The information we receive from subsidiaries can be summarized mainly in several categories

- The balance sheet accounts
- The P&L accounts
- Notes to the accounts, including what we call flows, which are amounts explaining the evolution between opening and closing accounts. Flows can be seen as acquisitions, disposals, depreciations, transfers between accounts, ...

For these subsidiaries whose accounts are booked in foreign currency, we highly recommend to receive foreign currency information instead of information already translated into consolidation currency. The explanations developed in this chapter will show that this process of currency translation must be managed by the consolidation department.

How do we translate these three main categories of information?

The balance sheet accounts

A balance sheet is a picture taken at the end of the consolidation period. It seems normal to use the currency rate corresponding to that date to translate all amounts.

Obviously, the translated balance sheet is of course in balance. Nevertheless we will explain on a basis of an example that, from an accounting point of view, this translation brings some problems. We will explain why and how we need to introduce historical rates for equity and financial investments.

The P&L accounts

The P&L is not a picture. It is a movie. To give a correct economical picture of it, one should translate all income and expenses of January 1 at the rate of that date, and all income and expenses of January 2 at the rate of that second date, and so on until the end of the period. Very difficult to apply!

A much more realistic approach consists in using an average rate over the twelve months of the year. Usually, this average rate is the arithmetic mean of the twelve monthly closing rates of the period.

The notes to the accounts

Speaking about the flows, they are also a kind of movie showing different pictures during the consolidation period. Happening during the year, it seems reasonable to also use the same average rate as the one used for the P&L.

Moreover, we should keep in mind that some validations are usually made when receiving the subsidiaries information. For instance, in local currency, the flow corresponding to a new provision booked in the Liabilities should be found as equal to a provision booked in the P&L. Of course, after currency translation, these two amounts should remain equal. This is only possible if we use the same average rate.

6.2 Currency translation of a balance sheet and a P&L

In this section, we will explain how to translate into consolidation currency a balance sheet and a P&L of a company presenting its statutory accounts in a certain local currency CUR for Year 1 and Year 2.

But before starting this process, let us make some remarks.

We will notice these accounts are presented before appropriation. The profit of Year 1 of 300 in P&L is found on a profit account in equity. We keep the same presentation for the profit of 400 in Year 2.

| (CUR) | | |
|------------------|--------|--------|
| | Year 1 | Year 2 |
| Assets | 5,000 | 5,700 |
| | 5,000 | 5,700 |
| Capital Reserves | | |
| Liabilities | 1 200 | 1 500 |
| | 5,000 | 5,700 |
| Income | 2,500 | 3,000 |
| Expenses | 2,200 | 2,600 |
| Profit | 300 | 400 |

It is also important to see that the capital of 3.500 remains unchanged from Year 1 to Year 2.

Moreover, this company doesn't pay any dividends on the basis of the profit of 300 because we can find back this amount in the reserves next year.

Finally, we are aware that the number of accounts is quite reduced, but it is sufficient to explain fully the translation process.

We will first start to translate Year 1 accounts by applying the principle of the closing rate ($1\text{CUR} = 2\text{ EUR}$) for each balance sheet account and the average rate ($1\text{CUR} = 2.1\text{ EUR}$) for the P&L. This translation appears in column (1).

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| | (CUR) | (EUR) | (EUR) | (EUR) |
|-------------------------|--------|--------|-------------|--------|
| | Year 1 | (1) | (2) | (3) |
| Assets | 5,000 | 10,000 | | 10,000 |
| | 5,000 | 10,000 | 0 | 10,000 |
| Capital | 3,500 | 7,000 | | 7,000 |
| Reserves | 0 | 0 | | 0 |
| Profit | 300 | 600 | 30 | 630 |
| Translation adjustments | | | (30) | (30) |
| Liabilities | 1,200 | 2,400 | | 2,400 |
| | 5,000 | 10,000 | 0 | 10,000 |
| Income | 2,500 | 5,250 | | 5,250 |
| Expenses | 2,200 | 4,620 | | 4,620 |
| Profit | 300 | 630 | 0 | 630 |

By considering this column, we have to admit that a problem appears in the accounts because the profit in the P&L (630) is no longer the same as the profit in the equity (600). The correct value is the one corresponding to a translation at the average rate. That's the reason why we have to book in column (2) a consolidation adjustment transferring 30 (debit) from an account names "Translation adjustments" to the profit (credit).

Column (3), which is just the addition of columns (1) and (2) gives the correct translated accounts of that company for Year 1.

Now, one year later, we receive again the local currency accounts of that company. Let's process the translation on the basis of a closing rate 1 CUR = 2.2 EUR and an average rate 1 CUR = 2.5 EUR.

Here is what we get.

| | (CUR) | (EUR) | (EUR) | (EUR) | (EUR) | (EUR) | (EUR) |
|-------------------------|--------|--------|-------------|------------|--------------|-----------|------------|
| | Year 2 | (1) | (2) | (3) | (4) | (5) | (6) |
| Assets | 5,700 | 12,540 | | | | | 12,540 |
| | 5,700 | 12,540 | 0 | 0 | 0 | 0 | 12,540 |
| Capital | 3,500 | 7,700 | | | | | 7,000 |
| Reserves | 300 | 660 | 30 | | | | 630 |
| Profit | 400 | 880 | | | | | 1,000 |
| Translation adjustments | 1,500 | 3,300 | (30) | 120 | (120) | 60 | 700 |
| Liabilities | 5,700 | 12,540 | 0 | 0 | 0 | 0 | 12,540 |
| Income | 3,000 | 7,500 | | | | | 7,500 |
| Expenses | 2,600 | 6,500 | | | | | 6,500 |
| Profit | 400 | 1,000 | 0 | 0 | 0 | 0 | 1,000 |

In column (1), we see the local amounts all translated at closing rate 2.2 for the balance sheet and the P&L translated at the average rate of 2.5.

In consolidation, there is an important principle to consider. When we book an adjustment impacting the result one year, we must find this adjustment impacting the reserves next year. Moreover, if a consolidation adjustment impacts the reserves one year, we must find the same amount on the same reserves account next year. That's just a normal accounting principle.

That also means that the consolidation adjustment (1) booked in Year 1 must now appear in Year 2 with an impact on the reserves account. That is the role of column (2) to carry forward what we call "historical adjustments".

In column (3), we have the same problem as the one we had in Year 1. After translation, profit in P&L is 1.000 and profit in equity is only 880. So we need to book a debit of 120 on the "Translation adjustments account" and a credit of 120 on the profit account.

But another problem arises for the reserves account this year. Year 1 profit of 300 CUR (630 EUR) is carried forward to the reserves but we find 690 EUR instead of 630 EUR. That's the reason of the adjustment in column (4). Such an adjustment will be necessary each year from now on.

And we have a final problem with the capital because, in local currency we have no increase of capital, but after translation we find an increase of 700 EUR. This amount cannot remain on the capital account. That is the role of column (5) to debit the capital for 700 and to credit the translation adjustments for 700.

Column (6) shows the correct translated amounts.

All these adjustments pursue the same objective: find the same accounting relations on the equity after translation than the one we found in local currency.

And behind all that, we could also formulate another important consolidation principle: reserves can only evolve with the consolidated result of the group and the dividends paid by the parent company, just like (in most cases) in statutory accounts.

All other elements appearing as a variation of the reserves may not remain in that account but must be reclassified on another account, depending on its nature.

6.3 How do we consolidate foreign companies?

To explain how to consolidate a foreign company, we will make the following assumptions

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- We will consider the figures processed in the previous section for the foreign company named A
- We will suppose company A is owned at 80% by a parent company P
- Consequently, we will apply the global consolidation method, but all the principles would remain unchanged for the two other methods
- The consolidation will be done for Year 1 and Year 2
- Only balance sheets will be consolidated.

Consolidation of Year 1

Here is the balance sheet of P with a minimal number of accounts.

| P | | | |
|---------------|-------|-------------|-------|
| Investments S | 4,000 | Capital | 5,000 |
| Assets | 3,000 | Liabilities | 2,000 |
| Total | 7,000 | Total | 7,000 |

Balance sheet of A is presented after currency translation and the figures are the one we calculated in previous section.

| A after currency translation (80%) | | |
|------------------------------------|----------------|--------|
| | Capital | 7,000 |
| | Reserves | 0 |
| | Result | 630 |
| Assets | Trans. Adjust. | (30) |
| 10,000 | Liabilities | 2,400 |
| Total | Total | 10,000 |

The consolidated balance sheet hereunder implies the following comments

| P + A | | |
|--------|-------------------------|--------|
| | Capital | 5,000 |
| | Reserves | 0 |
| | Result | 0 |
| Assets | Conso. reserves (A) | 2,104 |
| 13,000 | Translation adjustments | (24) |
| | Minority interests | 1,520 |
| Total | Liabilities | 4,400 |
| 13,000 | Total | 13,000 |

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The consolidated reserves of A are $6104 = 80\% * [7000 + 0 + 630] - 4000$ and you can notice that the translation adjustments of (30) are not included in the formula. Indeed, we have made a special effort to "clean" the reserves with the undesirable effect of currency rates. Including that amount in the formula would make consolidated reserves unexplainable from the classical accounting point of view.

So, the rule is that consolidated reserves of a foreign company do not include the translation adjustments.

This means that the group part of the translation adjustments, $80\% * (30) = (24)$ remains on a separate line in the consolidated equity.

On the contrary, the calculation of minority interests will include these translation adjustments. No specific line is required and so they are $1520 = 20\% * [7000 + 0 + 630 + (30)]$.

These rules may be seen as exceptions, but for the rest of the process we are back to a classical global integration.

Consolidation of Year 2

For P, we suppose the balance sheet remains unchanged.

| P | | | |
|---------------|-------|-------------|-------|
| Investments S | 4,000 | Capital | 5,000 |
| Assets | 3,000 | Liabilities | 2,000 |
| Total | 7,000 | Total | 7,000 |

Here is the Year 2 balance sheet of company A as calculated in previous section.

| A after currency translation (80%) | | | |
|------------------------------------|----------------|-------------|--------|
| | Capital | 7,000 | |
| | Reserves | 630 | |
| | Result | 1,000 | |
| | Trans. Adjust. | 610 | |
| Assets | 12,540 | Liabilities | 3,300 |
| Total | 12,540 | Total | 12,540 |

The consolidated balance sheet account is obtained with the same remarks, as summarized hereunder

PART 2 BASICS OF CONSOLIDATION TECHNIQUES

| P + A | | |
|--------------|-------------------------|--------|
| | Capital | 5,000 |
| | Reserves | 0 |
| | Result | 0 |
| | Conso. reserves (A) | 2,904 |
| | Translation adjustments | 488 |
| | Minority interests | 1,848 |
| Assets | Liabilities | 5,300 |
| Total | 15,540 | Total |
| | | 15,540 |

- Consolidated reserves of A = **2904** = 80% * [7000 + 630 + 1000] - **4000**
- Translation adjustments = **488** = 80% * **610**
- Minority interests = **1848** = 20% * [7000 + 630 + 1000 + **610**].

The final significant remark comes from the comparison of the consolidated reserves between Year 1 and Year 2, whose difference is **800** = **2904** - **2104** = 80% * **1000**. This amount is just the group part in the Year 2 profit of A which brings us back to the basic definition: the accumulation of group profit year after year.

6.4 Currency translation of flows?

We have seen part of the consolidation reporting consists in notes to the accounts, most of them explaining the evolution between opening and closing value of accounts.

| | |
|---------------|-------|
| Opening value | 2,000 |
| Acquisitions | 800 |
| Disposals | (300) |
| Closing value | 2,500 |

and disposals for (300) CUR.

Let's consider the following example of a 'Building account' in local foreign currency CUR. The evolution between the opening and closing values consists in acquisitions for 800 CUR

The closing rate of Year 1 is 1 CUR = 2 EUR and the closing rate of Year 2 is 1 CUR = **2.2**EUR.

As such transactions of acquisitions and disposals may happen several times during the consolidation period, it is the average rate of 1 CUR = **2.5** EUR that will apply.

After currency translation, here is what we get. We are placed in a situation of "discontinuity" in the consolidation process because of the existence of different rates.

| | |
|-------------------------|-------|
| Opening value | 4,000 |
| Acquisitions | 2,000 |
| Disposals | (750) |
| Translation adjustments | 250 |
| Closing value | 5,500 |

Indeed, the opening value is $4000 = 2000 * 2$ when the closing value is $5500 = 2500 * 2.2$. These 2500 still includes a part of the 2000 included in the opening value. This common part is once translated at 2 and next year

translated at 2.2.

Moreover, the flows are translated at average rate of 2.5, always different of these closing rates. Again, we are faced to a situation which is correct in foreign currency but wrong after translation currency. The only way to put all things back in balance is to introduce a special flow named "Translation adjustments" for an amount of 250.

This flow has nothing to see with the translation adjustments account previously seen.

The difficult point is that for the need of the different notes to the accounts, the translation of flows must be done for at least non current accounts in the balance sheet. Moreover, if a cash flow statement is also required, then the translation of flows must apply to all the accounts.

6.5 How to manage historical rates on the equity accounts?

When translating the balance sheet, we have seen that the equity has to be translated at historical rate in order to avoid some problems in justifying evolution of consolidated reserves.

Year after year, this situation is becoming more and more difficult to manage all these currency rates and the purpose of this section consists in explaining one best practice.

We will consider a capital account of a foreign company from Year 1 to Year 4, with the following assumptions

- In Year 1, Year 2 and Year 3, the capital amount remains unchanged, except the closing rate of each year which changes
- In Year 4, we suppose a capital increase happening during the year.

PART 2 BASICS OF CONSOLIDATION TECHNIQUES

What follows explains how to manage the translation adjustments in order to keep things auditable for every one.

We consider a capital of 100 CUR from Year 1 to Year 3.

| | Year 1 | Year 2 | Year 3 | Year 4 |
|----------------------------|--------|--------|--------|--------|
| Capital in local currency | 100 | 100 | 100 | 120 |
| Historical rate | 1.6 | | | |
| Closing rate | 1.5 | 1.7 | 1.8 | 1.4 |
| Capital at historical rate | 160 | 160 | 160 | 191 |
| Capital at closing rate | 150 | 170 | 180 | 168 |

The historical rate for this capital is 1.6. Of course, closing rate is changing as shown here above.

A certain day of Year 4, there is a capital increase of 20 CUR and the currency rate that day is 1.55 giving a valuation of that capital increase for $31 = 20 * 1.55$.

The main idea for historical rate is to keep track of translations adjustments instead of historical currency rates, as explained hereunder

| Adjustment of capital | Year 1 | Year 2 | Year 3 | Year 4 |
|---------------------------|--------|--------|--------|--------|
| Year 1 | 10 | 10 | 10 | 10 |
| Year 2 | | (20) | (20) | (20) |
| Year 3 | | | (10) | (10) |
| Year 4 | | | | 40 |
| Year 4 | | | | 3 |
| Capital after adjustments | 160 | 160 | 160 | 191 |

| Translation adjustments | Year 1 | Year 2 | Year 3 | Year 4 |
|-------------------------|--------|--------|--------|--------|
| Year 1 | (10) | (10) | (10) | (10) |
| Year 2 | | 20 | 20 | 20 |
| Year 3 | | | 10 | 10 |
| Year 4 | | | | (40) |
| Year 4 | | | | (3) |
| | (10) | 10 | 20 | (23) |

- In Year 1, closing rate value of capital is $150 = 100 * 1.5$ instead of historical rate $160 = 100 * 1.6$. So we have to increase by 10 the translated amount of the capital. That means a credit of 10 on Capital account and a debit of 10 on the Translation currency account.

- In Year 2, the process is made in two steps. First, we carry forward the Year 1 historical adjustment of 10 and secondly we compare the closing value of capital in Year 2 with the corresponding value in Year 1, which is $20 = 170 - 150$. That amount becomes the adjustment of Year 2 as shown above: debit capital for 20 and credit Translation adjustments for 20.
- In Year 3, we apply the same two processes. First, carry forward of both Year 1 and Year 2 translation adjustments and then compare closing value of capital between Year 3 and Year 2, $10 = 180 - 170$, which gives a debit capital for 10 and a credit Translation adjustments or 10.
- Year 4 is a little bit complicated because of the capital increase. First, let's carry forward the historical adjustments related to Year 1, Year 2 and Year 3. Then, the capital amount of 120 CUR must be split into 100 CUR and 20 CUR. For the 100 CUR, we apply the same rule: closing rate value of Year 4 - closing rate value of Year 3 = $(40) = 140 - 180$ which becomes a debit translation adjustment for 40 and a credit capital for 40. Finally, the capital increase for 20 has been translated at closing rate 1.4 instead of transaction rate 1.55, giving a difference of $3 = 20 * [1.55 - 1.41]$. So we have to debit the Translation adjustments for 3 and credit the capital for 3.

In most consolidation software, this kind of process is automatically provided, based on what has been explained in this section. None keeps tracks of individual rates. All of them are using adjustments.

We can easily understand that after a certain number of years, the number of translation adjustments increase. After audit, it is recommended to aggregate them in order to keep their number reasonable.

6.6 Consolidation adjustments in local currency

The subject of consolidation adjustments will be largely covered in chapter 8. However, within the scope of currency translation, we would like to explain how to translate a foreign currency adjustment.

A consolidation adjustment can be seen as a journal entry that cannot be booked in the legal accounting of a company for some reasons which may be legal, fiscal or inconsistent with Local Gaap. In such situation, these journal entries are booked at consolidation level. When the company accounting is in foreign currency, the consolidation adjustment must also be booked in local currency and translated into consolidation currency following specific rules.

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These will be explained on the basis of an example hereunder.

In Year 1, let's suppose we have to book the following adjustment in the consolidation

| Year 1 (CUR) | Debit | Credit |
|--------------------------------|-------|--------|
| Depreciations in P&L | 100 | |
| Tangible assets (deprecations) | | 100 |

Just to fix our mind, we can imagine a fixed asset which is depreciated over 10 years in statutory accounts but, referring to consolidation rules, this period of depreciation must be only 5 years. So we suppose we have to book an additional depreciation of 100 CUR over that period.

In Year 2, this consolidation adjustment becomes

| Year 2 (CUR) | Debit | Credit |
|--------------------------------|-------|--------|
| Depreciations in P&L | 100 | |
| Reserves | 100 | |
| Tangible assets (deprecations) | | 200 |

Of course, these adjustments are impacting the consolidation finally in EUR after currency translation. Let's suppose the rates are the following.

| | Year 1 | Year 2 |
|--------------|--------|--------|
| Closing rate | 1.5 | 1.2 |
| Average rate | 1.4 | 1.3 |

The Year 1 adjustment is translated just like a balance sheet and a P&L would be. Balance sheet accounts are translated at closing rate, P&L accounts at average rate and we must take care of the profit/reserve effect that is translated at historical rate.

Here are the translated adjustments of Year 1 with

- Tangible assets (deprecations) = 100 CUR * 1.5 = 150
- Depreciations in P&L = 100 CUR * 1.4 = 140
- Translation adjustments (equity account) for a difference of 10

| Year 1 (EUR) | Debit | Credit |
|--------------------------------|-------|--------|
| Depreciations in P&L | 140 | |
| Translation adjustments | 10 | |
| Tangible assets (deprecations) | | 150 |

The Year 2 adjustment, after translation, becomes

| Year 2 EUR | Debit | Credit |
|---------------------------------|-------|--------|
| Depreciations in P&L | | |
| Reserves | | |
| Translation adjustments | | |
| Tan_ible assets _de_reciations. | 240 | |

where

- Tangible assets (depreciations) = 200 CUR * 1.2 = 240
- Depreciation in P&L = 100 CUR * 1.3 = 130
- Reserves is the value of the P&L impact of Year 1 = 140
- Translation adjustments (equity account) for a difference of 30.

Through this example, we see that as soon as a consolidation adjustment has been booked in local currency, we have to keep track of historical impacts on P&L, which are carried forward to reserves. Ignoring this mechanism leads to technical problems in the consolidation.

This example shows also the difficulty to explain the content of the translation adjustments account in the equity.

7 INTERCOMPANY MATCHING ANALYSIS

7.1 Some important principles about intercompany matching

Why an intercompany matching analysis?

Let's repeat again one of the main objectives of the consolidated financial statements: to produce an economical picture of a set of companies acting with the outside world, just as if they would behave as a single company.

It becomes then normal that all transactions between companies of a group, whenever they impact the balance sheet or the P&L, should not appear in the final consolidated financial statements.

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From an accounting point of view, this means that we have to eliminate receivables in one company with corresponding payables booked in the partner accounts, same for turnover and purchases. In fact, the general rule is that any balance sheet or P&L amount related to another company of the group must be eliminated.

But before eliminating intercompany amounts between two companies, we must first check that both amounts are the same. This is the reason why we need to proceed to that intercompany matching.

Which companies are concerned with intercompany positions?

We have seen that companies in a group can be consolidated with the global integration method, the proportional integration method or the equity method.

For the two first methods, all accounts are integrated in the consolidated financial statements at 100% or at the proportional percentage, which means we need to have knowledge of all intercompany positions for these two kinds of companies. But for the equity method companies, we do not integrate their individual accounts.

Consequently, it makes no sense to ask the intercompany positions for equity method companies nor to ask the same information for the two first consolidation method companies when the transactions are done with equity method companies.

Let's summarise this hereunder

| | Global integration | Proportional integration | Equity method |
|--------------------------|--------------------|--------------------------|---------------|
| Global integration | Yes | Yes | No |
| Proportional integration | Yes | Yes | No |
| Equity method | No | No | No |

Main reasons to find disagreement between intercompany positions?

The experience shows that it is rather difficult for companies in a group to produce matched intercompany positions and for a certain number of reasons that we can explain

- If a group contains a large number of companies or if the group increases its consolidation scope by acquiring new companies, the risk exists for companies to forget some intercompany positions or to indicate wrong partners.
- An important number of unmatched transactions can come from a lack of information in some local accounting systems. Some of them just don't give the possibility to keep track of intercompany information.
- A group without internal procedures can also meet problems with intercompany. A typical example is an invoice sent to the production manager instead of the accounting department, with consequence that such invoice is not booked and gives an unmatched situation with the turnover in the partner accounts.
- Besides the fact a group relies on organized procedures, using professional ERP systems with well trained employees in all companies, one cannot avoid that a transaction between two foreign companies will probably generate some differences because of the currency rates used in each accounting system.
- Moreover, we cannot avoid some accounting practices leading to unmatched transactions. The most frequent one consisting for a company to send an invoice with an impact on the turnover when the partner decides to capitalize the corresponding amount. That means an intercompany turnover in one company but no intercompany purchase in the other company.

Finally, we are justifying that is normal for a group to produce unmatched transactions. Of course, we can hope that this number remains reasonable.

How a group can improve the quality of the intercompany process ?

Usually, a group checks intercompany positions when a consolidation is performed. The problem happens if such consolidation is produced only once a year because intercompany matching has to be done over a period of 12 months. This means an analysis of quite a huge number of transactions.

It is highly recommended to proceed to an intercompany matching several times during the year and independently of the consolidation cycle itself. Ideally, intercompany matching should be organized each quarter.

For groups having foreign companies, closing rates and average rates should be sent to each company the first day after the date of the closing period. This organization would give the opportunity to each company to adapt their

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intercompany positions and to avoid currency translation differences at consolidation time.

There also exist web systems giving the possibility for each company of a group to upload their intercompany positions and to check them with all the other partners. When a difference is detected they are able to correct the situation or to add a comment explaining the reason for such difference.

In most of the groups using such a system, the quality of the information has been largely improved for the satisfaction of every one, including Auditors.

What to do when an intercompany difference has been detected?

Considering a classical organization of intercompany matching, differences are detected by the consolidation office during the consolidation process.

In such situation, several actions can be undertaken

- Consolidation office sends back the difference to the two companies, asking them to solve or explain it within a short delay
- With the Auditor's agreement, the consolidation department can avoid losing too much time and give the priority to the amount on the invoice side. The same amount is then reflected in the partners accounts.
- Consolidation office may also solve the difference the best way by booking a consolidation adjustment. But we have to keep in mind that such adjustment will have to be reversed next year. This means an additional work.

When we consider the possible number of differences that may appear in a group, we again recommend to decentralize the whole intercompany matching process using today's technologies (web) with the benefit of making each company responsible for this problem.

Now, intercompany differences will be adjusted depending of the nature of the transaction. Here are some examples.

7.2 Intercompany matching adjustments: some examples

Unmatched intercompany transactions because of "lost" invoices

The situation

Company A sends an invoice of 100 to company B the last day of the year. Instead of addressing that invoice to the Accounting department of company B, the document arrives at the Technical department and the manager is out of the office for two weeks!

Meanwhile, the Accounting department of B fills in a consolidation bundle and sends it to the parent company without mentioning an intercompany purchase with company A, of course.

When proceeding to the intercompany matching, a difference of 100 is detected between both companies.

The adjustments

Company B accounts shows no payables and no purchases with company A

| A (Year 1) | | |
|-------------------|-----|-------------|
| Receivables/B | 100 | Result 100 |
| Result | 100 | Sales/B 100 |

| B (Year 1) | | |
|-------------------|--|-------------------|
| | | Result Payables/A |
| Purchases/A | | |
| Result | | |

and this situation requires to book a consolidation adjustment in company B.

| B (Year 1) | | |
|-------------------|--------------|------------------------------------|
| | | Result Payables/A (100) 100 |
| Purchases/A | 100 | |
| Result | (100) | |

During Year 2, we can suppose that the invoice finally will arrive at the Accounting department of B. That means the invoice is booked twice in B accounts, once at consolidation level during Year 1 and a second time in statutory accounts of B during Year 2. That's the reason why in Year 2 consolidation, this adjustment has to be reversed as shown here.

| B (Year 2) | | |
|-------------------|--------------|---------------------------|
| | | Reserves (100) 100 |
| Purchases/A | (100) | |
| Result | 100 | |

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Unmatched intercompany transactions because of foreign currencies

The situation

Company A (EUR) sends an invoice of 1000 to company B (CUR) booked for an amount of 778 CUR , corresponding to a transaction rate of 1 CUR = 1.4 EUR at that time.

At the end of the year, we suppose the invoice is not paid yet and the situation in both company accounts is the following

| A (EUR) | | B (CUR) | |
|---------------|-------|---------|-------|
| Receivables/B | 1,000 | Result | 1,000 |
| Result | 1,000 | Sales/B | 1,000 |

| A (EUR) | | B (CUR) | |
|-------------|-----|------------|-------|
| | | Result | (714) |
| Purchases/A | 714 | Payables/A | 714 |

At the end of the year, closing rate is 1 CUR = 1.5 EUR and average rate is 1 CUR = 1.7 EUR, giving the following translated accounts for B

| A (EUR) | | B (EUR) | |
|---------------|-------|---------|-------|
| Receivables/B | 1,000 | Result | 1,000 |
| Result | 1,000 | Sales/B | 1,000 |

| A (EUR) | | B (EUR) | |
|-------------|---------|-------------|---------|
| | | Result | (1,214) |
| Purchases/A | 1,214 | Trans. Adj. | 143 |
| Result | (1,214) | Payables/A | 1,071 |

where we can see a double intercompany difference arising because of the currency conversion, one in the balance sheet for 71 and another in the P&L for 214.

The adjustments

The transaction is supposed to be labelled in EUR and so we are going to adjust B accounts by considering the Payables/A too high, the difference consisting in a currency effect. Speaking about a transaction that will be paid within a short term, we consider the amount of 71 as an exchange gain impacting the result.

The Purchases/A are also too high for 214, but here they are already booked in the P&L and we have to consider that amount as an expense booked on a wrong account. In fact, these 214 should be considered as an exchange loss.

Here is the impact of these two adjustments

| B (EUR) | | |
|----------------|--------------|-------------|
| | Result | (1,214) |
| | | 71 |
| | Trans. Adj. | 143 |
| | Payables/A | 1,071 |
| | | (71) |
| Purchases/A | 1,214 | |
| | (214) | |
| Exchange loss | (71) | |
| | 214 | |
| Result | (1,214) | |
| | | 71 |

where 71 is indeed an exchange gain, but we have to net that amount with the exchange loss of 214, both amounts coming from a single transaction.

Note also that the adjustment of 71 will need to be reversed next year after the payment of the invoice.

Unmatched intercompany transactions because of cut-off problems

The situation

Supposing a group that produces consolidated accounts at the end of Year 1, a "cut-off" procedure consists in asking to all group companies not to make transactions any more between them during a certain number of days before the end of the year. The idea behind this organization procedure is to avoid transactions that are booked on one company side but not on the partner side.

The adjustments

There are two different consequences when speaking about the non respect of a cut-off procedure.

First consequence : Company A sends an invoice which is not booked by the partner B within the required reporting delays needed for consolidation. In such situation, the invoice has to be booked in company B accounts through a consolidation adjustment. This is what we have in fact already explained in point 7.2.1. But this situation has to be analyzed a little deeper depending on the type of transaction. Let's consider the two following examples.

First example: we suppose that the invoice is related to some R&D activities. The question is how these R&D costs have been booked in B accounts? If they have been considered as intangible assets and depreciated over a certain period, is that compatible with the group rules? If not (IFRS), depreciations must be reversed and the total R&D costs have to be booked in P&L.

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Second example: Let's suppose the invoice is related to some stocks disposed from company A to company B. These stocks are not in company A accounts any more, but they are not yet in B accounts and nevertheless these stocks didn't leave the group. More precisely, the stocks are in a truck somewhere on a highway! The consolidation adjustment has to debit the stock in company B accounts.

Second consequence : Company A has sent an invoice to company B quite a long time before the end of the year and transactions are correctly booked in both companies accounts. But the problem is that company B pays this invoice the last day of the period. It is not recorded in A accounts in the same period. In such situation, the consolidation adjustment consists in a credit on the Receivables account and a debit on the Cash account of company A.

Unmatched intercompany transactions because of different closing dates

The situation

When a group is closing, for instance, on December 31, it is supposed that all companies of the consolidation scope are closing at the same date.

Unfortunately, from a legal point of view, there is flexibility in such a way that it is accepted for some companies to report on another date, if there is less than three months difference between these two dates.

We consider the parent company P closing on December 31 and a company A producing its reporting on September 30, three months before, which is legally acceptable. Intercompany problems arise when company A sends invoices to P during October because these invoices are all booked in P accounts but not known in A accounts.

The adjustments

There is an important principle in consolidation called the "Simultaneity principle". It means that if a transaction impacts the accounts of a company A of a group and if that transaction has also an impact on another company B in the group, both impacts must be booked during the same consolidation period.

This is clearly not the situation we are just considering and consolidation adjustments are again required. By closing on December 31, the transactions considered in October must be booked in company A accounts.

The same argument applies for any payment that would be done on one side but not recorded on the other side, just as in the cut-off situation.

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The advice we would suggest is to ask to all companies to close their accounts at the same date, whatever the legal closing date is.

Unmatched intercompany transactions because of non deductible VAT

The situation

Depending on groups and countries, holding companies having mainly financial activities instead of commercial activities may sometimes not deduct VAT on the invoices they receive. This is again a situation leading to intercompany problems.

| | | A | | | H | | |
|---------------|-----|----------|-----|----------------|----------|------------|-------|
| Receivables/B | 120 | Result | 100 | Payables (VAT) | 20 | Result | (120) |
| Result | 100 | Sales/H | 100 | Purchases/A | 120 | Payables/A | 120 |

Let's consider company A invoicing an amount of 120 to a holding company H. The amount of 120 includes VAT for 20 which is a payable to the VAT administration. In H accounts, the VAT is considered as an expense because it cannot be deducted. Here are the accounts of both companies, reflecting the described situation.

The adjustments

It just consists in a reclassification of 20 from Purchases/A to some Other expenses account.

| | | H | | |
|----------------|------|------------|-------|--|
| | | Result | (120) | |
| | | Payables/A | 120 | |
| Purchases/A | 120 | | | |
| Other expenses | (20) | | | |
| Result | 20 | | | |

Looking to each individual accounts, they show A having a debt of 20 with the VAT administration but it is H that recognizes the expense of 20 in its P&L accounts.

When both accounts are consolidated, we just see that the group has a debt of 20 corresponding to an expense of 20.

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Unmatched intercompany transactions because of capitalization of costs

The situation

A company A charges intellectual services to company B that decides to capitalize them in the Intangible Assets, which is accepted by the group's procedures.

| A | | B | |
|---------------|-----|---------|-----|
| Receivables/B | 100 | Result | 100 |
| Result | 100 | Sales/B | 100 |

| B | |
|--------------------------|-----|
| Intangible assets | 100 |
| Payables/A Payables/A | 100 |

Here is the situation showing matched intercompany amounts in the balance sheet but a problem at P&L level.

The adjustments

Considering the Intangible assets are accepted by the group procedures, we book the following adjustment

| B | |
|-------------------|------------|
| Intangible assets | 100 |
| Purchases/A | 100 |

| | |
|----------------|------------|
| Payables/A | 120 |
| Own production | 100 |

which has no impact on the result of the company. The "Own production" account or "Capitalized costs" account is used when costs are finally booked as an asset. The only problem we can have, just as in the previous example, is that the costs are in A accounts (employees salaries) and it is B showing the capitalization of these costs.

Fortunately, at consolidation level, we will just see the group capitalizing some costs, which is the correct view.

CONSOLIDATION ADJUSTMENTS

8.1 Methodology

The step of consolidation adjustments is certainly the most important one for which the person in charge of the consolidation will play a critical role for various reasons.

- Consolidation adjustments require a good knowledge of all events having potentially an impact on the consolidated financial statements. By events we mean company acquisition, company disposal, merge of companies, capital increase, shares acquisition/disposal, dividends, ... These events are usually easy to identify.
- Some other events such as disposal of assets with group profit between companies, local bookings which do not comply with group's rules of consolidation, ... also require consolidation adjustments but are sometimes rather difficult to identify.
- Very often, some adjustments may last for long in the consolidation and it is part of the job to keep track of these adjustments through time.

For all these reasons, consolidation adjustments require method.

- A consolidation adjustment is a journal entry that a local company cannot book on its own. By journal entry, we mean accounts that are debited and accounts that are credited because behind all this, we speak about a consolidation accounting approach.
- Each adjustment is fully booked within a single company. If an event requires adjustments impacting accounts of two or more companies, the consolidation accounting approach recommend booking a fully balanced adjustment in each individual company. In such case, use of "linked accounts" will be sometimes necessary.
- Some difficult events imply to book adjustments that will stay for a long time in the consolidation. Such events need to be documented because consolidation actors will maybe stay for less time in the consolidation department than these adjustments.
- Same comment can be stated for Auditors who may change from time to time. A professional documentation maintained up-to-date is highly recommended to prevent these transition situations.

Within the scope of a choice of a consolidation software, an advantage will be given to those offering the possibility to classify consolidation

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adjustments by journals just as in a classical accounting system. Elimination of dividends will be booked in a specific journal, same for goodwill, elimination of group profit, stocks margins, ... Such feature gives the possibility to keep the information system clear and auditable.

The following sections will provide a number of consolidation adjustments examples based on the application of this methodology.

However, it is not possible to draw up an exhaustive list of all the consolidation adjustments or the events related to them. In the next section, our objective is to propose a set of the most classical events usually met during a consolidation. These examples are generally built over at least two periods, which shows how consolidation adjustments are booked. Methodology is really the key point until the end of this chapter, much more than the technical issues behind the events we describe.

8.2 A company doesn't apply the group's rules in its statutory accounts

The situation

Beginning of Year 1, company A acquires an asset for a price of 110, including an amount of secondary costs for 10. This asset is depreciated over 10 years, so 11 at the end of Year 1.

The problem is that the group's rules of consolidation ask to book in P&L all secondary costs attached to an acquisition.

| A (Year 1) | | | |
|-------------------|------|----------|------|
| Asset (Acq. Val.) | 110 | Capital | 200 |
| Asset (Deprec.) | (11) | Reserves | 0 |
| Cash | 90 | Result | (11) |

Decision is taken to adjust that situation at consolidation level via adjustments.

During Year 2, the asset remains in company A and it is depreciated again for 11. Its net value is now $88 = 110 - 22$.

| A (Year 2) | | | |
|-------------------|------|----------|------|
| Asset (Acq. Val.) | 110 | Capital | 200 |
| Asset (Deprec.) | (22) | Reserves | (11) |
| Cash | 90 | Result | (11) |

At the beginning of Year 3, company A sells this asset to 3rd Parties for a price of 120, making a profit of $32 = 120 - 88$.

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| A {Year 3} | | | |
|-------------------|-----|----------|------|
| Asset (Acq. Val.) | 0 | Capital | 200 |
| Asset (Deprec.) | 0 | Reserves | (22) |
| Cash | 210 | Result | 32 |

How to book professional consolidation adjustments during these three years?

The adjustments - Year 1

At the end of Year 1, we proceed as follows:

| A (Year 1) | | | |
|-------------------|------|----------|------|
| Asset (Acq. Val.) | 110 | Capital | 200 |
| (b) (10) | | | |
| Asset (Deprec.) | (11) | Reserves | 0 |
| (a) 11 | | | |
| (c) (10) | | | |
| Cash | 90 | Result | (11) |
| | | (a) 11 | |
| | | (b) (10) | |
| | | (c) (10) | |

Adjustment (a) : Reverse the statutory depreciation of 11, which is based on an unacceptable value from the group's rules point of view

Adjustment (b) : Eliminate the secondary costs of 10 and book them in P&L

Adjustment (c) : Book an adjustment depreciation of 10 based on the correct value of 100 for that asset

The adjustments - Year 2

At the end of Year 2, we are in an on going process and we proceed as follows

| A (Year 2) | | | |
|-------------------|------|----------|------|
| Asset (Acq. Val.) | 110 | Capital | 200 |
| (b) (10) | | | |
| Asset (Deprec.) | (22) | Reserves | (11) |
| (a) 22 | | | |
| (c) (20) | | | |
| Cash | 90 | Result | (11) |
| | | (a) 11 | |
| | | (b) (10) | |
| | | (c) (10) | |

Adjustment (a) : Reverse the statutory depreciations of 22, one impacting the P&L for 11 and the other one impacting the Reserves for 11

Adjustment (b) : Eliminate the secondary costs of 10 and book them in Reserves

Adjustment (c) : Book depreciations of 20, 10 impacting the P&L and the other 10 impacting the Reserves

To say it in other words, we carry forward in Year 2 to Reserves all adjustments impacting the P&L in Year 1. We usually speak about carry forward of historical adjustments.

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The adjustments - Year 3

At the end of Year 3, that asset is not in company A accounts any more. The problem is that the sale has been done based on a statutory value of 88 which is different from the value in consolidation of 80. For a given price of 120, the statutory profit is 32 and the consolidation profit is 40.

Here are the adjustments.

| A (Year 3) | | | |
|-------------------|-----|-----------------|------|
| Asset (Acq. Val.) | 0 | Capital | 200 |
| (z) 110 | | | |
| (b) (10) | | | |
| (d) (100) | | | |
| Asset (Deprec.) | 0 | Reserves | (22) |
| (z) (22) | | (a) 22 | |
| (a) 22 | | (b) (10) | |
| (c) (20) | | (c) (20) | |
| Cash | 210 | Result | 32 |
| (z) (120) | | (z) (32) | |
| (d) 120 | | (d) 40 | |

Adjustment (z) : Reverse the sale which has been done on the basis of values not acceptable from a consolidation point of view

Adjustment (a) : Carry forward the historical adjustment (a) of Year 2 related to the reverse of the depreciation of 22

Adjustment (b) : Carry forward the historical adjustment (b) of Year 2 related to the reverse of the secondary costs of 10

Adjustment (c) : Carry forwards the historical adjustment (c) of Year 2 related to the consolidation depreciation of 20

Adjustment (d) : Make the sale in consolidation, based on a price of 120 and a net value of 80, giving a profit of 40.

Finally, we can see that assets and cash accounts are impacted for zero, the P&L for a profit of 8 and the Reserves for a debit of 8.

The final adjustments could just have been

| | Debit | Credit |
|----------|-------|--------|
| Reserves | 8 | |
| Result | | 8 |

but a little bit more difficult to understand for inexperienced people.

Now, it can be interesting to compare the impact from a statutory point of view, supposing we adjust nothing, or from a consolidation point of view. Here is the summary.

| | Year1 | Year2 | Year3 | Total |
|----------------------------|-------|-------|-------|-------|
| Statutory Consolidation | (11) | (11) | 32 | 10 |
| | (20) | (10) | 40 | 10 |

Over these three years, the net impact on P&L is 10 and the net impact after consolidation adjustments is also 10. Was it worth to adjust that situation? No considering the total impact, but yes if we look at individual years where the profit is quite different.

Did we have the choice to adjust or not. No if group's rules are clear and a materiality level is defined. This example indeed shows that it is quite a lot of work to adjust such situation. That's the reason why we recommend defining, in accordance with Auditors, realistic thresholds.

Over that difficulty, one should keep in mind that as soon as an asset has been adjusted by means of a consolidation adjustment, it is important to verify each year if the concerned asset is still in the accounts of the company.

In our example, if the reporting system doesn't ask such question, the risk is to continue to book consolidation adjustments for an asset that is no longer in the accounts!

8.3 Disposal of an asset between two companies, with a group profit

The situation

Three years ago, company A acquired a tangible asset for a price of 300 depreciated by 30 over a period of 10 years. This year (let's call it Year 1), this asset whose net value is now $210 = 300 - 3 * 30$ is sold to group company B for a price of 280, giving a gain of 70 for company A. Company B decides to depreciate the asset over the remaining economical period of 7 years with an annual depreciation of $40 = 280 / 7$.

During Year 2, that asset remains in company B and its net value is $200 = 280 - 2 * 40$.

Beginning of Year 3, company B decides to sell that asset to 3rd Parties for a price of 260, making a gain of 60.

What will be the impact of this transaction on the consolidated accounts?

Some questions about the transaction

Company A is making a profit of 70 with company B. Supposing that within the same year, B is selling the same asset to a third company C of the same

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group, again with a gain, we would conclude this kind of transactions is a marvellous tool to generate profits. Obviously, this cannot be acceptable and consequently must be eliminated. But how?

We can define three approaches to eliminate such group profit (or loss).

The first approach consists in noticing that the transaction is made in the conditions of the market and then it is acceptable not to eliminate the group profit. However we would like to add a comment to this approach. Let's suppose a company having a land acquired a long time ago. This land remained in the accounts at acquisition value. Meanwhile, that land is now close to a highway access and located in a new and well-equipped activity area. The value of that land has been multiplied by three and the disposal to another group company would have two impacts: a huge gain in P&L and a corresponding revaluation of the land. But the transaction being made at market conditions, we eliminate nothing. We think the correct approach would be to eliminate the group profit and, possibly book a revaluation of the land to reflect a correct fair value with an impact in equity, not in the P&L.

The second approach consists in eliminating the profit in company A accounts and eliminating the same amount from the acquisition price in company B accounts. Of course, the statutory depreciation amount must also be adjusted to make it compliant with the adjusted acquisition value. In this approach, we would eliminate the profit in A accounts by booking a "Deferred income" account and, in company B accounts, the elimination of the profit in the asset would be done against a "Deferred expense" account. Both deferred accounts would be defined as intercompany accounts in order no to appear in the financial consolidated statement. Indeed, this is an internal group transaction that cannot appear in the accounts. Speaking about deferred accounts implies that these accounts must be closed sooner or later. Most of the time, the event will be the disposal of that asset finally to 3rd Parties. If this event cannot be predictable, the third approach should be used.

The third approach is quite similar to the previous one, but instead of using deferred accounts, we use Reserves accounts. In such case, a particular attention must be drawn because a technical difficulty could arise if companies are not owned at the same financial percentage.

The situation described below will be adjusted, based on the second approach.

The adjustments - Year 1

At the end of Year 1, companies A and B present the following statutory accounts after having booked the necessary consolidation adjustments.

| A (Year 1) | | | B (Year 1) | | |
|-------------------|-------|---------------|------------|-------------------|--------|
| Asset (Acq. Val.) | 0 | Capital | 1,000 | Asset (Acq. Val.) | 280 |
| Asset (Deprec.) | 0 | Reserves | 0 | (b) | (70) |
| | | Result | 70 | Asset (Deprec.) | (40) |
| Cash | 1,070 | Def. Income/B | (a) 70 | (a) | 40 |
| | | | (a) 70 | (c) | (30) |
| | | | | Cash | 220 |
| | | | | Def. Expense/A | (b) 70 |
| | | | | | |
| | | | | | |

Company A adjustment (a) : We eliminate the group profit of 70 and transfer it to the Deferred income account, which is intercompany with company B.

Company B adjustment (a) : We reverse the statutory depreciation of 40 which is calculated on an amount not acceptable from a consolidation point of view.

Company B adjustment (b) : The 70 profit which is included in the acquisition value is reversed against the Deferred Expense account, which is also intercompany with A.

Company B adjustment (c) : And finally, we depreciate the asset for 30.

If we look at these final adjusted accounts, we find a net value of the asset for 180 and a depreciation in the P&L for 30, just as if this transaction would not have taken place.

The adjustments - Year 2

At the end of Year 2, no new transaction happens and the asset is still in company B accounts, but at consolidation level, adjustments of Year 1 must be carried forward into the Year 2 consolidation (historical adjustments carry forward principle).

| A (Year 2) | | | B (Year 2) | | |
|-------------------|-------|---------------|------------|-------------------|--------|
| Asset (Acq. Val.) | 0 | Capital | 1,000 | Asset (Acq. Val.) | 280 |
| Asset (Deprec.) | 0 | Reserves | 70 | (b) | (70) |
| | | Result | (a) (70) | Asset (Deprec.) | (80) |
| Cash | 1,070 | Def. Income/B | (a) 70 | (a) | 80 |
| | | | (a) 70 | (c) | (60) |
| | | | | Cash | 220 |
| | | | | Def. Expense/A | (b) 70 |
| | | | | | |
| | | | | | |

Company A adjustment (a) : This adjustment is the same as the one booked in Year 1, with the P&L impact carried forward to Reserves

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Com~anB adjustment (a) : We have to reverse now two depreciations, one impacting the P&L and the other one of Year 1 impacting the Reserves

Com~anB adjustment (b) : This adjustment is the same as the one booked in Year 1.

Company B adjustment (c) : We have to depreciate twice the asset on the basis of the consolidation value, one impact of (30) is for the P&L of this year and the other impact of (30) is on the Reserves account.

Behind these adjustments, there are two methodology principles

- Each time an adjustment is booked on the P&L, we have to find the same booking on the Reserves next year
- Each time an adjustment is booked on the Reserves, we have to find the same booking on the P&L next year

otherwise we would get some unjustified variation of reserves.

The adjustments - Year 3

At the end of Year 3, the asset is disposed to 3rd Parties. The first idea would be to say that there is nothing else to do. The problem is that the disposal has been done with the statutory net value of the asset but in consolidation we consider another value. So, let's be careful and let's proceed step by step.

| A (Year 3) | | | |
|-------------------|-------|---------------|----------|
| Asset (Acq. Val.) | 0 | Capital | 1,000 |
| Asset (Deprec.) | 0 | Reserves | 70 |
| | | (a) | (70) |
| | | Result | 0 |
| Cash | 1,070 | Def. Income/B | (b) 70 |
| | | (a) 70 | (b) (70) |

Company A adjustment (a) : This adjustment is again the same as the one booked in Year 2

Com~anA adjustment (b) : Now that the asset has left the group, we can reverse the Deferred income and book it to the P&L. We give the profit back to A.

Com~anB adjustment (z) : We first reverse the selling transaction because made with statutory amounts. So we find back in the accounts the acquisition value, the cumulated depreciations, the reverse of the cash received and the reverse of the gain on disposal

| B (Year 3) | | | |
|--------------------------------------|-----|----------|----------|
| Asset (Acq. Val.) | 0 | Capital | 500 |
| (z) 280 | | | |
| (b) (70) | | | |
| (d) (210) | | | |
| Asset (Deprec.) | 0 | Reserves | (a) 80 |
| (z) (80) | | | (c) (60) |
| (a) 80 | | | |
| (c) (60) | | | |
| (d) 60 | | | |
| Cash | 480 | Result | 60 |
| (z) (260) | | (z) (60) | |
| (d) 260 | | (d) 110 | |
| Def. Expense/A (b) 70 (e) (70) | | (e) (70) | |

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Company B adjustments (a,b,c): These adjustments are just the carried forward of Year 2 adjustments with Reserves impact

Company B adjustment (d): Then we make the sale with consolidation amounts, giving a gain of 110

Company B adjustment (e): And finally, we have to reverse to P&L the Deferred expense of 70 which is still open in the accounts

To summarize, we could just book one adjustment in A accounts and another

| Company A | Debit | Credit |
|-----------|-------|--------|
| Reserves | 70 | |
| Result | | 70 |

| Company B | Debit | Credit |
|-----------|-------|--------|
| Result | 20 | |
| Reserves | | 20 |

one in B accounts, as follows

but again we would do it with a loss of clarity, excepted if we keep an additional explanation in notes to the accounts.

To close this example, it can be interesting to compare the P&L impact in case we would have booked no adjustments (approach 1) with the approach 2 developed above. The amounts are summarized hereunder

| Approach 1 | Year 1 | Year 2 | Year 3 | Total |
|------------|--------|--------|--------|-------|
| Company A | 70 | 0 | 0 | 70 |
| Company B | (40) | (40) | 60 | (20) |
| Total | 30 | (40) | 60 | 50 |

| Approach 2 | Year 1 | Year 2 | Year 3 | Total |
|------------|--------|--------|--------|-------|
| Company A | 0 | 0 | 70 | 70 |
| Company B | (30) | (30) | 40 | (20) |
| Total | (30) | (30) | 110 | 50 |

The total contribution of each company in the P&L over these three years is the same in both approaches: 70 for A and (20) for B. But the contribution for each year is quite different. In fact, in approach 2, profit is taken in P&L only when the asset leaves the group. Before that, the principle of prudence is applied.

Of course, considering these figures and practices, it is important for the company A manager to be aware of these approaches and to specify in his contract on which profit his bonus will be calculated ...

8.4 Elimination of stocks margins

The situation

In most of the industrial groups, some companies are dedicated to supply on the market and make products and some other companies are dedicated to sell these products. In such situation, the normal practice for the industrial companies is to sell the products to the commercial companies, including a benefit called stocks margin. From that point of view, these transactions imply a group profit and, as was explained in the previous section, it should be eliminated. However, we will see that the set of consolidation adjustments differs from the previous one because of the stocks accounts.

For the explanation, let's consider a company A manufacturing some products and selling them to a commercial company B which, in turn, sells these products on the market. We will also suppose that each stock stays in the companies accounts for less than a year.

In Year 1, the group decides for the first time to eliminate stocks margins. Company A sells to company B some stocks for a price of 350 and initially booked for 300, making a stock margin of 50.

In Year 2, company A sells again some stocks to company B for a price of 460 and initially booked for 400, making a stocks margin of 60. The Year 1 stocks bought by company B are no longer in its accounts because sold to the market.

How do we eliminate these stocks margins ?

The adjustments - Year 1

We first consider the statutory journal entry (1) booked in company A for the sale of the products to company B. The stocks of 300 are sold for a cash value of 350 generating a stocks margin of 50. Notice that the sales to B for 350 in the P&L are declared as intercompany.

| A (Year 1) | | | |
|-------------|-------|-------------|-------|
| Stocks | 300 | Capital | 500 |
| (1) | (300) | Reserves | 0 |
| Cash | 200 | Result | 0 |
| (1 | 350 | (1) | 50 |
| Purchases | 300 | Sales/B | 0 |
| Stocks var. | (300) | (1) | 350 |
| Result | 0 | Stocks var. | 0 |
| (1) | 50 | (1) | (300) |

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In company B accounts, we see a booking (2) of stocks for 350.

| B (Year 1) | | |
|-------------------|---|---------------|
| Stocks | 0 | Capital 800 |
| (2) 350 | | Reserves 0 |
| Cash 800 | | Result 0 |
| (2) (350) | | |
| Purchases/A | 0 | Sales/B 0 |
| (2) 350 | | |
| Stocks var. 0 | | Stocks var. 0 |
| (2) (350) | | |
| Result 0 | | |

Notice that the Purchases account is also intercompany.

Everything is consistent except the fact that there is a group profit of 50 that has to be eliminated.

Here are the consolidation adjustments.

| A (Year 1) | | |
|-------------------|---|-------------------|
| Stocks | 0 | Capital 500 |
| | | Reserves 0 |
| | | (a) 50 |
| Cash 550 | | Result 50 |
| | | (a) (50) |
| Purchases 300 | | Sales/B 350 |
| | | (a) (50) |
| Stocks var. (300) | | Stocks var. (300) |
| Result 50 | | |
| (a) (50) | | |

The 50 profit is eliminated by reducing the sales because we consider that the group value of the stocks is 300 instead of 350. Of course, at this moment, we introduce a difference between the two intercompany positions.

The other peculiarity to be indicated is the use of the reserves account. In the previous case we have used

deferred accounts which were corresponding to what we called the "Approach 2". In this section we use 'Approach 3' in order to give a complete overview.

In B accounts, we also consider the group value of the stocks and this is the reason of the credit 50 with a counterpart on the Reserves account again.

Notice that both Reserves accounts are impacted together for a net value of zero if each company A and B is owned at the same financial percentage.

| B (Year 1) | | |
|-------------------|--|---------------|
| Stocks 350 | | Capital 800 |
| (b) (50) | | Reserves 0 |
| Cash 450 | | (b) (50) |
| Purchases/A 350 | | Sales/B 0 |
| (b) (50) | | |
| Stocks var. (350) | | Stocks var. 0 |
| (b) 50 | | |
| Result 0 | | |

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As the stocks purchased have a value of 300, we have to correct the values in the P&L to be consistent. That's a good point because now intercompany positions are again in line.

The adjustments - Year 2

Again, we first consider the statutory journal entry (3) in company A accounts which is similar to the one seen in Year 2.

| A (Year 2) | | | B (Year 2) | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
|-------------|-------|-------------|------------|-------------|-------|--------|---|-----|-----|-----|-----|--|--|------|-----|-----------|-----|---------|---|-----|-------|--|--|-----|-----|-------------|---|-------------|-------|-------------|---|-----|-----|--------|---|-----|-------|-------------|---|-----|----|--|--|-----|-------|--|--|--|--|--------|-----|
| Stocks | 400 | Capital | 500 | Stocks | 0 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| (3) | (400) | Reserves | 50 | Cash | 150 | Result | 0 | (4) | 460 | (3) | 460 | | | Cash | 950 | Purchases | 400 | Sales/B | 0 | (4) | (460) | | | (3) | 460 | Purchases/A | 0 | Stocks var. | (400) | Stocks var. | 0 | (4) | 460 | Result | 0 | (3) | (400) | Stocks var. | 0 | (3) | 60 | | | (4) | (460) | | | | | Result | 150 |
| Cash | 150 | Result | 0 | (4) | 460 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| (3) | 460 | | | Cash | 950 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Purchases | 400 | Sales/B | 0 | (4) | (460) | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | | (3) | 460 | Purchases/A | 0 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Stocks var. | (400) | Stocks var. | 0 | (4) | 460 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| Result | 0 | (3) | (400) | Stocks var. | 0 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| (3) | 60 | | | (4) | (460) | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | | | | Result | 150 | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |

In B accounts, the statutory journal entry (4) is also similar to the one in Year 1. Of course, in the meantime, the stocks bought last year have been completely sold to 3rd Parties. As we isolate the situation, we can suppose these stocks have generated a profit of 150.

Let's book now the consolidation adjustments.

No surprise for company A. We find the same consolidation adjustment as the one booked in Year 1, except the stocks margin which is now 60.

| A (Year 2) | | | B (Year 2) | | |
|-------------|-------|-------------|------------|-------------|-------|
| Stocks | 0 | Capital | 500 | Stocks | 460 |
| | | Reserves | 50 | (b) | (50) |
| Cash | 610 | (c) | 60 | (d) | 50 |
| | | Result | 60 | (e) | (60) |
| Purchases | 400 | Sales/B | 460 | Cash | 490 |
| | | (c) | (60) | Purchases/A | 460 |
| Stocks var. | (400) | Stocks var. | (400) | (e) | (60) |
| Result | 60 | | | Stocks var. | (460) |
| (c) | (60) | | | Result | 150 |
| | | | | (d) | 50 |

For company B it is a little bit more complicated. First, we have to carry forward the "historical" adjustment (b) of Year 1 because it has an impact on the Reserves with another account. But this credit on Stocks account cannot be kept because these stocks have been sold in the meantime. So, we reverse that adjustment by the journal entry (d). You can notice that we improve the

profit by 50 and this is normal because, from the group point of view, the value of these stocks was 300 and not 350.

Then, we see the adjustment (e) which is the same as the one booked in Year 1, corresponding to the elimination of the new stocks margin of 60.

We would conclude with three comments.

- First, eliminating stocks margins between companies is not an easy process. At the end of each consolidation period, it is necessary to audit the stocks of each company and to identify which part has been sold by another company of the group with the corresponding stocks margin.
- When decision is taken to eliminate stocks margins, the impact on the group profit can be really important the first year (50 in our case study).

| | Year 1 | Year 2 |
|-----------|--------|--------|
| Company A | (50) | (60) |
| Company B | 0 | 50 |
| | (50) | (10) |

- As illustrated here above, we can see that after Year 1, and for ever, if the stocks margins are relatively similar each year, the impact on the profit cannot be significant (-10 in our case study). That's why we recommend simulating figures before taking such decision.

8.5 Leasing not booked in balance sheet

The situation

Depending on local accounting regulations, the same leasing contract may not be booked the same way by companies of a same group.

- In some countries, the booking consists in showing the gross value of the asset and its depreciations and the remaining value of the loan. In the P&L, we find depreciations and financial interest charges. In fact, this is the expected way to book such transaction which is also compliant with the IFRS practices.
- In some other countries, we don't see the leased asset or the loan. Only the P&L shows a single services amount including capital reimbursement and financial interests.

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For those companies having such accounting practices, additional consolidation adjustments must be booked.

Let's explain how with the following example.

Company A decides to lease an asset under the following conditions:

- The corresponding leased capital is 100
- Contract duration is 10 years
- Financial lease interest is a fixed 3%/year during the 10 years.

Here are the company A statutory accounts for Year 1 and Year 2, which are the two periods we will follow.

| A (Year 1) | | | |
|--------------------|-----|---------------|------|
| Asset (Acq. Value) | 0 | Capital | 300 |
| Asset (Deprec.) | 0 | Reserves | 200 |
| Cash | 487 | Result | (13) |
| | | Loan(leasing) | 0 |

| | | | |
|-------------------|------|--|--|
| Depreciation | 0 | | |
| Services | 13 | | |
| Interests charges | 0 | | |
| Result | (13) | | |

| A (Year 2) | | | |
|--------------------|-----|---------------|------|
| Asset (Acq. Value) | 0 | Capital | 300 |
| Asset (Deprec.) | 0 | Reserves | 187 |
| Cash | 474 | Result | (13) |
| | | Loan(leasing) | 0 |

We can see that the only impact of the leasing transaction is a services expense of 13 in the P&L accounts, which consists in a reimbursement of capital for 10 and financial interests for 3.

This presentation is not compliant with group's rules or IFRS rules and so need some consolidation adjustments.

The adjustments - Year 1

There are three consolidation adjustments (a), (b) and (c).

| | | A (Year I) | |
|--------------------|------|-------------------|------|
| Asset (Acq. Value) | 0 | Capital | 300 |
| (a) 100 | | | |
| Asset (Deprec.) | 0 | Reserves | 100 |
| (b) (10) | | | |
| Cash | 287 | Result | (13) |
| | | Loan(leasing) | 0 |
| | | (a) 100 | |
| | | (b) (10) | |
| Depreciation | 0 | | |
| (c) 10 | | | |
| Services | 13 | | |
| (c) (13) | | | |
| Interests charges | 0 | | |
| (c) 3 | | | |
| Result | (13) | | |

Adjustment (a) consists in booking the gross value of the leased asset in Assets and the leased capital as a loan in the Liabilities.

Adjustment (b) depreciates the asset value on the basis of a 10 years (10%) duration and the corresponding debit is the decreasing of the capital loans by the same amount.

Adjustment (c) consists in a reclassification in the P&L accounts. Services for an amount of 13 are set to zero, 10 being transferred to Depreciation account and 3 to Financial interest charges.

No impact on the result for such journal entries, only reclassifications.

The adjustments - Year 2

When receiving the statutory accounts of company A for Year 2, the leasing transaction does not appear and again, not only consolidation adjustments are required but we also have to take care of "historical" adjustments of Year 1.

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Here are company A adjusted accounts.

| A (Year 2) | |
|--------------------|------|
| Asset (Acq. Value) | 0 |
| (a) 100 | |
| Asset (Deprec.) | 0 |
| (b) (20) | |
| Cash | 474 |
| | |
| | |
| | |
| | |
| Capital | 300 |
| Reserves | 187 |
| Result | (13) |
| Loan(leasing) | 0 |
| (a) 100 | |
| (b) (20) | |
| Depreciation | 0 |
| (c) 10 | |
| Services | 13 |
| (c) (13) | |
| Interests charges | 0 |
| (c) 3 | |
| Result | (13) |

Adjistment (a) is the same as the one we have booked in Year 1.

Adjistment (b) shows a depreciation of the asset for two years and the corresponding reimbursement of capital loan.

Adjistments (c) reclassifies services into depreciation and financial interest charges in the same way we booked it in Year 1. This journal entry will last for 10 years.

The important question is to know who has to book these adjustments. We recommend to practise the "push down" policy consisting to ask companies to book these adjustments themselves somewhere between their accounting system and the consolidation reporting.

8.6 Deferred tax adjustments

The situation

When we receive the accounts of a company, we can check with more or less accuracy that the amount of tax is a certain tax rate applied to the profit before tax. But as soon as we book consolidation adjustments, this relation is not verified any more.

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For instance, in section 8.2, we modified the depreciation and consequently the profit before tax but we didn't calculate a tax effect on these adjustments. It is not correct. On such adjustments modifying the result (profit or loss), we should calculate what is called a deferred tax.

Such tax (real and deferred) shows the amount of tax the company would have to pay by booking all these consolidation adjustments in its local accounting.

When we consider these combined tax effects on a transaction over the periods for which they have an impact in consolidation, we will notice that the total amount of tax paid remains the same as if we would have considered only real taxes. But the annual tax rate is much more consistent when we include deferred tax.

Let's consider an example.

In Year 1, a company A has booked R&D in its statutory assets for a gross amount of 120 and decides to depreciate it over three years.

To make things simple, we will suppose that for the next three years, company A has an ongoing business generating a profit before tax of 200 each year. Tax rate for this company is 30%.

Here are the accounts of Year 1.

| A (Year 1) | | | |
|------------------|-----------|--------------|----------|
| R&D (Acq. Value) | 120 | Capital | 500 |
| R&D (Deprec.) | (40) | Reserves | 0 |
| Cash | 580 | Result | 112 |
| | | Tax payables | 48 |
| Purchases | 700 | Sales | 900 |
| Depreciation | 40 | | |
| Tax | 48 | | |
| Result | 112 | | |

We also suppose that Year 2 and Year 3 accounts generate the same ongoing profit of $200 = 900 - 700$ and the R&D continues to be depreciated for 40. This means that each year, company A pays a tax of $48 = 30\% * [200 - 40]$.

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The adjustments - Year 1

Now, the difficult point is that the group does not accept R&D (IFRS approach) in the intangible assets and asks the company to book them as an expense of the year.

That approach requires consolidation adjustments that will be booked in consolidation and not in the statutory accounts.

Here are the accounts with the consolidation adjustments.

| | | A (Year 1) | |
|------------------|--------------|-------------------|-------------|
| R&D (Acq. Value) | 120 | Capital | 500 |
| (b) | (120) | Reserves | 0 |
| R&D (Deprec.) | (40) | | |
| (a) | 40 | Result | 112 |
| Deferred tax | | | |
| (a) | (12) | (a) | 28 |
| (b) | 36 | (b) | (84) |
| Cash | 580 | Tax payables | 48 |
| Purchases | 700 | Sales | 900 |
| (b) | 120 | | |
| Depreciation | 40 | | |
| (a) | (40) | | |
| Tax (Real) | 48 | | |
| Tax (Deferred) | | | |
| (a) | 12 | | |
| (b) | (36) | | |
| Result | 112 | | |
| (a) | 28 | | |
| (b) | (84) | | |

Adjustment (a) reverses the statutory depreciation of 40, but includes a deferred tax effect of 30% giving a net impact of result for 28.

Adjustment (b) reverses the statutory gross value of R&D for 120, again with a deferred tax effect of 30% giving a net impact of result for (84) and an asset deferred tax of 36 = 30% * 120.

Statutory and adjusted profits before tax are represented in the report below

| Tax proof Year 1 | Statutory | Consolidation |
|-------------------------|------------------|----------------------|
| Profit before tax | 160 | 80 |
| Tax (Real) | 48 | 48 |
| Tax (Deferred) | 0 | (24) |
| Calculated tax rate | 30% | 30% |

which shows that real and deferred taxes, considered together, give the expected tax rate of 30%.

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The adjustments – Year 2

Receiving Year 2 statutory accounts, R&D have been depreciated twice. In consolidation, we have to carry forward Year 1 adjustments and book an appropriate adjustment for Year 2.

Here are the accounts after consolidation adjustments.

| A (Year 2) | | | |
|------------------|------|-----------------|-----------|
| R&D (Acq. Value) | 120 | Capital | 500 |
| (b) (120) | | | |
| R&D (Deprec.) | (80) | Reserves | 112 |
| (a) 80 | | (a) 28 | |
| Deferred tax | | (b) (84) | |
| (a) (24) | | Result | 112 |
| (b) 36 | | (a) 28 | |
| Cash | 732 | Tax payables | 48 |
| Purchases | 700 | Sales | 900 |
| Depreciation | 40 | | |
| (a) (40) | | | |
| Tax (Real) | 48 | | |
| Tax (Deferred) | | | |
| (a) 12 | | | |
| Result | 112 | | |
| (a) 28 | | | |

Adjustment (a) reverses two depreciations for a total of 80, one amount of 40 is the carry forward of Year 1 and impacts the Reserves and the other one impacts the P&L because related to Year 2. For each of these depreciations, we take care of a deferred tax effect of 30%.

Adjustment (b) is just the carry forward of adjustment (b) of Year 1.

Here is the corresponding tax proof comparing statutory and adjusted figures

| Tax roof Year 2 | Statuto | Consolidation |
|---------------------|------------|---------------|
| Profit before tax | | |
| Tax (Real) | | |
| Tax Deferred | | |
| Calculated tax rate | 30% | 30% |

where we find hopefully the same tax rate again.

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The adjustments – Year 3

This Year 3 is the final year for this transaction and we present here below the consolidation adjustments without any comments because it is quite obvious.

One can see that statutory net value of R&D is zero as required in consolidation.

Deferred tax assets are also equal to zero.

| | | A (Year 3) | |
|------------------|--------------|-------------------|-------------|
| R&D (Acq. Value) | 120 | Capital | 500 |
| (b) | (120) | Reserves | 224 |
| R&D (Deprec.) | (120) | (a) | 56 |
| (a) | 120 | (b) | (84) |
| Deferred tax | (36) | Result | 112 |
| (a) | 36 | (a) | 28 |
| Cash | 884 | Tax payables | 48 |
| Purchases | 700 | Sales | 900 |
| Depreciation | 40 | | |
| (a) | (40) | | |
| Tax (Real) | 48 | | |
| Tax (Deferred) | 12 | | |
| (a) | 12 | | |
| Result | 112 | | |
| (a) | 28 | | |

In Year 4, everything will be set to zero in statutory and no consolidation adjustments have to be carried forward any more.

Let's conclude this case study by comparing the effective tax amounts really paid during these three years and the total tax adjusted by our adjustments during that same period.

| | Year 1 | Year 2 | Year 3 | Total |
|-----------------------|--------|--------|--------|-------|
| Tax paid | 48 | 48 | 48 | 144 |
| Tax paid and deferred | 24 | 60 | 60 | 144 |

This report gives two messages:

- The total tax paid is 144 and the adjusted tax over these three periods is also 144
- The second line shows which amount of tax the company A would have paid by applying the group rules in its statutory accounts.

Annual amounts are different but both totals are equal over the three years.

And our final conclusion will be to say that not all consolidation adjustments require calculation of a deferred tax effect. Most of the time, depreciation adjustment implies a deferred tax, depreciations and impairments on consolidation goodwill and elimination of dividends never imply a deferred tax effect.

8.7 Elimination of dividends in a classical situation

The situation

Up to now, we have seen some examples of consolidation adjustments which are booked because of group's evaluation rules or because of a group profit which has no economic meaning with regard to the basic consolidation principles. This means that if these adjustments would not have been booked, someone not having a knowledge of what is happening in that group wouldn't be aware of the fact. To say it in another way, not booking such adjustments doesn't generate technical or visible errors in a consolidation.

This last comment is not true for some other transactions in a group like dividends paid by a company to its shareholders, acquisition or disposal of a company, ... For these events, it is absolutely compulsory to book some adjustments. Not booking them would lead to visible errors again.

We are going to illustrate this problem with some of these events, the first one being the dividends.

We consider a company A owned by the parent company P with a financial percentage of 80% and this percentage is maintained unchanged during Year 1 and Year 2.

At the end of Year 1, company A pays a dividend of 10 to its shareholders, which means that P books a gross dividend of $8 = 80\% * 10$. At the same time, P decides to pay a dividend of 15 to its own shareholders.

Here are the statutory accounts of P and A for Year 1 and Year 2

| P (Year 1) | | | P (Year 2) | | |
|----------------|-----|-------------------|------------|----------------|-----------------------|
| Fin. Invest./A | 80 | Capital | 200 | Fin. Invest./A | 80 |
| | | Reserves | 100 | | Capital |
| | | Result | 30 | | Reserves |
| Other assets | 420 | Other liabilities | 170 | Result | 45 |
| | | | | Other assets | 530 |
| | | | | | Other liabilities 250 |

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| A (Year 1) | | A (Year 2) | | |
|--------------|----------|-------------------|----------|-----|
| | Capital | 100 | Capital | 100 |
| | Reserves | 50 | Reserves | 60 |
| | Result | 20 | Result | 30 |
| Other assets | 400 | Other liabilities | 230 | |
| | | Other assets | 540 | |
| | | Other liabilities | 350 | |

with the following remarks

- We see by considering the Result and Reserves accounts that indeed P is paying a gross dividend of 15
- Same remark for company A paying a gross dividend of 10
- For some practical reasons, we will not consider the P&L but it is understood that the P profit of 45 includes a dividend received for 8
- In consolidation, we always consider the gross dividend, whatever the net dividend received because of local taxes
- At the end of each year, we consolidate accounts before any appropriation. This is an organizational requirement because it wouldn't be acceptable to wait for the final audited accounts approved by the general annual meeting. Consolidated figures would be closed to late.

This group will be consolidated by the global method with a financial percentage of 80% for each of the two years.

But what is the problem in consolidation with this dividend ?

The group dividend of 8 received by P is booked as a financial income in Year 2 but that amount was part of the profit of A in Year 1. This means that the consolidated profits of these two years are showing the same amount and this duplication leads to an unacceptable situation.

Going back to some basic principles of consolidation, profit of A in Year 1 is an economical profit contributing to the consolidated profit and accepted as such. The duplication use appearing in Year 2 in P accounts has to be eliminated. Clearly, we have to debit the financial income of 8.

What will be the counterpart of this account?

Let's suppose company A doesn't pay that dividend which would then be transferred to its own reserves (or retained earnings). This is the answer but, from a group point of view, the counterpart account will not be company A reserves but P reserves.

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The adjustment - Year 2

Here is the consolidation adjustment to book in P accounts of Year 2.

| | Debit | Credit |
|------------------------------|-------|--------|
| Financial income (dividends) | 8 | |
| Resewes | | 8 |

Taking advantage of this transaction concerning dividends, we would like to introduce a new tool to justify the consolidated reserves. But before entering into details, we need first to build consolidated balance sheets of both Year 1 and Year 2.

Consolidation of Year 1

Let's go back to the statutory accounts

| P (Year 1) | | A (Year 1) | |
|----------------|-----|-------------------|-----|
| Fin. Invest./A | 80 | Capital | 200 |
| | | Reserves | 100 |
| | | Result | 30 |
| Other assets | 420 | Other liabilities | 170 |

which do not include adjustments.

Based on the global integration method, here is the consolidated balance sheet

| P + A (Year 1) | | | |
|----------------|----------------------|-------------------|-----|
| | Capital | 200 | |
| | Reserves | 100 | |
| | Result | 30 | |
| | Conso. Reserves (A) | 56 | |
| | Minor. Interests (A) | 34 | |
| Other assets | 820 | Other liabilities | 400 |

in which

- Consolidated reserves = $56 = 80\% * [100 + 50 + 20] - 80$
- Minority interests = $34 = 20\% * [100 + 50 + 20]$

other assets and other liabilities being just the addition of the corresponding A and P accounts.

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Consolidation of Year 2

This time we consolidate adjusted accounts for P as follows

| P (Year 2) | | | A (Year 2) | | |
|----------------|-----|-------------------|------------|-------------------|-----|
| Fin. Invest./A | 80 | Capital | | 100 | |
| | | Reserves | 115 | | 60 |
| | | (a) | 8 | | |
| | | Result | 45 | | 30 |
| | | (a) | (8) | | |
| Other assets | 530 | Other liabilities | 250 | Other assets | 540 |
| | | | | Other liabilities | 350 |

which give, after global integration again, the following consolidated balance sheet

| P + A (Year 2) | | |
|----------------|----------------------|-----|
| | Capital | 200 |
| | Reserves | 123 |
| | Result | 37 |
| | Conso. Reserves (A) | 72 |
| Other assets | Minor. Interests (A) | 38 |
| 1,070 | Other liabilities | 600 |

where

- Reserves of P = 123 = 115 + 8
- Result of P = 37 = 45 + (8)
- Consolidated reserves = 72 = 80% * [100 + 60 + 30] - 80
- Minority interests = 38 = 20% * [100 + 650 + 30]

Justification of consolidated reserves evolution

One difficult issue while processing a consolidation is to validate that equity, and in particular group reserves, can be justified just like in a normal accounting approach : opening reserves + profit - dividends = closing reserves.

That's what we are going to check by using the following appropriate report.

| | Year 1 Reserves | Year 2 Result | Divid. (-) paid | Divid. (+) | P Approp. | Year 2 Reserves |
|-----------|--------------------|------------------|--------------------|------------|-----------|--------------------|
| Company P | 130 | 37 | | 8 | (15) | 160 |
| Company A | 56 | 24 | (8) | | | 72 |
| | 186 | 61 | (8) | 8 | (15) | 232 |

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The number of lines of this report is the number of companies in the consolidation scope.

Column (1) contains the contribution of each company in the Year 1 consolidated reserves.

Column (2) shows the same for the individual result of each company, taking into account that the profit shown is the group profit ($24 = 80\% * 30$).

Column (3) shows the group part of dividends paid by each company (A pays a group dividend of 8)

Column (4) shows the part of dividends received from group companies (P receive a group dividends of 8)

Column (5) shows the dividends paid by the parent company to its shareholders. Obviously there can be an amount only on the P line of this report.

Column (6) is similar to Column (1), but for Year 2

At this stage, we make the following checks:

- The total of dividends paid must be equal to the total of dividends received. We recommend to use two columns because one can easily see which company is paying a dividend and which companies are receiving dividends. A single column would be more ambiguous.
- The total line must show that opening reserves + result - P dividends = closing reserves
- And if that total line is correct, then we recommend to check that opening reserves + result - dividends paid + dividends received = closing reserves

When these three checks have been validated, there is a good probability that the consolidated equity is correct.

Justification of minority interests evolution

The same question arises for the Minority interests evolution which is summarized in another report, different from the previous one, as follows

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| | Year 1 Minor. Int. | Year 2 Result | Divid. (-) paid | Divid. (+) | Year 2 Minor. Int. |
|-----------|-----------------------|------------------|--------------------|------------|-----------------------|
| Company A | 34 | 6 | (2) | | 38 |

The principles are quite similar.

On each line appear companies for which there are minority interests.

Column (1) contains the contribution of each company in the Year 1 Minority interests.

Column (2) shows the minority result of each company ($6 = 20\% * 30$)

Column (3) shows the dividends paid by A to the 3rd Parties ($20\% * 10$)

Column (4) is not used for our example, but it could be used for more complex groups structures where companies own other companies, each with minority interests and each company is supposed to pay dividends.

For each individual line, the sum of all amounts of columns (1) to (4) must be equal to the Year 2 Minority interests.

We will come back later with a deeper approach about this methodology in a specific chapter.

8.8 Elimination of dividends paid by a foreign company

The situation

The situation is similar to the previous one, except for company A whose accounts are in a certain foreign currency CUR. That company is owned by the parent company P with a financial percentage of 80% over Year 1 and Year 2.

At the end of Year 1, company A pays a gross dividend of 100 CUR to the shareholders while P pays a gross dividend of 150 EUR.

Why is this situation different from the previous one with a classical dividend ?

The amount of 100 CUR was part of the economical profit of A in Year 1 consolidation and its value was 100 CUR at average rate of that period. After the annual general meeting of company A, parent company P receives 80 CUR

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(80% * 100 CUR) and booked at a value depending of the rate that day. We will suppose P receives from the bank an amount of 110 EUR.

There is clearly again a double impact in group profit : once in company A accounts for 80 CUR and once in parent company accounts for 110 EUR.

With this situation, we have a nice opportunity to consolidate a foreign company with the global integration method. Let's go through the process again and give all explanations at the right moment.

We are going to setup first the Year 1 consolidated accounts after currency conversion of company A accounts.

Then we will book the correct adjustment for the elimination of the dividend.

We will produce the Year 2 consolidated figures and check the equity and the minority interests in the same way we did in the previous section.

Currency conversion of company A accounts - Year 1

Let's proceed the way it has been explained in chapter 6 on the basis of the following currency rates

| | Year 1 | Year 2 |
|------------------------------|--------|--------|
| Closing rate | 1.5 | 1.6 |
| Average rate | 1.3 | 1.4 |
| Historical rate for Capital | 1.2 | |
| Historical rate for Reserves | 1.1 | |

| A (Year 1) in CUR | |
|-------------------|-------|
| Capital | 1,000 |
| Reserves | 500 |
| Result | 200 |
| Other assets | 4,000 |
| Other liabilities | 2,300 |

| A (Year 1) in EUR | |
|-------------------|-------|
| Capital | 1,500 |
| (1) | (300) |
| Reserves | 750 |
| (2) | (200) |
| Result | 300 |
| (3) | (40) |
| Trans. Adj. | |
| (1) | 300 |
| (2) | 200 |
| (3) | 40 |
| Other assets | 6,000 |
| Other liabilities | 3,450 |

We translate all accounts of the balance sheet with the closing rate 1.5 and then adjust equity accounts with historical rate and average rate as follows.

Adjustment (1) reclassifies 300 to translation adjustment because historical rate for this account is 1.2 instead of 1.5.

Adjustment (2) reclassifies 200 to translation adjustment because historical rate for this account is 1.1 instead of 1.5.

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Adjustment (3) reclassifies 40 to translation adjustment because profit must be translated at average rate 1.3 instead of closing rate 1.5.

Currency conversion of company A accounts - Year 2

| A (Year 2) | | A (Year 2) in EUR | |
|--------------|----------|-------------------|-------|
| | | Capital | 1,600 |
| | Capital | (4) | (400) |
| | Reserves | 960 | |
| | Result | (5) | (280) |
| | | 480 | |
| | | (6) | (60) |
| | | Trans. Adj. | |
| | | (4) | 400 |
| | | (5) | 280 |
| | | (6) | 60 |
| Other assets | 5,400 | Other liabilities | 5,600 |

After translation of the whole balance sheet at closing rate 1.6, we adjust equity accounts as follows

Adjustment (4) reclassifies 400 to translation adjustment because historical rate for this account is 1.2 instead of 1.6.

Adjustment (5) reclassifies 280 to translation adjustment because the amount of reserves of 600 CUR consists of 500 CUR at historical of 1.1 and 100 CUR transferred from the Year 1 profit, initially translated at average rate of 1.3, which gives a historical amount of $500 * 1.1 + 100 * 1.3 = 680$ instead of 960.

Adjustment (6) reclassifies 60 to translation adjustment because profit must be translated at average rate 1.4 instead of closing rate 1.6.

Consolidation of Year 1

Here are the parent statutory company accounts and the consolidated accounts

| P (Year 1) | | | |
|----------------|-------|-------------------|-------|
| Fin. Invest./A | 800 | Capital | 2,000 |
| | | Reserves | 1,000 |
| | | Result | 300 |
| Other assets | 4,200 | Other liabilities | 1,700 |

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| P + A (Year 1) | | |
|----------------|----------------------|-------------------|
| | Capital | 2,000 |
| | Reserves | 1,000 |
| | Result | 300 |
| | Conso. Reserves (A) | 808 |
| | Minor. Interests (A) | 510 |
| | Trans. Adj. | 432 |
| Other assets | 10,200 | Other liabilities |
| | | 5,150 |

where

- Consolidated Reserves (A) = $808 = 80\% * [1500 + (300) + 750 + (200) + 300 + (40)] - 800$
- Minority Interests (A) = $510 = 20\% * [1500 + (300) + 750 + (200) + 300 + (40) + 300 + 200 + 40]$
- Translation Adj. = $432 = 80\% * [300 + 200 + 40]$

As explained in chapter 6, consolidated reserves never include translation adjustments amount in order to be able to justify the evolution of reserves in an accounting way without mixing up currency effects.

We keep a specific account which shows the group part in this amount.

Consolidation of Year 2

With the same arguments as for the classical dividend seen in previous section, we have to eliminate in the parent company profit the part of that dividend that was included in the Year 1 profit of company A. We are speaking about $80\% * 100 \text{ CUR} * 1.3 = 104 \text{ EUR}$.

But P has received an amount of dividend of 110 EUR as mentioned initially. From a consolidation point of view, we consider two amounts: 104 corresponding to the dividend and 6 considered as an exchange gain. Theoretically speaking, P should have received exactly 104. If more it is indeed a gain, if less it is a loss.

Here is the adjustment eliminating that dividend

| | Debit | Credit |
|------------------------------|-------|--------|
| Financial income (dividends) | 110 | |
| Exchange gain | | 6 |
| Reserves | | 104 |

and we can see that we eliminate the 110 from the Financial income but we reclassify 6 on the Exchange gain, corresponding to a correct view for

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consolidation. Reserves are impacted only by the dividend amount valued at average rate of Year 1.

The reason to proceed that way is, in particular, for audit purpose. It is indeed more easy to check that this specific account has been set to zero.

Let's now consider parent statutory accounts and the consolidated accounts, including that adjustment.

| | | P (Year 2) |
|----------------|-------|----------------------------------|
| Fin. Invest./A | 800 | Capital 2,000 |
| | | Reserves 1,150 |
| | | (a) 104 |
| | | Result 450 |
| | | (a) (104) |
| Other assets | 5,300 | Other liabilities 2,500 |

| | | P + A (Year 2) |
|--------------|--------|----------------------------------|
| | | Capital 2,000 |
| | | Reserves 1,254 |
| | | Result 346 |
| | | Conso. Reserves (A) 1,040 |
| | | Minor. Interests (A) 608 |
| | | Trans. Adj. 592 |
| Other assets | 13,940 | Other liabilities 8,100 |

where

- Consolidated Reserves (A) = $1040 = 80\% * [1600 + (400) + 960 + (280) + 480 + (60)] - 800$
- Minority Interests (A) = $608 = 20\% * [1600 + (400) + 960 + (280) + 480 + (60) + 400 + 280 + 60]$
- Translation Adj. = $592 = 80\% * [400 + 280 + 60]$

Justification of consolidated reserves evolution

Let's check if consolidated reserves evolution can be justified in an accounting way by using the same report as for the classical dividend.

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| | Year 1 Reserves | Year 2 Result | Divid. (-) paid | Divid. (+) | P Approp. | Year 2 Reserves |
|-----------|--------------------|------------------|--------------------|------------|-----------|--------------------|
| Company P | 1,300 | 346 | | 104 | (150) | 1,600 |
| Company A | 808 | 336 | (104) | | | 1,040 |
| | 2,108 | 682 | (104) | 104 | (150) | 2,640 |

Column (1) contains the contribution of each company in the Year 1 consolidated reserves

Column (2) shows the same for the individual result of each company, taking into account that the profit shown is the group profit $336 = 80\% * [480 + (60)]$

Column (3) shows the group part of dividends paid by each company (A pays a group dividend of 104)

Column (4) shows the part of dividends received from group companies (P receive a group dividends of 104)

Column (5) shows the dividends paid by the parent company to its shareholders

Column (6) is similar to Column (1), but for Year 2

and reading the total line, we get "Opening reserves + group profit - parent dividend = Closing reserves".

Justification of minority interests evolution

The same question arises for the Minority Interests evolution which is summarized in the following report

| | Year 1 Minor. Int. | Year 2 Result | Divid. (-) paid | Divid. (+) | Trans. Adj. | Year 2 Minor. Int. |
|-----------|-----------------------|------------------|--------------------|------------|----------------|-----------------------|
| Company A | 510 | 84 | (26) | | 40 | 608 |

Column (1) contains the contribution of each company in the Year 1 minority interests

Column (2) shows the same for the individual minority result of each company ($84 = 20\% * [480 + (60)]$)

Column (3) shows the dividends paid by A to the 3rd Parties, that is $26 = 20\% * 100 * 1.3$

Column (4) is not used for our example

Column (5) is the contribution in the translation adjustments variation between Year 1 and Year 2 for $40 = 20\% * [[400 + 280 + 60] - [300 + 200 + 40]]$.

8.9 Elimination of interim dividends

The situation

Interim dividend is a dividend decided during the current year instead of a classical dividend that is decided at the end of current year and paid after the general meeting, a few months after the closing.

The reason to pay an interim dividend is generally to transfer cash to the shareholder earlier than what would happen with a classical dividend. It is also a way to improve the current year statutory profit of the shareholder.

In consolidation, we are faced to a similar problem of double impact on the consolidated profit, once in the company paying the interim dividend and once in the shareholders' accounts receiving it. And moreover, this double impact occurs during the same year.

We thus have to eliminate the financial income booked in the shareholders' accounts in a similar way we did it for the two previous situations.

However, we will not develop again a complete case study but we will focus on how to book that interim dividend in both company A accounts and shareholders' accounts.

We suppose interim dividends are paid

Here are the accounts of company A owned by parent company P with a financial percentage of 80%. We suppose that an interim dividend of 10 is decided and will be paid in very short term, before the end of the year.

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| Accounts before interim dividends | | | Accounts after interim dividends (paid) | | |
|-----------------------------------|------------|-----------------------|---|------------|--------------------------------|
| | | | P | | |
| | | | Fin. Invest./A | 80 | Capital 200 |
| Fin. Invest./A | 80 | Reserves 100 | Reserves | 100 | Result 30 |
| Cash | 420 | Other liabilities 170 | Cash | 420 | 8 Other liabilities 170 |
| | | | | | |
| | | | | | |
| | | | A | | |
| | | | | | |
| | | | | | |
| | | | Capital 100 | | |
| | | | Reserves 50 | | |
| Cash | 400 | Result 20 | Cash | 400 | (10) Result 20 |
| | | Other liabilities 230 | | | Other liabilities 230 |

On the left, we have the accounts corresponding to the situation before the decision to pay an interim dividend.

On the right, we have the situation on December 31 including the booking of the interim dividend.

The recommendation for company A is to ask to book the counterpart of the cash out of 10 to the debit of the Reserves account. This will seem quite unusual for a local accountant but it is necessary for consolidation needs.

Parent company P will book the cash received for $8 = 80\% * 10$ with a credit on Financial income (P&L).

The consolidation adjustment that will have to be booked is then a debit on this Financial income account and a credit on the Reserves account.

It is easy to see on this example that the Reserves account is playing a kind of link account because, in consolidation, it is impacted once in P account for credit 8 and in A account for debit $8 = 80\% * 10$. Net impact on Reserves is then zero.

We suppose interim dividends are not paid

Sometimes, an interim dividend is decided during the last days of the year, depending on company final profit, with a payment during the first days of next year.

This situation leads to the following recommended booking

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| Accounts before interim dividends | | | Accounts after interim dividends (not paid) | | |
|-----------------------------------|----------|-------------------|---|-------------------|------|
| | P | | P | | |
| Fin. Invest./A | 80 | Capital | 200 | Capital | 200 |
| | | Reserves | 100 | Reserves | 100 |
| | | Result | 30 | Result | 30 |
| Cash | 420 | Other liabilities | 170 | Receivables/A | 8 |
| | | | | Cash | 420 |
| | | | | Other liabilities | 170 |
| A | | | A | | |
| | A | | | A | |
| | Capital | 100 | | Capital | 100 |
| | Reserves | 50 | | Reserves | 50 |
| | Result | 20 | | Result | (10) |
| Cash | 400 | Other liabilities | 230 | Cash | 400 |
| | | | | Payable/P | 8 |
| | | | | Payable/Others | 2 |

In company A there is a debit on Reserves account and a credit on Payables, but 8 out of 10 is defined as an intercompany amount with P, the remaining 2 are paid to 3rd Parties.

In P accounts, the amount of 8 is booked on a Receivables account defined as intercompany with A.

Payables and Receivables will thus not appear in the consolidated accounts because of the intercompany eliminations.

Moreover, the same comment can be done for the Reserves account which has an impact of zero in consolidation.

8.10 Statutory write-off of a consolidated financial investment

The situation

Here is a group where parent company P has a financial investment in company A for 1000 corresponding to a 100% financial percentage. We can suppose company A has been founded by P a few years ago.

Equity of company A is

- Capital : 1000
- Retained earning : (600)
- Loss of Year 1 : (200)

giving a net equity of 200.

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In Year 1, consolidated reserves are $(800) = 100\% * 200 - 1000$ and this amount is just the accumulated losses of A since the first consolidation.

In Year 2, P decides to book a write-off on that investment for the full amount of 1000. This means the financial investment is now zero.

In the meantime, we receive company A accounts

- Capital : 1000
- Retained earning : (800)
- Loss of Year 1 : (200)

again with a loss of (200), leading to a net equity of zero.

Without doing anything about this situation in the consolidation, we would calculate consolidated reserves as $0 = 100\% * 0 - 0$.

But the evolution between (800) and 0 is supposed to correspond to the result of this year, (200), which is not the case.

The problem comes from the fact that, on one side, we show the bad situation of company A in the consolidated figures by consolidating the company and on the other side, by booking a write-off, P is saying company A situation is bad. If we do nothing, we are saying twice that A situation is bad with different figures. Duplication and contradiction problems arise.

The adjustments

Considering A is consolidated, we must reverse the write-off in P accounts by the following consolidation adjustment.

| | Debit | Credit |
|---------------------|-------|--------|
| Financial Invest./A | 1,000 | |
| Write-off | | 1,000 |

This adjustment has to be maintained in the consolidation as long as the statutory financial investment in P is reduced to zero. If, in a few years, P decides to reverse part of its write-off because situation of A is improving, we will have to do the same with this adjustment.

8.11 Difference on opening reserves

The situation

Most groups are producing their consolidated accounts a few weeks after the closing date and sometimes long before the statutory accounts of the subsidiaries. It is indeed not possible to wait for each company to report their accounts after the approval of the shareholders' annual meeting. The consequence is that in the next consolidation we find that the result previously consolidated before is not the final one.

What to do in such situation?

Let's consider an example

| A | | | | | |
|--------------|--------|--------|-------------------|--------|--------|
| | Year 1 | Year 2 | | Year 1 | Year 2 |
| | | | Capital | 1,000 | 1,000 |
| | | | Reserves | 700 | 850 |
| | | | Result | 200 | 120 |
| Other assets | 2,500 | 2,900 | Other liabilities | 600 | 930 |

Here are Year 1 and Year 2 statutory accounts of company A.

The Year 1 profit we consolidated was 200, but when we receive the Year 2 accounts, we find an opening equity of $1850 = 1000 + 850$ while it should have been $1900 = 1000 + 700 + 200$. After investigation, company A confirms there has been a late booking for a provision of 50.

The adjustments

That provision of 50 has to be booked in Year 2 accounts by the following adjustment.

| | Year 1 | Year 2 | | Year 1 | Year 2 |
|--------------|--------|--------|-------------------|--------|-------------|
| | | | Capital | 1,000 | 1,000 |
| | | | Reserves | 700 | 850 |
| | | | (a) | | 50 |
| | | | Result | 200 | 120 |
| | | | (a) | | (50) |
| Other assets | 2,500 | 2,900 | Other liabilities | 600 | 930 |

The P&L booking is done on a provision account while the counterpart in the balance sheet is the Reserves account.

By booking such adjustment, two consolidation principles are respected

- First, reserves are now correctly justified with an adjusted amount of 1900 for Year 2, in line with 1900 in Year 1
- Any "mistake" has to be corrected via adjustments in the consolidated accounts as soon as it has been noticed.

8.12 Acquisition of a company with a badwill

The situation

When a new company is entering the consolidation scope after a shares acquisition, two questions need an answer

- What is the equity at the date of acquisition?
- Can the difference between the acquisition price and the percentage of equity acquired be justified by some accounts to reevaluate or devalue?

After booking some assets and liabilities accounts against the opening equity, there might remain a residual difference between price and adjusted equity. If this difference is negative, we call it a badwill.

Depending on Local Gaap or IFRS rules, this badwill will be booked on a specific account in the equity or booked in the P&L as a profit.

The situation of a badwill is rather rare. Most of the time, it happens for the three following reasons

- The CEO of a company dies and the family, which is not involved in the business, wishes to sell the company as soon as possible
- The CEO of a company retires and there is a restructuring to be done with possible employees dismiss. As he doesn't want to make this job himself and support the related costs, the price of the company is of course reduced.
- An industrial company has some environment costs which will be supported by the acquirer. This again decreases the acquisition price.

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We are going to analyse the situation of parent company P acquiring 80% of shares of company A on July 1st. At that date, the equity is 800, including a profit of 20 for the first six months of the year.

A due diligence shows that there will be some costs for an amount of 100 to be supported by the company during the next two years, starting in Year 2.

The adjustments

Here are companies P and A accounts, at the end of Year 1, including already the consolidation adjustments with the necessary comments

| P | | A | |
|----------------|-----------|-------------------|-------------|
| Fin. Invest./A | 500 | Capital | 1,000 |
| (c) | 84 | Reserves | 300 |
| | | Result | 100 |
| | | Badwill | |
| | | (c) | 84 |
| Other assets | 1,500 | Other liabilities | 600 |
| | | | |
| Assets DT | | Capital | 500 |
| | | Reserves | 280 |
| | | (a) | 20 |
| | | (b) | (70) |
| | | Result | 50 |
| | | (a) | (20) |
| | | Provision | |
| | | (b) | 100 |
| Other assets | 1,500 | Other liabilities | 670 |

Adjustment (a) eliminates a profit of 20 which corresponds to a period not belonging to the group. The starting date to show any revenue from A is July 1st. This meets here again one important principle of statutory consolidation: to show the contribution of each company since the beginning of their life in the group. That profit is just transferred in the acquired equity.

The adjustment (a) impacts two accounts in the balance sheet but all income and expense accounts in P&L are in principle impacted to eliminate the first six months.

Adjustment (b) books a provision of 100 to cover future costs identified during the due diligence process. Again, this amount of 100 has an impact on the reserves and not the P&L. A deferred tax of 30 corresponding to a tax rate of 30% is calculated for that adjustment.

Adjustment (c) books the goodwill of $84 = 500 - 80\% * [500 + 280 + 20 + (70)]$, supposing we are in some non IFRS rules. If IFRS rules are applied, the goodwill is booked immediately into the P&L as a profit.

Let's look now at the consolidated accounts of this first year

| P + A | | |
|--------------|----------------------|-------|
| | Capital | 1,000 |
| | Reserves | 300 |
| | Result | 100 |
| | Conso. Reserves (A) | 24 |
| | Minor. Interests (A) | 152 |
| | Badwill | 84 |
| Assets DT | Provision | 100 |
| Other assets | Other liabilities | 1,270 |

where

- Consolidated Reserves = $24 = 80\% * [500 + 280 + 20 + (70) + 50 + (20)] - [500 + 84]$
- Minority Interests = $152 = 20\% * [500 + 280 + 20 + (70) + 50 + (20)]$

A final check can be done on the consolidated reserves because if we go back to the definition, it is the accumulated profit contributed by company A since its life time in the group. Company A indeed, has belonged to the group only for the last six months of this first year, making a profit of $30 = 50 + (20)$. The group has 80% of that profit, that is 24.

What will happen to the badwill in the future?

If the participation of 80% remains unchanged, the badwill will stay unchanged in the equity.

No reduction of value is accepted for the badwill.

If company P decides to sell 20% of its participation in the future, then the group will book $\frac{1}{4}$ of the badwill into P&L.

If the remaining 20% can be acquired in the future, the logic of evaluation of a possible badwill is the same and if a new badwill is confirmed, the second one is just added to the first one.

8.13 Acquisition of a company with a goodwill

The situation

A goodwill occurs when the acquisition price is higher than the corresponding equity acquired.

The main reasons are the following

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- It is generally normal to pay more than the equity
- Certain values of the acquired company are not reflected in the balance sheet, as
 - The value of the customers
 - The value of the employees
 - The value of certain products, trade marks or ideas not booked as intangible assets
- The fact that by acquiring a company, we eliminate a competitor
- The new shares acquired may give the control on the company

Anyway, it is supposed that in case of goodwill, the acquirer identifies the main reasons of paying more than the equity. This approach leads to book adjustments by reevaluating some assets with a counterpart in the equity. A new goodwill calculation must be done afterwards and the remaining goodwill will then be considered as an intangible asset in the consolidated balance sheet.

At this point of the process, these explanations apply to any consolidation rules: IFRS or Local Gaap.

The future of the goodwill depends now on the evaluation rules.

In IFRS, a goodwill remains unchanged during the lifetime of the company in the consolidation scope. At the end of each year, an impairment test is applied to each company in order to compare the present value of the company against the value of the company at acquisition time. If that value has decreased, we will have to book an impairment (=provision, write-off) on the goodwill. That impairment has a negative impact on the P&L.

By such a process, the goodwill can decrease but cannot be reevaluated.

A last possibility that can be done under IFRS rules is the calculation of a full goodwill whenever the group acquires, for instance, only 80% of a company.

Let's consider the following example.

A group acquires 80% of a company A for a price of 100. Its equity being 90, the goodwill is equal to $28 = 100 - 80\% * 90$. IFRS rules offer the possibility to calculate a full goodwill as if the group would have bought 100%, by calculating a goodwill of $28/80\% = 35$.

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Booking of that goodwill will be as follows

| | Debit | Credit |
|---------------------|-------|--------|
| Goodwill | 35 | |
| Financial Invest./A | | 28 |
| Minority Interests | | 7 |

In Local Gaap, a goodwill must be depreciated on a linear and economical basis. The duration of the depreciation is a choice of the group. In most countries, the number of years is limited.

No deferred taxes apply to the impairment or the depreciation of a goodwill.

Let's consider an example

We are going to analyse the situation of parent company P acquiring 80% of shares of company A for a price of 1200 on July 1st. At that date, the equity of A is 860, including a profit of 60 for the first six months of the year.

A due diligence identifies a tangible asset that should be revaluated for an amount of 500, with a 10% per year depreciation.

The adjustments

We present hereunder companies P and A accounts, already including the consolidation adjustments.

| P | | | |
|-----------------------|--------------|-------------------|--------------|
| Goodwill (Gross Val.) | | Capital | 2,000 |
| (d) 272 | | Reserves | 300 |
| Goodwill (Dep.) | | Result | 100 |
| (e) (34) | | (e) (34) | |
| Fin. Invest./A | 1,200 | | |
| (d) (272) | | | |
| Other assets | 1,800 | Other liabilities | 600 |
| Total | 2,966 | Total | 2,966 |

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| A | | | |
|------------------------|--------------|-------------------|--------------|
| Tang. Assets(Acq.Val.) | 1,000 | Capital | 500 |
| (b) | 500 | Reserves | 300 |
| Tang. Assets(Dep.) | (300) | (a) | 60 |
| (c) | (25) | (b) | 300 |
| | | Result | 100 |
| | | (a) | (60) |
| | | (c) | (15) |
| | | Liabilities DT | |
| | | (b) | 200 |
| | | (c) | (10) |
| Other assets | 1,300 | Other liabilities | 1,100 |
| Total | 2,475 | Total | 2,475 |

Adjustment (a) eliminates the profit of 60 for exactly the same reason as the one we gave for the goodwill situation.

Adjustment (b) revalues the tangible asset for a gross amount of 500. A liabilities deferred tax is booked on the basis of a 40% tax rate, so for 200, and the remaining amount of 300 is booked against the Reserves.

Adjustment (c) is the depreciation of that revaluation, corresponding to the period of the last six months of this year, so $25 = \frac{1}{2} \text{ of } 10\% \text{ of } 500$. Of course, there is also a deferred tax impact for $10 = 40\% * 25$. Net impact on P&L is only 15.

Now we have to calculate the difference between the acquisition price of 1200 and 80% of the adjusted equity which is $928 = 80\% * [500 + 300 + 60 + 300]$ giving a goodwill of 272.

Adjustment (d) is the booking of the goodwill which is considered as an intangible asset.

Adjustment (e) is the depreciation of the goodwill on a basis of 4 years, so $34 = \frac{1}{2} * [272 * 25\%]$ because we have to depreciate over the last six months of this first year.

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Here are the consolidated accounts

| | | P + A | |
|------------------------|--------------|----------------------|--------------|
| Goodwill (Gross Val.) | 272 | Capital | 2,000 |
| Goodwill (Dep.) | (34) | Reserves | 300 |
| | | Result | 66 |
| Tang. Assets(Acq.Val.) | 1,500 | Conso. Reserves (A) | 20 |
| Tang. Assets(Dep.) | (325) | Minor. Interests (A) | 237 |
| | | Liabilities DT | 190 |
| Other assets | 3,100 | Other liabilities | 1,700 |
| Total | 4,513 | Total | 4,513 |

by applying the global integration method with a financial percentage of 80% on adjusted accounts. In particular

- Consolidated Reserves = $20 = 80\% * [500 + 300 + 60 + 300 + 100 + (60) + (15)] - [1200 + (272)]$
- Minority Interests = $237 = 20\% * [500 + 300 + 60 + 300 + 100 + (60) + (15)]$

and we will check again that consolidated reserves of 20 are equal to 80% of the adjusted profit of company A.

What will happen to the goodwill in the future ?

If the participation of 80% remains unchanged, the goodwill will be depreciated on a linear basis.

If, for instance, company P decides to sell 20% of its participation in the future, then the group will book $\frac{1}{4}$ of the net goodwill into P&L.

If the remaining 20% can be acquired in the future, the logic of evaluation of a possible goodwill is the same and if a new goodwill is confirmed, the second begins a four years life in the group. It is not requested to depreciate that second goodwill in order to finish its life at the same time as the first goodwill.

What happens if, buying the remaining 20%, we calculate a badwill? Booking the badwill as explained before, we would have in the consolidated accounts a goodwill corresponding to the first 80% and simultaneously a badwill for the 20%. This situation is not acceptable. In Local Gaap, we must make a netting between both goodwill and badwill.

In IFRS, we know a **badwill** doesn't exist in the consolidated accounts because it is booked immediately in P&L. But, in this special situation, we also have to net both.

8.14 Disposal of consolidated shares to 3rd Parties

The situation

A company A is consolidated since a number of years and, one day the group decides to sell the company to 3rd Parties. Such situation leads to a certain number of remarks, amongst which

- The shareholders' company selling company A makes a gain or loss on disposal which is calculated as the difference between the selling price and the statutory value of the financial investment booked in its accounts. Usually this value corresponds to the historical acquisition value.
- From the consolidation point of view, we have seen that company A has a value which corresponds to its net equity. This means that the gain or loss on disposal should be calculated as the difference between the selling price and the percentage owned in company A equity. That gain or loss will not be the same as the one calculated in a statutory point of view. A consolidation adjustment may be necessary.
- Most of the time, such a disposal never happens the first day of the year. This means that the company has still to be consolidated during the months preceding the disposal. Of course, at the end of the year, the company is not in the consolidation scope any more which means there will be no impact in the consolidated balance sheet but only an impact in the P&L for the months before disposal.
- There may be a goodwill booked on company A or a badwill (if Local Gaap) which will have to be reversed via P&L at time of disposal.
- When speaking about selling a company, we must understand selling shares of a company. It can happen that we don't sell all the shares of a certain company but only part of them. The consequence is that after disposal of these shares, we still keep the company in the consolidation scope, but with a different financial percentage and maybe with a different consolidation method.

- A last remark will concern foreign companies for which we have accumulated translation adjustments. This is again a technical problem we will not discuss in this section. We leave it for Part 4 related to case studies.

These remarks show that the disposal of shares of a consolidated company is quite technical.

Let's consider an example

Company A has been consolidated with a financial percentage of 80% since a certain number of years. On the 1st of July this year, parent company P, its unique shareholder, decides to sell 20% of shares to 3rd Parties for a price of 500. After disposal, the consolidation method remains the global integration.

Profit of A on June 30, Year 2 is 50.

At acquisition time, a goodwill of 400 has been booked in P accounts. Consolidation is done under IFRS rules and no impairments have been booked since the beginning.

In A accounts, there is one adjustment reevaluating a land as allocation of part of the initial goodwill.

The scenario we will apply to this situation is

- Consolidate the group before disposal of 20% of shares (Year 1)
- Analyse the disposal from the consolidation point of view
- Consolidate the group at the end of Year 2, after disposal of 20% of shares
- Justify the consolidated reserves of the group between Year 1 and Year 2
- Justify minority interests between Year 1 and Year 2

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Consolidation of Year 1

Here are the P and A accounts, including the consolidation adjustments. P owns 80% of A and consolidates A with the global integration method.

| P | | | |
|-----------------------|--------------|-------------------|--------------|
| Goodwill (Gross Val.) | | Capital | 2,000 |
| (a) 400 | | Reserves | 300 |
| | | Result | 100 |
| Fin. Invest./A | 1,200 | | |
| (a) (400) | | | |
| Other assets | 3,800 | Other liabilities | 2,600 |
| Total | 5,000 | Total | 5,000 |
| A | | | |
| Land | 1,000 | Capital | 1,000 |
| (b) 200 | | Reserves | 500 |
| | | (b) 200 | |
| | | Result | 100 |
| Other assets | 1,800 | Other liabilities | 1,200 |
| Total | 3,000 | Total | 3,000 |

Adjustment (a) concerns the gross value of the goodwill that has been calculated a few years ago when acquiring the company. No impairment has been booked since that time.

Adjustment (b) books an allocation of that initial goodwill on a land. For some local reasons, there are no deferred taxes and, of course, speaking about a land, there is no depreciation.

The consolidated accounts are presented hereunder

| P + A | | | |
|-----------------------|--------------|----------------------|--------------|
| Goodwill (Gross Val.) | 400 | Capital | 2,000 |
| | | Reserves | 300 |
| Land | 1,200 | Result | 100 |
| | | Conso. Reserves (A) | 640 |
| | | Minor. Interests (A) | 360 |
| Other assets | 5,600 | Other liabilities | 3,800 |
| Total | 7,200 | Total | 7,200 |

after consolidating company A by the global integration method, which leads to

- Consolidated Reserves = $640 = 80\% * [1000 + 500 + 200 + 100] - [1200 + (400)]$

- Minority Interests = $360 = 20\% * [1000 + 500 + 200 + 100]$

So, nothing really particular at the end of this Year 1.

Analysis of the selling transaction

This will be the difficult part of this example and our explanations will consider three different methods, each one of course giving the same consolidation adjustment.

Method 1 : Statutory view versus Consolidation view

At the end of chapter 4, when considering the equity method consolidation, we explained that in consolidation the value of a company was the value of its equity and the problem is that the transaction is booked based not on that equity value but on the historical value of the financial investment in P accounts.

| In consolidation | |
|-------------------------------------|-------|
| Disposal price | 500 |
| Equity of company A | |
| Capital | 1,000 |
| Reserves | 600 |
| Profit before disposal | 50 |
| Consolidation adjust. (Revaluation) | 200 |
| | Total |
| | 1,850 |
| Percentage disposed | 20% |
| Group equity | 370 |
| Gain on disposal | 130 |
| Book 1/4 of goodwill to P&L | 100 |
| Final gain on disposal | 30 |

Here is the gain on disposal calculated with statutory figures.

| In statutory accounts | |
|-----------------------|-----|
| Disposal price | 500 |
| Shares value | 300 |
| Gain on disposal | 200 |

In consolidation, we consider the adjusted equity. We mean statutory equity and the revaluation of the land for 200. Moreover, the 20% shares of company A being disposed on July 1st, Year 2, we also include the 50 profit of the first six months of the year. 20% of the total, 1850, equals 370 which is the equity value of these shares. A first gain is the difference between the selling price and that equity value, 130. Now, initially we booked a goodwill of 400 corresponding to 80% of shares initially acquired. As we remain with only

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60% after that transaction, $100 = 20\%/80\% * 400$ must be booked as a reduction of that gain, giving a net gain of 30.

Comparing both approaches, the first one gives a gain of 200 and the second one a gain of 30 and we have to give priority to the consolidation approach of course. This leads to the following adjustment reducing the statutory gain from 200 to 30

| | Debit | Credit |
|-----------------------|-------|--------|
| Gain on disposal | 170 | |
| Consolidated reserves | | 170 |

and we must admit that for inexperienced readers, the booking of consolidated reserves can seem a little bit strange.

Let's try to clarify this point with the second method.

Method 2 : A step by step approach

This method contains three main steps

- First we reverse the statutory transaction
- Then we take into account historical adjustments and equity value of the shares disposed instead of the statutory financial investment
- Finally, we make the transaction with these values.

Reverse the *statutory* transaction by booking the following adjustment

| | Debit | Credit |
|------------------|-------|--------|
| Fin. Invest./A | 300 | |
| Other assets | | 500 |
| Gain on disposal | 200 | |

In which we find back the statutory value of the 20% of shares disposed for a value of 300, we reverse the cash (Other assets) received for 500 and we eliminate the gain for 200.

Book the *goodwill* attached to the 20% shares *disposed* which consists in carrying forward a historical adjustment

| | Debit | Credit |
|----------------|-------|--------|
| Goodwill | 100 | |
| Fin. Invest./A | | 100 |

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Replace the *statutory* financial investment by the *equity* value of the *company*

| | Debit | Credit |
|-----------------------|-------|--------|
| Equity value | 370 | |
| Net Fin. Invest. | | 200 |
| Consolidated reserves | | 170 |

This booking is based of the following relation: equity value = statutory financial value + consolidated reserves, as explained at the end of Chapter 4.

In this adjustment, 370 has been calculated a few lines above, 200 is the net value of the financial investment ($300 - 100$) and 170 is the value of the consolidated reserves accumulated on company A since first consolidation until disposal (limited to 20%).

This may request maybe an additional explanation.

Let's go back to the consolidated reserves of company A at the end of Year 1, which is 640 as booked in the consolidated balance sheet above. We know that this amount is equal to non distributed profits during company A life time in the consolidation scope until end of Year 1. But we consider the situation at the end of June Year 2 and, in the meantime, we have to add a group profit of $40 = 80\% * 50$ to these consolidated reserves. This gives a total of 680 and corresponds to a participation of 80%. For 20% of shares, these consolidated reserves are equal to $170 = 20\% / 80\% * 680$.

We then make the transaction on the basis of these *figures*

| | Debit | Credit |
|------------------|-------|--------|
| Other assets | 500 | |
| Equity value | | 370 |
| Gain of disposal | | 130 |

We find back our cash (Other assets) for 500, we sell a financial asset valued to 370 and this transaction is giving a gain of 170.

And finally, the *goodwill* attached to the 20% of shares *disposed* must be *written-off*

| | Debit | Credit |
|------------------|-------|--------|
| Gain on disposal | 100 | |
| Goodwill | | 100 |

When we now aggregate these five adjustments, most of these accounts are just compensating and we remain with the following adjustment

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| | Debit | Credit |
|-----------------------|-------|--------|
| Gain on disposal | 170 | |
| Consolidated reserves | | 170 |

which is exactly the same as the one we got in the previous method.

Method 3 : A direct approach

We would advise not to use only this method without checking the result with one of the two first methods or both.

We have seen that the consolidated reserves at the end of June Year 2, attached to the 20% shares disposed, were equal to 170. This accumulated profit has to be reversed by using the following adjustment

| | Debit | Credit |
|-----------------------|-------|--------|
| Gain on disposal | 170 | |
| Consolidated reserves | | 170 |

Changes of financial percentages from 80% to 60% during Year 2

We know that company A profit for the first six months of Year 2 is 50. As, at the end of Year 2, the financial percentage is 60%, the consolidation process will apply this percentage to the full year, including the 50.

Most of the consolidation software on the market are processing this way, which needs the following adjustment.

Indeed, the group profit for the first six months is 40 ($= 80\% * 50$) instead of 30 ($= 60\% * 50$). This means 10 is missing in the group profit at the end of Year 2. And these 10 are given to the 3rd Parties!.

Here is the adjustment correcting this wrong situation

| | Debit | Credit |
|--------------------------|-------|--------|
| Reserves | | |
| Group result | | |
| Minority interest result | | |
| <u>Minori. interests</u> | | |

It is called a 'after 3rd Parties' or "top" or "group" adjustment because, regardless of the fact that it is booked in company A accounts, owned at 60%, these amounts must be considered as impacting each account at 100%.

We see that we give an additional profit of 10 to the group and we reduce the 3rd Parties profit for the same amount.

In the balance sheet, the impact of that adjustment can be seen on group sides because it consists in a transfer between reserves and result but we see nothing on the 3rd Parties side because Minority interests reserves and result are aggregated.

In the P&L, there is no impact on expense and income accounts, but just a transfer between Minority result and Group result, generally on the two last lines.

Consolidation of Year 2

Here are the accounts of companies P and A, including the consolidation adjustments.

| | | P | |
|-----------------------|------------------|-------------------|------------------|
| Goodwill (Gross Val.) | | Capital | 2,000 |
| | (a) 300 | Reserves | 400 |
| Fin. Invest./A | 900 | | (c) 170 |
| | (a) (300) | Result | 300 |
| Other assets | 4,800 | | (c) (170) |
| | | Other liabilities | 3,000 |
| Total | 5,700 | Total | 5,700 |

| | | A | |
|--------------|----------------|--------------|------------------|
| Land | 1,000 | Capital | 1,000 |
| | (b) 200 | Reserves | 600 |
| | | | (b) 200 |
| | | Result | (d*) (10) |
| Other assets | 2,300 | | 150 |
| | | | (d*) 10 |
| Total | 3,500 | Total | 1,550 |
| | | | 3,500 |

Adjustment (a) shows the 300 remaining goodwill related to the 60% of shares the group still owns.

Adjustment (b) concerns the allocation of this initial goodwill on a land for 200. Independently of the 20% shares disposal, the land is still owned by company A.

Adjustment (c) modifies the statutory gain on disposal as explained above for an amount of 170.

Adjustment (d*) is the reclassification of the profit of 10 between 3rd Parties and Group. The * indicates these amounts have to be considered at 100% on each account

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We get the following consolidated accounts

| | | P + A | |
|-----------------------|--------------|----------------------|--------------|
| Goodwill (Gross Val.) | 300 | Capital | 2,000 |
| | | Reserves | 570 |
| Land | 1,200 | Result | 130 |
| | | Conso. Reserves (A) | 570 |
| Other assets | 7,100 | Minor. Interests (A) | 780 |
| | | Other liabilities | 4,550 |
| Total | 8,600 | Total | 8,600 |

where

- Consolidated Reserves = $570 = 60\% * [1000+600+200+150] + (10) + 10 - [900 + (300)]$
- Minority Interests = $780 = 40\% * [1000 + 600 + 200 + 150] + 10 + (10)$

Justify the evolution of the consolidated reserves

In the same way we did for the dividends, we are going to use the following report

| | Year 1 Reserves | Year 2 Result | Divid. (-) paid | Divid. (+) | Transfer | P Approp. | Year 2 Reserves |
|-----------|--------------------|------------------|--------------------|------------|----------|-----------|--------------------|
| Company P | 400 | 130 | | | 170 | | 700 |
| Company A | 640 | 100 | | | (170) | | 570 |
| | 1,040 | 230 | 0 | 0 | 0 | 0 | 1,270, |

in which the first column shows the contribution of Year 1 reserves of each company and same for the last column corresponding to Year 2. These amounts are coming from Year 1 and Year 2 consolidated balance sheet.

The second column shows contribution of Year 2 result of each company. For P, it corresponds to its statutory result of 300 adjusted by the 170 gain on disposal. For A, Year 2 statutory result is 150 consisting in 50 for the first six months and so 100 for the last six months. Applying 80% to 50 and 60% to 100, we find indeed 100 for the full year.

There are no dividends paid but we keep these two columns.

The transfer of reserves appears because of the gain on disposal adjustment. In fact, 170 is leaving company A because of the reduction of 20% of percentage but these reserves do not leave the group. There are now

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allocated in P accounts. The adjustment of the gain on disposal shows clearly a credit on reserves in P accounts for 170.

P is not paying dividends so no "P Appropriation" column in this case study.

Justify the evolution of the minority interests

The principles are the same for minority interests which appear in the first column for Year 1 and last column for Year 2, both amounts coming again from the consolidated balance sheets.

Year 2 result of 50 is 40% of the statutory result of 150, 60 reduced by the (d*) adjustment above.

| | Year 1 Minor. Int. | Year 2 Result | Divid. (-) paid | Divid. (+) | % variation | Year 2 Minor. Int. |
|-----------|-----------------------|------------------|--------------------|------------|-------------|-----------------------|
| Company A | 360 | 50 | | | 370 | 780 |

The amount of 370 is the consequence of what is called in consolidation a 'structure' problem or a "discontinuing process" problem. In fact, until June Year 2, 3rd Parties have 20% of interests in company A equity and on July 1st they have suddenly 40%. This increase of 20% in the equity at this date is equal to $370 = 20\% * [1000 + 600 + 200 + 50]$ and it shows that 3rd Parties have just more interests in A equity.

This column doesn't appear for the group because, of course, it loses these 370 but receives a price for that. We don't manage the same information for the 3rd Parties.

9 THE ELIMINATION PROCESS

9.1 What has been done until now?

A spreadsheet view

To summarize what has been done until now, we can use the following 'spreadsheet' picture.

| | Local currency | Conso currency | Adjustment 1 | Adjustment 2 | ... | Adjusted accounts | Elimination 1 | Elimination 2 | ... | Contribution |
|--------------------------|----------------|----------------|--------------|--------------|-------------|-------------------|---------------|---------------|----------|--------------|
| Goodwill | 80 | 400 | | 10 (10) | | 10 390 | | | | |
| Fin. Invest./A | 320 | 1,600 | | | (20) | 1,580 | | | | |
| Other assets | | | | | | | | | | |
| Total assets | 400 | 2,000 | 0 | 0 | (20) | 1,980 | 0 | 0 | 0 | 0 |
| Capital | 100 | 500 | | | | 500 | | | | |
| Reserves | 80 | 400 | | | | 400 | | | | |
| Result | 30 | 150 | (30) 30 | | (5) | 115 30 0 | | | | |
| Translation adj. | | | | | | | | | | |
| Minority Interests | | | | | | | | | | |
| Other liabilities | 190 | 950 | | | (15) | 935 | | | | |
| Total Liabilities | 400 | 2,000 | 0 | 0 | (20) | 1,980 | 0 | 0 | 0 | 0 |
| Turnover | 800 | 3,200 | | | | 3,200 | | | | |
| other income | 50 | 200 | | | | 200 | | | | |
| Cost of sales | (710) | (2,840) | | | | (2,845) | | | | |
| Other expense | (100) | (400) | | | | (400) | | | | |
| Tax | (10) | (40) | | | | (40) | | | | |
| Result | 30 | 220 | 0 | 0 | (5) | 115 | 0 | 0 | 0 | 0 |

It represents the figures (balance) of one company belonging to the consolidation scope and it is easy to imagine there are as many spreadsheets like this one as there are companies in the group, including the parent company.

In the first column, we start with the local currency amounts.

Going through the currency conversion step, we translate the balance sheet with a closing rate (5 in our example) and the P&L with an average rate (4 in our example). We know this is not totally correct and we have to adjust the equity accounts to comply with the historical rates. These consolidation adjustments are booked in the columns "Adjustment 1, 2, ...".

More generally speaking, all consolidation adjustments as the ones seen previously are booked in these columns.

The consolidation currency amounts and all these adjustments are then added horizontally to produce adjusted accounts, into an adjusted balance which is similar to the statutory balance received from each company, but including some additional specific consolidation accounts like goodwill, translation adjustments, ...

What still remains to be done are the eliminations adjustments, considering the consolidation method defined for each company.

However, it is important to notice right now that these eliminations will also appear as adjustments in the "Elimination 1, 2, ..." columns.

Finally, these elimination amounts added to the adjusted amounts give a final column to the right of each spreadsheet, which represents the balance contribution of the company in the consolidated balance.

By adding this last column of each spreadsheet, we get the consolidated balance.

Consolidated reporting can start at this time.

Some methodoloav principles

By working in this way, we can point out some important principles

- Each consolidation adjustment consists in a journal entry with debits and credits, just like in an accounting system.
- When receiving the local currency balance sheet of a company, via the consolidation reporting, the result coming from the P&L is equal to the result account in the equity. We can see that this principle applies also to each individual consolidation adjustment.
- Some transactions need to book adjustments in two (or more) companies. We have seen such situations when eliminating group profit based on an asset disposal or when eliminating the stocks margins. In such case, each adjustment is fully booked in balance in each company. We don't accept to debit one company and credit another company.
- We also recommend not booking all the adjustments in a kind of "group" company because we loose the benefit of getting a contribution. Moreover, most of the time, it could just be wrong because this dummy company would probably be defined with a financial percentage of 100% while the concerned companies would have different percentages.

- When booking consolidation adjustments in a foreign company, it should be done in local currency. Of course, in our spreadsheet approach, this adjustment would finally be in the consolidation currency, but after a correct translation as explained in Chapter 6.

We are now going to explain how to produce the eliminations adjustments and you will see that the process is made in respect of the principles just stated above.

9.2 Global integration companies

We consider a company A consolidated with the global integration method and a financial percentage of 80%.

| A - Global integration - 80% | | | | | |
|------------------------------|--------------|--------------|---------------------|--------------|----------------|
| Goodwill | 400 | | Capital Reserves | 2,000 | (400) (160) |
| Fin. Invest./B | 1,000 | (200) | Result | 800 | (30) |
| | | | Translation Adjust. | 150 | (10) |
| | | | Minority Interests | 50 | 400 |
| Other assets | 3,600 | | Other liabilities | 2,000 | |
| Total | 5,000 | (200) | | 5,000 | (200) |
| Cost of sales | 5,850 | | Sales | 5,000 | |
| Other expenses | | | Other income | 1,000 | |
| Result | 150 | (30) | | | |
| Minority Result | | 30 | | | |
| Total | 6,000 | 0 | | 6,000 | 0 |

The first columns in Assets and Liabilities represent adjusted amounts and we have explained that for such company, Minority Interests were calculated as 20% * Equity accounts less 20% * Financial Investments accounts. This formula is then converted into the elimination adjustment shown in the second columns.

It is indeed a balanced adjustment as announced.

After booking this elimination, it is important to notice that

- The remaining Equity is 80%, corresponding to the Group part
- Same for Financial Investments

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- All other Assets and Liabilities accounts are just not eliminated because, speaking about a global integration, we have to add them to parent company accounts.

On the P&L side, all accounts are to be kept in the consolidation and we just have to transfer $30 = 20\% * 150$ from Group Result to the Minority Result.

9.3 Proportional integration companies

Considering company A consolidated with the proportional integration at 50%, only 50% of Assets, Liabilities and P&L accounts remain in the final consolidated balance sheet.

The elimination adjustment hereunder just eliminates 50% of all these accounts. It can be quite a large journal entry depending on the number of accounts booked.

| A - Proportional integration - 50% | | | | | |
|------------------------------------|--------------|----------------|---|----------------|-----------------------|
| Goodwill | 400 | (200) | Capital Reserves | 2,000 | (1,000) |
| Fin. Invest./B | 1,000 | (500) | Result Translation Adjust. | 800 50 | (400) (75) (25) |
| Other assets | 3,600 | (1,800) | Minority Interests Other liabilities | 2,000 | (1,000) |
| Total | 5,000 | (2,500) | | Total | 5,000 |
| | | | | | |
| Cost of sales | 5,850 | (2,925) | Sales Other income | 5,000 1,000 | (2,500) (500) |
| Other expenses | 150 | (75) | | | |
| Result | | | | | |
| Minority Result | | | | | |
| Total | 6,000 | (3,000) | | Total | 6,000 |
| | | | | | |

Of course, for such consolidation method, there are no minority interests in the balance sheet and no minority result in the P&L.

Again, we see that 50% of the equity still remains because it belongs to the group.

9.4 Equity method companies

We now consider company A consolidated by the equity method with a financial percentage of 30%. Following this method, all Assets, Liabilities and

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P&L accounts are not added to parent company accounts, except Equity which is kept at 30% and possibly financial investments.

| A - Equity method - 30% | | | | | |
|-------------------------|--------------|----------------|---------------------|--------------|--------------|
| Goodwill | 400 | (400) | Capital Reserves | 2,000 | (1,400) |
| Fin. Invest./B | 1,000 | (700) | Result | 800 | (560) |
| Equity Value | | 600 | Translation Adjust. | 150 | (105) |
| Other assets | 3,600 | (3,600) | Minority Interests | 50 | (35) |
| | | | Other liabilities | 2,000 | (2,000) |
| Total | 5,000 | (4,100) | | Total | 5,000 |
| | | | | | (4,100) |

| | | | | | |
|-----------------|--------------|----------------|--------------------|--------------|--------------|
| Cost of sales | 5,850 | (5,850) | Sales | 5,000 | (5,000) |
| Other expenses | | | Other income | 1,000 | (1,000) |
| Result | 150 | (105) | Profit/Equity Cies | | 45 |
| Minority Result | | | | | |
| Total | 6,000 | (5,955) | | Total | 6,000 |
| | | | | | (5,955) |

The balance sheet elimination is again a long journal entry because all assets and liabilities accounts are eliminated. Nevertheless, we keep 30% of the Equity and 30% of the Financial Investments which belong to the Group. Of course, this unbalances the journal entry and everything is going back to normal when booking the Equity Value for 600.

The approach is similar for the P&L where we eliminate also all income and expense accounts except 30% of the revenue we keep for the Group. To balance that journal entry, we book the specific account "Profit/Equity Cies"

9.5 Elimination of intercompany positions

The elimination of intercompany amounts will necessarily impact one account of a company with a corresponding account in another company named the partner.

We are going to consider two different situations, either intercompany amounts have to be eliminated between integral consolidation companies or elimination is done between an integral company and a proportional company.

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Elimination of intercompany amounts between integral companies

In our example, we consider three companies A, B and C, supposing all intercompanies are correctly matched. If not, some consolidation adjustments will have been previously booked to correct these differences.

| A - Global integration | | | | | |
|-------------------------------|-----|----------------------|------------|----|------|
| Receivables/B Link account | 100 | (100) 100 (80) | Payables/C | 80 | (80) |

| B - Global integration | | | | | |
|-------------------------------|-----|-----------------------|------------|-----|-------|
| Receivables/C Link account | 200 | (200) 200 (100) | Payables/A | 100 | (100) |

| C - Global integration | | | | | |
|-------------------------------|----|----------------------|------------|-----|-------|
| Receivables/A Link account | 80 | (800) 80 (200) | Payables/B | 200 | (200) |

For each company, we eliminate each intercompany amount on receivables and payables and book the counterpart on a "Link account". This Link account enables a balanced journal entry for each company.

Of course, the intercompany amounts being reconciled, the Link account is set to zero at consolidation level after these eliminations.

It is easy to see that all these accounts will not impact the final consolidated balance sheet.

Elimination of intercompany amounts in the P&L is done in the same way by also using another 'Link account'.

If there is a threshold accepted by the Auditors under which reconciliation is not done, these Link accounts will not be zero at the end of the consolidation process. If the remaining differences look material, it is the consolidator responsibility to investigate the origin of the problem, otherwise we recommend to reclassify the differences on appropriate accounts. For audit purpose, it is better to have all Link accounts set finally to zero.

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Elimination of intercompany amounts between an integral company and a proportional company

We now consider company A consolidated by integration method and company B with the proportional method. Initially, intercompany reconciliation is made, no matter the consolidation method (global or proportional, equity not needed).

On the following example, we can see that in first column, company A has receivables with company B for 100 and company B has payables with company A for 100. So they agree.

| | A - Global integration | | | | | | |
|--|------------------------|-------|------|------------|-----|------|------|
| Receivables/B Receivables/- Link account | 100 | (100) | 50 | | | | |
| | | | | | | | |
| B - Proportional integration - 50% | | | | | | | |
| Link account | | (1) | (2) | | | (1) | (2) |
| | | | | Payables/A | 100 | (50) | (50) |
| | | | (50) | | | | |

Company B being consolidated with the proportional method, one of the preceding process has already eliminated 50% of each amount of the balance sheet, included the intercompany amounts. That elimination is represented in column (1).

This means intercompany amounts between both companies are no longer reconciled.

The elimination will then consider that the receivables of 100 in company A accounts consist in two amounts: one intercompany amount of 50 with company B and an amount of 50 with the other partner of company B who is considered as a 3rd Party.

The elimination adjustment in company A consists in eliminating the 100 receivables declared as intercompany and in transferring 50 to receivables with 3rd Parties (Receivables/-) and 50 to the Link account.

At the end of the consolidation process, the consolidated accounts will show remaining receivables of 50, but the Link account will be set to zero.

The process of elimination is exactly the same for the P&L, with another Link account.

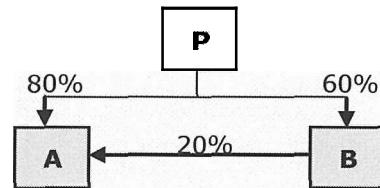
9.6 Elimination of financial investments and equity of each company

While consolidating a group, whatever the consolidation method is, we calculate the consolidated reserves of a company as the indirect financial percentage in the equity less the indirect percentage in the value of the financial investment of each shareholder.

We are now going to explain how to book the consolidated reserves and eliminate equity and financial investments in one set of elimination adjustments.

Let's do it on the basis of the following example.

We will focus on company A that is owned by parent company P at 80% and by company B at 20%, this company being owned by P at 60%. The indirect financial percentage in company A is $92\% = 80\% + 60\% * 20\%$.



In the following accounts we limit our view to those necessary to calculate the consolidated reserves of company A which is

$$1352 = 92\% * [2000 + 1000 + 100] - 1200 - 60\% * 500$$

| P , | | | | | |
|----------------|-------|---------|---------|-----|--|
| | | (3) | | | |
| Fin. Invest./A | 1,200 | (1,200) | Capital | ... | |
| Fin. Invest./B | ... | | | | |
| Link Account | | 1,200 | | | |

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| B - Global integration - 60% | | | | | | |
|------------------------------|-----|-------|-------|---------|-----|--|
| | | (5) | (6) | | | |
| Fin. Invest./A | 500 | (200) | (300) | Capital | ... | |
| Link Account | | | 300 | | | |

| | | A | Global Integration - 92% | | (1) | (2) | (4) | (7) |
|--------------|-----|---------|--------------------------|---|-------------------------------------|------------------------------------|---|-------|
| | | (4) | (7) | | | | | |
| Other assets | ... | | | Capital Reserves Result Translation Adjust. Conso. Reserves Minority Interests | 2,000 1,000 100 200 264 | (160) (80) (16) 2,852 | (1,840) (920) (92) (1,200) | |
| Link Account | | (1,200) | (300) | | | | | (300) |

Let's now analyze all the elimination adjustments.

Column (1) is the impact of the reclassification on minority interests for 8% of company A equity, consequence for the first step of elimination related to global integration

Column (2) eliminates the group part in A equity (92%) and reclassifies the total amount on consolidated reserves. This corresponds to the first term of our previous calculation.

Column (3) in P accounts eliminates the Financial Investment on A for 1200 and transfers the amount on a link account also in P. This elimination journal entry is in balance in P (methodology!).

Column (4) will be probably considered as an 'artificial' journal entry. In fact, the amount having been booked on the link account in P for 1200 is now booked for (1200) on the same link account, but in A. The counterpart of this booking is the consolidated reserves and the consolidated link account is set to zero. In the meantime, if we look at the consolidated reserves in A we have now brought the second term of our calculation.

Column (5) is the consequence of applying the integration method to company B (first step) for which there is 40% of minority interests to reclassify for an amount of 200

Column (6) The remaining amount of 300, which corresponds to the Group amount, is then eliminated in the same way we did in P accounts

Column (7) We now book the opposite amount (300) on the link account in A with the consolidated reserves as counterpart. This gives us the last term of our calculation.

Finally, through all these elimination adjustments, financial investments are eliminated in shareholders' accounts and equity is eliminated in company

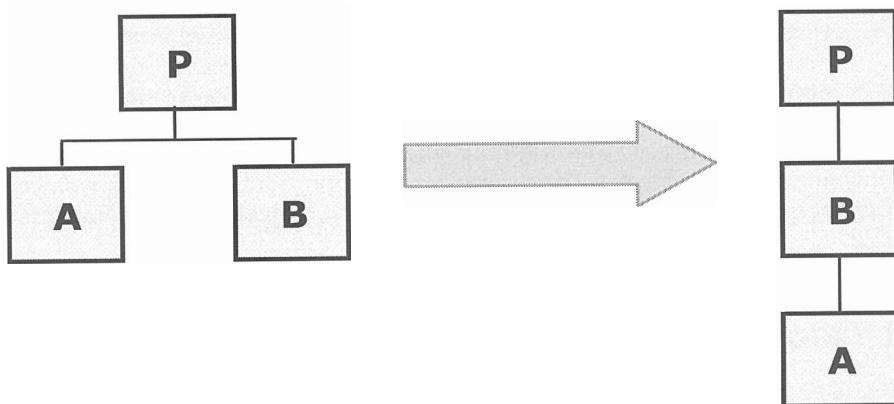
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accounts. However, there are still two accounts dealing with equity in company accounts: Minority Interests and the Group part in the translation adjustments.

This process has to be applied to each company, except the parent company. It clearly shows that the final consolidated accounts remain only with the parent company Equity (Capital, ...) and all financial investments are eliminated in the Assets.

BART 3

EVOLUTION OF CONSOLIDATED ACCOUNTS



1 EVOLUTION OF ASSETS AND LIABILITIES ACCOUNTS

Justifying the evolution of consolidated financial statements between two periods can sometimes turn to a challenge.

In a classical accounting system, a period is closed and all balance sheet accounts are carried forward to the next period as opening amounts.

In a consolidation process, this is not so easy for the following reasons

- Accounts received from a company for the last period are not always the final ones
- Currency rates used in consolidation are changing between two periods
- Some financial percentages may also change between two periods, implying at least some difficulties at the Equity level
- If the change in percentage becomes material for a certain company, its consolidation method may also change
- Historical adjustments booked in former consolidations still remain active in current consolidation. Not carrying forward one of these adjustments in current consolidation may give some trouble...

All these situations are at the origin of what is called a discontinuing problem in consolidation. We have to deal with it while the evolution of consolidated figures represents the most important part of the consolidated disclosures to provide.

1.1 Flows on each balance sheet account

One important set of information asked to each company of the consolidation scope is an explanation on how each individual assets and liabilities account is changing between two consolidation periods.

Of course, the reasons of these changes will depend of the account. Evolution of tangible assets (acquisition value) will be explained by acquisitions, disposals, ... when evolution of tangible assets (depreciations) will be explained by depreciation of the period, depreciation on disposals,

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cancellations, ... Evolution of the capital account may be described with increase by cash, increase by non cash, ...

For current assets and liabilities, we can limit the request to a net variation which, most of the time, is sufficient for the disclosures. It is indeed generally not significant to ask for increase and decrease of Payables.

These reasons of changes are booked on what is called "flows" in consolidation. They must be seen as an independent dimension with regard to the chart of accounts.

Hereunder is a more complete example of flows generally asked to each company for an account that could be tangible assets (acquisition value).

| | |
|---------------------------------|-------|
| Opening value | 2,000 |
| Acquisitions | ... |
| Disposals | ... |
| Transfer between accounts | ... |
| Difference on opening | ... |
| Translation adjustments | ... |
| Entry in consolidation scope | ... |
| Merge between companies | ... |
| Changes in consolidation method | ... |
| ... | ... |
| Closing value | 2,500 |

Amounts of 2000 and 2500 are supposed to come from the balance sheet and are in local currency.

- "Transfer between accounts" flow supposes that the opposite amount is found on another account.
- "Difference on opening" flow is booked when the closing amount imported in previous consolidation was not the final one. This amount cannot be aggregated with "Acquisitions" or "Disposals" flows. From an economical point of view, it wouldn't be correct.
- "Translation adjustments" flow is booked for foreign companies as explained in Part 2, Chapter 6 Section 4.
- "Entry in the consolidation scope" flow is booked when a company is consolidated for the first time. Again, it wouldn't give a correct economical picture to aggregate such amount with the "Acquisitions" flow. What has been purchased are shares of that company, not individual assets and liabilities.

- "Merge between companies" flow is used when two companies belonging to the consolidation scope are merging. This flow can be seen as a transfer flow between these two companies.
- "Changes in consolidation method" will be booked when consolidation method is different from one period to another

1.2 Flows and consolidation process

Flows are submitted to the consolidation process in a similar way as are the balance accounts.

That means

- Flows in local currency are translated into consolidation currency, most generally at average rate of the period
- Some flows will be intercompany because explaining intercompany accounts evolution
- Flows may be adjusted by consolidation adjustments
- Flows will then be processed during the eliminations in a similar way as accounts are.

Let's consider a few examples.

Example 1 : Elimination process on flows

| | | Eliminations if | | |
|----------------------------|-----------|-----------------|---------------------|---------------|
| Tangible assets (Acq.Val.) | Statutory | Global 80% | Proportional 50% | Equity 30% |
| Year 1 | 1,000 | | (500) | (1,000) |
| Acquisitions | 300 | | (150) | (300) |
| Disposals | (100) | | 50 | 100 |
| Transfer | 200 | | (100) | (200) |
| Year 2 | 1,400 | | (700) | (1,400) |

This example shows the elimination process on flows depending on the consolidation method.

For the global integration, we know that we keep 100% of all balance sheet accounts and we do so for the flows.

For a proportional integration (50%), we eliminate 50% of each flow as we do for the closing amounts.

For an equity method company, we eliminate 100% of the flow amounts as we do for the closing amounts.

This example finally shows that the elimination process acting on closing flows is the same as the one acting on closing amounts.

Examvle 2 : Elimination vrocess on flows when consolidation method is changing

| Tangible assets (Acq.Val.) | Statutory | Eliminations | Consolidated |
|----------------------------|-----------|--------------|--------------|
| Year 1,(Equity method 30%) | 1,000 | (1,000) | 0 |
| Acquisitions | 300 | | 300 |
| Disposals | (100) | | (100) |
| Transfers | 200 | | 200 |
| Changes in conso. method | | 1,000 | 1,000 |
| Year 2 (Global 80%) | 1,400 | 0 | 1,400 |

In this example, the company is consolidated with the equity method in Year 1 and with the global integration method in Year 2, which is the consequence of shares acquisition giving the control on that company.

We first suppose the acquisition happened on the 1st of January, Year 2 which means that the whole activity of the 12 months of Year 2 must be consolidated with the global integration method. Of course, the opening amount, consolidated at end of Year 1, was eliminated by the equity method. This situation implies that the only way to justify an evolution from 0 to 1400 is to book a flow called 'Changes in conso. method' with an amount corresponding to the opening. Booking these 1000 on Acquisition flow would again not be economically correct. The group has acquired shares giving the control on that company, but it didn't acquire these 1000 tangible assets.

If the transaction would have been closed let say on the 1st of May Year 2, theoretically, we would have to consolidate these flows with the equity method for the first four months preceding the closing and with the global integration method for the remaining eight months of the year. Such approach requires the knowledge of each flow split in two parts, before closing and after closing of the transaction. This could represent a real difficulty for a company not prepared to such specific reporting.

1.3 Flows on intercompany accounts

When reporting the figures for consolidation, each company usually provides the first flows on each balance sheet accounts and if that account is defined as intercompany, it should also provide a more detailed information on flows attached to each intercompany amounts.

Let's put this through the following example.

| | Company A | Receivables | |
|-------------|-----------|---------------|--------|
| | Year 1 | Net variation | Year 2 |
| Balance | 1,000 | 400 | 1,400 |
| Company B | 200 | 100 | 300 |
| 3rd Parties | 800 | 300 | 1,100 |

Here is the situation of the Receivables for company A showing first the balance evolution for 400 and then an intercompany position with company B for a variation of 100. The net variation of 300 concerns 3rd Parties.

| | Company B | Payables | |
|-------------|-----------|---------------|--------|
| | Year 1 | Net variation | Year 2 |
| Balance | 1,300 | (500) | 800 |
| Company A | 200 | 100 | 300 |
| 3rd Parties | 1,100 | (600) | 500 |

Company B shows its Payables account with the same presentation and, moreover, we can observe that both companies are correctly reconciled on intercompany level not only on opening and closing amounts but also on the net variation flow of 100.

Everything is perfect and both consolidations of closing amounts and of flows can go on without any problem.

The situation can become more difficult to manage if we suppose company B presents its figures in a certain local currency (CUR) as hereunder

| | Company B | Payables | (in CUR) |
|-------------|-----------|---------------|----------|
| | Year 1 | Net variation | Year 2 |
| Balance | 260 | (110) | 150 |
| Company A | 40 | 10 | 50 |
| 3rd Parties | 220 | (120) | 100 |

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These figures are first translated into the consolidation currency on the basis of 5 for closing rate Year 1, 6 for closing rate Year 2 and 7 for average rate Year 2 giving the following figures in EUR.

| | Company B | Payables | (in EUR) | |
|-------------|-----------|---------------|-------------|--------|
| | Year 1 | Net variation | Trans. adj. | Year 2 |
| Balance | 1,300 | (770) | 370 | 900 |
| Company A | 200 | 70 | 30 | 300 |
| 3rd Parties | 1,100 | (840) | 340 | 600 |

We notice now that if intercompany opening and closing amounts between company A and company B are still reconciled (200 and 300), the intercompany flow corresponding to the net variation is 100 on Receivables side and 70 on Payables side.

This has to be considered as an intercompany difference on flows with some consequence on some consolidated disclosures.

The most important one impacted by this difference is the cash flow statement that will be studied later on in this Part 3. But, in the meantime, let's just consider that these intercompany flows of 100 and 70 will have to be eliminated, leaving a difference of 30. Speaking about a cash flow statement, the amounts of 100 and 70 are considered as cash amounts but not 30 which is non cash.

In order to avoid this kind of problem, it is necessary to book the following consolidation adjustment

| Company B | (in EUR) | Debit | Credit |
|------------|------------------------|-------|--------|
| Payables/A | Translation adjustment | 30 | |
| Payables/A | Net variation | | 30 |

reclassifying 30 between "Translation adjustment" flow and "Net variation" flow, leaving unchanged the closing amount of 100 which is correct.

Are you ready to book this kind of adjustment considering the number of differences that may occur in a group? While purchasing a consolidation software, the possibility to benefit from an automatic process would certainly be an advantage.

1.4 Flows related to asset disposal between companies

Another situation requires a particular attention which is explained by the following example. Let's consider company A selling a tangible asset (land) to

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company B. This transaction is supposed to be done without any group profit, both companies are consolidated by the global integration method and have their accounts in consolidation currency.

Here is what we find in the bundle of each company and this looks "locally" correct.

| | Year 1 | Acquisitions | Disposals | Year 2 |
|-----------|--------|--------------|-----------|--------|
| Company A | 1,000 | 0 | (1,000) | 0 |
| Company B | 0 | 1,000 | 0 | 1,000 |

Once these figures are consolidated, their contribution gives this information.

| | Year 1 | Acquisitions | Disposals | Year 2 |
|--------------|--------|--------------|-----------|--------|
| Consolidated | 1,000 | 1,000 | (1,000) | 1,000 |

showing a group having concluded two transactions with the outside world: one acquisition for 1000 and one disposal for 1000. That's totally wrong. The group did only an internal transaction that cannot be seen in the consolidated disclosures.

So what to do?

We recommend defining two 'Acquisitions" flows, one for transactions with 3rd Parties and one for transactions with other group companies and the same for the "Disposals" flow.

These group transaction flows can then just be ignored in the consolidated disclosures but, of course, the amounts must be checked as equal.

Let's now consider a similar situation with company B figures in a local currency (CUR). Both companies produce a bundle with the recommended group flows.

| | Year 1 | Group acquisitions | Group disposals | Translation | Year 2 |
|-----------------|--------|--------------------|-----------------|-------------|--------|
| Company A | 1,000 | 0 | (1,000) | 0 | 0 |
| Company B (CUR) | 0 | 210 | | | 210 |
| Company B | 0 | 1,260 | | (10) | 1,050 |

At acquisition time, the land is booked in company B accounts for an amount of 210 CUR, the local accountant using a day rate of 4.762.

A problem arises at the end of Year 2 because closing rate and average rate used for consolidation are 5 and 6 respectively. The last line of this report is showing company B information after currency translation with a Translation adjustment flow of 10.

If we just ignore this group transaction, we get a net value of $260 = 1260 + (1000)$ that will be booked on an acquisition flow. This information has no economical background.

Again, we should reclassify 260 from the "Group acquisitions" flow to the "Translation adjustments" flow, in the same way we did in the previous example.

2 **EVOLUTION OF EQUITY ACCOUNTS**

2.1 Content of equity accounts

Before analyzing the consolidated equity evolution, it can be worth seeing which items are usually found in the consolidated equity. Here is a list of these items

- Capital
- Share premium
- Revaluation reserves
- Reserves
- Translation adjustments
- Badwill
- Grants
- Minority interests

although it strongly depends on the accounting rules, IFRS or Local Gaap, applied.

For each of these items, we are now going to explain with more details their content and the way they are processed in the consolidation.

Capital

For a "normal" group with a unique parent company, the capital item shows only the parent company capital. As already explained, capital amounts from all other companies are just eliminated against the consolidated reserves.

This means that the evolution of this account, after consolidation, reflects only the changes at parent company level, mainly increase or reimbursement of capital and, possibly, transfer from Reserves to Capital.

For a group structured as a consortium, with two or more parent companies, the capital amount is the addition of the capital of each company in the consortium.

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In most countries, capital is presented as 'Subscribed capital' and 'Uncalled capital' on separate lines, sometimes the "Uncalled capital" may be booked as an asset.

In the consolidated accounts, these two sub-items are aggregated.

Share premium

It is only the parent company share premium that contributes to this line, the share premium from other companies is eliminated against the reserves.

For a consortium, share premium behaves as the capital account, it is the addition of the share premium of the different parent companies.

Revaluation reserves

In statutory accounts, this account is the counterpart of assets that are revaluated to a fair value.

In consolidation, we have to make a distinction between the first consolidation of a company and the next consolidations.

For a first consolidation of a company, these revaluation reserves will be transferred to normal reserves of the company. Moreover, when consolidating a company for the first time, there is an evaluation of assets (and liabilities), in order to allocate part of the goodwill. If this evaluation concludes to revaluation (or devaluation), the impact is also booked directly on the normal reserves of the company.

For subsequent consolidations, these revaluation reserves are maintained on that account. Possibly, they can also be reversed if not compliant with the consolidation evaluation rules.

The main reason of doing this is to keep the normal reserves evaluated only through P&L impacts. Any other movement on the reserves, without P&L impact, should be booked on this Revaluation reserves account.

Whatever the consolidation method may be, the final amount appearing in the consolidated equity is the indirect financial percentage applied to the Revaluation reserves amount.

Let's conclude with an example on how to justify the evolution of this account by considering a company consolidated with a percentage of 60% in Year 1 and a percentage of 80% in Year 2. We suppose this 80% applies for the full year.

| | Year 1 | Increase | Change in % | Year 2 |
|---------------|--------|----------|-------------|--------|
| Statutory | 60% | 80% | | 80% |
| | 1,000 | 200 | | 1,200 |
| Consolidation | 600 | 160 | 200 | 960 |

At statutory level, there is an increase flow of 200 explaining the evolution from 1000 to 1200. End of Year 1, 600 is kept at group level and 960 at end of Year 2 while the flow amount contributes for 160. There is a discontinuing effect because of the percentage variation of 20% which requires a technical flow of 200 to put figures back in balance between opening and closing.

This 200 is the consequence of an increase of 20% in the opening value of 1000.

Reserves

The evolution of this item should be justified only by the group result and the parent company dividends paid to the shareholders.

However, let's go back to the detailed content of this account.

It includes all reserves accounts of the parent company (legal reserves, other reserves, retained earnings, result of the period) and the consolidated reserves of each company belonging to the consolidation scope, whatever consolidation method we apply to each.

Consolidated reserves have been explained in Part 2 Chapter 4 and we just recall here the formal definition

$$\%(C)^* \text{Equity} - \%(S)^* \text{Financial Investment}$$

where $\%(C)$ means indirect financial percentage owned in company C and $\%(S)$ means indirect percentage owned in shareholder S of C. There may be more than one shareholder.

Looking at this definition, it is easy to understand that as soon as the percentages are changing from Year 1 to Year 2, whatever the reason is, it becomes doubtful that the evolution will be justified easily.

Moreover, supposing there is no change in the percentages, Equity and Financial investment may also change.

It is also important to keep in mind that these accounts also include consolidation adjustments, not only of the period, but also from the previous periods (historical adjustments).

For all these reasons, we will analyze more in details that Reserves account in the next section and will conclude to the necessity of applying some methodology.

Translation adjustments

This account is booked each time we consider a company whose accounts are in a currency different from the consolidation currency. Again, justifying the evolution is really not easy because of so many different rates involved in the translation of equity and financial investments.

Once the justification is done for one company, on the basis of 100% of that account, we have to justify any percentage variation in the same way we did for the "Revaluation reserves" account.

The amount finally included in the consolidated equity is the indirect financial percentage of the translation adjustment calculated per each company.

Badwill

If we start by considering IFRS rules, this account needs no explanation because it is not an equity account. A badwill is booked immediately in P&L except if there is already a goodwill for the same company, in such case badwill and goodwill are netted.

If we are in Local Gaap, badwill is usually an item in the equity.

It remains unchanged during the time we own the company which has produced that badwill. In case we acquire additional shares implying again a badwill, it will be added to the existing one and the evolution of that account will show this new badwill as a variation. In case of selling shares, the corresponding part of the badwill will be booked in the P&L as a profit and the variation will consist in a P&L impact.

However, there are some group structures in which a company A (not the parent company) acquires another company B with a badwill. Supposing that company A is consolidated with an indirect percentage of 80%, then the final badwill contributing to the consolidated equity will be 80% of that badwill.

Again, if the percentage of company A changes, let's say from 60% last year to 80% this year, there will be a flow variation corresponding to 20% of the opening badwill amount.

Grants

In IFRS, grants are considered as debts and do not appear as equity. In Local Gaap, grants may be booked directly in equity because they correspond to

PART 3 EVOLUTION OF CONSOLIDATED ACCOUNTS

not refundable cash received from some state organization. So it is indeed not a debt...

Basically, this account is changing between opening and closing periods for two reasons : first for new grants received and secondly for part of grants to book in P&L, depending on the depreciation plan of the assets for which these grants have been received.

From a consolidation point of view, the consolidated amount of grants is the indirect financial percentage in the grants of each company, including grants of parent company.

If a percentage variation appears between opening and closing, the same principles as for Revaluation reserves apply again.

Minority interests

We consider a company with its statutory equity, including consolidation adjustments.

Moreover, for foreign companies, we suppose that equity is translated into consolidation currency.

Minority interests are then calculated as 100% less the indirect financial percentage in each company consolidated by the global integration method.

It is important to notice that all accounts are considered in this calculation, including revaluation reserves, badwill, translation adjustments and grants.

To say it in another way, minority interests are calculated on equity at closing rate while consolidated reserves are calculated on historical rate equity, not including revaluation reserves, badwill, translation adjustments and grants for which the group part is presented in the consolidated equity separately.

To be complete in our explanation, we have to describe two special situations with regard to minority interests.

First, when a company A owns shares of a company B, but company A is consolidated with an indirect financial percentage of less than 100%, Minority interests have to be calculated also in the financial investment amount on company B booked in company A.

Secondly, in a basic approach (Part 2), we have explained that there were Minority interests only in global integration companies. This remains not necessarily true in some group structures where a *global integration company* owns, for instance, an equity method company. In such situation, there is

what we call indirect minority interests in the equity method company. This situation will be explained with more details in the case studies of Part 4.

2.2 Evolution of consolidated reserves

If we go back to our preliminary definition of consolidated reserves we gave in Part 2 Section 4.4, we said it was, for each company, the accumulation of results less dividends paid since the first day the company has entered the consolidation scope.

Consequently, we can also state that the difference between consolidated reserves between a given period and the previous one must be only the result of that period less the dividend paid, if any.

Moreover, it is understood that all direct booking on the reserves of a company, without impacting the P&L, will be done on another specific account, generally Revaluation reserves.

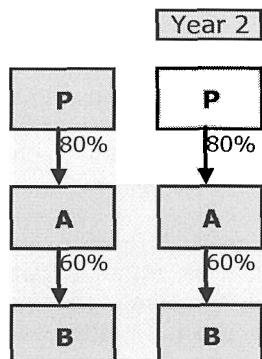
When we consider the formula used to calculate the consolidated reserves of a company, as reminded hereunder,

$$\text{Consolidated reserves (of C)} = \%(\text{C}) * \text{Equity} - \%(\text{S}) * \text{Financial Investment}$$

we easily understand that the previous accounting relation will not be necessarily respected for some changes in the percentages or in the accounts themselves.

To explain clearly this problem we are going to progress in complexity through different situations and try to build some methodology.

Let's consider the following group structure over Year 1 and Year 2 with the following assumptions:



- Companies A and B are supposed to have their statutory accounts in consolidation currency. This condition is not a limitation because by the currency translation step, we reclassify on the Translation adjustments account the currency effects in order to make the evolution of statutory reserves compatible with classical accounting principles.
- We will calculate only company B consolidated reserves and try each time to justify their evolution from Year 1 to Year 2.

Situation 1 : The result and dividends effects

In this first step we suppose there are no changes in the percentages over the two years and the indirect financial percentage in company B is $48\% = 80\% * 60\%$.

Company B has a statutory profit of 100 and pays a gross dividend of 50 to its shareholders.

| | | Year 1 | Year 2 |
|-----------|-------------------------------|---------------------|---------------------|
| Company A | Fin. Inv./B | 600 | 600 |
| Company B | Capital Reserves Result | 1,000 800 200 | 1,000 950 100 |

Consolidated reserves of B for each year are equal to

- $480 = 48\% * [1000 + 800 + 200] - 80\% * 600$ for Year 1
- $504 = 48\% * [1000 + 950 + 100] - 80\% * 600$ for Year 2

giving a variation of $24 = 504 - 480$ which consists of two components, namely

- $48 = 48\% * 100$ corresponding to the group part of the result
- $(24) = 48\% * (50)$ corresponding to the group part of the dividends

That is the conclusion we expected from an accounting point of view.

Situation 2 : An increase of capital in company B, without oercentaae variation

In this step, we keep the same situation as above but we suppose that company B increases its capital by 500. All shareholders are subscribing on the basis of their participation, so P subscribes $300 = 60\% * 500$ and the 3rd Parties $200 = 40\% * 500$.

Here are the accounts reflecting the situation

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| | | Year 1 | Year 2 |
|-----------|-------------------------------|---------------------|---------------------|
| Company A | Fin. Inv./B | 600 | 900 |
| Company B | Capital Reserves Result | 1,000 800 200 | 1,500 950 100 |

And the consolidated reserves of B for each year are equal to

- $480 = 48\% * [1000 + 800 + 200] - 80\% * 600$ for Year 1
- $504 = 48\% * [1500 + 950 + 100] - 80\% * 900$ for Year 2

giving the same variation of $24 = 504 - 480$ which consists in two components, namely

- $48 = 48\% * 100$ corresponding to the group part of the result
- $(24) = 48\% * (50)$ corresponding to the group part of the dividend

This means the capital increase has no effect on the consolidated reserves and it is perfectly normal. The group is not becoming "richer" or "poorer" because of such capital increase. There is just an amount of cash transferred from company A bank account to company B bank account.

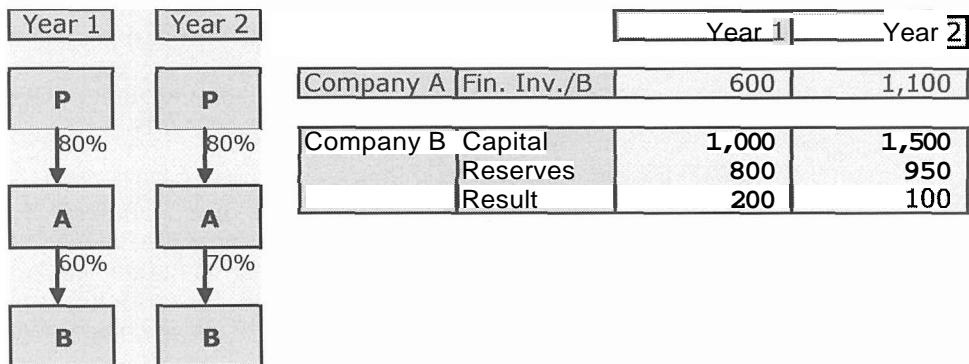
This is a pure internal transaction with no effect on the outside world.

Situation 3 : An increase of capital in company B. with percentage variation

In this step, we suppose 3rd Parties are not willing to subscribe to the capital increase (1st of January, Year 2), which implies a percentage from A in B changing from 60% to 70%. This new percentage should be calculated on the basis on new shares issues. We skip this calculation.

Here are the new group structure and the corresponding statutory accounts.

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The consolidated reserves of B for each year are equal to

- $480 = 48\% * [1000 + 800 + 200] - 80\% * 600$ for Year 1
- $548 = 56\% * [1500 + 950 + 100] - 80\% * 1100$ for Year 2

giving a variation of $68 = 548 - 480$ which consists in the following components,

- $56 = 56\% * 100$ corresponding to the group part of the result
- $(24) = 48\% * (50)$ corresponding to the group part of the dividend
- $156 = 8\% * 1950$ which is a good illustration of the discontinuing process of consolidation. Between the instant "before/after" the increase in capital, the indirect percentage is suddenly increased by 8% acting in the opening equity, not included the capital increase
- $280 = 80\% * [70\% * 500]$ which is the net part of the capital increase belonging to the group
- $(400) = 80\% * (500)$ corresponding to the group part of the capital increase.

If we find again the group result and the group dividends, there are three other components impacting the reserves and which cannot be kept as such.

The net amount of $36 = 156 + 280 - 400$ has to be considered as a goodwill because by this transaction, the group has gained some reserves.

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Depending on consolidation rules (IFRS/Local Gaap), we have to book a consolidation adjustment for this amount and to transfer it to the appropriate account.

In order to finalize this step, let's suppose we are consolidating under IFRS rules. Here is the adjustment we would book in company A accounts.

| | Debit | Credit |
|----------------|-------|--------|
| Fin. Inv./B | 45 | |
| Badwill profit | | 45 |

But why 45 instead of 36? Because 36 has been calculated as a net group amount. By booking this amount in company A, owned at 80%, we would calculate $28.8 = 80\% \text{ of } 36$ instead of 36. Another way to book this adjustment would be to use the amount of 36 but to define the adjustment as impacting the group account at 100%. It is a choice. We recommend booking the amount of 45.

So, consolidated reserves of B have to be recalculated

- $512 = 56\% * [1500 + 950 + 100] - 80\% * [1100 + 45]$ for Year 2

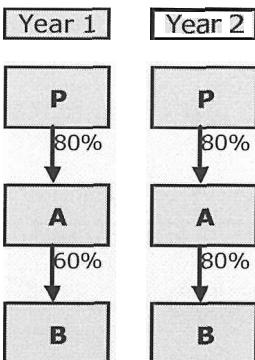
giving a difference of 32 with Year 1, which again is equal to 56 (the group result) minus 24 (the group dividends).

Finally, we remain again with these two expected components.

Situation 4 : Company A acquires new shares of company B

We now forget the capital increase and come back to company B just paying the 50 dividends.

Company A acquires 20% of shares of company B, on the 1st of January Year 2, for a price of 700. These new shares acquired are supposed not giving rights to dividends.



| Year 1 | Year 2 | Year 1 | Year 2 |
|--------|--------|---------------------|-------------------------|
| P | P | Company A | Fin. Inv./B |
| 80% | 80% | 600 | 1,300 |
| A | A | Company B | Capital Reserves Result |
| 60% | 80% | 1,000 800 200 | 1,000 950 100 |
| B | B | | |

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Consolidated reserves of company B are

- $480 = 48\% * [1000 + 800 + 200] - 80\% * 600$ for Year 1
- $272 = 64\% * [1000 + 950 + 100] - 80\% * 1300$ for Year 2

and the evolution to justify is now (208).

Here are the different components

- **64** = $64\% * 100$ corresponding to the group part of the result
- **(24)** = $48\% * (50)$ corresponding to the group part of the dividend
- $312 = 16\% * 1950$ just as in the step before. We instantaneously get 16% more in the opening equity
- **(560) = $80\% * (700)$** which is the group part in the acquisition price of B shares acquired.

The two last items must be considered as a group price of **560** to acquire an additional group part in company B equity for **312** as goodwill on the transaction. Net amount of that goodwill is **248** and we propose the following consolidation adjustment to book in company A accounts

| | Debit | Credit |
|-------------|------------|------------|
| Goodwill | 310 | |
| Fin. Inv./B | | 310 |

In this adjustment, the amount of **310** must be seen as $248/80\%$ for the same reason as explained in the previous step.

Let's recalculate the consolidated reserves of company B

- $520 = 64\% * [1000 + 950 + 100] - 80\% * [1300 - \underline{310}]$ for Year 2

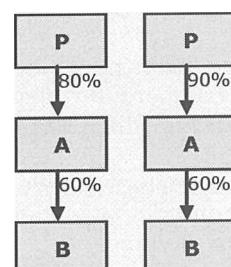
The difference with Year 1 is now $40 = 64 + (24)$.

Situation 5 : Company P acquires new shares of company A

The change in structure is now happening above company B.

It is company P acquiring 10% of company A shares, on the 1st of January Year 2, giving a percentage of 90% from P in A.

When we consider B situation, nothing has changed.



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| | | Year 1 | Year 2 |
|-----------|-------------|--------|--------|
| Company A | Fin. Inv./B | 600 | 600 |
| Company B | Capital | 1,000 | 1,000 |
| | Reserves | 800 | 950 |
| | Result | 200 | 100 |

Let's now proceed as we did before starting by considering this new situation and noticing that if the direct percentage between A and B remains unchanged, the indirect percentage in company B becomes 54%.

Consolidated reserves of company B are

- $480 = 48\% * [1000+800+200] - 80\% * 600$ for Year 1
- $567 = 54\% * [1000+950+100] - 90\% * 600$ for Year 2

giving a variation of $87 = 567 - 480$ which consists in the following components,

- $54 = 54\% * 100$ corresponding to the group part of the result
- $(24) = 48\% * (50)$ corresponding to the group part of the dividend
- $117 = 6\% * 1950$ for the same reason as explained in previous step
- $(60) = 10\% * (600)$ because we increase by 10% the group part in the opening value of the Year 1 Financial investment in B.

The two last components can be considered as a group price acquisition of 60 to compare to the corresponding group part of equity we receive for that price, which is 117. This looks like a badwill calculation giving a value of 57. That amount, again, cannot remain in the reserves.

The problem is just a little bit more complicated here because the company P transaction of acquiring 10% of company A shares has probably produced a goodwill. We mean that this badwill should be netted with the goodwill.

To confirm this point of view, the best economical reason we can give is that the company P transaction is not buying shares of a company but shares of a subgroup which is A+B.

In such situation, we recommend to book that badwill in the most appropriate way in company P accounts. By doing this, the two last components are not there anymore.

Situation 6 : And if all transactions were happening at the same time

Indeed, we can imagine all the previous transactions happening at the same time (1st of January Year 2), we mean

- Capital increase in company B for an amount of 500, 3rd Parties not subscribing to that capital increase
- Company A acquiring shares of company B for a price of 500
- Company P acquiring shares of company A for a price of 700

Here are the group structure and the statutory accounts

| Year 1 | Year 2 | Year 1 | Year 2 |
|--------|--------|-----------|-------------|
| P | P | Company A | Fin. Inv./B |
| 80% | 90% | 600 | 1,800 |
| A | A | Company B | |
| 60% | 90% | Capital | 1,000 |
| B | B | Reserves | 800 |
| | | Result | 200 |
| | | | 1,500 |
| | | | 950 |
| | | | 100 |

```

graph TD
    P1[Company P] -- "80%" --> A1[Company A]
    A1 -- "60%" --> B1[Company B]
    P2[Company P] -- "90%" --> A2[Company A]
    A2 -- "90%" --> B2[Company B]
  
```

Consolidated reserves of company B are

- $480 = 48\% * [1000 + 800 + 200] - 80\% * 600$ for Year 1
- $445.5 = 81\% * [1500 + 950 + 100] - 90\% * 1800$ for Year 2

and the difference to justify is (34.5).

In such a complex structure situation, we recommend to calculate consolidated reserves of B just before the transaction and just after the transaction. The difference should be considered as a goodwill or a badwill.

Here are the amounts found for our example

- Consolidated reserves before transaction : $480 = 48\% * 2000 - 80\% * 600$
- Consolidated reserves after transaction : $364.5 = 81\% * 2450 - 90\% * 1800$

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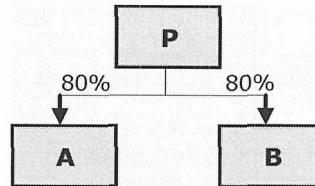
This implies a net variation of (115.5). This amount represents a goodwill we book at company P level as an additional goodwill related to the 10% shares acquired by company P in company A.

Situation 7 : Elimination of group profit between two companies

In this last situation, we consider two companies A and B consolidated with the integral consolidation method at the same percentage.

The only transaction happening between them is a disposal of an asset from company A to company B with a group profit of 100.

Here are the group structure and the adjusted accounts concerned by the transaction.



| A | | | | | |
|--------------|-----|------------------|---|------------------|---------------------------|
| Tang. Assets | 0 | Capital Reserves | 500 300 (a) 100 100 (a) (100) | Tang. Assets | 500 (b) (100) |
| Assets | 900 | Result | | Capital Reserves | 1,000 (b) (100) |
| | | | | Assets | 1,600 Result |

In company A accounts, consolidation adjustment (a) eliminates the group profit of 100 by booking the counterpart on the Reserves.

In company B accounts, we eliminate the group profit of 100 included in the Tangible asset acquired and the counterpart is also the Reserves.

By booking this way, we see that the net group impact on the reserves is $0 = 80\% * 100 + 80\% * (100)$, but at the same time consolidated reserves of company A increase by 80 and consolidated reserves of B decrease by (80).

Moreover, these variations do not impact the P&L. In fact we have what we call a transfer of reserves between both companies. At group level, the net amount is zero as announced above.

We are aware to present a particularly easy case by supposing both companies are owned at the same percentage. Some special topics in Part 4 will consider more realistic situations, but the principles explained here are still valid.

2.3 A status board to justify consolidated reserves evolution

The situations explained in previous section illustrate the difficulty to validate the evolution of the consolidated reserves of a group and consequently justify the use of some status board to help validation of this technical account.

How does this status board look like?

This following status board works perfectly well and is adapted

- To groups of any size (number of companies)
- To groups of any activity
- To groups independently of their evaluation rules (IFRS or Local Gaap) under the only condition that booking of reserves without impacting the P&L should be done on a specific account (not the consolidated reserves but revaluation reserves)

This status board justifies the group consolidated reserves, not the Minority Interests and the Translation Adjustments which require another format and content.

Let's explain its content.

| | Conso. Reserves Year 1 (1) | Result Year 2 (2) | Dividends paid (3) | Dividends received (4) | Transfer of reserves (5) | Other transfers (6) | Parent dividends (7) | Total (8) | Conso. Reserves Year 2 (9) | Difference (9)-(8) (10) |
|----------------|-------------------------------|----------------------|-----------------------|---------------------------|-----------------------------|------------------------|-------------------------|--------------|-------------------------------|-------------------------------|
| Parent company | | | | | | | | | | . |
| Company 1 | | | | | | | | | | |
| Company 2 | | | | | | | | | | |
| ... | | | | | | | | | | |
| Company N | | | | | | | | | | |
| Total | | | X | (X) | 0 | | | | | |

It looks like a matrix of 10 columns and as many lines as there are companies in the consolidation scope. We usually start with parent company on line 1.

Column (1) contains the consolidated reserves of each company as calculated in Year 1 consolidation

Column (2) contains the group part of the result of each company

Column (3) shows the group part of dividends paid by each company, parent company excluded

Column (4) shows the group part of dividends received by each company, parent company included

Column (5) contains all transfer of reserves between companies, as explained in Situation 7 of previous section

Column (6) is to be used only in case parent company transfers reserves to its capital account. Indeed, in such situation, we notice only a decrease of its reserves and not an increase of the capital because this account is not managed by this status board.

Column (7) shows the dividends paid by the parent company. These dividends are in a separate column with regard to the dividends of the other companies, for a reason that will be explained later in this section.

Column (8) is just the horizontal total of all amounts of each line

Column (9) contains the consolidated reserves of each company as calculated in Year 2 consolidation

Column (10) shows the difference between column (9) and column (8)

How to use this status board?

A certain number of visual checks can be done as explained below.

Check 1 consists to verify that total of column (3) and (4) together is zero. This means that all dividends paid by subsidiaries are effectively received. Supposing this is indeed the case and one dividend received has not been eliminated, then the status board will show an error in column (10). It is important to say that all amounts of column (3) are signed negative and those of column (4) are signed positive.

Check 2 consists in verifying that total of column (5) is zero. This means that all amounts of reserves transferred between companies are correctly mentioned.

Check 3 consists in verifying the dividends paid by the parent company, including interim dividends and allowances. The reason to use a specific column enables an easier check 1. This cell contains a negative amount.

Check 4 consists in verifying each cell of column (10) is equal to zero. If not, this means there is a problem somewhere for that company. Sometimes, it may happen that one line shows an amount and another line shows the same amount with the opposite sign. This means either an adjustment has been booked in a wrong company or some transfer amounts should be put in column (5).

Check 5 is a global check on the total line. Column (1) + Column (2) + Column (6) + Column (7) = Column (9). To say it with words, opening

reserves + group profit – parent company dividends + transfer of reserves to capital equal closing reserves.

Once all these validations are correct, we usually say that the consolidated equity is technically correct. It doesn't mean completely correct because some adjustments of the period may be wrong or forgotten. Moreover, the content of statutory accounts may contain some wrong information.

Anyway, when this status board is "in balance" with all zeros in column (10), the difficult step of justifying the consolidated reserves is achieved and the consolidation is under control for this item.

This status board has been applied thousands of times to groups sometimes having hundreds of companies. It has also been used for so many different activities and in different countries with a full success. Auditors are asking for this status board.

We will conclude by recommending to consolidators not to communicate consolidated figures outside their office before having checked the validity of the status board. If it is not in balance in the way we explained, there are some remaining errors in the consolidation. No doubt about that.

2.4 Consolidated reserves status board: A case study

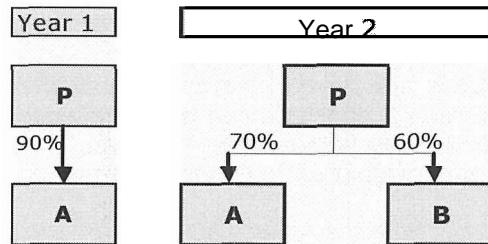
Before leaving this difficult subject, we propose to give an illustration of how to produce such status board on the basis of an example, not too complex but sufficiently realistic to be interesting.

In Year 1, the group consists in two companies, P and A, founded by P a few years ago, owned at 90%.

In Year 2, P sells 20% of A shares to 3rd Parties and acquires 60% of a company B. All these companies are supposed to have the same currency and both transactions are concluded on January 1st, Year 2.

Here is the group structure for Year 1 and 2.

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Consolidation of Year 1

Here are the statutory accounts of companies P and A. No consolidation adjustments being required for this Year 1, we present hereunder the consolidated accounts

| | | |
|---------------|-----|-----------------------|
| Investments/A | 180 | Capital |
| | | Reserves |
| | | Result |
| Other assets | 720 | Other liabilities 150 |

| A | |
|-------------------|-----|
| Tang. assets | 100 |
| Capital | 200 |
| Reserves | 150 |
| Result | 30 |
| Other assets | 400 |
| Other liabilities | 120 |

| P + A | |
|-------------------|-------|
| Tang. assets | 100 |
| Capital | 500 |
| Reserves | 200 |
| Result | 50 |
| Cons. Res.(A) | 162 |
| Minor. Int.(A) | 38 |
| Other assets | 1,120 |
| Other liabilities | 270 |

with the only following explanations

- Consolidated reserves of A = $162 = 90\% * [200 + 150 + 30] - 180$
- Minority interests of A = $38 = 10\% * [200 + 150 + 30]$

Consolidation of Year 2

Here are the statutory accounts of the three companies for Year 2

| P | |
|-------------------|-----|
| Investments/A | 140 |
| Investments/B | 400 |
| Other assets | 660 |
| Capital | 500 |
| Reserves | 220 |
| Result | 80 |
| Other liabilities | 400 |

| A | | |
|--------------|-----|-----------------------|
| Tang. Assets | 0 | Capital 200 |
| | | Reserves 160 |
| | | Result 50 |
| Other assets | 600 | Other liabilities 190 |

| B | | |
|--------------|-----|-----------------------|
| Tang. Assets | 150 | Capital 300 |
| | | Reserves 200 |
| | | Result 40 |
| Other assets | 650 | Other liabilities 260 |

which reflect the following events

- P sells 20% of shares of company A to 3rd Parties for a price of 70
- P acquires 60% of shares of company B for a price of 400. This transaction leads to a goodwill that cannot be allocated to assets.
- A sells its tangible assets to B for a price of 150, making a group profit of 50
- Parent company P pays dividends of 30
- Company A pays dividends of 20. It has been agreed that P keeps the rights to receive dividends related to the 20% of shares disposed.

These different events need the following consolidation adjustments explained hereunder.

Adjustment (a) : Disposal of 20% of shares of company A

In statutory accounts, the 90% of shares owned by P have a value of 180. The 20% disposed have thus a value of $40 = 180 * (20\% / 90\%)$.

On the basis of a selling price of 70, the statutory gain is 30.

In consolidation, the gain or loss is the difference between the same sale price of 70 and the equity value on the 1st of January Year 2 of the 20% disposed. Translated into a formula, it becomes

$$(2) = 70 - 20\% * [200 + 160]$$

The statutory gain of 30 is turning into a loss of 2 in consolidation.

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We have seen in Part 2 Section 8.14 that we have to book the following adjustment

| Parent P | Debit | Credit |
|------------------|-------|--------|
| Gain on disposal | 30 | |
| Loss on disposal | 2 | |
| Reserves | | 32 |

in which we set to zero the statutory gain and we book an additional loss of 2.

Adjustment (b) : Goodwill on the acquisition of 60% of shares of company B

The acquisition price is 400 for a 60% of the opening equity of 500, which gives a goodwill of 100. As said above, we suppose it is not possible to allocate this goodwill to assets. Moreover, we will suppose consolidating under IFRS rules with no depreciation of the goodwill, giving the following adjustments in P accounts

| Parent P | Debit | Credit |
|---------------|-------|--------|
| Goodwill | | |
| Fin.Invest./B | | 100 |

Adjustments (c*) and (d) : Elimination of group profit on the assets disposal

This transaction is supposed to occur just after the disposal of the 20% of A shares. This means the seller is owned at 70% and the acquirer is owned at 60%. The statutory profit of A is 50 and the group part in consolidation becomes $35 = 70\% * 50$.

Because of these different percentages, we have to split these 35 into $30 = 60\% * 50$ which is really the group profit and $5 = 10\% * 50$ which represents the profit A realizes with the 3rd Parties of company B.

There will be two adjustments, one in company A and one in company B.

| Company A | Debit | Credit |
|--------------|-------|--------|
| Result (*) | 30 | |
| Reserves (*) | | 30 |

Notice that this adjustment impacts the accounts of A at 100%.

| Company B | Debit | Credit |
|--------------|-------|--------|
| Reserves | 50 | |
| Tang. Assets | | 50 |

Amounts of this adjustment will split into group and Minority interests on the basis of 60%.

PART 3 EVOLUTION OF CONSOLIDATED ACCOUNTS

After consolidation process, we will notice two interesting points

- Net impact on Reserves will be 30 from A and $(30) = 60\% * 50$ from B, so an impact of zero
- Contribution of A profit for the group will be $5 = 70\% * 50 + (30)$ as announced above.

Adjustment (e) : Elimination of dividends paid by company A

P negotiated the preservation of its rights on 90 % of dividends, although it owns now after the sale only 70 %. The amount of dividends to eliminate is thus $18 = 90\% * 20$.

| Parent P | Debit | Credit |
|-----------------|-------|--------|
| <u>Reserves</u> | | |

The dividends of 30 paid by parent company require no consolidation adjustment.

Let's now consider the accounts of each company, including these adjustments

| P | | |
|---------------------------------|-----|--|
| Goodwill/B (b) | 100 | Capital |
| Investments/A | 140 | Reserves |
| Investments/B (b) | 400 | (a) (e) |
| Other assets | 660 | Result 80 (100) (a) (e) |
| | | Other liabilities 400 |
| A | | |
| Tang. Assets | 0 | Capital |
| | | Reserves |
| | | (c*) |
| | | Result 50 (c*) (30) |
| Other assets | 600 | Other liabilities 190 |

Tang. Assets 150 Capital

Result
Other assets 650 Other liabilities

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and the final consolidated accounts

| P + A + B | | |
|------------------|-------|-----------------------|
| Goodwill | 100 | Capital 500 |
| | | Reserves 270 |
| Tang. assets | 100 | Result 30 |
| | | Cons. Res.(A) 147 |
| | | Cons. Res.(B) (6) |
| | | Minor. Int.(A) 123 |
| | | Minor. Int.(B) 196 |
| Other assets | 1,910 | Other liabilities 850 |

with

- Consolidated reserves of A = $147 = 70\% * [200 + 160 + 50] + 30 + (30) - 140$
- Consolidated reserves of B = $(6) = 60\% * [300 + 200 + (50) + 40] - [400 + (100)]$
- Minority interests of A = $123 = 30\% * [200 + 160 + 50]$
- Minority interests of B = $196 = 40\% * [300 + 200 + (50) + 40]$

Justification of consolidated reserves evolution

We propose to present the status board first and then to bring the necessary comments afterwards

| Conso. Reserves Year 1 (1) | Result Year 2 (2) | Dividends paid (3) | Dividends received (4) | Transfer of reserves (5a) | Transfer of reserves (5b) | Other transfers (6) | Parent dividends (7) | Total (8) | Conso. Reserves Year 2 (9) (9)-(8) (10) | Difference (10) |
|-------------------------------|----------------------|-----------------------|---------------------------|------------------------------|------------------------------|------------------------|-------------------------|--------------|--|--------------------|
| P 250 | 30 | 18 | 18 | 32 | | (30) | 300 | 300 | 0 | 0 |
| A 162 | 5 | (18) | | 30 | (32) | | 147 | 147 | 0 | 0 |
| B 0 | 24 | | | (30) | | | (6) | (6) | 0 | 0 |
| Total 412 | 59 | (18) | 18 | 0 | 0 | 0 | (30) | 441 | 441 | 0 |

Column (1) shows the consolidated reserves calculated for Year 1

Column (2) shows the group result of each company, taking into account adjustments and percentage calculation

Columns (3) and (4) shows the group dividends of 18 paid by A and received by P

To be clear, we opted for two columns to show the group transfers.

Column (5a) shows a transfer of reserves of $30 = 60\% * 50$, related to the elimination of the group profit. To understand this transfer, let us consider the

adjustments (c*) and (d) which consist in a credit of 30 in A and a debit of 60% * 50 in B.

Column (5b) shows a transfer of 32 because of the 20% share disposal. This is also an important point to check. Each time we sell shares the corresponding part of consolidated reserves of the concerned company decreases and the same amount appears as an increase on the line of the vendor.

Let's illustrate it with figures.

Consolidated reserves of A in Year 1 (after dividends distribution) are $144 = 162 + (18)$. This net amount corresponds to a participation of 90%. After the transaction, we only keep 70% of that company. This means we are "loosing" $32 = 144 * (20\% / 90\%)$ on company A line but the group keeps these reserves of 32 by considering the adjustment (d).

Column (6) is just not applicable in this case study

Column (7) shows P dividends paid

Finally, we see that the Total column (8) is equal, line per line, with the consolidated reserves coming from the Year 2 consolidation.

Again, we confirm this consolidation is technically correct regarding the group equity.

3 EVOLUTION OF TRANSLATION ADJUSTMENTS

3.1 Some important principles

For each foreign company, the translation adjustments amount at the end of a period represents the total adjustments booked on equity and financial investment accounts to maintain them at their historical value, since the first time this company has entered the consolidation scope.

This means that during a certain number of years, not only the initial amounts but each variation of these amounts (increases/decreases of capital, shares acquisitions/disposals, transfer of result to reserves, dividends payments, ...) have been translated with so many different rates that justifying the evolution becomes rather difficult.

It is however true that the evolution of translation adjustments is in most cases required by the Auditors. To proceed further let's come back to some principles.

Period to justify

Translation adjustments evolution is justified from one period with regard to the previous closing period. We never justify the evolution since the beginning of the life time of each company in the group. Reference period figures have been audited and the corresponding figures constitute a kind of starting line.

Historical translation adjustments

Every year, for each foreign company, there is a consolidation adjustment reclassifying the effect of rates on equity and financial investment accounts to the translation adjustments account in order to keep these accounts at historical rate.

All these adjustments are individually carried forward to the next consolidation period. Most of the consolidation software are processing this correctly.

This means that, for each company, after a certain number of years, we can find quite a lot of these adjustments. As the justification is made from the current period with the reference period, it is not really a loss of information to aggregate these historical adjustments, in order to keep the consolidation more easily auditable.

The currency translation process

Before going ahead, let's also remind that, considering Year 1 and Year 2, the historical value of an amount in Year 2 is equal to its corresponding historical value in Year 1 increased by the variation noticed during Year 2, translated at some transaction rate, which can be the average rate or a certain day rate.

That historical value compared to the Year 2 value at closing rate gives the translation adjustment of Year 2.

In this process, the historical value of an account is equal to the value of this account at closing rate adjusted by all the translation adjustments aggregated since the early beginning.

3.2 Variation analysis from a theoretical point of view

The idea is to produce a status board showing, for each foreign company, the effect of rates variations on equity and financial investments accounts.

Beforehand, it seems to us useful to explain some currency translation mechanisms.

Year 1 : First year consolidation for a foreign company

We will consider one equity account, the capital account for instance. As all balance sheets accounts, its corresponding amount, named M1 is first translated at a certain closing rate named C1. But we know this capital amount entered the consolidation scope a certain day of Year 1 when the rate was H (for Historical).

This capital amount valued for $M1 * C1$ has to be adjusted by a certain value J1 such that $M1 * C1 + J1 = M1 * H$.

So we get $J1 = M1 * (H - C1)$ which is the amount of translation adjustment to book on that capital amount and the same amount, opposite sign, that's to say $M1 * (C1 - H)$, will be booked on the translation adjustments account.

At this moment of the explanation, we can state that the variation of translation adjustment for the capital is the difference of rates C1 - H on amount M1 which can be considered as the variation from 0 to M1 for this Year 1.

Year 2 : A capital increase

Let's now look how the process is performed during Year 2 with a capital increase of K, giving $M2 = M1 + K$ in foreign currency, with M2 being the Year 2 closing value of the capital.

We suppose the capital increase happened a certain day of Year 2 with a transaction rate of T.

What will be the historical value of the capital at end of Year 2?

The answer is quite easy: $M1 * H + K * T$ but the consolidation process makes it a little bit more complex.

We know that we first get the capital value at end of Year 2 at closing rate C2, giving a value of $M2 * C2$. We also know that the translation adjustment J1 is carried forward to Year 2.

If J_2 represents the translation adjustment needed for Year 2, we can write the following

$$M_2 * C_2 + J_1 + J_2 = M_1 * H + K * T$$

$$J_2 = M_1 * H + K * T - M_2 * C_2 - J_1$$

and by replacing M_2 by $M_1 + K$ and J_1 by $M_1^* (H - C_1)$, we get

$$J_2 = M_1 * H + K * T - (M_1 + K) * C_2 - M_1^* (H - C_1)$$

$$J_2 = M_1 * (C_1 - C_2) + K * (T - C_2)$$

which becomes

$$J_2 = M_1^* (C_2 - C_1) + K^* (C_2 - T)$$

if we look at the booking amount on the translation adjustment account (opposite sign).

And we now see that the Year 2 translation adjustment on this capital account includes two impacts

- A first one is the variation of closing rates on opening amount M_1
- A second one is the variation of closing rate with regard to the transaction rate on the variation amount of the year.

Generalisation to result, reserves and dividends

By a similar method, we deduce that the amount of translation adjustment of Year 2 impacting the reserves account after appropriation of the part of result which has not been paid as dividends is

$$\begin{aligned} J_2 = & (\text{Opening reserves } Y_1 + \text{non distributed Result of } Y_1)^* (C_2 - C_1) \\ & + D^* (C_2 - A_1) \end{aligned}$$

where D represents the amount of gross dividends paid and A_1 is the average rate of Year 1.

As it can be seen, justifying the evolution of translation adjustments accounts rely more on "algebra" calculations than on economical information.

To comply with this kind of request, we recommend using a status board per company. That's what we are going to explain in the next section, on the basis on a realistic example.

3.3 Case study

In this case study, we are going to analyze three years of consolidation with the following foreign currency equity evolution and the corresponding rates that will be used.

| | Year 1 CUR | Capital increase | Approp. | Result | Year 2 CUR | Approp. | Divid. | Result | Year 3 CUR |
|----------|---------------|---------------------|---------|--------|---------------|---------|--------|--------|---------------|
| Capital | 100 | 50 | | | 150 | | | | 150 |
| Reserves | 80 | | 20 | 30 | 100 | 20 | | | 120 |
| Result | 20 | | (20) | 30 | 30 | (20) | (10) | 10 | 10 |
| | 200 | 50 | 0 | 30 | 280 | 0 | (10) | 10 | 280 |

| | | | | | | | | | |
|--------------|----|----|--|--|----|--|--|--|----|
| Closing rate | 10 | | | | 14 | | | | 12 |
| Average rate | 11 | | | | 13 | | | | 10 |
| Hist. Rate | 9 | | | | | | | | |
| Trans. Rate | | 12 | | | | | | | |

That company enters the group on the 1st of January Year 1 with a total equity of 180 translated at the historical rate of 9. During Year 2, the capital is increased by 50 at a transaction rate of 12.

At the end of Year 2, the company pays gross dividends of 10.

We propose to proceed in two steps. We first calculate the historical equity of each year and book the corresponding translation adjustments amount on the appropriate account.

We then fill in the status board to justify the evolution of translation adjustments.

Currency translation of Year 1

Considering the company entering the consolidation scope on the 1st of January Year 1 with a rate of 9, capital and reserves accounts have a historical value of $900 = 100 * 9$ and $720 = 80 * 9$ respectively and the profit of 20 is translated at the average rate of 11, giving $220 = 20 * 11$.

| | Year 1 CUR | At closing rate | 31 | Year 1 EUR |
|----------------|---------------|--------------------|-------|---------------|
| Capital | 100 | 1,000 | (100) | 900 |
| Reserves | 80 | 800 | (80) | 720 |
| Result | 20 | 200 | 20 | 220 |
| Trans. Adjust. | | | 160 | 160 |
| | 200 | 2,000 | 0 | 2,000 |

Column J1 represents the currency translation adjustment for Year 1.

Currency translation of Year 2

Before entering calculation, notice

- There is a capital increase for 50 to be translated at a transaction rate of 12, that is $600 = 50 * 12$
- The Year 1 profit of 20 is entirely carried forward to the Reserves
- The Year 1 translation adjustment 31 is carried forward to Year 2 consolidation. In the meantime, the impact on result for 20 is of course carried forward to the Reserves.

| | Year 2 CUR | At closing rate | J1 | J2 | Year 2 EUR |
|----------------|---------------|--------------------|-------|-------|---------------|
| Capital | 150 | 2,100 | (100) | (500) | 1,500 |
| Reserves | 100 | 1,400 | (60) | (400) | 940 |
| Result | 30 | 420 | | (30) | 390 |
| Trans, Adjust. | | | 160 | 930 | 1,090 |
| | 280 | 3,920 | 0 | 0 | 3,920 |

On this basis, the capital consists in two parts: 100 to be translated at historical rate of 9 and 50 translated at 12, giving a new historical value of $1500 = 100 * 9 + 50 * 12$. Regarding the closing rate value of 2100, adjusted by J1 for (100), we need an additional J2 adjustment for (500).

For the Reserves, the same view applies because 100 consists in 80 at historical rate of 9 and 20 at average rate of 11, giving a correct value of $940 = 80 * 9 + 20 * 11$. The closing rate value of 1400 adjusted by J1 for (60) must be adjusted by 32 for (400).

And, finally, the profit of 30 translated at closing rate for $420 = 30 * 14$ must be adjusted for 30 to bring it to the average rate value of 390.

It is interesting to notice that the total equity value remains unchanged, at a value of the closing rate because we only book some transfers between equity accounts and the translation adjustments account belongs to equity.

The question that now arises is to explain how do we get a variation of 930 on the translation adjustments account by passing from 160 in Year 1 to 1090 in Year 2.

Let's just apply the formulas explained above.

| | CTA/opening 14/10 | CTA/variations 14/12 | CTA/divid. | CTA/result 14/13 | Total |
|----------|----------------------|-------------------------|------------|---------------------|-------|
| Capital | 400 | 100 | | | 500 |
| Reserves | 400 | | | | 400 |
| Result | | | | 30 | 30 |
| | 800 | 100 | 0 | 30 | 930 |

For the currency translation adjustment (CTA) on opening

- Opening capital of $400 = 100 * (14 - 10)$
- Opening reserves (including Year 1 profit) of $400 = 100 * (14 - 10)$

For the currency translation adjustment (CTA) on variations

- Capital increase of $100 = 50 * (14 - 12)$

For the currency translation adjustment (CTA) on result

- Year 2 result of $30 = 30 * (14 - 13)$

Currency translation of Year 3

For this last year, we just have to take care of dividends paid for 10, the capital increase of Year 2 belongs now to the past and is fully integrated in the 12 adjustment.

| | Year 3 CUR | At closing rate | 11 | 32 | 33 | Year 3 EUR |
|----------------|---------------|--------------------|-------|-------|-------|---------------|
| Capital | 150 | 1,800 | (100) | (500) | 300 | 1,500 |
| Reserves | 120 | 1,440 | (60) | (430) | 250 | 1,200 |
| Result | 10 | 120 | | | (20) | 100 |
| Trans. Adjust. | | | 160 | 930 | (530) | 560 |
| | 280 | 3,360 | 0 | 0 | 0 | 3,360 |

To understand the above report, we start again with the closing amounts first translated at closing rate of 12 and we carry forward adjustments J1 and J2.

The capital of 1500 is unchanged in this period and so keeps its value of Year 2, that is 1500. To reach this value, we need an adjustment J3 for 300.

Reserves consist in an amount of 100 translated last year for 940 and 20 corresponding to the non distributed part of Year 2 profit whose value at

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average rate 13 was 260, giving a historical value of 1200. This amount justifies the translation adjustment J3 of 250.

The Year 3 result translated at average of 10 implies a translation adjustment J3 of (20).

We close Year 3 consolidation with a translation adjustment of 560 and 1090 in Year 2, so we have to justify an evolution of (530).

Here is the status board explaining that evolution.

| | CTA/opening | CTA/variations | CTA/divid. | CTA/result | Total |
|----------|-------------|----------------|------------|------------|-------|
| | 12/13 | | | | |
| Reserves | | (300) | | | (300) |
| Result | | (240) | | | (250) |
| | (540) | | 0 | (10) | 20 |
| | | | | | (530) |

For the currency translation adjustment (CTA) on opening

- Opening capital of $150^* (12 - 14) = (300)$
- Opening reserves (including non distributed Year 2 profit) $120^* (12 - 14) = (240)$

For the currency translation adjustment (CTA) on dividends

- Dividend paid for $10^* (12 - 13) = (10)$

For the currency translation adjustment (CTA) on result

- Year 3 result of $10^* (12 - 10) = 20$

4 **EVOLUTION OF MINORITY INTERESTS**

4.1 **On which accounts are calculated the Minority interests?**

To answer the question as stated in the title of this section, we would just like to remind some useful properties with regard to Minority interests.

Minority interests are calculated on all items composing the equity as defined in section 3.1 of Part 3. By all items, we mean capital, reserves, result, badwill (depending on chosen rules), translation adjustments, grants, ...). In other words, we can calculate the Minority interests on the total equity.

Minority Interests are also calculated on financial investments.

To analyse Minority interests variations, we will need to identify the most important items that explain the equity variation between two successive periods.

Evolution of Minority interests may be analyzed through a status board as we did for the consolidated reserves but, unfortunately, as we will see, the columns are not as standard.

Anyway, we can try to identify the most important variations of equity as follows

- Capital increase/decrease
- Result of the year
- Dividends paid
- Movement on revaluation reserves (with no impact on result)
- Translation adjustments variation
- Variation of badwills
- Variation of grants

Moreover, we will have to take care of possible financial investments variations as acquisitions/disposals of shares on consolidated companies.

Finally, we will also consider companies in which the minority percentages may change between periods, including consolidation methods changes with no minority interests in one period and minority interests in the other one.

4.2 How to explain variations?

The problem is quite simple and we can give a general approach for a "conceptual" account because it will apply to any other equity or financial account.

We will see that only the financial nature of the variation, depending of the account, will have to be stored in an appropriate column of the status board.

Suppose that the minority percentage for Year 1 is p_1 and for Year 2 is p_2 . p_1 or p_2 may be 0%, depending on the consolidation method or the fact that we consider a global integration company owned at 100%.

We now consider one equity amount M_1 in Year 1 and M_2 in Year 2, with a variation V . Of course, we can write $M_2 = M_1 + V$. This situation can apply to any account. V could be a capital increase, a dividend paid, a translation adjustment variation, an increase of grants, ...

The consolidation process calculates Minority interests respectively equal to $M_1 * p_1$ for Year 1 and $M_2 * p_2$ for Year 2 and we are interested in explaining the variation

$$M_2 * p_2 - M_1 * p_1 = (M_1 + V) * p_2 - M_1 * p_1 = M_1 * (p_2 - p_1) + V * p_2$$

where we see that the net variation always consists in two components

- The first component showing the percentage variation $p_2 - p_1$ between Year 2 and Year 1 in the opening value M_1 of the account
- The second component showing the Year 2 percentage p_2 in the variation.

Let's just see what we get with this formula considering a capital increase in the following example

| | Year 1 | Capital increase | Year 2 |
|--------------------|--------|------------------|--------|
| Capital | 100 | 40 | 140 |
| Minority % | 30% | | 20% |
| Minority interests | 30 | | 28 |

where we can see that the variation of Minority interests to justify is (2).

The status board would mention the following two elements

- A variation in the opening amount for $100 * (20\% - 30\%) = (10)$

And $20\% * 40 = 8$ corresponding to the part of the 3rd Parties in the capital increase.

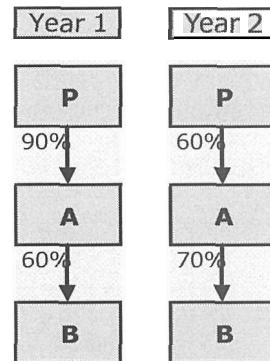
4.3 Case study

In this group, we are going to produce a justification of the Minority interests evolution for companies A and B which is a foreign company.

For Year 1, the 3rd Parties percentages are 10% in A and $46\% = 100\% - 90\% = 60\%$ in B.

For Year 2, we find 40% in A and $58\% = 100\% - 60\% = 70\%$ in B.

Moreover, we will restrict our view on the necessary accounts, without making a complete consolidation.



Here are these accounts

| Company A | Year 1 | Capital increase | Approp. | Divid. | Result | Shares disp. | Year 2 |
|------------------|--------|------------------|---------|--------|--------|--------------|--------|
| Fin. Invest./B | 80 | | | | | 30 | 110 |
| Capital Reserves | 200 | 100 | | | | | 300 |
| Result | 160 | | 10 | | | | 170 |
| | 30 | | (10) | (20) | 10 | | 10 |

| Company B | Year 1 | Capital increase | Approp. | Divid. | Result | CTA variation | Year 2 |
|------------------|--------|------------------|---------|--------|--------|---------------|--------|
| Capital Reserves | 100 | | | | | | 100 |
| Result | 60 | | | | | | 100 |
| Trans. Adjust. | 40 | | 40 | | | | 30 |
| | 30 | | (40) | | 30 | 20 | 50 |

Let's first calculate Minority interests in the usual way of a consolidation process.

For Year 1

- Company A : $31 = 10\% * (200 + 160 + 30 - 80)$
- Company B : $105.8 = 46\% * (100 + 60 + 40 + 30)$

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For Year 2

- Company A : $148 = 40\%^* (300 + 170 + 10 - 110)$
- Company B : $162.4 = 58\%^* (100 + 100 + 30 + 50)$

The status board to be built will contain the necessary number of columns, depending on the different variations we feel useful to show.

In our example, we have noticed result of the year, increase in capital, payment of dividends, shares acquisition, translation adjustment account and percentages variations.

Here is the status board for which we provide comments hereunder

| | Year 1 | Result | Divid. | Capital increase | CTA | Fin. Inv. acquisition | Var. % | Year 2 |
|---|--------|--------|--------|------------------|------|-----------------------|--------|--------|
| A | 31 | 4 | (2) | 40 | | | 87 | 148 |
| B | 105.8 | 17.4 | | | 15.2 | (12) | 24 | 162.4 |

Result

- Company A : $4 = 40\%^* 10$
- Company B : $17.4 = 58\%^* 30$

Dividends

We will suppose parent company has disposed its 30% company A shares by keeping the rights on 90% of the dividends. This implies 3rd Parties will receive 10% of these dividends besides the fact they have now 40% a participation in A.

This means a dividend of $(2) = 10\%^* (20)$. It is important to notice that we won't find a compensation of 2 in another column. We are not consolidating the 3rd Parties group and we only act a decrease of their interests.

Capital increase corresponding to $40 = 40\%^* 100$

CTA includes two components

- First component on the opening: $3.6 = 30^* (58\% - 46\%)$
- Second component on the Year 2 variation: $11.6 = 20^* 58\%$

giving a net variation of 15.2.

Fin. invest. acquisition for 12 = 30 * 40%. This amount is written as negative in the status board because it is an asset (debit) netted on a liabilities account (Minority interests).

Var.% is the impact on variation percentage on opening amounts.

- Company A : $87 = [200 + 160 + 30 - 20 - 80] * [40\% - 10\%]$
- Company B : $24 = [100 + 60 + 40] * [58\% - 46\%]$

A particular attention must be brought to the equity of company A which includes the amounts of Year 1 less the dividends paid, processed separately. Financial investment must also be included in the calculation with the correct sign.

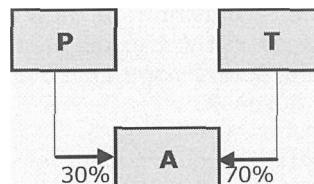
We cannot help noticing that this status board requires a huge arithmetical effort for a weak interest from an accounting or financial point of view.

Could it be sometimes a requirement from Auditors to test the capability of the consolidator and check how he is able to master his consolidation?

5 EVOLUTION OF PARTICIPATION AT EQUITY VALUE

5.1 When Equity value and Minority Interests are the two sides of the same mirror

The company A, owned by parent company P at 30%, is consolidated with the equity method. The other shareholder, company T considered as 3rd parties, owns the remaining 70% and, if required, would consolidate company A with the global integration method.



In its consolidated balance sheet, we would then find Minority Interests related to company A for an amount equal to 30% of its equity valued at the closing date.

But this valuation is exactly the same as the one that would be used in the consolidation of company P when applying the equity method to company A at 30%. If we suppose both P and T are consolidating with the same rules and

with no adjustments booked in A, Minority interests and Equity value would be equal.

This means that the methodology explained to justify Minority interests evolution can be reused exactly in the same way to justify the evolution of equity method participations.

The columns of the status board will also be non standard and adapted depending on the nature of the equity accounts and their evolution.

THE CASH FLOW STATEMENT

6.1 About the cash flow statement and its utility

Difficulties to understand some variations by considering only the consolidated balance sheet

The only consideration of the closing amounts of two periods in a consolidated balance sheet does not allow to understand the policy of investment or financing of a group.

The risk of wrong conclusions is very likely.

For example, the increase of an account such as stocks can of course be the consequence of bad decisions at management level.

But the acquisition of new companies and their global or proportional integration in the consolidation scope will have the same effect while, maybe, for the existing companies in both periods stocks may be managed with a good efficiency.

Moreover, the only change of consolidation method will also provoke a failure to understand these evolutions correctly.

Finally, an important jump of an exchange rate will lead to the same consequence.

To face these difficulties, the notes to the accounts will certainly help for a better understanding, but generally these notes concern mainly non current assets and some of the non current liabilities.

Because of the consolidation process, important information is also rather difficult to find such as

- The price paid to acquire a new company that cannot be deduced from the consolidated balance sheet because that item is eliminated
- The contribution of the 3rd Parties in the increase of capital of a company is also impossible to evaluate
- The same can be said for the dividends paid by group companies to 3rd Parties

and more generally, how to analyze correctly the use of cash in a group?

The only acceptable answer to that question is the "Cash Flow Statement"

The cash flow statement

The basic idea behind the cash flow statement is to explain how a group managed its cash with the outside world all along the consolidation period.

There is no standard format for the cash flow statement but, beyond this problem of presentation, all groups consider three main categories, namely cash related to

- Operating activities
- Investments and disinvestments
- Financial transactions

The information necessary to build a cash flow statement comes from some P&L accounts and from flows and we will see that if justifying consolidated reserves is sometimes a quite technical challenge, building a correct cash flow statement requires a great deal of rigor at any time of the consolidation process.

The main reason for this is the fact that we must keep in mind that only cash items will be used in the cash flow statement, while cash transactions between group companies cannot appear.

The process of building a consolidated cash flow statement

Some basic recommendations can already be issued in order to bring a chance of success on our side while building a cash flow statement.

- Each group company should provide a correct local currency statutory cash flow statement as an input to the consolidation process
- Each consolidation adjustment should be booked, after checking the cash and non cash impacts

- A very strong knowledge of all financial and investments transactions in the group is a necessary guarantee to achieve the work.

Of course, all technical issues such as currency rates changes, changes in consolidation scope, changes in consolidation methods will be highly under control and understood because these technical effects could present some important and unexpected effects.

6.2 A cash flow statement presentation

What follows applies to both statutory and consolidated cash flow statement. However, when analyzing more in detail each category, we will highlight some differences brought by consolidated figures.

A cash flow statement consists in three following categories

| |
|---|
| Cash from operating activities |
| Cash from investments and disinvestments activities |
| Cash from financial activities |
| Net cash variation |

The "Net cash variation" is equal to the total of the three first categories and one difficult point by saying this is the check to be made with the variation of Cash and Cash equivalent accounts as presented in the balance sheet. Both must be equal.

Cash from operating activities

This category shows the cash related to the ongoing business and is usually presented under two different methods: the direct method or the indirect method.

The direct method presentation

Let's say immediately that this method is supported by few groups only, besides the fact that it is a recommendation of the IFRS rules. The reason for this is the difficulty to capture the input information.

Following this method, the following information is supposed to be provided

- Cash received from customers

- Cash paid to suppliers
- Cash paid to employees
- Financial interests paid/received
- Tax and VAT paid/paid back

and we understand that most accounting systems make it difficult to pick up payments, certainly for customers and suppliers, because there are all mixed up with other financial transactions on different bank accounts.

The indirect method avoids such a difficulty and explains its success.

The indirect method presentation

We have two main sub-categories: the cash flow and the working capital.

The cash flow

We start by considering the company result which consists in income and expenses, both cash and non cash. The idea is then to evaluate the cash part of that result by reversing all non cash income and expenses.

Without giving the most general and complete definition, cash flow could be defined as follows

- Result of the period
- + Non cash expenses
 - + Depreciations
 - + Use of provisions
 - + Write-off
 - + Exchange losses (unrealized)
 - + Losses on assets disposals
 - + Deferred taxes (charges)
 - + ...
- - Non cash income
 - - Reverse of depreciations
 - - Reverse of provisions
 - - Write-back
 - - Exchange gains (unrealized)
 - - Gains on assets disposals
 - - Deferred taxes (income)
 - - ...

The total of all these items gives what is called the cash flow.

The working capital

This sub-category contains the net variation of current receivables and current payables.

From a cash point of view, if payables variation is a decrease (negative amount), this variation will appear with a negative sign in the cash flow statement because it represents a cash out.

The opposite must be said for a decrease of receivables, so also a negative amount, with a positive impact in the cash flow statement because it represents cash received from customers.

Cash flow and working capital added together give the "Cash from operating activities".

Cash from investments and disinvestments activities

This category represents all acquisitions of intangible, tangible and financial assets on one side and all disposals of these same items on the other side.

Obviously, investments will appear with a negative sign, representing a cash out, and the opposite for all disinvestments.

Nothing special should be added to this if we speak about a statutory cash flow statement, but on the other hand it becomes a problem while considering the consolidated cash flow statement because acquisitions and disposals of consolidated financial investments are eliminated in the balance sheet.

We will have to come back more deeply to that issue later in this chapter.

Cash from financial activities

This category includes all transactions that are not current. Amongst these transactions, we list hereunder the main items

- Capital increase/decrease (in cash)
- New long term loans
- Reimbursement of long term loans
- Grants received
- Dividends paid to shareholders

Net cash variation

This is simply the addition of these three cash categories and, as said above, this net amount must be equal to the net variation of Cash and Cash equivalent accounts found in the balance sheet.

6.3 Let's build a statutory cash flow statement

To do so the basic information comes from the flows on balance sheet accounts and from some non cash P&L accounts.

Here is the necessary information.

| | Year 1 | Acq. | Disp. | Net var. | Dep. | Gain/disp. | Year 2 |
|-----------------|---------|-------|---------|----------|-------|------------|---------|
| Tangible assets | | | | | | | |
| Acq. Val. | 7,000 | 3,000 | (1,200) | | | 200 | 9,000 |
| Deprec. | (1,000) | | | | (600) | | (1,600) |
| Fin. Invest. | 2,000 | 800 | (300) | | | | 2,500 |
| Receivables | 1,200 | | | 400 | | | 1,600 |
| Cash | 800 | | | (300) | | | 500 |
| Total | 10,000 | | | | | | 12,000 |

| | Year 1 | Increase | Reimb. | Net var. | Prov. | Divid. | Approp. | Profit | Year 2 |
|------------|--------|----------|--------|----------|-------|--------|---------|--------|--------|
| Capital | 3,000 | 1,000 | | | | | | | 4,000 |
| Reserves | 2,000 | | | | | | | | 2,300 |
| Result | 500 | | | | | | | | 400 |
| Provisions | 800 | | | | | | | | 1,200 |
| Loans | 2,000 | | | | | | | | 1,500 |
| Payables | 1,700 | | | | | | | | 2,600 |
| Total | 10,000 | | | | | | | | 12,000 |

For each balance sheet account, we explain in a financial or an accounting way what are the changes between opening and closing values.

As you can see, the reason of changes depends on the nature of each account and some flows are "cash" and so candidate to impact the cash flow statement while some others are "non cash". In the assets, flows considered as cash are "acquisitions", "disposals" and net variations". In the liabilities, flows considered as cash are "Increase", "Reimbursement", "Net variation" and "Dividends".

The 'Result' flow showing the Year 2 profit is ambiguous because it includes cash and non cash amounts as seen in the P&L

| | Year 2 |
|----------------|---------|
| Turnover | 10,000 |
| Cost of sales | (8,800) |
| Depreciations | (600) |
| Provisions | (400) |
| Gain/disposals | 200 |
| Result | 400 |

An important validation between flows and P&L accounts must be done for "Depreciations", "Provisions" and "Gain on disposals". If the amounts booked on flows and on the corresponding P&L accounts are different, there will be an error in the cash flow statement.

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But how are we able to see this kind of error? We said in the previous section that the net cash calculated in the cash flow statement had to be equal to the net variation of Cash and Cash equivalent accounts deduced from the balance sheet. That's what we mean by an error.

The problem is when such error occurs, it is rather difficult to identify its origin.

We now consider the cash flow statement deduced from these figures, with some additional comments.

| | |
|--------------------------------|-------|
| Result | 400 |
| Depreciations | 600 |
| Provisions | 400 |
| Gain on disposals | (200) |
| Cash flow | 1,200 |
| Var. Receivables | (400) |
| Var. Payables | 900 |
| Working capital | 500 |
| Cash from operating activities | 1,700 |

We start with the profit of 400 and adjust it by eliminating non cash expenses and non cash income. This gives the cash flow.

The net variation of current assets and liabilities is the working capital.

Addition of both gives the cash from operating activities.

| | |
|------------------------|---------|
| Investments | |
| Tangible assets | (3,000) |
| Financial invest. | (800) |
| Disinvestments | |
| Tangible assets | 1,200 |
| Financial invest. | 300 |
| Cash from Inv./Disinv. | (2,300) |

Investments are negative amounts and presented separately from the disinvestments.

| | |
|--------------------------------|-------|
| Capital increase | 1,000 |
| Loans reimbursement | (500) |
| Dividends | (200) |
| Cash from financial activities | 300 |
| Net cash variation | (300) |

These are the financial transactions of the period.

If we go back to the assets above, we will notice that the net variation of the Cash amount is (300) corresponding to the net cash variation calculated in the cash flow statement.

At this stage, we can say that the cash flow statement is technically correct, but it would still need some more investigations on the content of accounts and flows. This is the job of the Auditors and if they make some remarks, this

cash flow statement would be modified only by reclassifications of amounts between lines.

In a certain way, we would perform an accounting process by debiting and crediting flows as we usually do it for accounts!

6.4 Flows for the consolidated cash flow statement

We know that the main objective of a consolidation is to show through a set of structured accounting reports what a group of companies has done with the outside world. This economical (non fiscal) picture is provided through balance sheet, P&L and a number of notes to the accounts. But now, we want to know what this group did with its cash?

In other words, is it possible to build a cash flow statement for a group of companies in a similar way we proceed for a single company?

Some new issues

We are now in a consolidation environment faced to a certain number of companies and here are some questions related to the cash flow statement we have to build

- How to manage the impacts of currency translation on accounts and flows, being aware that these impacts are to be considered as technical and non cash. Which precautions to take?
- How to consider a new company entering the consolidation scope and how will all its assets and liabilities impact the cash flow statement?
- How to show the price paid or received concerning a financial investment transaction, knowing that the corresponding account doesn't exist in the balance sheet?
- In a consolidated balance sheet, there are some specific accounts as "Goodwill", "Financial investments at equity value", "Minority interests", "Badwill", "Translation adjustments", ... and these accounts are changing between opening and closing like all the other accounts. How to handle theses specific accounts with regard to the cash flow statement?
- How to consider consolidation adjustments when building a cash flow statement?

and so many other questions arising from such a complex moving structure as a consolidation scope can be.

Different categories of flows

Going back just for a moment to a single statutory company, as we have already seen, we have defined two kinds of flows : cash flows as acquisitions, disposals, increases in capital, ... and non cash flows as depreciations, provisions, write-off, transfers between accounts, ...

Only cash flows are to be considered in the cash flow statement.

In consolidation, we consider three categories of flows.

Cash flows reflecting real financial transactions with the outside world

A simple example would be the acquisition of a tangible asset by a company. If that company is consolidated with the global integration method, the acquisition price would appear as an investment in the cash flow statement. If that company is consolidated with the proportional method at 50%, only 50% of the investment would appear in the cash flow statement and nothing would appear for an equity method company.

Cash flows reflecting financial transactions with other companies of the group

It could be an increase of capital in a company A, completely subscribed by the parent company P. In such situation, the cash is moving from the P bank account to the A bank account. In the individual statutory cash flow statement of P and A, we would see that financial transaction but not in the consolidated cash flow statement because it becomes a pure group transaction not made with the outside world. Same comment can be made with regard to intercompany loans.

Non cash flows as in statutory accounts

This category of flows is similar to what we have at statutory level. Depreciations, provisions, transfers, ... flows are typical examples of flows to be ignored while building a consolidated cash flow statement, in the same way we ignore them at statutory level.

On top of these flows, we also have to consider flows that would be booked in consolidation adjustments. Let's consider a classical example of a tangible asset whose depreciation is based on another value. This would imply an additional depreciation in the balance sheet with the correspondent depreciation in the P&L (same amount!). Moreover, we could possibly have a deferred tax impact. All these amounts are pure non cash items with no interference with the cash flow statement.

Non cash flows from the consolidation process

A particular attention should be brought to quite a large number of situations linked to consolidation. It is rather difficult to give a complete list of these situations, however here are some of the main topics

- When consolidating a company for the first time, all assets and liabilities in the balance sheet at the date of acquisition will not impact the cash flow statement. What the group is acquiring are the shares of that company and not its assets and liabilities. The same comment can be made in case of disposal of a company.
- For all changes in consolidation method for a certain company, we are faced to a similar problem. Let's take an example. In Year 1, a company A is consolidated by the proportional integration at 50% and in Year 2 by the global integration method with 80% for the group. Clearly, in the consolidated balance sheet, we show 50% of the assets in Year 1 and we show 100% in Year 2. Again, that variation cannot appear in the cash flow statement for the same reason: the cash transaction is the acquisition of additional shares of company A giving the control. That's the only cash information to show.
- When two companies in a group are merging, all assets and liabilities of one of these companies are brought to the other company. Most of the time, there is no financial transaction between the two merged companies and the cash flow statement must show nothing about it. We are in a situation of transfer accounts but not inside a single company but between two companies.
- When a company A, owned at 80% by its parent company P, increases its capital for an amount of 100 and supposing 80 is subscribed by P and 20 by the 3rd Parties, this transaction is partly internal to the group for 80 and external to the group for 20. Indeed, 80 is just moving from the P bank account to the A bank account and the remaining 20 represents cash from 3rd Parties. Only this amount will appear in the cash flow statement.
- The next situation is quite similar to the increase in capital. A company A, owned by parent company P at 80%, is paying a dividend of 100. An amount of 80 is paid to P and 20 to the 3rd Parties. For the same reason as explained above, only (20) will appear as cash out in the cash flow statement.
- When explaining the currency translation on flows, in Part 1, we mentioned the booking of a translation adjustment flow on each assets and liabilities account for all foreign companies, because of the use of different rates. These flows will not appear in the cash flow

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statement because they are just technical flows not related to a financial transaction. Moreover, it will be necessary to check that the total of these translation adjustments flows are the same on the assets and liabilities sides, including variation of translation adjustments account in the equity.

- A company consolidated by the equity method implies the booking of a "Result from equity method companies" in the P&L. Such account has to be considered as non cash. Supposing it is a profit, the group received no cash for this income. On the contrary, if that company is paying a dividend, it will appear in the cash flow statement because cash arrives on the bank account of the group shareholder but we don't consolidate the bank account of the equity method company.

All these examples show that the consolidation process itself make the building of a consolidated cash flow statement even more difficult.

We could summarize all these comments by the following conceptual presentation.

| | Year 1 | Cash variations | Non cash variations | CTA variations | Structure variations | Year 2 |
|-------------|--------|-----------------|---------------------|----------------|----------------------|--------|
| ASSETS | | | | | | |
| | = | = | = | = | = | = |
| | Year 1 | Cash variations | Non cash variations | CTA variations | Structure variations | Year 2 |
| LIABILITIES | | | | | | |

Balance sheet accounts are changing for four basic reasons

- Cash variations which will be imported in the cash flow statement
- Non cash variations as depreciations, ...
- CTA variations
- Structure variations, including companies acquired and disposed and changes in the consolidation methods

and the difficult validation to make is that, considering initial opening and closing amounts equal between assets and liabilities, the same condition must be satisfied for each of the four categories. The total of all cash flows coming from assets accounts must be equal to the total of all cash flows coming from the liabilities. And it is the same for the three other columns. Processing this

validation brings a good assurance to build a technically correct cash flow statement.

6.5 How would finally a consolidated cash flow statement look like?

To answer this question, we propose to keep the structure of the statutory cash flow statement seen previously and to adapt it to comply with consolidation requirements.

The numbers between brackets refer to additional comments given hereunder.

| Consolidated result | (1) |
|---|-----|
| Minority result | |
| Group result | |
| Non cash expenses (+) | |
| Losses of equity method companies (+) | (2) |
| Depreciations/impairments of goodwill (+) | (3) |
| Deferred taxes (charges) (+) | (4) |
| Non cash income (-) | |
| Profits of equity method companies (-) | (2) |
| Badwills booked in P&L (-) | (5) |
| Deferred taxes (income) (-) | (4) |
| Cash flow | |
| Net variation of receivables | (6) |
| Net variations of payables | (6) |
| Working capital | |
| Cash from operating activities | |

- (1) The cash flow starts with the consolidated result, that is the group result added to the minority result. Behind this, it is important to mention that for integral consolidation method companies we will deal with 100% of the flows whatever the financial percentage is. That's the reason why we include the result of 3rd Parties.
- (2) Losses and profits generated by equity method companies are non cash items. It is just a consequence of the consolidation process.
- (3) Depending on IFRS (impairments) or Local Gaap (depreciations), goodwill will soon or later impact the P&L. It is of course a non cash item.

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- (4) All deferred taxes do not correspond to any payment. We can say, in a synthetic approach, they are there to show what should have been paid if the consolidation adjustment would have been booked in the legal accounting of the company.
- (5) In IFRS, badwills are considered as a profit, but no cash has been received.
- (6) For net variations of receivables and payables, it is important to keep in mind that all intercompany flows must be ignored while building the cash flow statement. More generally, this comment is of course true for any intercompany account (loans, ...).

| | | |
|------------------------|---|------------|
| Investments | Intangible assets Tangible assets Financial invest. | (7) |
| Disinvestments | Intangible assets Tangible assets Financial invest. | (8) (7) |
| Cash from Inv./Disinv. | | |

- (7) In Local Gaap, an investment (or disinvestment), appears in the cash flow statement for the amount of the transaction, paid or not paid. Let's take an example. A company acquires a land in December Year 1 for a price of 100 and there is an agreement to pay in two slices, 60 in January Year 2 and 40 in January Year 3. The cash flow statement will show an investment of (100). In IFRS, we have to show as an investment only what has been paid. In our example, we would show 0 in Year 1, 60 in Year 2 and 40 in Year 3.
- (8) Financial investment must show the acquisition price of consolidated companies. Usually such acquisition generates a goodwill or a badwill which must be considered as a "technical" part of the acquisition price and being difference with the equity acquired. Goodwill (or badwill) never appears in a cash flow statement, but just the acquisition price. It is the true cash out.

| | |
|---------------------------------------|--------------|
| Capital increase | (9) |
| Loans reimbursement | |
| New grants | |
| Dividends | |
| Paid by parent company | |
| Paid to 3rd Parties | |
| Received from equity method companies | (10) (11) |
| Cash from financial activities | |
| Net cash variation | |

- (9) Capital increase (or decrease) is really a difficult part to manage. In some situation a capital increase may appear with a positive sign, sometimes with a negative sign, depending on the consolidation method of the company whose capital is increased.
- (10) Dividends paid to 3rd Parties apply, in most cases, to global integration method companies paying dividends. It is a cash out. But this problem is a tricky one and we will come back to this point later on.
- (11) If profits/losses from equity method companies are non cash items, dividends paid by such companies are really cash entering the group. It must appear in the cash flow statement.

It is maybe the right time to remind that a standard cash flow statement format doesn't exist. The one presented below has been experienced in a large number of groups of variable size (number of companies). Depending on the group activity, the CFO requirements and the Auditors, this format has been adapted.

This is only a format problem. All explanations provided in this chapter remain valid, independently of the cash flow statement format.

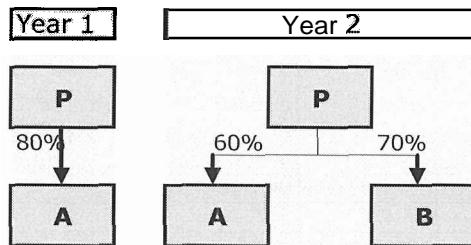
6.6 Let's build a consolidated cash flow statement

In this section, we are going to build the cash flow statement of a group consisting in two companies in Year 1 and three companies in Year 2.

The main question to be asked is which method will be used to build a cash flow statement. Without the use of professional consolidation software, we

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would recommend to proceed with a spreadsheet approach. It works perfectly well for a reasonable number of companies (5 to 10, not more however).



Let's take knowledge of the main events of this group.

- In Year 1, nothing special happened, excepted the existence of intercompany receivables and payables between both companies
- In Year 2, company P sells to 3rd Parties 20% of its participation in company A.
- The cash received gives the financial means for P to acquire 70% of a new company B.
- Moreover, P increases its capital in order to follow an increase in capital in company B.
- All these transactions take place on the first days of January, Year 2.
- After their general annual meetings closing Year 1, both companies P and A pay dividends. When negotiating the disposal of 20% of A shares, there was an agreement for P to keep the rights to dividends for these 20%.

All these transactions are clearly reflected in the statutory accounts.

Some general comments before looking to the statutory accounts

The information will follow the same presentation for each company.

The balance sheet has three columns

- One for closing amounts of Year 1
- One for closing amounts of Year 2
- And in between, one column containing the flows explaining the evolution of these amounts.

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We do not provide the P&L but we confirm that the only non cash amounts it contains are depreciations and gain on disposal on tangible assets and financial investments depending on the companies.

These P&L amounts are consistent with the flows in the balance sheet.

For each company, we will notice the main figures and then build the statutory cash flow statement. Once all three will be done, we will add them together and book some reclassifications in order to reach the consolidated cash flow statement.

Statutory accounts of company P

| Company P | | Year 1 | Flows | Year 2 |
|---------------|-------------------------------------|--------|--------------|--------|
| Fin. Inv./A | <i>Disposal Gain/disposal</i> | 800 | (350) 150 | 600 |
| Fin. Inv./B | <i>Acquisition Subscription</i> | 0 | 300 560 | 860 |
| Receivables/A | <i>Net variation</i> | 200 | 100 | 300 |
| Receivables/- | <i>Net variation</i> | 1,600 | 200 | 1,800 |
| Cash | <i>Net variation</i> | 400 | 40 | 440 |
| | Total | 3,000 | 1,000 | 4,000 |

Company P is selling 20% of its participation in company A for a price of 350. The book value of the initial 80% being 800, the book value disposed is $800 * (20\% / 80\%)$, justifying the gain on disposal of 150.

Acquisition of 90% of company B is done at a price of 300.

There are intercompany receivables with company A. The account 'Receivables/-' means receivables with 3rd Parties. We confirm intercompany matching has been successfully done and these intercompany amounts are reconciled.

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| Company P | | Year 1 | Flows | Year 2 |
|------------|----------------------|--------|-------------------------|--------|
| Capital | | 1,500 | | 2,000 |
| Reserves | <i>Increase</i> | 400 | <i>500</i> <i>50</i> | 450 |
| Result | <i>Transfer</i> | 100 | | 80 |
| | <i>Transfer</i> | | (50) | |
| | <i>Dividend</i> | | (50) | |
| Payables/- | <i>Result Year 2</i> | 1,000 | <i>80</i> | 1,470 |
| | <i>Net variation</i> | | <i>470</i> | |
| | Total | 3,000 | 1,000 | 4,000 |

Capital is increased by 500 and the Year 1 profit of 100 is partly paid as a dividend for (50) and partly transferred to reserves.

Let's now show the statutory cash flow statement built with the flows mentioned above.

| Company P | Year 2 |
|--------------------------------|--------|
| Result | 80 |
| Depreciations | 0 |
| Gain on disposals | (150) |
| Cash flow | (70) |
| Var. Receivables | (300) |
| Var. Payables | 470 |
| Working capital | 170 |
| | |
| Cash from operating activities | 100 |

We start with the profit of 80 and eliminate non cash amounts in the P&L, gain on disposals in this case.

Considering statutory accounts, net variation of receivables must include also intercompany amounts.

| | |
|------------------------|-------|
| Investments | |
| Tangible assets | 0 |
| Financial invest. | (860) |
| Disinvestments | |
| Tangible assets | 0 |
| Financial invest. | 350 |
| Cash from Inv./Disinv. | (510) |

The acquisition of 90% of shares of company B is considered as an investment.

The disposal of 20% of A shares is a disinvestment. It's the cash received that appear here and not the book value disposed.

| | |
|--------------------------------|------|
| Capital increase | 500 |
| Dividends | (50) |
| Cash from financial activities | 450 |
| | |
| Net cash variation | 40 |

The financial part includes a capital increase for 500 and the payment of the dividend for 50.

The net cash variation calculated here can be cross-checked with the net variation found in the balance sheet. It's one of the most important technical validations we can do. If this validation fails, something is certainly wrong in the cash flow statement.

Statutory accounts of company A

| Company A | | Year 1 | Flows | Year 2 |
|---------------------|----------------------|--------|--------------|--------|
| Tang. Assets (Acq.) | <i>Acquisition</i> | 3,000 | <i>1,000</i> | 3,700 |
| | <i>Disposal</i> | | <i>(370)</i> | |
| Tang. Assets (Dep.) | <i>Gain/disposal</i> | (800) | <i>70</i> | (850) |
| | <i>Depreciation</i> | | <i>(50)</i> | |
| Receivables/- | <i>Allocation</i> | 1,300 | <i>500</i> | 1,800 |
| Cash | <i>Net variation</i> | 500 | <i>(150)</i> | 350 |
| | Total | 4,000 | <i>1,000</i> | 5,000 |

This company acquires tangible assets for 1000 and sells some others for 300. These transactions are made with 3rd Parties.

| Company A | | Year 1 | Flows | Year 2 |
|------------|----------------------|--------|--------------|--------|
| Capital | <i>Increase</i> | 1,000 | | 1,000 |
| Reserves | <i>Transfer</i> | 600 | <i>20</i> | 620 |
| Result | <i>Transfer</i> | 50 | <i>(20)</i> | 40 |
| | <i>Dividend</i> | | <i>(30)</i> | |
| Payables/P | <i>Result Year 2</i> | 200 | <i>40</i> | 300 |
| Payables/- | <i>Net variation</i> | 2,150 | <i>100</i> | 3,040 |
| | Total | 4,000 | <i>1,000</i> | 5,000 |

The Year 1 profit of 50 is paid as a dividend for 30 and transferred to reserves for 20. As explained earlier, this dividend of 30 is paid for $24 = 80\% * 30$ to company P.

There are intercompany payables correctly reconciled with receivables in company P accounts.

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Here is the corresponding statutory cash flow statement.

| Company A | Year 2 |
|--------------------------------|--------|
| Result | 40 |
| Depreciations | 50 |
| Gain on disposals | (70) |
| Cash flow | 20 |
| Var. Receivables | (500) |
| Var. Payables | 990 |
| Working capital | 490 |
| Cash from operating activities | 510 |

Profit is 40 and there is a depreciation flow of 50 corresponding to depreciations in the P&L for the same amount.

Net variation of payables includes intercompany amounts.

| | |
|------------------------|---------|
| Investments | |
| Tangible assets | (1,000) |
| Financial invest. | 0 |
| Disinvestments | |
| Tangible assets | 370 |
| Financial invest. | 0 |
| Cash from Inv./Disinv. | (630) |

There are acquisitions of tangible assets for 1000 and disposals for 370. These transactions are made with 3rd Parties. Notice that this disposal gives a gain of 70 as shown in the cash flow above.

| | |
|--------------------------------|-------|
| Capital increase | 0 |
| Dividends | (30) |
| Cash from financial activities | (30) |
| Net cash variation | (150) |

No capital increase but only the payment of the dividend for 30. Remember company P receives 24 = 80% * 30.

The net cash variation for (150) is again equal to the net cash variation found in the balance sheet.

Statutory accounts of company B

The most important issue for this company is the fact that it was not consolidated in Year 1. Being acquired on the 1st of January Year 2, all flows mentioned will be taken into account to build the cash flow statement, but all the opening balance sheet amounts have to be ignored. In a consolidation software, these opening amounts would be mentioned on specific flows "Entry in the consolidation scope", considering the fact the opening amounts would have been zero. These flows are considered as non cash.

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| Company B | | Year 1 | Flows | Year 2 |
|---------------------|---------------|--------|-------|--------|
| Tang. Assets (Acq.) | Acquisition | 1,000 | 700 | 1,500 |
| | Disposal | | (300) | |
| | Gain/disposal | | 100 | |
| Tang. Assets (Dep.) | Depreciation | (600) | (50) | (650) |
| Receivables/- | Net variation | 500 | 300 | 800 |
| Cash | Net variation | 100 | 250 | 350 |
| | Total | 1,000 | 1,000 | 2,000 |

| Company B | | Year 1 | Flows | Year 2 |
|------------|---------------|--------|-------|--------|
| Capital | Increase | 200 | 800 | 1,000 |
| Reserves | Transfer | 70 | 30 | 100 |
| Result | Transfer | 30 | (30) | 20 |
| | Dividend | | 0 | |
| | Result Year 2 | | 20 | |
| Payable, - | Net variation | 700 | 180 | 880 |
| | Total | 1,000 | 1,000 | 2,000 |

The disposal of tangible assets has been made for a price of 300, giving a gain on disposal of 100.

As announced, there is a capital increase for 800 which is subscribed for 70% by company P and for 30% by the 3rd Parties. So, we keep the same financial percentage before and after the capital increase. There are no dividends paid.

Here is the corresponding statutory cash flow statement.

| Company B | Year 2 |
|--------------------------------|--------|
| Result | 20 |
| Depreciations | 50 |
| Gain on disposals | (100) |
| Cash flow | (30) |
| Var. Receivables | (300) |
| Var. Payables | 180 |
| Working capital | (120) |
| Cash from operating activities | (150) |

We start with the profit of 20 and adjust it with the depreciations and gain on tangible assets disposals.

No intercompany amounts in these net variations.

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| | | |
|-------------------------------|--------------|--|
| Investments | | |
| Tangible assets | (700) | |
| Financial invest. | 0 | |
| Disinvestments | | |
| Tangible assets | 300 | |
| Financial invest. | 0 | |
| Cash from Inv./Disinv. | (400) | |

There are acquisitions of tangible assets for 700 and disposals for a cash received of 300.

| | |
|---------------------------------------|------------|
| Capital increase | 800 |
| Dividends | |
| Cash from financial activities | 800 |
| Net cash variation | 250 |

We only have a capital increase and no dividends.

Net cash variation is in line with the one in the balance sheet.

The consolidated cash flow statement

With these three statutory cash flow statements, we are ready to apply the following methodology which consists in adding first these three cash flow statements together. Of course, we will get a technically correct cash flow statement but it will be premature to call it consolidated cash flow statement.

Why?

Because we will have to take into account some of the events which are at this time reflected directly from the statutory accounts but should be adapted to the consolidation requirements.

In the column "Total" hereunder we find the three cash flow statements simply added together.

PART 3 EVOLUTION OF CONSOLIDATED ACCOUNTS

| | P | A | B | Total | J1 | J2 | J3 | J4 | Conso |
|--------------------------------|-------|---------|-------|---------|-------|------|-------|-------|---------|
| Result | 80 | 40 | 20 | 140 | | (24) | | (124) | (8) |
| Depreciations | 0 | 50 | 50 | 100 | | | | | 100 |
| Gain on disposals | (150) | (70) | (100) | (320) | | | | 124 | (196) |
| Cash flow | (70) | 20 | (30) | (80) | 0 | (24) | 0 | 0 | (104) |
| Var. Receivables | (300) | (500) | (300) | (1,100) | 100 | | | | (1,000) |
| Var. Payables | 470 | 990 | 180 | 1,640 | (100) | | | | 1,540 |
| Working capital | 170 | 490 | (120) | 540 | 0 | 0 | 0 | 0 | 540 |
| Cash from operating activities | 100 | 510 | (150) | 460 | 0 | (24) | 0 | 0 | 436 |
| Investments | | | | | | | | | |
| Tangible assets | 0 | (1,000) | (700) | (1,700) | | | | | (1,700) |
| Financial invest. | (860) | 0 | 0 | (860) | | | | | (300) |
| Disinvestments | | | | | | | | | |
| Tangible assets | 0 | 370 | 300 | 670 | | | | | 670 |
| Financial invest. | 350 | 0 | 0 | 350 | | | | | 350 |
| Cash from Inv./Disinv. | (510) | (630) | (400) | (1,540) | 0 | 0 | 560 | 0 | (980) |
| Capital increase | 500 | 0 | 800 | 1,300 | | | (560) | | 740 |
| Dividends | (50) | (30) | | (80) | | 24 | | | (56) |
| Cash from financial activities | 450 | (30) | 800 | 1,220 | 0 | 24 | (560) | 0 | 684 |
| Net cash variation | 40 | (150) | 250 | 140 | 0 | 0 | 0 | 0 | 140 |

The four columns J1 to J4 are adjustments in order to make it converge towards the final consolidated cash flow statement. Of course, this requires some consolidation knowledge.

Adjustment J1

If we go back to the statutory accounts of parent company P, we see that receivables have been considered as intercompany amounts included with a total net variation of **600**. In consolidation, we know these intercompany amounts are eliminated as well as the flows attached to them. This means a net variation of only **500**.

The same comment can be done for the payables in company A accounts, which implies to reduce from **990** to **890** their variation. This explains the amount of **100**.

Adjustment J2

In consolidation, we eliminate dividends received from consolidated companies, as it has been explained in Part 2 Chapter 8. This means the company P statutory profit of **80** must be reduced by **24** corresponding to the $80\% * 30$ of dividends received.

But there is a counterpart to this adjustment. The dividends paid as mentioned on line "Dividends" in the cash flow statement show a payment of **(30)** in A. In fact **(24)** remains in the group by being paid to P. Only **(6)** represents a cash out corresponding to dividends paid to 3rd Parties.

Adiustment J3

We know that the capital of company B has been increased by 500 and that each shareholder has subscribed according to its percentage. Company P brings $560 = 70\% * 800$ to company B and the 3rd Parties the remaining 240 = $30\% * 800$. The 560 must be considered as a cash transfer between companies with no effect in the cash flow statement.

The counterpart is the financial investment of (860) that must be adapted to be only (300) corresponding to the cash paid to 3rd Parties for the acquisition of the 70% shares of company B.

Adiustment J4

This last comment concerns the sale of 20% of the shares of company A. In the statutory accounts the 200 book value of these shares has been disposed for a price of 350, giving a gain of $150 = 350 - 200$.

In consolidation we know that the value of these 20% is the corresponding part of the equity on that date, that is $324 = 20\% * [1000 + 600 + 50 - 30]$, giving a gain of only $26 = 350 - 324$. In such situation, we have to book a consolidation adjustment correcting the statutory gain and bringing it to the consolidated gain. The correction amount is $124 = 150 - 26$ and the corresponding adjustment is a debit in P&L and a credit in reserves. Consequently, the net profit of parent company P is reduced by 124 and the gain in P&L is now 26 and not 150 any more.

Conclusions

If we are sure we have adjusted the necessary items, then we can state the final column on the right is the consolidated cash flow statement.

A few comments should be given before going further.

- Starting with technically correct statutory cash flow statement, the addition we made maintain a technically valid cash flow statement
- This method requires a good knowledge of all the events that have occurred in Year 2, with a good understanding of their cash influence
- Moreover, the knowledge of what is happening during the consolidation process is also required. All consolidation adjustments modifying the result of a company have an impact in the cash flow statement, most of the time it merely leads to some reclassifications between result and non cash items without modifying the cash flow.

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- A special care must be brought to dividends and capital increase to reflect the real cash out or cash in attached to these transactions.
- Without really being aware of the fact, this group has acquired a new company and we didn't worry about a possible goodwill and we will see there is indeed one!
- In the same way, the consolidated equity requires sometimes heavy calculations and difficult justification of evolution between two periods. The cash flow statement doesn't care about minority interests percentages. We 'think 100%".

The example we have just analyzed shows clearly that this method works for a limited number of companies. Adding statutory cash flow statements together is easy, but finding all the necessary adjustments to converge to the consolidated cash flow statement becomes impracticable for groups with a large number of companies, a priori if some are foreign companies. A professional consolidation software becomes a must.

Consolidated accounts – Year 1

We are now going to approach the same problem in a more natural way

- By providing the consolidated accounts of Year 1
- And the same for Year 2
- And by calculating the consolidated flows explaining the evolution of these accounts.

Once these flows are known, we will be able to fill in a first version of a cash flow statement.

Consolidated accounts – Year 1

These accounts are produced with the logic explained in Part 2 Chapter 4 concerning the consolidation method.

| Consolidation Year 1 | P | A | 31 | J2 | J3 | 34 | 35 | 36 | Conso. |
|--------------------------|-------|-------|-------|-------|-------|----|----|-------|--------|
| Tang. Assets (Acq.) | | 3,000 | | | | | | | 3,000 |
| Tang. Assets (Dep.) | | (800) | | | | | | | (800) |
| Fin. Inv./A Receivables | 800 | | (800) | | | | | | 0 |
| Cash | 1,800 | 1,300 | | (200) | | | | | 2,900 |
| | 400 | 500 | | | | | | | 900 |
| Link account (Interco) | | | 800 | 200 | (200) | | | | 0 |
| Link account (Fin. Inv.) | | | | | | | | (800) | 0 |
| Total | 3,000 | 4,000 | 0 | 0 | (200) | 0 | 0 | (800) | 6,000 |

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| Consolidation Year 1 | P | A | J1 | J2 | J3 | J4 | J5 | J6 | Conso. |
|----------------------|-------|-------|----|----|-------|-------|-------|-------|--------|
| Capital | 1,500 | 1,000 | | | | (200) | (800) | | 1,500 |
| Reserves | 400 | 600 | | | | (120) | (480) | | 400 |
| Result | 100 | 50 | | | | (10) | (40) | | 100 |
| Cons. Res. (A) | | | | | | | 1,320 | (800) | 520 |
| Min. Int. (A) | | | | | | 330 | | | 330 |
| Payable | 1,000 | 2,350 | | | (200) | | 0 | 0 | 3,150 |
| Total | 3,000 | 4,000 | 0 | 0 | (200) | | 0 | (800) | 6,000 |

Adjustment 31: Elimination of the financial investment via a link account

Adjustments 32 and 13:-Elimination of intercompany amounts via link account

Adjistment J4: Elimination of minority equity of company A and reclassification on minority interests

Adjistment J5: Elimination of group equity of company A and reclassification on consolidated reserves

Adjistment 36: Set link account to zero with counterpart on consolidated reserves of company A

Consolidated accounts - Year 2

This consolidation is a little bit trickier because of the new company B, the dividends and the disposal of shares. Here are the accounts followed by the necessary comments.

| Consolidation Year 2 | P | A | B | 31 | 32 | 33 | 34 | 35 | 36 | 37 |
|--------------------------|-------|-------|-------|----|----|----|-----|-----|-----|-------|
| Goodwill | | | | | | 90 | | | | |
| Tang. Assets (Acq.) | | | | | | | | | | |
| Tang. Assets (Dep.) | | | | | | | | | | |
| Fm. Inv./A | 600 | (850) | 1,500 | | | | | | | |
| Fin. Inv./B | 860 | | (650) | | | | | | | |
| Receivables | 2,100 | 1,800 | | | | | | | | |
| Cash | 440 | 350 | 800 | | | | | | | |
| Link account (Interco) | | | | | | | | | | |
| Link account (Fin. Inv.) | | | | | | | | | | |
| Total | 4,000 | 5,000 | 2,000 | 0 | 0 | 0 | 600 | 770 | 300 | (300) |

| Consolidation Year 2 | P | A | B | J1 | J2 | J3 | 34 | 35 | 36 | 37 |
|----------------------|-------|-------|-------|------|-------|----|----|----|----|-------|
| Capital | 2,000 | 1,000 | 1,000 | | | | | | | |
| Reserves | 450 | 620 | 100 | 24 | 124 | | | | | |
| Result | 80 | 40 | 20 | (24) | (124) | | | | | |
| Cons. Res. (A) | | | | | | | | | | |
| Cons. Res. (B) | | | | | | | | | | |
| Min. Int. (A) | | | | | | | | | | |
| Min. Int. (B) | | | | | | | | | | |
| Payables | 1,470 | 3,340 | 880 | | | | | | | |
| Total | 4,000 | 5,000 | 2,000 | 0 | 0 | 0 | 0 | 0 | 0 | (300) |

Adjistment J1: Elimination of company A dividend for 24 = 80% * 30

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Adjustment 12: Correction of gain on 20% A shares disposal. For more explanation, see below.

Adjustment 13: Goodwill concerning company B acquisition is $90 = 300 - 70\%$
 $(200 + 100)$, the equity considered here is before the capital increase

Adjustment J4: Elimination of the A financial investment via a link account

Adjustment 15: Elimination of the B financial investment via a link account

Adjustments 16 and 37:-Elimination of intercompany amounts via link account

| Consolidation Year 2 | J8 | 39 | 310 | 311 | 312 | 313 | Conso. |
|--------------------------|----|----|-------|-----|-----|-------|---------|
| Goodwill | | | | | | | 90 |
| Tang. Assets (Acq.) | | | | | | | 5,200 |
| Tang. Assets (Dep.) | | | | | | | (1,500) |
| Fin. Inv./A | | | | | | | 0 |
| Fin. Inv./B | | | | | | | 0 |
| Receivables | | | | | | | 4,400 |
| Cash | | | | | | | 1,140 |
| Link account (Interco) | | | | | | | 0 |
| Link account (Fin. Inv.) | | | | | | | 0 |
| Total | 0 | 0 | (600) | 0 | 0 | (770) | 9,330 |

| Consolidation Year 2 | J8 | J9 | J10 | J11 | 312 | 313 | Conso. |
|----------------------|-------|-------|-------|-------|-------|-------|--------|
| Capital | (400) | (600) | | (300) | (700) | | 2,000 |
| Reserves | (216) | (372) | | (30) | (70) | | 598 |
| Result | | (24) | | (6) | (14) | | (58) |
| Cons. Res. (A) | | 996 | (600) | | | | 396 |
| Cons. Res. (B) | 664 | | | | 784 | (770) | 14 |
| Mm. Int. (A) | | | | | | | 664 |
| Min. Int. (B) | | | | 336 | | | 336 |
| Payables | | | | | | | 5,390 |
| Total | 0 | 0 | (600) | 0 | 0 | (770) | 9,330 |

Adjustment 18: Elimination of minority equity of company A and reclassification on minority interests

Adjustment 19: Elimination of group equity of company A and reclassification on consolidated reserves

Adjustment 110: Set link account to zero with counterpart on consolidated reserves of company A

Adjustment J11: Elimination of minority equity of company B and reclassification on minority interests

Adjustment 112: Elimination of group equity of company B and reclassification on consolidated reserves

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Adjustment J13: Set link account to zero with counterpart on consolidated reserves of company B

Consolidated flows

We summarize now the consolidated accounts calculated as above and between Year 1 and Year 2, we add a column with the consolidated flows. In general, these flows are just the addition of the statutory flows, except for the equity which needs some comments.

| | | Year 1 | Year 2 |
|---------------------|-----------------------|--------|---------|
| Goc . .. | New goodwill | 0 | 90 |
| Tan Acq.) | Acquisition | 3,000 | 90 |
| | Disposal | | 5,200 |
| | Gain/disposal | | |
| | Entry in conso. Scope | | |
| Tang. Assets (Dep.) | Depreciation | (800) | (1,500) |
| | Entry in conso. Scope | | |
| Fin. X/nv. | Net variation | 0 | 0 |
| Receivables | Entry in conso. Scope | 2,900 | 4,400 |
| Cash | Net variation | 900 | 1,140 |
| | Entry in conso. Scope | | |
| | Total | 6,000 | 9,330 |

| | Year 1 | Year 2 |
|----------------|--------------------------|--------|
| Capital | 1,500 | 2,000 |
| Reserves | 400 | 598 |
| Result | 100 | (68) |
| Cons. Res. (A) | 520 | 396 |
| Cons. Res. (B) | 0 | 14 |
| Min. Int. (A) | 330 | 664 |
| Min. Int. (B) | 0 | 336 |
| | 2,850 | 3,940 |
| | Capital increase | 500 |
| | Dividends P | (50) |
| | Result P | (68) |
| | Result A | 40 |
| | Result B | 20 |
| | Entry of min. int. (A) | 324 |
| | Entry of min. int. (B) | 330 |
| | Dividends to 3rd Parties | (6) |
| Payables | | 1,090 |
| | | 3,150 |
| | Net variation | 1,540 |
| | Entry in conso. Scope | 700 |
| | Total | 6,000 |
| | | 3,330 |
| | | 9,330 |

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The equity considered here includes the minority equity. If we restrict our view to group equity only, we know that the evolution consists in

- Capital increase of the parent company P
- Group profit
- Dividends paid by company P

and these are indeed the first flows here above.

But when we include minority interests in the equity, and we have to do so, there are some new flows as

- Entry of minority interests (A) corresponding to an increase of 20% in the equity of company A
- Entry of minority interests (B) corresponding to new minority interests for 30% in the equity of company B
- And there is a dividend of $6 = 20\% * 30$ paid to the 3rd Parties, which is a decrease

All these flows explain the evolution of the consolidated equity.

The first column of the following report is supposed to be our consolidated cash flow obtained by picking up some flows (cash) from the above balance sheets.

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| | Year 2 | J1 | J2 | J3 | J4 | Conso |
|---------------------------------------|----------------|-------------|--------------|------------|------------|--------------|
| Result | (8) | | | | | (8) |
| Depreciations | 100 | | | | | 100 |
| Gain on disposals | (170) | (26) | | | | (196) |
| Cash flow | (78) | (26) | 0 | 0 | 0 | (104) |
| Var. Receivables | (1,000) | | | | | (1,000) |
| Var. Payables | 1,540 | | | | | 1,540 |
| Working capital | 540 | 0 | 0 | 0 | 0 | 540 |
| Cash from operating activities | 462 | (26) | 0 | 0 | 0 | 436 |
| Investments | | | | | | |
| Tangible assets | (1,700) | | | | | (1,700) |
| Financial invest. | | | | | | (300) |
| Disinvestments | | | | | | |
| Tangible assets | 670 | | | | | 670 |
| Financial invest. | | | | | | 350 |
| Cash from Inv./Disinv. | (1,030) | 0 | (300) | 350 | 0 | (980) |
| Capital increase | 500 | | | | | 240 |
| Dividends | (56) | | | | | (56) |
| Cash from financial activities | 444 | 0 | 0 | 0 | 240 | 684 |
| Net cash variation | (124) | (26) | (300) | 350 | 240 | 140 |

Restricting our view to column Year 2, we find some figures equal to the ones in our previous consolidated cash flow statement, built with the statutory approach. But we need some additional adjustments to finalize the work.

Adjustment J1: The cash flow calculation takes into account the gains on tangible assets disposals but ignores the consolidated gain on 20% A shares disposal for 26. This amount is not present because financial investments are not in the balance sheet.

Adjustment J2: For the same reason, the acquisition price of company B must be added

Adjustment J3: And also the disposal price of the 20% A shares

Adjustment J4: Finally, the amount of cash subscribed by the 3rd Parties to the increase of capital of company B is not there either because the capital is eliminated in the consolidation process. To be added.

Notice that all these adjustments have an impact on the cash line of the cash flow statement.

Conclusion

This example of a group of three companies looks quite simple as it needed only a few adjustments. But it clearly shows that the building of a cash flow statement can increase rapidly in complexity.

PART 3 EVOLUTION OF CONSOLIDATED ACCOUNTS

First because the process hides a lot of calculations: translation differences, percentages in flows, different consolidation methods and changes in group structure.

On top of these difficulties, the cash view can be rather difficult because the basic information is not necessarily prepared for this purpose. We start with a pure accounting set of information, mixing up cash and non cash accounts and flows.

Moreover, for certain flows, only part of them are to be considered as cash, the other part being also cash but internal to the group.

Building a cash flow statement technically and economically correct remains a difficult exercise that cannot be imagined without a professional consolidation software rich of audit trail functions to help.

Now our final consolidated cash flow statement is obtained.

Is it definitely correct? Yes and no.

| | Conso(1) | Conso(2) |
|--------------------------------|----------|----------|
| Result | (8) | (8) |
| Depreciations | 100 | 100 |
| Gain on disposals | (196) | (196) |
| Cash flow | (104) | (104) |
| Var. Receivables | (1,000) | (1,000) |
| Var. Payables | 1,540 | 1,540 |
| Working capital | 540 | 540 |
| | | |
| Cash from operating activities | 436 | 436 |
| | | |
| Investments | | |
| Tangible assets | (1,700) | (1,700) |
| Financial invest. | (300) | (200) |
| Disinvestments | | |
| Tangible assets | 670 | 670 |
| Financial invest. | 350 | 350 |
| Cash from Inv./Disinv. | (980) | (880) |
| | | |
| Capital increase | 740 | 740 |
| Dividends | (56) | (56) |
| Cash from financial activities | 684 | 684 |
| | | |
| Net cash variation | 140 | 240 |

No because while acquiring company B for a price of 300 as we can see, we acquired also its bank account which was 100 on the day of acquisition.

As we have the control on that company, we could consider that the amount of cash decreases the acquisition price.

In such approach, we would have a financial investment for only (200) and a net cash variation for 240 instead of 140.

Conso (2) is an acceptable presentation with the interesting consequence that the acquisition price being reduced by 100 the impact is a little bit less visible to an external observer.

6.7 Some traps to avoid when producing a consolidated cash flow statement

Obtaining a "successful" cash flow statement in a first blow does not happen really very often and our example from previous section brings some arguments.

We would like to close this chapter with some additional situations each one should be aware of because they can occur even in normal consolidations. They are easy to explain and to understand but the problem mainly comes from the combination of these situations in such a way that it becomes very hard to find our way out.

Let's transform these hidden traps into tips and tricks opportunities.

Unmatched intercompany amounts

In this situation we consider two companies, A and B, having Receivables and Payables intercompany amounts between them.

To make the explanation as clear as possible, we will limit our view to balance sheets consisting only of Receivables and Payables accounts.

Here are their statutory situations.

| Company A | | variation | | Company B | | Year 1 | Cash variation | Year 2 |
|-------------|---|-----------|-----|-----------|-----|--------|----------------|--------|
| Receivables | - | 400 | 300 | 1,000 | | 200 | | 1,200 |
| Payables | - | A | | 900 | 100 | 200 | | 1,100 |

The “-” sign means amounts with 3rd Parties.

In Year 1, Company A has intercompany Receivables with B for 100 and company B has the same amount on the Payables account. These positions are matched.

But in Year 2, the new intercompany amounts are unmatched for a difference of 50, 150 Receivables in A accounts and 100 Payables in B accounts.

PART 3 EVOLUTION OF CONSOLIDATED ACCOUNTS

To analyze the impact on the consolidated cash flow statement, we have to make some assumptions.

We first suppose the group has defined an intercompany materiality threshold

It specifies that all differences less or equal to 50 don't need to be adjusted and so here is what we get at consolidation level.

| Consolidation | Year 1 | Cash variation | Year 2 |
|-----------------------------|------------|----------------|-------------|
| Receivables Link account | 1,300 0 | 450 50 | 1,750 50 |
| Payables | 1,300 | 500 | 1,800 |

We will find the difference on the Link account used during the elimination process (Part 2, Chapter 9).

The flow justifying the evolution of this account is the cash variation. If the Link account is considered as a pure technical account, it is possible that it has been ignored in the parameterization of the cash flow statement report of your consolidation software.

The impact is then very clear: the working capital shows $50 = (450)$ as Receivables + 500 as Payables instead of zero. A technical error or 50 will be detected.

By considering all the accepted differences that could be generated depending on the number of intercompany combinations existing in the group, the net difference will be rather difficult to analyze.

The best option consists in reclassifying these differences

Indeed, we could transfer the 50 amount from the Link account to the consolidated Receivables account as shown here

| Consolidation | Year 1 | Cash variation | Transfer flow | Year 2 |
|---------------|--------|----------------|---------------|--------|
| Receivables | 1,300 | 450 | | 1,750 |
| Link account | 0 | 50 | 50 | 50 |
| Payables | 1,300 | 500 | (50) | (50) |

by using a "transfer" flow. Intercompany closing amounts would now be reconciled correctly but we still remain with a problem on flows because a 'transfer' flow is typically considered as a non cash item. This means that in

the cash flow statement we keep the same situation as in the previous assumption. We solved only half of the problem.

The final good solution is to use a "cash" flow to transfer these 50 from Link account to Receivables account.

Our final conclusion is not to recommend not using materiality thresholds. This is a realistic option, certainly in large groups. Our only recommendation concerns the residual amount on the Link account that should be either transferred by using a "cash" flow or by adding the Link account and the "cash" flows in the cash flow statement report.

This transfer by using a "cash" flow can be on the net difference and company per company.

Disposal of an asset from a company in foreign currency to a company in consolidation currency

Company A, whose accounts are in local currency (CUR), sells a land to company B whose accounts are in consolidation currency (EUR). The transaction doesn't generate any group profit.

| Company A (CUR) | Year 1 [5] | Net variation [7] | Disposal [7] | Year 2 [9] [7] |
|-----------------|---------------|----------------------|-----------------|----------------------|
| Closing rate | | | | |
| Average rate | | | | |
| Land | 100 | | (100) | 0 |
| Cash | 200 | 100 | | 300 |
| Payables | 300 | | | 300 |

| Company B (EUR) | Year 1 | Net Acquisiton variation | Year 2 |
|-----------------|--------|--------------------------|--------|
| Cash | 1,000 | (800) | |
| Payables | 1 000 | | 1 000 |

In the heading of each column, we mention between [] the rates used for currency conversion. Moreover, these accounts show that A is selling the land for an amount of 100 CUR, which is booked in B accounts, after currency translation, for an amount of 800 EUR, corresponding to a day rate.

Of course, once company A accounts are translated into EUR, we get the following situation

PART 3 EVOLUTION OF CONSOLIDATED ACCOUNTS

| Company A (EUR) | Year 1 | Net variation | Disposal | CTA | Year 2 |
|-----------------|--------|---------------|----------|-------|--------|
| Land | 500 | | (700) | 200 | 0 |
| Cash | 1,000 | 700 | | 1,000 | 2,700 |
| Payables | 1,500 | | | 1,200 | 2,700 |

and if we accept these figures as they are, the consolidated situation of these two companies gives

| Consolidation | Year 1 | Net variation | Acquisiton Disposal | CTA | Year 2 |
|---------------|--------|---------------|------------------------|-------|--------|
| Land | 500 | | 100 | 200 | 800 |
| Cash | 2,000 | (100) | | 1,000 | 2,900 |
| Payables | 2,500 | | | 1,200 | 3,700 |

Because that transaction is internal to the group, we have to net the "Acquisition" and "Disposal" flows and this is where we see that we have a problem with a remaining amount of 100 that should be 0.

We could accept it as it is, but the cash flow statement would show

- An acquisition of 100 that has no economic background, even if it would be technically correct. This amount of 100 has to be reclassified as a currency translation amount (CTA).
- A cash impact of (100) and no cash transaction happened with the outside world.

These two amounts must be reclassified as CTA as indicated in bold figures hereunder

| Consolidation | Year 1 | Net variation | Acquisiton Disposal | CTA | Year 2 |
|---------------|--------|---------------------|------------------------|-----------------------|--------|
| Land | 500 | | 100 (100) | 200 100 | 800 |
| Cash | 2,000 | (100) 100 | | 1,000 (100) | 2,900 |
| Payables | 2,500 | | | 1,200 | 3,700 |

With this example, one can see that the total variation of CTA assets equals the total variation of CTA liabilities before and after adjustment. It is one issue to keep under control. Any difference between these two amounts would put the cash flow statement out of balance.

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Payment of a dividend by a company in foreign currency

This situation is quite similar to the previous one.

We consider a foreign company A (currency CUR) paying a dividend and this is reflected in the following accounts limited to the ones strictly necessary for our explanations.

| Company A (CUR) | Year 1 [5] [6] | Net variation [7] | Dividends paid [6] | Transfer [6] | Year 2 [8] [7] |
|-----------------|----------------------|----------------------|-----------------------|-----------------|----------------------|
| Cash | 200 | (40) | | | 160 |
| Reserves | 200 | | (40) | 160 | 160 |
| Result | | | (160) | 0 | 0 |

We see the dividends paid in cash is 40 CUR.

The particular issue we have here is that, in consolidation, the currency translation process translates the "Dividends" flow at average rate of Year 1 while the "cash" flow is translated at average rate of Year 2.

The reason to proceed this way has been explained in Part 2 – Chapter 6.

| Company A (EUR) | Year 1 | Net variation | Dividends paid | Transfer | CTA | Year 2 |
|-----------------|--------|---------------|----------------|----------|-----|--------|
| Cash | 1,000 | (280) | | | 560 | 1,280 |
| Reserves | | | | 960 | | 960 |
| Result | 1,200 | | (240) | (960) | 0 | 0 |
| CTA | (200) | | | | 520 | 320 |

In the accounts translated in EUR here above we can immediately notice that something is wrong by the fact that the total of CTA assets is not equal to the total of CTA liabilities.

Moreover, to be consistent, the value of the dividends translated at average rate Year 1 should be the expected cash out, which is not the case.

Again, a consolidation adjustment should reclassify some CTA on flow amounts as hereunder

PART 3 EVOLUTION OF CONSOLIDATED ACCOUNTS

| Company A | Year 1 | Net variation | Dividends paid | Transfer | CTA | Year 2 |
|-----------|--------|--------------------|----------------|----------|--------------------|--------|
| Cash | 1,000 | (280) 40 | | | 560 (40) | 1,280 |
| Reserves | | | | 960 | | 960 |
| Result | 1,200 | | (240) | (960) | 0 | 0 |
| CTA | (200) | | | | 520 | 320 |

In order to avoid such adjustment, we would recommend to foresee a "Dividends paid" flow on the cash or cash equivalent account and to add a validation between this flow and the corresponding dividends flow in equity.

This feature can easily be developed in a consolidation bundle.

Dividends paid to indirect 3rd Parties

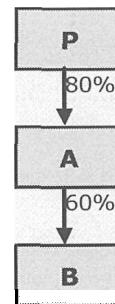
The problem we want to highlight happens in this group structure where we suppose company B is paying a dividend of 100.

The 3rd Parties percentage of B is the addition of direct 3rd Parties for 40% and indirect 3rd Parties, through A, for 12% = 20% * 60% in B.

We say that the indirect 3rd Parties percentage is then 52%.

Let's suppose the following equity situation of company B

| | Year 1 | Div.- | Year 2 |
|--------------------|--------|-------|------------|
| Equity | 1,000 | (100) | 900 |
| Minority interests | 520 | (52) | 468 |



which decreases from 1000 to 900 by dividends for 100.

The consolidation process calculates the minority interests of 52% in each amount of the line and we use it in one of the notes to the accounts to justify the evolution of this item.

On the other hand, we know that in the cash flow statement we have to show the dividends paid to 3rd Parties as being classically equal to the 3rd Parties percentage times the "Dividends" flow amount, so (52).

And this will lead to a cash flow statement with an error.

Let's "think" cash.

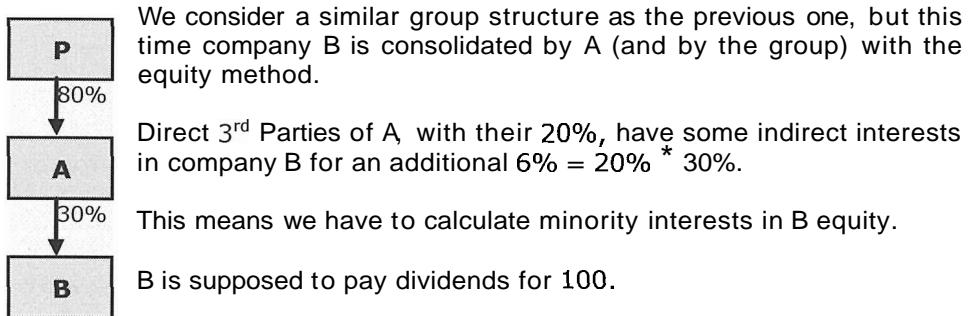
DIRECT CONSOLIDATION

When company B pays its dividends, $40 = 40\% * 100$ goes (definitely) to the bank account of the direct 3rd Parties and $60 = 60\% * 100$ goes to the bank account of company A. This company being consolidated with the global method, these 60 are integrated at 100% in the final consolidated accounts.

The conclusion is that the cash flow statement should show a payment to 3rd Parties for only 40 and not 52.

Our recommendation here should be to check how this event has been parameterized in your consolidation software. Not sure it is correctly done...

Dividends paid to indirect 3rd Parties through an equity method company



Here is its equity evolution limited to these dividends.

| | Year 1 | Divid. | Year 2 |
|--------------------|--------|--------|--------|
| Equity | 1,000 | (100) | 900 |
| Minority interests | 60 | (6) | 54 |

Again, one of the notes to the accounts requires justifying the minority interests evolution and here above is the company B contribution to this note.

But we must closely check that the amount of (6) is not imported also in the cash flow statement as well as dividends paid to 3rd Parties, which would be wrong.

Thinking cash again, company B pays a dividend of 100, 30 being transferred to the bank account of A fully consolidated, and 70% being paid to the other shareholders of B.

The amount of 6 has no economical signification and should not appear in the cash flow statement. The amount of 30 is not cash because B is consolidated

PART 3 EVOLUTION OF CONSOLIDATED ACCOUNTS

by the equity method, but 30 will appear as cash in paid by an equity method in the consolidated accounts.

Finally, this 30 amount will be the only impact of company B in the cash flow statement.

Differences on opening reserves

The reasons of this situation and the way to adjust it have been explained in Part 2 – Chapter 8.11. But there is a little trap behind when we try to build a cash flow statement.

Here are the accounts of a company in the situation of a difference on opening reserves.

| Company A | Year 1 | Diff. on opening | Transfer | Net variation | Year 2 |
|-----------|--------|------------------|----------|---------------|--------|
| Cash | 160 | | | 70 | 230 |
| Reserves | 80 | (10) | 30 | | 100 |
| Result | 30 | | (30) | | 0 |
| Payables | 50 | 10 | | 70 | 130 |

When receiving the Year 2 figures, we expect Reserves to be $110 = 80 + 30$, and we find only 100. The reason is that after reporting Year 1 figures to the consolidation office, company A had to book a purchase invoice for 10 corresponding to costs of sales.

The bundle received for Year 2 is correct, showing a difference on opening not only on the Reserves account but also on the Payables account.

Of course, we have to book a consolidation adjustment impacting this Year 2 result for a debit of 10 on Cost of sales account and a credit on the Reserves account. In most consolidation software, the booking of adjustments requires to book also some flows for balance sheet accounts. In this example, we book the "Difference on opening" flow of the Reserves account.

| | Flow | Debit | Credit |
|---------------|------------------|-------|--------|
| Cost of sales | | 10 | |
| Reserves | Diff. on opening | | 10 |

Here is the impact of this adjustment limited to the balance sheet accounts

DIRECT CONSOLIDATION

| Company A | Year 1 | Diff. on opening | Transfer | Year 2 result | Net variation | Year 2 |
|-----------|--------|------------------|----------|---------------|---------------|--------|
| Cash | 160 | | | | 70 | 230 |
| Reserves | 80 | (10) | 30 | | | 100 |
| Result | 30 | 10 | (30) | | | 10 |
| Payables | 50 | 10 | | (10) | 70 | 0 |
| | | | | | | (10) |
| | | | | | | 130 |

and, starting from this information, we show what would be the effect in the cash flow statement.

| | |
|---------------------------------|------|
| | (1) |
| Result | (10) |
| ... | |
| Cash flow | (10) |
| Variation of Receivables | |
| Variation of Payables | 70 |
| Working capital | 70 |
| Operating cash | 60 |
| ... | |
| Net cash variation | 60 |
| | |
| Cash variation in balance sheet | 70 |

A difference of 10 between the net cash variation of 60 deduced from the cash flow statement and the cash variation in balance sheet of 70.

This indicates there is an error somewhere.

Indeed, our adjustment should be completed as follows with a reclassification of flows on the Payables account.

| | Flow | Debit | Credit |
|------------------|------|-------|--------|
| Cost of sales | | 10 | |
| Reserves | | | 10 |
| Payables | | 10 | |
| Payables | | | 10 |
| Diff. on opening | | | |
| Diff. on opening | | | |
| Net variation | | | |

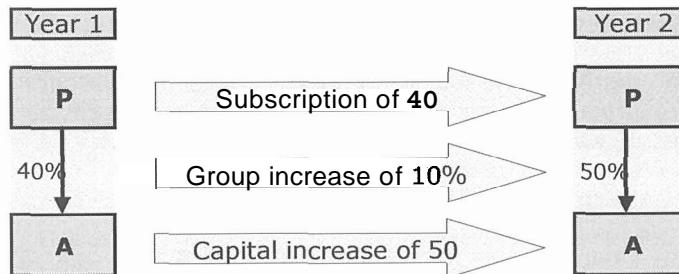
| Company A | Year 1 | Diff. on opening | Transfer | Year 2 result | Net variation | Year 2 |
|-----------|--------|------------------|----------|---------------|---------------|--------|
| Cash | 160 | | | | 70 | 230 |
| Reserves | 80 | (10) | 30 | | | 100 |
| Result | 30 | 10 | (30) | | | 10 |
| Payables | 50 | 10 | | | 70 | 0 |
| | | (10) | | | 10 | (10) |
| | | | | | | 130 |
| | | | | | | 0 |

By booking like this we get the following accounts with the corresponding correct cash flow statement.

| | (1) | (2) |
|--|-----------|-----------|
| Result | (10) | (10) |
| ... | | |
| Cash flow | (10) | (10) |
| Variation of Receivables | | |
| Variation of Payables | 70 | 80 |
| Working capital | 70 | 80 |
| Operating cash | 60 | 70 |
| ... | | |
| Net cash variation | 60 | 70 |
| Cash variation in balance sheet | 70 | 70 |

Increase in capital depending on the consolidation methods

In Year 1, the parent company P consolidates a company A at 40% by the equity method.



On January 1st, Year 2, company A increases its capital by 50 for which P subscribes 40 and the 3rd Parties 10. By subscribing in a proportion different from the existing percentages, the participation of P is increasing by 10%. We should normally study this increase of capital based on the number of shares but for the scope of this case, it brings nothing additional.

When we look at a consolidation software, we usually find two flows impacting the cash flow statement

- The amount of capital the group subscribes, that is $40 = 100\% * 40$ which represents a cash out for P
- The amount of capital maintained in the group as being $25 = 50\% * 50$

DIRECT CONSOLIDATION

giving a net impact of $(15) = (40) + 25$.

This amount is either correct or not depending on the consolidation method defined for Year 2 as shown hereunder

| | Global integration | Proportional integration | Equity method |
|------------------|--------------------|--------------------------|----------------|
| Subscription | (40) | (40) | (40) |
| Capital increase | $50 = 100\% * 50$ | $25 = 50\% * 50$ | $0 = 0\% * 50$ |
| | 10 | (15) | (40) |

Again, we have to think cash.

For the global integration method, the bank account of A is integrated at 100% of its value in the consolidated figures and the net impact of the capital increase is the cash of 10 brought by the 3rd Parties.

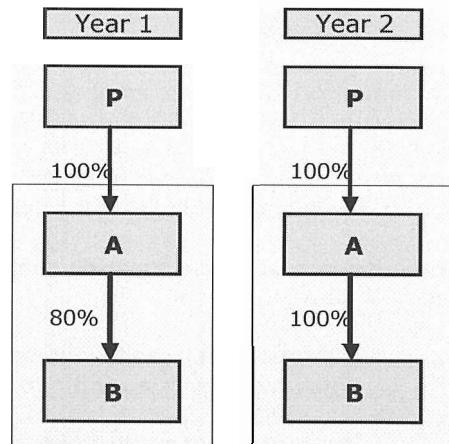
For the proportional integration method, the bank account of A is integrated at 50% of its value in the consolidated figures and the net impact of the capital increase is now (15), a negative amount. The group gives 40 but receives only 25 in return.

For the equity method, the bank account of A is not integrated in the consolidated figures and the net impact of the capital increase is zero. The group gives 40 and receives nothing in return.

Acquisition of shares through state consolidation

Parent company P consolidates its group on the basis of the consolidated figures A + B and the only transaction in Year 2 is the acquisition of the remaining 20% of shares of company B.

Supposing company P is not informed of that acquisition and supposing also that the subgroup A + B does not provide a cash flow statement, then we would only see the following two changes



PART 3 EVOLUTION OF CONSOLIDATED ACCOUNTS

| | A + B | | | | |
|----------|-------|-----|---------|-----|-----|
| | 0 | 10 | Capital | 200 | 200 |
| Goodwill | | | RC(B) | 0 | 0 |
| Cash | 220 | 190 | MI(B) | 20 | 0 |

- A new goodwill of 10
- Minority interests disappearing from 20 to 0

Of course, with such simple accounts, one can also observe a cash variation of (30), but this would be impossible to detect for a larger group with many transactions.

Building a cash flow statement in this situation would not be possible. We definitely need a cash flow statement for the stage A+B showing the price paid for this 20% shares acquisition.

Going back to our simple example, we can say that by knowing the goodwill of 10 and the minority interests variation of (20), we could "guess" the acquisition price by subtracting one by the other $30 = 10 - (20)$.

If not convinced, then let's go back to some fundamentals

$$\text{Additional goodwill} = \text{Price} - (1 - \text{Group\%}) * \text{Equity}$$

$$\text{Minority interests variation} = -(1 - \text{Group\%}) * \text{Equity}$$

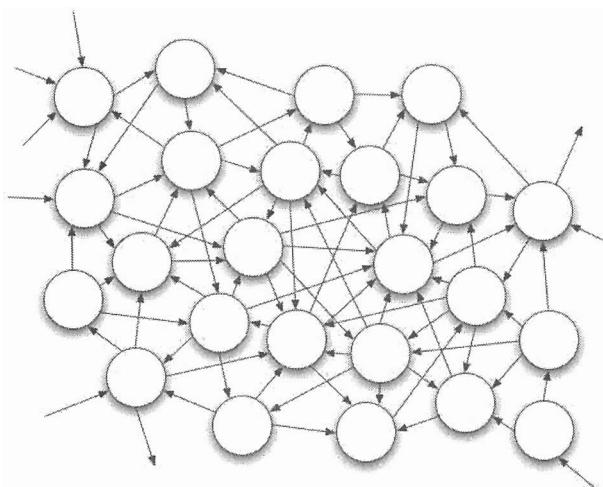
and subtracting the second from the first, we get

$$\text{Additional goodwill} - \text{Minority interests variation} = \text{Price}$$

This approach is really not recommended because it includes a high level of risk to be wrong. The only issue is to receive a cash flow statement from that stage.

BART 4

SPECIAL CONSOLIDATION TOPICS



This Part 4 analyzes situations that don't occur each year in the consolidation of a group. However, from time to time, they really happen and then they are sometimes rather difficult to solve.

Moreover, the situation is sometimes getting more complex by the fact that several events are combined together.

The situations we analyze in this Part 4 are kept separate in order to give a complete and clear solution for each one.

If more than one event happens during the same consolidation period, we recommend solving them sequentially.

For each individual situation, it is sometimes worth extracting the case from the reality of the group and transforming it into a "school-case" with easier figures, simple percentages (without decimals) and a limited number of accounts. Most of the time, solving the case within one consolidation period will not guarantee the solution. The experience shows that it is much more useful to first consolidate a situation before the particular transaction and then to consolidate just after the transaction by justifying both the Equity and the Minority interests evolutions. A cash flow statement can also be useful in some situations.

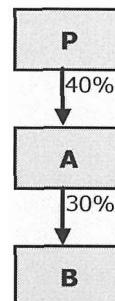
That's the methodology we will adopt for most of the cases analyzed in this Part 4.

UNUSUAL GROUP STRUCTURES

1.1 Chain of equity method companies

In this group companies A and B are consolidated by the equity method because none of them is controlled by the group.

As in the previous section, we will process the consolidation by using first the stage technique and then the direct technique in order to identify possible traps.



State consolidation technique

Here are the accounts of companies A and B, A being considered temporarily as the consolidating company.

| A | | | B | | |
|--------------|-----|-------------------|-----|-------------------|-----|
| Fin. Inv./B | 50 | Capital | 200 | | |
| | | Reserves | 100 | Reserves | |
| | | Result | 30 | Result | 20 |
| Other assets | 550 | Other liabilities | 270 | Other assets | 500 |
| | | | | Other liabilities | 300 |

| A + B | | |
|--------------|----------|-------------------|
| | Capital | 200 |
| | Reserves | 100 |
| Equity value | 60 | Result |
| | | 30 |
| | | Conso. Res. |
| | | 10 |
| | | Minority int. |
| | | 0 |
| Other assets | 550 | Other liabilities |
| | | 270 |

where

- Consolidated reserves = $10 = 30\% * [100 + 80 + 20] - 50$
- Equity value = $60 = 30\% * [100 + 80 + 20]$
- Other assets and liabilities are those of A because of the equity method applied to B

Now we consolidate A+B in P by the equity method with a percentage of 40%.

| P | | |
|--------------|-------|-------------------|
| Fin. Inv.A | 100 | Capital |
| | | Reserves |
| | | Result |
| Other assets | 1,400 | Other liabilities |
| | | 650 |

| P + [A + B] | | |
|-------------------|----------|-------------------|
| | Capital | 500 |
| | Reserves | 300 |
| Equity value(A+B) | 136 | Result |
| | | 50 |
| | | Conso. Res. |
| | | 36 |
| Other assets | 1,400 | Other liabilities |
| | | 650 |

where

- Consolidated reserves = $36 = 40\% * [200 + 100 + 30 + 10] - 100$
- Equity value (A+B) = $136 = 40\% * [200 + 100 + 30 + 10]$
- Other assets and liabilities are those from P only because of the equity method applied to A and B

DIRECT CONSOLIDATION

So, nothing particular in this process.

Direct consolidation technique

By consolidating now carefully with the direct technique, we get the following consolidated accounts

| P + A + B | | | |
|------------------|----------|-------------------|-----|
| | Capital | 500 | |
| | Reserves | 300 | |
| Equity value (A) | 112 | Result | 50 |
| Equity value (B) | 24 | Conso. Res.(A) | 32 |
| | | Conso. Res.(B) | 4 |
| Other assets | 1,400 | Other liabilities | 650 |

where

- Consolidated reserves (A) = 32 = 40% * [200 + 100 + 30] - 100
- Consolidated reserves (B) = 4 = 12% * [100 + 80 + 20] - 40% * 50
- Equity value (A) = 112 = 40% * [200 + 100 + 30] - 40% * 50
- Equity value (B) = 24 = 12% * [100 + 80 + 20]

On the Consolidated reserves side, nothing new to explain. We just apply the well-known formulas.

On the Equity values side, two remarks must be mentioned

- First, the percentage used to evaluate the equity is the group percentage. We could say it is the integration percentage but the 3rd Parties percentage being zero, group and integration percentages are equal.
- Second, for company A, the equity value is calculated on what is called the "net equity" which is the equity less the financial investments in the consolidated companies.

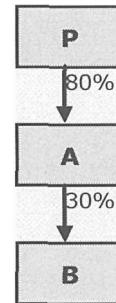
When taking into account these two remarks, we get the same consolidated accounts as those obtained by the stage technique.

1.2 Equity method company owned by a global integration company

We consider the following group where parent company P owns 80% of shares of company A which is consolidated by the global integration method.

This company owns 30% of shares of company B for which the equity method will be applied.

We will first consolidate the structure by the stage technique, considering company A as a consolidating company and B being consolidated by the equity method with 30%.



Once consolidated figures A+B are produced, company P will consolidate them by the global integration method.

This process can be done without questioning ourselves about possible mistakes. It is rather easy, with no traps.

Then, we will proceed the consolidation again by using the direct technique, but at the same time we will give some information to avoid some traps in this case.

Stage consolidation technique

We start by considering companies A and B accounts

| | A | | B | |
|--------------|-----|-------------------|-----|-------------------|
| Fin. Inv./B | 50 | Capital | 200 | |
| | | Reserves | 100 | Capital |
| | | Result | 30 | Reserves |
| Other assets | 550 | Other liabilities | 270 | Result |
| | | | | Other assets |
| | | | | 500 |
| | | | | Other liabilities |
| | | | | 300 |

and by consolidating them we get

| | A + B | |
|--------------|-------|-------------------|
| | | Capital |
| | | 200 |
| | | Reserves |
| | | 100 |
| | | Result |
| | 60 | 30 |
| Equity value | | Conso. Res. |
| | | 10 |
| | | Minority int. |
| | | 0 |
| Other assets | 550 | Other liabilities |
| | | 270 |

where

- Consolidated reserves = $10 = 30\% * [100 + 80 + 20] - 50$

DIRECT CONSOLIDATION

- Minority interests are 0 because B is an equity method company
- Equity value = $60 = 30\% * [100 + 80 + 20]$
- Other assets and liabilities are those from A because of the equity method

by just applying the definitions we have explained in Part 2.

We can now consolidate one stage higher, at company P level, with the following accounts

| P | | |
|--------------|-------|-----------------------|
| Fin. Inv./A | 150 | Capital 500 |
| | | Reserves 300 |
| | | Result 50 |
| Other assets | 1,350 | Other liabilities 650 |

giving the final consolidated accounts

| P + [A + B] | | |
|--------------|-------|-----------------------|
| | | Capital 500 |
| | | Reserves 300 |
| Equity value | 60 | Result 50 |
| | | Conso. Res. 122 |
| | | Minority int. 68 |
| Other assets | 1,900 | Other liabilities 920 |

where

- Consolidated reserves = $122 = 80\% * [200 + 100 + 30 + 10] - 150$
- Minority interests = $68 = 20\% * [200 + 100 + 30 + 10]$
- Equity value, other assets and other liabilities are now processed as usual by the global integration method.

So, nothing special to say about this stage technique that works perfectly well.

Direct consolidation technique

This consolidation technique requires to be more careful.

First, we have to calculate the indirect financial percentage for companies A and B which are respectively 80% for A and $24\% = 80\% * 30\%$ for B. That's indeed the percentage we will use to calculate the group part in the Equity of company B.

PART 4 SPECIAL CONSOLIDATION TOPICS

On the other hand, let's take temporarily the place of the 3rd Parties which are present as shareholders of company A. It is clear that the value of their shares depends on 30% of the value of B. Moreover, if B paid dividends, these 3rd Parties would receive indirectly $6\% = 20\% * 30\%$ of them.

That means we have to consider the existence of a minority interest percentage of 6% in company B, besides the fact that this company is consolidated with the equity method.

Here are the consolidated accounts by applying the direct technique and we can see there are the same as the ones we obtained by the stage consolidation.

| | | P + A + B | |
|--------------|-------|-------------------|-----|
| Equity value | 60 | Capital | 500 |
| | | Reserves | 300 |
| | | Result | 50 |
| | | Conso. Res.(A) | 114 |
| | | Conso. Res.(B) | 8 |
| | | Minority int. (A) | 56 |
| Other assets | 1,900 | Minority int. (B) | 12 |
| | | Other liabilities | 920 |

Here are the corresponding comments

- Consolidated reserves (A) = 114 = 80% * [200 + 100 + 30] - 150
- Consolidated reserves (B) = 8 = 24% * [100 + 80 + 20] - 80% * 50
- Minority interests (A) = 56 = 20% * [200 + 100 + 30] - 20% * 50
- Minority interests (B) = 12 = 6% * [100 + 80 + 20]
- Equity value = 60 = [24% + 6%] * [100 + 80 + 20]

The Consolidated reserves of B are calculated with the indirect financial percentage in the equity and the financial percentage in A, just as explained in Part 2.

Minority interests in A are calculated on the basis of its equity less the financial investments.

The equity value of company B is calculated on the basis of its equity in which we apply the indirect financial percentage (24%) plus the 3rd Parties percentage (6%).

The addition of both percentages is called the integration percentage, which is equal to 30%. This definition is to be compared to a global integration

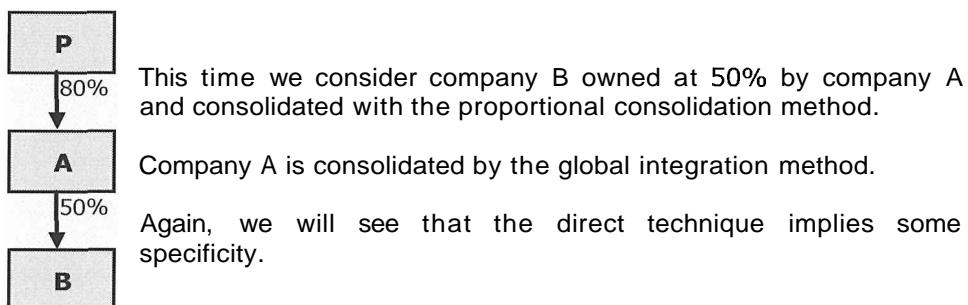
company for which we apply also an integration percentage on all assets and liabilities. This integration percentage is 100% equal to the group percentage plus the 3rd Parties percentage.

What happens if we don't apply this particularity?

The consolidated accounts will remain in balance and unfortunately we will not get a red light saying something is wrong.

However the balance sheet will contain two errors, an equity value equal to $48 = 24\% * 200$ instead of 60, so a difference of 12, and minority interests missing these 6% and equal to 12, so the same difference on both sides of the balance sheet.

1.3 Proportional integration company owned by a global integration method company



State consolidation technique

We start by consolidating company B by the proportional method in company A on the basis of the following statutory accounts

| | A | | B | |
|--------------|-----|--|------------------|---|
| Fin. Inv./B | 50 | Capital 200 Reserves 100 Result 30 | | Capital 100 Reserves 80 Result 20 |
| Other assets | 550 | Other liabilities 270 | Other assets 500 | Other liabilities 300 |

| | | A + B |
|--------------|-----|--|
| | | Capital 200 Reserves 100 Result 30 Conso. Res. 50 |
| Other assets | 800 | Other liabilities 420 |

where

- Consolidated reserves = $50 = 50\% * [100 + 80 + 20] - 50$
- Other assets = $800 = 550 + 50\% * 500$
- Other liabilities = $420 = 270 + 50\% * 300$

We then consolidate A + B in P by the global integration method on the basis of the following statutory accounts for P

| P | | |
|--------------|-------|-----------------------|
| Fin. Inv./A | 200 | Capital 500 |
| | | Reserves 300 |
| | | Result 50 |
| Other assets | 1,300 | Other liabilities 650 |

giving

| P + [A + B] | | |
|--------------|------------------|-------------------------|
| | Capital 500 | |
| | Reserves 300 | |
| | Result 50 | |
| | Conso. Res. 104 | |
| | Minority int. 76 | |
| Other assets | 2,100 | Other liabilities 1,070 |

with

- Consolidated reserves = $104 = 80\% * [200 + 100 + 30 + 50] - 200$
- Minority interests = $76 = 20\% * [200 + 100 + 30 + 50]$
- Other assets and liabilities are just the addition of corresponding accounts

Direct consolidation technique

The group percentage of company B is $40\% = 80\% * 50\%$ and, like the previous equity method case, the 3rd Parties with their 20% in company A have also a financial interest in B for $10\% = 20\% * 50\%$.

The same principle applies here by calculating an integration percentage for company B equal to group percentage (40%) + 3rd Parties percentage (10%).

By doing this we get the following consolidated accounts

DIRECT CONSOLIDATION

| P + A + B | |
|-------------------|-------|
| Capital | 500 |
| Reserves | 300 |
| Result | 50 |
| Conso. Res.(A) | 64 |
| Conso. Res.(B) | 40 |
| Minority int.(A) | 56 |
| Minority int.(B) | 20 |
| Other assets | 2,100 |
| Other liabilities | 1,070 |

in which

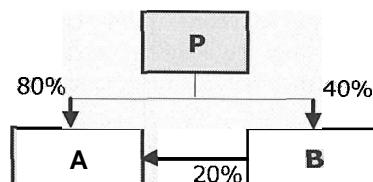
- Consolidated reserves(A) = 64 = 80% * [200 + 100 + 30] - 200
- Consolidated reserves(B) = 40 = 40% * [100 + 80 + 20] - 80% * 50
- Minority interests(A) = 56 = 20% * [200 + 100 + 30] - 20% * 50
- Minority interests(B) = 20 = 10% * [100 + 80 + 20]
- Other assets = 2100 = 1300 + 550 + 50% * 500
- Other liabilities = 1070 = 650 + 270 + 50% * 300

The conclusion is similar to the one concerning company B as an equity method company. There are minority interests to calculate in the equity of B and again, we have to consider the integration percentage as 40% + 10%.

If we forget these 10% of Minority interests and, if in the same time, we apply the proportional method with 40% instead of 50%, the consolidated balance sheet will be in balance and no "red light" will tell something is wrong.

1.4 An equity method company owns shares of a global integration method company

This case considers company A consolidated with the global integration method and company B with the equity method. Moreover, B owns 20% shares of A.



The consolidation of this structure will show how easy it is to apply the direct technique while the stage technique brings some difficulties.

We will start by using the direct technique.

Direct consolidation technique

We provide the statutory accounts of each company, reflecting the above structure

| P | | |
|--------------|-------|-----------------------|
| Fin. Inv./A | 200 | Capital 500 |
| Fin. Inv./B | 70 | Reserves 300 |
| | | Result 50 |
| Other assets | 1,230 | Other liabilities 650 |

| A | | |
|--------------|-----|-----------------------|
| | | Capital 200 |
| | | Reserves 100 |
| | | Result 30 |
| Other assets | 600 | Other liabilities 270 |

| B | | |
|--------------|-----|-----------------------|
| Fin. Inv./A | 50 | Capital 100 |
| | | Reserves 80 |
| | | Result 20 |
| Other assets | 450 | Other liabilities 300 |

which are followed immediately by the consolidated figures and the necessary comments relevant to the direct technique used. Of course, it will be noticed that the indirect percentage in A is $88\% = 80\% + 40\% * 20\%$ and so 12% of 3rd Parties percentage. Company B is consolidated by the equity method with a percentage of 40%.

| P + A + B | | |
|-----------------|-------|-----------------------|
| | | Capital 500 |
| | | Reserves 300 |
| Equity value(B) | 60 | Result 50 |
| | | Conso. Res.(A) 70.4 |
| | | Conso. Res.(B) 10 |
| | | Minority int.(A) 39.6 |
| Other assets | 1,830 | Other liabilities 920 |

- Consolidated reserves (A) = $70.4 = 88\% * [200 + 100 + 30] - 200 - 40\% * 50$
- Consolidated reserves (B) = $10 = 40\% * [100 + 80 + 20] - 70$
- Minority interests (A) = $39.6 = 12\% * [200 + 100 + 30]$
- Equity value (B) = $60 = 40\% * [100 + 80 + 20 - 50]$

DIRECT CONSOLIDATION

For this last account, we consider the net equity of company B which is the equity less the financial investments in consolidated companies.

Stage consolidation technique

The difficult issue with this structure is not the fact that company B is consolidated by the equity method. The real problem is the difficulty to identify stages in this structure.

The stage technique approach supposes to consolidate two companies at a time, starting from the bottom of the structure until we remain with the parent company only.

We could start with P and A and then P and B but then we would remain with a 20% participation from B into A not consolidated. But what can we do else?

Let's try the following.

Stage 1 : P consolidates 80% of A by the global integration method

This consolidation produces the following consolidated accounts

| P + 80% A | | |
|--------------|-------|-----------------------|
| Fin. Inv./B | 70 | Capital 500 |
| | | Reserves 300 |
| | | Result 50 |
| | | Conso. Res.(A) 64 |
| | | Minority int.(A) 66 |
| Other assets | 1,830 | Other liabilities 920 |

where

- Consolidated reserves (A) = 64 = 80% * [200 + 100 + 30] - 200
- Minority interests (A) = 66 = 20 * [200 + 100 + 30]

And of course, these consolidated accounts still contain the financial investment on company B for 70.

Stage 2 : B consolidates 20% of A by the equity method

| B + 20% A | | |
|-----------------|-----|-----------------------|
| Equity value(A) | 66 | Capital 100 |
| | | Reserves 80 |
| | | Result 20 |
| | | Conso. Res.(A) 16 |
| Other assets | 450 | Other liabilities 300 |

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No particular problem with this consolidation where

- Consolidated reserves (A) = $16 = 20\% * [200 + 100 + 30] - 50$
- Equity value (A) = $66 = 20\% * [200 + 100 + 30]$

State 3 : [P+80%A] consolidates 40% of [B+20%A] by the equity method

And again nothing particular in this final consolidated balance sheet

| [P + 80% A] + 40% [B + 20% A] | | |
|-------------------------------|-------|--------------------------|
| | | Capital 500 |
| | | Reserves 300 |
| Equity value(B+20%A) | 86.4 | Result 50 |
| | | Conso. Res.(A) 64 |
| | | Conso. Res.(B+20%A) 16.4 |
| | | Minority int.(A) 66 |
| Other assets | 1,830 | Other liabilities 920 |

where

- Consolidated reserves (A) are just coming from the "pre" consolidated figures of [P+80%A]. They are part of the consolidating entity reserves.
- Consolidated reserves (B+20%A) = $16.4 = 40\% * [100 + 80 + 20 + 16] - 70$
- Equity value (P+80%A) = $86.4 = 40\% * [100 + 80 + 20 + 16]$

But this final consolidated balance sheet is not the same as the one produced by the direct technique!

The difference on the equity value is 26.4 higher and the minority interests are also higher for the same amount, but even if the consolidated reserves are the same with an amount of 80.4.

Which approach is wrong ?

Let's consider first the Minority interests account.

The group has an indirect financial percentage of 88% in company A which is controlled and as such, consolidated by the global integration method. This gives 12% of minority interests. In the stage 1 approach, we have considered a global integration of A with 80%. So 8% of company A equity are given to the 3rd Parties instead of keeping them on group side and

$$8\% * [200 + 100 + 30] = 26.4$$

which is the explanation of the difference on that account.

A similar error appears for the equity value account because we consider indirectly $8\% = 40\% * 20\%$ of the company A as a contribution to that account. This is too much and the equity value should be limited to 40% of company B net equity. It is of course the same amount.

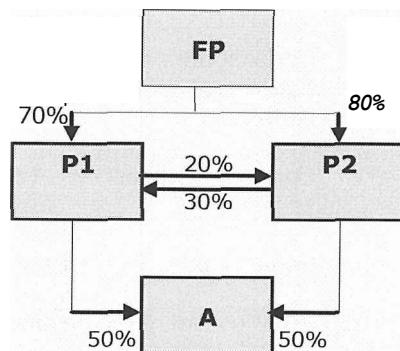
This simple group structure, without complex crossed participation, shows how weak can be the stage technique by leading to wrong consolidated figures.

1.5 Consolidation of a consortium

A consortium group has already been defined in Part 2 Section 3.7. However, our objective in this section is to show how to consolidate such particular structure on a basis of an existing situation we met earlier.

Initially, there are two companies P1 and P2 controlled by the same physical persons. P1 and P2 are both groups of companies.

The situation we met was unfortunately a little bit more complex because P1 and P2 were owning together 100% of a common company A. Moreover, there were also crossed participations between P1 and P2 as shown in the following structure. We already presented the consortium with a "fictitious" parent company FP.



This group will be consolidated over Year 1 (column 1) and Year 2 (column 2) on the basis of the following statutory accounts.

Looking at the equity of each company, we confirm

- Company P1 is paying a dividend of 10
- Company P2 is paying a dividend of 20
- Company A is paying a dividend of 30

And that's the reason why we already booked consolidation adjustments to eliminate group dividends.

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| | | | P1 | | |
|--------------|-----|-----|-------------------|-------------|------------|
| Fin. Inv./P2 | 40 | 40 | Capital | 100 | 100 |
| Fin. Inv./A | 50 | 50 | Reserves | 0 | 10 |
| | | | | 15 | 4 |
| | | | Result | 20 | 40 |
| | | | | (15) | (4) |
| Other assets | 110 | 210 | Other liabilities | 80 | 150 |

| | | | P2 | | |
|--------------|-----|-----|-------------------|-------------|------------|
| Fin. Inv./P1 | 30 | 30 | Capital | 200 | 200 |
| Fin. Inv./A | 50 | 50 | Reserves | 0 | 10 |
| | | | | 15 | 3 |
| | | | Result | 30 | 25 |
| | | | | (15) | (3) |
| Other assets | 320 | 420 | Other liabilities | 170 | 265 |

| | | | A | | |
|--------------|-----|-----|-------------------|-----|-----|
| | | | Capital | 100 | 100 |
| | | | Reserves | 0 | 10 |
| | | | Result | 40 | 25 |
| Other assets | 300 | 400 | Other liabilities | 160 | 265 |

Now we have to build the balance sheet of the fictitious company FP keeping in mind that the capital of a consortium is the sum of the capital amount of each parent of the consortium, so $300 = 100 + 200$.

On the assets side, we will balance that capital with financial investments on P1 and P2 by considering the percentage owned and acting on the corresponding capital. This means the financial investment on P1 will be $70 = 70\% * 100$ and on P2 $160 = 80\% * 200$.

Of course, we are not in balance. The special approach is to qualify the missing 70 as own shares at consortium level. It is indeed shares parent companies owned on themselves.

Here is that balance sheet.

| | | | FP | | |
|--------------|-----|-----|---------|-----|-----|
| Fin. Inv./P1 | 70 | 70 | Capital | 300 | 300 |
| Fin. Inv./P2 | 160 | 160 | | | |
| Own shares | 70 | 70 | | | |

Before consolidating, we need to calculate the indirect financial percentages in each company. This is not really an issue in this case because all the shares of

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each company are owned by the group. There are no 3rd Parties and so we can consider 100% for each company.

Consolidated balance sheet

Nothing special makes the process difficult and the consolidated balance sheets is the following

| | | | p1 + p2 + A | |
|--------------|-----|-------|--------------------|---------|
| | | | Capital | 300 300 |
| | | | Reserves | 0 0 |
| | | | Result | 0 0 |
| | | | Conso. Res.(P1) | 20 50 |
| | | | Conso. Res.(P2) | 30 35 |
| Own shares | 70 | 70 | Conso. Res.(A) | 40 35 |
| Other assets | 730 | 1,030 | Other liabilities | 410 680 |

Comments for Year 1

- Consolidated reserves (P1) = 20 = 100% * [100 + 0 + 20] - 70 - 30
- Consolidated reserves (P2) = 30 = 100% * [200 + 0 + 30] - 160 - 40
- Consolidated reserves (A) = 40 = 100% * [100 + 0 + 40] - 50 - 50

Comments for Year 2

- Consolidated reserves (P1) = 50 = 100% * [100 + 10 + 15 + 4 + 40 - 15 - 4] - 70 - 30
- Consolidated reserves (P2) = 35 = 100% * [200 + 10 + 15 + 3 + 25 - 15 - 3] - 160 - 40
- Consolidated reserves (A) = 35 = 100% * [100 + 10 + 25] - 50 - 50

Consolidated reserves evolution

| | Year 1 reserves | Year 2 result | Dividends - | Dividends + | Dividends out | Year 2 reserves |
|----|--------------------|------------------|----------------|----------------|------------------|--------------------|
| FP | 0 | 0 | | 16+7 | (23) | 0 |
| P1 | 20 | 21 | (10) | 15+4 | | 50 |
| P2 | 30 | 7 | (20) | 15+3 | | 35 |
| A | 40 | 25 | (30) | | | 35 |
| | 90 | 53 | (60) | 60 | (23) | 120 |

This

report shows the four companies, including the fictitious parent company and is structured as explained in Part 2 and Part 3.

The only issue concerns the dividends. We first show correctly all dividends paid and received for a total of (60) and 60. However, the 23 received by FP are mentioned as 'Dividends out' in an appropriate column because it represents a cash amount that is leaving the group.

A final remark can be made about the booking of the owned shares of 70 as they should be transferred in equity when consolidating under IFRS rules. Depending on Local Gaap, maintaining the 70 as an asset can be acceptable.

2 CAPITAL TRANSACTIONS

2.1 Capital increase with a change of financial percentage during the consolidation period

We first consider a parent company P owning 100% of the shares of a company A. If A decides to increase its capital by 100, P will subscribe this amount and nothing will happen in the consolidation. The consolidated reserves of A become $100\% * \text{equity before increase} + 100 - (\text{financial investment} + 100)$ and the 100 has no impact.

Considering the cash flow statement, we have also seen that 100 is just moving from P bank account to A bank account. Both being consolidated, no cash impact will appear.

Now, if P owns only 80% of A but the capital increase is subscribed by both P and the 3rd Parties in the proportion of 80% and 20%, again such situation will have no impact on the consolidated reserves for the same reason as above. On the cash flow statement side, we notice a cash in for $20 = 20\% * 100$.

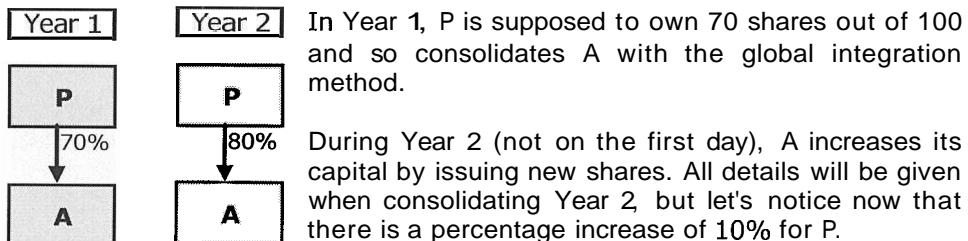
However, other situations become a little more difficult, mainly for the two following reasons

- P, owning 80% of A, agrees to subscribe the capital increase but the 3rd Parties deny. This will imply a percentage variation if P subscribes the total amount of capital increase on its own.
- If that capital increase, with a percentage variation, occurs during the consolidation period, and not on the first day, the group profit of the year of company A must be calculated with the percentage 'before'

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and 'after'. We need to know the results before and after capital increase. Of course, this will apply for significant amounts.

The case we analyze hereunder includes these two issues.



Situation before capital increase - Year 1

Company A has been founded by company P a few years ago. Its capital is represented by 100 shares. Here are the statutory accounts of these companies.

| | | P | |
|--------------|-------|-------------------|-----|
| Fin. Inv./A | 140 | Capital | 500 |
| | | Reserves | 300 |
| | | Result | 50 |
| Other assets | 1,360 | Other liabilities | 650 |

| | | A | |
|--------------|-----|-------------------|-------|
| | | Capital | 200 |
| | | Retained earn. | (100) |
| | | Result | (20) |
| Other assets | 500 | Other liabilities | 420 |

We notice that the equity of A becomes bad. Normally, P should book a write-off on its participation but, in order to keep things simple, we will ignore it. Anyway, in consolidation, such write-off will be reversed.

Consolidated figures are presented below

| | | P + A | |
|--------------|-------|-------------------|-------|
| | | Capital | 500 |
| | | Reserves | 300 |
| | | Result | 50 |
| | | Conso. Res.(A) | (84) |
| | | Minority int.(A) | 24 |
| Other assets | 1,860 | Other liabilities | 1,070 |

where

- Consolidated reserves (A) = $(84) = 70\% * [200 + (100) + (20)] - 140$
- Minority interests = $24 = 30\% * [200 + (100) + (20)]$

Situation after capital increase - Year 2

Here are the statutory accounts of each company, already including the consolidation adjustments, which are commented just after

| P | | | |
|--------------|-------------|-------------------|-----|
| Goodwill | 13 | Capital | 500 |
| Fin. Inv./A | 240 | Reserves | 350 |
| | (13) | Result | 40 |
| Other assets | 1,360 | Other liabilities | 710 |

| A | | | |
|--------------|----------------|-------------------|-----|
| | Capital | 235 | |
| | Share premium | 65 | |
| | Retained earn. | (120) | |
| | (1)* | | |
| | Result | 10 | |
| | | 1* | |
| Other assets | 700 | Other liabilities | 510 |

Let's suppose the capital increase occurs on the 1st of July, Year 2. For the first six months of the year, A makes a loss of 10 and for the last six months A makes a profit of 20. This explains a profit of 10 for the twelve months fiscal year.

On that date, the total equity of A is $70 = 200 - 100 - 20 - 10$ represented by 100 existing shares. One existing share equals thus 0.7. The company decides to increase its capital by an amount of 100, issuing 50 new shares for the value of 0.7, so 35 and the remaining 65 is booked as a share premium. This explains the two first accounts of the A equity.

What is the financial percentage owned in A after capital increase?

Before capital increase, P owned 70 shares out of 100 shares issued and after it owns $120 = 70 + 50$ shares out of $100 + 50$ shares issued. This means the percentage is now $80\% = 120 / 150$.

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Let's look now at the consolidation adjustments.

Goodwill

Each time a variation of percentage happens, we should trigger a goodwill/badwill logic as follows.

On June 30, Year 2, company P owns an equity equal to $49 = 70\% * [200 + (100) + (20) + (10)]$.

On July 1, Year 2, company owns an equity equal to $136 = 80\% * [200 + 35 + 65 + (120) + (10)]$.

This means P has a "gain" in equity for $87 = 136 - 49$, but on the other side, P has subscribed the capital increase for 100.

Difference between 100 and 87, that is 13, is to be considered as a goodwill.

Correction of the group part in the result of company A

Without specifying anything, most of the consolidation software knows the opening and the closing situations. That means that the A profit of 10 being done over twelve months, the corresponding group part will be calculated with the 80%, giving 8. This is not correct.

For the first six months of Year 2, A makes a loss of (10) and the group interest is $(7) = 70\% * (10)$ and for the last six months its group interest is $16 = 80\% * 20$. So, the correct group result is $9 = (7) + 16$ instead of $8 = 80\% * 10$.

The complete consolidation adjustment would be the following.

| | Debit | Credit |
|--------------------|-------|--------|
| Reserves | 1 | |
| Result | | 1 |
| Minority result | 1 | |
| Minority interests | | 1 |

This adjustment must be considered as impacting each account at 100%. That's the meaning of the * against the amounts in the page before.

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And here are the consolidated accounts

| | | P + A | |
|--------------|-------|-------------------|-------|
| Goodwill | 13 | Capital | 500 |
| | | Reserves | 350 |
| | | Result | 40 |
| | | Conso. Res.(A) | (75) |
| | | Minority int.(A) | 38 |
| Other assets | 2,060 | Other liabilities | 1,220 |

where

- Consolidated reserves (A) = $(75) = 80\% * [235 + 65 + (120) + 10] + (1) + 1 - [240 + (13)]$
- Minority interests (A) = $38 = 20\% * [235 + 65 - 120 + 10] + 1 + (1)$

We will conclude by justifying the consolidated reserves evolution of the group

| | Year 1 reserves | Year 2 result | Dividends - | Dividends + | Dividends P | Year 2 reserves |
|---|--------------------|------------------|----------------|----------------|----------------|--------------------|
| P | 350 | 40 | | | | 390 |
| A | (84) | 9 | | | | (75) |
| | 266 | 49 | 0 | 0 | 0 | 315 |

and the minority interests

| | Year 1 reserves | Year 2 result | % Var | Year 2 reserves |
|---|--------------------|------------------|-------|--------------------|
| A | 24 | 1 | 13 | 38 |
| | 24 | 1 | 13 | 38 |

This "% Var" says that the 3rd Parties make a gain of 13 in equity.

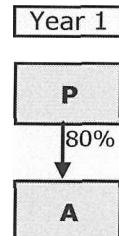
Indeed, before the capital increase, they were owning $21 = 30\% * [200 + (100) + (20) + (10)]$ and after capital increase they own $34 = 20\% * [235 + 65 + (100) + (20) + (10)]$. The difference is $13 = 34 - 21$ which is ... the goodwill of course.

2.2 Dividends paid by issuing new shares

Parent company P owns 800 shares of company A whose capital is represented by 1000 shares issued. So P consolidates A by the global integration method with a percentage of 80%.

At the end of Year 1, company A decides to pay dividends and proposes two options to its shareholders

- Either they receive a gross dividend of 0.4 per share
- Or they accept to receive new shares after transferring these dividends to the capital by issuing new shares based on 1 new share received for 4 existing shares and by paying an additional price of 0.2 per new share. Of course, this option implies an increase in capital.



Company P chooses the second option whilst 3rd Parties ask to receive the cash corresponding to their dividends.

Let's see how to consolidate this situation by first considering Year 1 before the transaction and then Year 2 after the transaction.

Consolidation - Year 1

We need this first year consolidation to be able to study the evolution of group equity and Minority interests.

Here are the statutory accounts of companies P and A

| | P | | A | |
|--------------|-------|-------------------|-------|-------------------|
| Fin. Inv./A | 2,000 | Capital | 2,000 | Capital |
| | | Reserves | 1,000 | Reserves |
| | | Result | 500 | Result |
| Other assets | 3,000 | Other liabilities | 1,500 | Other assets |
| | | | | 2,000 |
| | | | | Other liabilities |
| | | | | 400 |

and the corresponding consolidated accounts

| P + A | | |
|--------------|------------------|-------------------|
| | Capital | 2,000 |
| | Reserves | 1,000 |
| | Result | 500 |
| | Conso. Res.(A) | (720) |
| | Minority int.(A) | 320 |
| Other assets | 5,000 | Other liabilities |
| | | 1,900 |

where

- Consolidated reserves (A) = $(720) = 80\% * [1000 + 800 + (200)] - 2000$
- Minority interests (A) = $320 = 20\% * [1000 + 800 + (200)]$

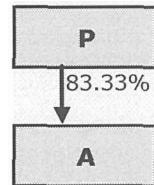
so, a consolidation without any difficulties.

Consolidation – Year 2

This consolidation is not as easy as the previous one.

First, we have to calculate the new financial percentage owned by company P.

Initially, P owns 800 existing shares and the dividends transaction proposes to receive 1 new share against 4 existing shares. There will be 200 new shares fully owned by P, giving a new percentage of $83.33\% = (800 + 200) / (1000 + 200)$.



We now show the statutory accounts of each company, already including statutory bookings related to the dividends and the necessary consolidation adjustments.

| P | | |
|--------------------|--|-------------------------|
| Goodwill | | Capital 2,000 |
| (b) 20 | | Reserves 1,200 |
| (c) (20) | | (a) 320 |
| Fin. Inv./A 2,000 | | Result 80 |
| (1) 360 | | (1) 320 |
| (b) (20) | | (a) (320) |
| | | (c) (20) |
| Other assets 3,680 | | Other liabilities 2,400 |
| (1) (40) | | |

| A | | |
|--------------------|-------------------------|--|
| | Capital 1,000 | |
| | (3) 320 | |
| | Share premium (4) 40 | |
| | Reserves 600 | |
| | (2) (80) | |
| | (3) (320) | |
| Other assets 4,400 | Result 100 | |
| (2) (80) | | |
| (4) 40 | Other liabilities 2,700 | |

Let's understand the statutory bookings first

In company P, booking (1) shows there is a profit (financial income) for 320 corresponding to the 80% of the gross dividends of 400 proposed by A. But A pays also 0.2 per each new share, so $40 = 0.2 * 200$ which represents a cash payment (Other assets).

The total of $360 = 320 + 40$ is booked as a debit on the financial investment.

In company A, booking (2) shows the $80 = 20\% * 400$ cash paid to 3rd Parties as dividends.

Booking (3) shows that the dividends for company A, that is $320 = 80\% * 400$, are transferred from Reserves account to Capital account.

Booking (4) is related to the additional payment of 40 which is considered as a Share premium. We could also book it on the Capital account and it would make no difference from a consolidation point of view.

There are also consolidation adjustments to book in company P

Adjustment (a) eliminates the financial income corresponding to the dividends for an amount of 320, just as we would do for normal dividends as discussed in Part 2.

Adjustment (b) needs some explanations because of a percentage variation.

The approach we apply works perfectly well each time there is such variation.

First we calculate the group equity before the transaction, that is

$$80\% * [1000 + 800 + (200) + (400)] = 960$$

As equity, we consider Year 1 closing equity which is decreased by the 400 dividends that are processed separately.

Then we calculate the same group equity after the transaction

$$83.33\% * [1320 + 40 + 600 + (400)] = 1300$$

giving an increase of $340 = 1300 - 960$.

Of course, the financial investment in P on A has been increased by 360.

Let's go back to the logic of a normal company acquisition where we compare the price to acquire and the group equity, which gives a goodwill or a badwill.

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In this case, we have a goodwill for 20.

Adjustment (c) : Decision has been taken to fully book this goodwill on P&L, because of low materiality.

Here are now the consolidated accounts

| P + A | | |
|--------------|------------------|-------------------|
| | Capital | 2,000 |
| | Reserves | 1,520 |
| | Result | 60 |
| | Conso. Res.(A) | (957) |
| | Minority int.(A) | 277 |
| Other assets | 8,000 | Other liabilities |
| | | 5,100 |

where

- Consolidated reserves (A) = $(957) = 83.33\% * [1320 + 40 + 200 + 100] - [2000 + 360 + (20)]$
- Minority interests (A) = $277 = 16.67\% * [1320 + 40 + 200 + 100]$

In such consolidation, we recommend to justify at least the evolution of both group reserves and minority interests.

Group reserves evolution

We show the justification report hereunder whose content comes immediately from the consolidated figures above.

| | Year 1 reserves | Year 2 result | Dividends | Dividends + | Dividends P | Year 2 reserves |
|---|-----------------|---------------|-----------|-------------|-------------|-----------------|
| P | 1,500 | 60 | | 320 | (300) | 1,580 |
| A | (720) | 83 | (320) | | | (957) |
| | 780 | 143 | (320) | 320 | (300) | 623 |

Maybe just one comment: parent company P pays dividends for 300 to their shareholders. This information can be found in its statutory accounts.

Minority interests evolution

Here is the report

| | Year 1 reserves | Year 2 result | Dividends - | % var(1) | % var(2) | Year 2 reserves |
|---|-----------------|---------------|-------------|----------|----------|-----------------|
| A | 320 | 17 | (80) | (40) | 60 | 277 |
| | 320 | 17 | (80) | (40) | 60 | 277 |

which requires some additional comments for the "% var" columns, the other columns not needing comments.

% var(1) shows the variation of 3rd Parties percentage in the opening equity of Year 2 as

$$(40) = [16.67\% - 20\%] * [1000 + 800 + (200) + (400)]$$

% var(2) shows the 3rd Parties interests in the capital increase as

$$60 = 16.67\% * [320 + 40]$$

Notice that $20 = (40) + 60$ is the goodwill recognized in the consolidation.

But why do we have a goodwill on such capital increase? Was it expected?

This goodwill is a consequence of the additional price which should have been a refund of 80 instead of a payment of 40.

Before the transaction, we have seen that the equity was 1200 for 1000 shares issued, so 1.2 per share.

The transaction itself concerns 200 shares for a value of $360 = 320 + 40$, which gives a value of 1.8 per share. If, above the dividend of 320, company A would have refund 80, the value of one new share would have been $1.2 = (320 - 80)/200$.

Finally, on this revisited basis, the total equity becomes $1440 = 1200 + 240$ for 1200 shares, existing and new, giving a value of $1.2 = 1440 / 1200$ per share equal to the value of a share before the transaction.

2.3 Dividends paid on the basis of different types of shares representing the capital

When increasing its capital, a company can decide to issue new shares with special dividends. The capital is then represented by different categories of shares.

If the basic rules of consolidation apply to such dividends when eliminating them, the percentage owned by the shareholders may be different in each

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shares category which means that the part of result becomes more difficult to calculate.

Let's explain this with the following case study.

Description of a situation

We suppose parent company P is creating a new company A at the beginning of Year 1. Its capital is represented by two different categories of shares as shown hereunder, each share having a value of 1.

| Shareholders | Parent | 3rd Parties |
|-------------------|--------|-------------|
| Ordinary shares | 200 | 800 |
| Privileged shares | 1,000 | 0 |
| Total | 1,200 | 800 |
| Net percentage | 60% | 40% |

Shares of each category have voting rights.

The specific situation is that company A will pay each year dividends equal to 5% of the corresponding capital of 1000, so 50. If for cash reasons, company A is not able to pay these dividends at the end of a certain year, it is carried forward in a cumulative way and paid the next year.

For the analysis of our case study, we will limit our view to only equity accounts and study the consolidated reserves evolution.

The statutory accounts

We can see that parent company P is paying dividends of 100 at the end of Year 1 and Year 2.

| | Parent company P | | | Company A | | |
|----------|------------------|--------|--------|-----------|--------|--------|
| | Year 1 | Year 2 | Year 3 | Year 1 | Year 2 | Year 3 |
| Capital | 1,000 | 1,000 | 1,000 | 2,000 | 2,000 | 2,000 |
| Reserves | 800 | 900 | 1,000 | 0 | (100) | 30 |
| Result | 200 | 200 | 300 | (100) | 300 | 150 |

At the end of Year 1, company A makes a loss and, of course, the ordinary shares will give no dividends.

For the privileged shares, on the contrary, company A has no choice: a dividend of 50 must be paid to the shareholders. However, its cash situation being bad, these dividends will be paid at the end of Year 2 if the situation improves in the meantime.

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At the end of Year 2, company A is able to pay the 50 related to Year 1 and the dividends of 50 related to Year 2, both concerning the privileged shares. Moreover, A decides also to pay a dividend of 0.07 per ordinary shares, so $14 = 0.07 * 200$ to A and $56 = 0.07 * 800$ to the 3rd Parties.

The financial investment on company A in parent company P accounts can be deducted from the above information as $1200 = 200$ ordinary shares of value 1 + 1000 privileged shares of value 1.

Consolidated equity – Year 1, Year 2 and Year 3

Hereunder we present the consolidated equity and, on two lines, the group and the 3rd Parties result.

| | Year 1 | Year 2 | Year 3 |
|-----------------------|--------|--------|--------------|
| Capital | 1,000 | 1,000 | 1,000 |
| Reserves | 800 | 900 | 1,000 |
| | | | 114 |
| Result | 200 | 200 | 300 |
| | | | (114) |
| Consolidated reserves | (60) | 120 | 108 |
| Minority interests | 760 | 880 | 872 |
| Group result | 140 | 380 | 276 |
| 3rd Parties result | (40) | 120 | 60 |

For Year 1

- Consolidated reserves = $(60) = 60\% * [2000 + (100)] - 1200$
- Minority interests = $760 = 40\% * [2000 + (100)]$
- Group result = $140 = 200 + 60\% * (100)$
- 3rd Parties result = $(40) = 40\% * (100)$

Let's notice that the consolidated reserves for this first year are equal to the group result in company A.

For Year 2

- Consolidated reserves = $120 = 60\% * [2000 + (100) + 300] - 1200$
- Minority interests = $880 = 40\% * [2000 + (100) + 300]$
- Group result = $380 = 200 + 60\% * 300$
- 3rd Parties result = $120 = 40\% * 300$

For Year 3

During this Year 3, parent company P receives the dividends of 50 attached to the privileged shares of Year 1 and Year 2 and a dividend of 14 attached to the ordinary shares.

This financial income, for a total of 114, is eliminated in parent company P in the usual way.

- Consolidated reserves = $108 = 60\% * [2000 + 30 + 150] - 1200$
- Minority interests = $872 = 40\% * [2000 + 30 + 150]$
- Group result = $276 = 300 + (114) + 60\% * 150$
- 3rd Parties result = $60 = 40\% * 150$

Consolidated reserves evolution

Analyzing Year 2 with regard to Year 1, nothing special needs to be commented.

| | Year 1 reserves | Year 2 result | Dividends - | Dividends + | Dividends P | Year 2 reserves |
|---|--------------------|------------------|----------------|----------------|----------------|--------------------|
| P | 1,000 | 200 | | | (100) | 1,100 |
| A | (60) | 180 | | | | 120 |
| | 940 | 380 | 0 | 0 | (100) | 1,220 |

But when we do the same analysis for Year 3 with regard to Year 2, we get

| | Year 2 reserves | Year 2 result | Dividends - | Dividends + | Dividends P | Year 3 reserves |
|---|--------------------|------------------|----------------|----------------|----------------|--------------------|
| P | 1,100 | 186 | | 114 | (100) | 1,300 |
| A | 120 | 90 | (114) | | | 108 |
| | 1,220 | 276 | (114) | 114 | (100) | 1,408 |

showing a problem on the line corresponding to company A. An amount of 12 is not justified.

This problem appears because we consolidate with a unique percentage of 60% but in fact there are two percentages, 20% and 100%, depending on the shares categories.

In each consolidation, we systematically make a mistake on the group part in the result.

The reserves and result of previous year contain the future dividends that are calculated as 60% for the group. At the end of Year 2, the total dividends that

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will be paid is $170 = 50 + 50 + 70$ and we consider $102 = 60\% * 170$ to be received by P.

The cash situation is different. The group receives $114 = 50 + 50 + 20\% * 70$ and the 3rd Parties receive in cash $56 = 80\% * 70$ instead of $68 = 40\% * 170$ as calculated in the consolidation process.

So, the group should receive 12 more and the 3rd Parties 12 less and therefore the following consolidation adjustment needs to be booked in company A account.

| | Debit | Credit |
|--------------------|-------|--------|
| Reserves | 12 | |
| Group result | | 12 |
| 3rd Parties result | 12 | |
| Minority interests | | 12 |

This adjustment impacts all accounts with 100% of the amount.

Notice also that this adjustment has no impact on consolidated reserves and on minority interests, but only on the group result and the 3rd Parties result by applying a simple transfer for the amount of 12. No other accounts in the P&L are concerned by that adjustment.

Finally, the correct consolidated reserves evolution is the following

| | Year 2 reserves | Year 2 result | Dividends - | Dividends + | Dividends P | Year 3 reserves |
|---|-----------------|---------------|-------------|-------------|-------------|-----------------|
| P | 1,100 | 186 | | 114 | (100) | 1,300 |
| A | 120 | 102 | (114) | | | 108 |
| | 1,220 | 288 | (114) | 114 | (100) | 1,408 |

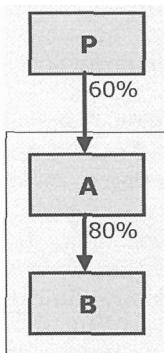
Can this problem be avoided ?

Yes, indeed because each year, we calculate a wrong contribution to the result. The adjustment booked once dividends are paid could be booked preventively at the end of each consolidation.

IN/OUT CONSOLIDATION SCOPE

3.1 Acquisition of a subgroup

On January 1, company P acquires 60% of company A which owns subsidiary B. This company has been founded by company A a few years ago. In such situation, we say that company P acquires a subgroup.



There are some important questions to consider before consolidating this subgroup for the first time

Which accounts do we receive (or accept) ? If A already consolidates since a number of years, it could indeed be interesting or easy to accept consolidated accounts for the subgroup A+B instead of consolidating individually these two new companies.

If we integrate A+B consolidated accounts, are we sure the consolidation has been made with respect to the evaluation rules issued at company P level. P consolidation could be IFRS but not A+B, or the opposite.

Supposing the evaluation rules are the same, there is a history in A+B. Initial goodwill, revaluation of some assets, new provisions, translation adjustments, ... all booked through consolidation adjustments. Is it normal to take over all these adjustments in group P consolidation? Not sure at all!

Moreover, we lose some transparency because the contribution in consolidated information will show A+B but not A and B individually.

By consolidating that subgroup for the first time, the goodwill or badwill will be naturally calculated on A+B consolidated equity.

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If there is a goodwill, such a "black box" will make difficult to book an allocation of this goodwill on some assets in A which are consolidated with those of B.

A final question under this assumption is to know what could be the future of company B. If the interesting company for group P is A, company B could be disposed to 3rd Parties in a short term. Integrating consolidated A+B figures should then be avoided.

If we consolidate individual accounts, goodwill/badwill calculated separately on A and B wouldn't be correct because there is a unique transaction to acquire a subgroup and not two companies.

Whether we consolidate companies A and B on a direct basis or not, with a unique goodwill/badwill, we would recommend to split the value on A and B in case company B is disposed and not A.

A last comment concerns the possibility that company P acquires shares of company B, taking a direct participation. This would not be advisable, but we never now. Supposing we consolidate on the A+B consolidated basis, this new group structure would become difficult to manage because we would know the value of the financial investment from P into B without knowing the exact value of the equity of B, hidden in A+B.

We will solve our case study by integrating separately companies A and B.

Adjusted statutory accounts of each company

Let's consider the statutory accounts already adjusted with the goodwill.

| | | P | |
|--------------|--------------|-------------------|-------|
| Goodwill | | Capital | 3,000 |
| (a) | 102 | Reserves | 1,000 |
| (b) | 42 | | |
| Fin. Inv./A | 1,500 | Result | 200 |
| (a) | (102) | | |
| (b) | (42) | | |
| Other assets | 4,500 | Other liabilities | 1,800 |

| | | A | |
|--------------|-------|-------------------|-------|
| Fin. Inv./B | 800 | Capital | 2,000 |
| | | Reserves | 500 |
| | | Result | 100 |
| Other assets | 4,200 | Other liabilities | 2,400 |

| B | |
|--------------------|-------------------------|
| | Capital 1,000 |
| | Reserves (300) |
| | Result (100) |
| Other assets 3,000 | Other liabilities 2,400 |

Goodwill calculation

The goodwill is the difference between the acquisition price, 1500, and the consolidated equity of the subgroup.

The calculation is detailed here.

| | |
|--------------------------|-------|
| <u>Acquisition price</u> | 1,500 |
| Equity (A) | 2,500 |
| Consolidated reserves B | |
| E uit A+B | |
| Grou. % ac_uired | 60% |
| Grou. e uit, ac_uired | |
| <u>Goodwill</u> | 144 |

For information, $(240) = 80\% * [1000 + (300)] - 800$.

This goodwill is then split into two parts, one related to A and one related to B in case of selling B separately. The criteria to use has to be proposed and accepted by the Auditors and, in our case, we would weight the goodwill according to the net equity of A and B as follows

- Opening net equity of A = $1700 = 2500 - 800$
- Opening net equity of B = 700

giving a total net equity of 2400 and so

- Goodwill attached to A = $102 = 144 * (1700 / 2400)$
- Goodwill attached to B = $42 = 144 * (700 / 2400)$

which explains consolidation adjustments (a) and (b).

Consolidated accounts of the subgroup

| | P + A + B | |
|--------------|-----------|-------------------------|
| Goodwill | 144 | Capital 3,000 |
| | | Reserves 1,000 |
| | | Result 200 |
| | | Conso. Res.(A) 204 |
| | | Conso. Res.(B) (192) |
| | | Minority int.(A) 720 |
| | | Minority int.(B) 312 |
| Other assets | 11,700 | Other liabilities 6,600 |

where

- Consolidated reserves (A) = 204 = 60% * [2000 + 500 + 100] - [1500 + (144)]
- Consolidated reserves (B) = (192) = 48% * [1000 + (300) + (100)] - 60% * 800
- Minority interests (A) = 720 = 40% * [2000 + 500 + 100 + (800)]
- Minority interests (B) = 312 = 52% * [1000 + (300) + (100)]

As explained in Part 2, consolidated reserves of a new company entering the consolidation scope are equal to the group part in the result since that date. In the case of a subgroup, this property doesn't apply individually to each company, but on the subgroup figures.

Indeed, the total of A and B consolidated reserves is equal to 12 = 204 + (192) which corresponds to the group part in the profit of A, 60 = 60% * 100, added to the group part in the loss of B, (48) = 48% * (100).

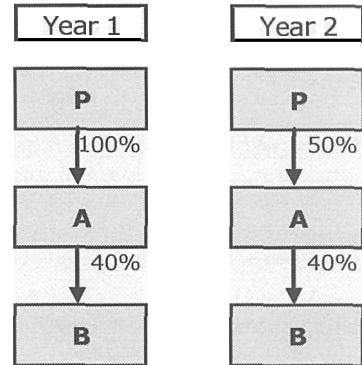
3.2 Disposal of a subgroup

Without any specific assumptions, this case study may look rather similar to the subgroup acquisition case seen before. That's the reason why we are going to add some complexity.

This subgroup has been acquired in Year 0 with a goodwill (for both companies) of 360, after having allocated part of it on a tangible asset in company A for a gross amount of 500.

It has been decided to depreciate the goodwill over a period of 5 years and its allocation over a period of 10 years.

Until Year 1, company A is consolidated by the global integration method and company B by the equity method.



On January 1st Year 2, a new law requires company P to sell 50% of its participation in company A to some state partner. Before closing the transaction, company A pays dividends to company P equal to its Year 1 result, so 200.

Of course, the disposal of these 50% shares of A for a price of 1300 implies the selling of part of the subgroup A+B. Consolidation method for company A becomes the proportional method whilst B remains consolidated with the equity method.

We will consolidate Year 1 and Year 2 and will justify the group equity and 3rd Parties variation.

Consolidation - Year 1

We propose to consider equity accounts with all the consolidation adjustments already included.

| | | P | |
|--------------|-------|-------------------|-------|
| Goodwill | | Capital | 1,500 |
| (a) | 360 | Reserves | 500 |
| (b) | (144) | (b) | (72) |
| Fin. Inv./A | 2,000 | Result | 300 |
| (a) | (360) | (b) | (72) |
| Other assets | 3,000 | Other liabilities | 2,700 |

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| A | | | |
|-----------------|-------|-------------------|-------|
| Fin. Inv./B | 500 | Capital Reserves | 1,000 |
| Tangible assets | 1,000 | (c) | 500 |
| (c) | 500 | (d) | (50) |
| (d) | (100) | Result | 200 |
| Other assets | 1,500 | (d) | (50) |
| | | Other liabilities | 1,300 |

| B | | | |
|--------------|-------|-------------------|-------|
| | | Capital Reserves | 1,000 |
| | | Result | 500 |
| Other assets | 2,000 | Other liabilities | 200 |
| | | | 300 |

Adjustment (a): Gross goodwill as calculated in Year 0 when acquiring the subgroup. This goodwill is unique for both companies A and B.

Adjustment (b): Cumulated depreciations on the goodwill. 20% in Year 0 booked on the Reserves account and 20% in Year 1 booked in the P&L.

Adjustment (c): Revaluation of tangible assets, corresponding to a partial allocation of the goodwill.

Adjustment (d): Cumulated depreciations of the revaluation as 10% booked on the Reserves account and 10% booked in the P&L.

Here are the consolidated accounts

| P + A + B | | | |
|------------------|-------|-------------------|-------|
| Goodwill | 216 | Capital | 1,500 |
| | | Reserves | 428 |
| Tangible assets | 1,400 | Result | 228 |
| | | Conso. Res.(A) | 460 |
| Equity value (B) | 680 | Conso. Res.(B) | 180 |
| Other assets | 4,500 | Other liabilities | 4,000 |

where

- Consolidated reserves (A) = $460 = 100\% * [1000 + 500 + 500 + (50) + 200 + (50)] - [2000 + (360)]$
- Consolidated reserves (B) = $180 = 40\% * [1000 + 500 + 200] - 100\% * 500$
- Equity value (B) = $680 = 40\% * [1000 + 500 + 200]$

In this consolidation, there are no 3rd Parties.

Consolidation – Year 2

Again, we first consider the adjusted statutory accounts of each company

| | | P | |
|--------------|-------|-------------------|-------|
| Goodwill | | Capital | 1,500 |
| (a) | 180 | Reserves | 800 |
| (b) | (72) | (b) | (72) |
| (e) | (36) | (f) | 200 |
| | | (g) | 148 |
| Fin. Inv./A | 1,000 | Result | 300 |
| (a) | (180) | (e) | (36) |
| | | (f) | (200) |
| | | (g) | (148) |
| Other assets | 3,000 | Other liabilities | 1,400 |

| | | A | B |
|-----------------|-------|-------------------|-------|
| Fin. Inv./B | 500 | Capital | 1,000 |
| | | Reserves | 500 |
| Tangible assets | 900 | (c) | 500 |
| (c) | 500 | (d) | (100) |
| (d) | (150) | Result | 100 |
| | | (d) | (50) |
| Other assets | 1,700 | Other assets | 2,200 |
| | | Other liabilities | 1,500 |
| | | Capital | 1,000 |
| | | Reserves | 700 |
| | | Result | 300 |
| | | Other liabilities | 200 |

with the following remarks from a statutory point of view

- The financial investment on company A in company P accounts is now equal to 1000 after a disposal of 1000 for a price of 1300 leading to a statutory gain of 300
- Company P pays no dividends
- As said above, company A pays dividends of 200, 100% of these dividends are booked as a financial income in company P accounts
- The tangible assets that have been revaluated are still in company A accounts
- Company B pays no dividends.

Let's analyze the consolidation adjustments.

Adjustment (a): The initial gross goodwill of 360 attached to the 100% shares is now reduced by 50% and so becomes equal to 180.

Adjustment (b): By the end of Year 1, the cumulated depreciations of that goodwill were (144) and now we keep only 50% of this amount.

Adjustment (c): Revaluation of a tangible asset for 500. This amount has to be maintained unchanged, regardless the consolidation method that is now

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changing from global to proportional integration. A change of consolidation method doesn't affect the economical view of reevaluating that asset.

Adjustment (d): Of course, depreciation continues to be applied to that revaluation on a 10% per year basis.

Adjustment (e): We have seen that the Year 2 net opening goodwill is 108. Moreover, it remains three years of depreciation still remain, so 36 per year.

Adjustment (f): The 200 dividends booked as financial income must be eliminated in the classical way against the reserves.

Adjustment (g): This adjustment concerns the disposal of the 50% shares of company A and requires some explanations.

In statutory accounts, company P has made a gain of $300 = 1300$ (selling price) - 1000 (shares value in statutory accounts).

In consolidation, the gain is calculated as the difference between that selling price and the group part of consolidated equity disposed. Moreover, we also have to consider as an expense the part of the goodwill attached to these shares, so $108 = 50\% * [360 + (148)]$.

Group part of consolidated equity disposed

This value is given by the following calculation, based on January 1st, Year 2 equity. The consolidated reserves of B are $180 = 40\% * [1000 + 700] - 500$.

| | |
|----------------------------|-------|
| Adjusted equity of A | 1,900 |
| Consolidated reserves of B | 180 |
| Total equity | 2,080 |
| % disposed | 50% |
| Equity disposed | 1,040 |

Compared to the selling price of 1300, there is a gain of $260 = 1300 - 1040$ in consolidation. But the net goodwill attached to the shares disposed cannot remain as an asset and must be booked in the P&L, reducing the gain by 108, giving a net gain of $152 = 260 - 108$.

So we have to adjust the statutory gain by (148) to show the consolidation gain as $152 = 300 + (148)$.

Here are finally the consolidated accounts

| P + A + B | | | |
|------------------|-------|-------------------|-------|
| Goodwill | 72 | Capital | 1,500 |
| | | Reserves | 1,076 |
| Tangible assets | 625 | Result | (84) |
| | | Conso. Res.(A) | 155 |
| Equity value (B) | 400 | Conso. Res.(B) | 150 |
| Other assets | 3,850 | Other liabilities | 2,150 |

where

- Consolidated reserves (A) = $155 = 50\% * [1000 + 500 + 500 + 100 + (100) + (50)] - [1000 + (180)]$
- Consolidated reserves (B) = $150 = 20\% * [1000 + 700 + 300] - 50\% * 500$
- Equity value (B) = $400 = 20\% * [1000 + 700 + 300]$
- Other assets = $3850 = 3000 + 50\% * 1700$
- Other liabilities = $2150 = 1400 + 50\% * 1500$

Consolidated reserves evolution

| | Year 1 reserves | Year 2 result | Dividends - | Dividends + | Transfers | Dividends P | Year 2 reserves |
|---|-----------------|---------------|-------------|-------------|-----------|-------------|-----------------|
| P | 656 | (84) | | 200 | 220 | 0 | 992 |
| A | 460 | 25 | (200) | | (130) | | 155 |
| B | 180 | 60 | | | (90) | | 150 |
| | 1,296 | 1 | (200) | 200 | 0 | 0 | 1,297 |

The only issue we want to point out concerns the transferred amounts. We find here the same property as when the group sells a single company: the consolidated reserves attached to the shares disposed are transferred to the company selling these shares.

Considering here shares related to a subgroup doesn't change this property.

The amount of (130) concerning company A corresponds to $50\% = 50\%/100\%$ of its consolidated reserves after having paid the 200 dividends, so $(130) = 50\% * [460 + (200)]$.

The amount of 90 concerning company B corresponds to $50\% = 20\%/40\%$ of its consolidated reserves of 180.

These two amounts are transferred to company P for a total of 220.

All the other figures are directly exported from the consolidated accounts.

3.3 Disposal of shares of a foreign company to 3rd Parties

The disposal of shares to 3rd Parties has already been analyzed in Part 2 of this book and with this present case we propose to give a clear answer to the following question: is the translation adjustments amount attached to the shares disposed booked in P&L?

Listening to the answer from experienced actors in consolidation such as consolidators, CFO's or Auditors, the answer can be sometimes yes and sometimes no!

We propose to illustrate this through a realistic case study in order to give our own conclusion with the necessary explanations.

Description of the situation



The scenario of this case study consists in

- Consolidate Year 1
- Analyze the impact of these 20% disposal of shares
- Consolidate Year 2
- Justify the evolution of consolidated reserves, minority interests and currency translation adjustments

and finally answer to the above question.

Consolidation – Year 1

Here are, as usual, the statutory accounts of both companies already adjusted, followed by the additional explanations.

| P | | | |
|--------------|--------|-------------------|-------|
| Goodwill | | Capital | 5,000 |
| (a) 400 | | Reserves | 3,000 |
| (b) (200) | | (b) (200) | |
| Fin. Inv./A | 2,000 | Result | 1,000 |
| (a) (400) | | | |
| Other assets | 10,000 | Other liabilities | 3,000 |

| A (CUR) | | | |
|-----------------|-----|-------------------|-----|
| Tangible assets | 600 | Capital | 200 |
| (c) 100 | | Reserves | 200 |
| (d) (30) | | (c) 100 | |
| | | (d) (20) | |
| | | Result | 100 |
| | | (d) (10) | |
| Other assets | 400 | Other liabilities | 500 |

Adjustment (a): Goodwill of 400

Adjustment (b): Total impairments until end of Year 0. The counterpart impacts the reserves.

Adjustment (c): Gross amount of goodwill allocation for 100 CUR on fixed tangible assets. Counterpart impacts the reserves.

Adjustment (d): Depreciation of the goodwill allocation, so 3*10% of 100 CUR corresponding to the periods Year -1, Year 0 and Year 1. An amount of (20) CUR is booked on the Reserves and (10) CUR on the P&L.

Currency translation of company A accounts

These accounts are translated according to the following rates

| | |
|-----------------|--|
| Historical rate | |
| Capital | |
| Reserves | |
| Closing rate | |
| Average rate | |

| A (EUR) | | | |
|-----------------|-------|-------------------|-------|
| Tangible assets | 5,400 | Capital | 2,000 |
| (c) 900 | | Reserves | 2,000 |
| (d) (270) | | (c) 1,000 | |
| | | (d) (200) | |
| | | Result | 800 |
| | | (d) (80) | |
| | | Trans. Adjust. | (300) |
| | | (c) (100) | |
| | | (d) 10 | |
| Other assets | 3,600 | Other liabilities | 4,500 |

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where

- All other assets accounts and Other liabilities accounts are translated with the closing rate of 9
- Capital account and Reserves accounts, including adjustments, are translated with the historical rate of 10
- The profit amounts are translated with the average rate of 8

and, finally, this translated balance sheet is balanced again by impacting the Translation adjustments account for a net amount of (300).

Then we translate each adjustment with the same rules giving an additional impact on the translation adjustments.

Consolidation of companies P and A

The global integration method applies to A with a percentage of 80%, giving

| | | P + A |
|-----------------|--------|-------------------------|
| Goodwill | 200 | Capital 5,000 |
| | | Reserves 2,800 |
| Tangible assets | 6,030 | Result 1,000 |
| | | Conso. Res.(A) 2,816 |
| | | Trans. Adjust. (312) |
| | | Minority int.(A) 1,026 |
| Other assets | 13,600 | Other liabilities 7,500 |

where

- Consolidated reserves (A) = $2816 = 80\% * [2000 + 2000 + 1000 + (200) + 800 + (80)] - [2000 + (400)]$
- Minority interests (A) = $1026 = 80\% * [2000 + 2000 + 1000 + (200) + 800 + (80) + (300) + (100) + 10]$
- Translation adjustments = $(312) = 80\% * [(300) + (100) + 10]$

Analysis of the 20% disposal of shares

We are going to consider three different points of view which will lead to the same consolidation adjustment.

The "straight to the point" method

In statutory accounts, parent company P makes a disposal of 500 = 2000 * (20% / 80%) for a price of 900, booking a statutory gain of 400.

In consolidation, we are selling 20% of the equity for the same price of 900, giving a loss of $900 - 20\% * [2000 + 2000 + 1000 + (200) + 800 + (80)] = 900 - 1104 = (204)$.

But why don't we take into account the translation adjustments for (390)?

This amount has never been booked in the P&L in the past, on the contrary of all the other amounts considered at historical rates which entered the Reserves through the elimination process. If not clear, let's wait for the two other methods.

For the moment, we have to consider a consolidation adjustment eliminating the statutory gain of 400 and booking an additional loss of 204.

Moreover, we also have to eliminate the part of the net goodwill attached to the 20% of shares disposed, that is $50 = [400 + (200)] * (20\% / 80\%)$, which gives the final adjustment

| | Debit | Credit |
|------------------|-------|--------|
| Gain on disposal | 400 | |
| Loss on disposal | 204 | |
| Impairment | 50 | |
| Reserves | | 654 |

The "step by step" method

The principle of this method consists in considering a transaction that occurred at statutory level with amounts that have no significance at consolidation level.

| | Debit | Credit |
|------------------|-------|--------|
| Fin. Invest./A | 500 | |
| Cash | | 900 |
| Gain on disposal | 400 | |

So we are going to temporarily reverse that statutory sale corresponding to the 20% of shares by the following adjustment

| | Debit | Credit |
|----------------|-------|--------|
| Goodwill | 100 | |
| Fin. Invest./A | | 100 |

Of course, the gross goodwill attached to these shares has to be booked back in the balance sheet.

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| | Debit | Credit |
|----------|-------|--------|
| Reserves | | |
| Goodwill | | |

And we do the same for the corresponding impairments.

| | Debit | Credit |
|----------------|-------|--------|
| Equity value | 1,026 | |
| Fin. Invest./A | | 400 |
| Trans. Adjust. | 78 | |
| Reserves | | 704 |

We now reach a critical step. We say that what we sell is the equity value of these 20% of shares and not the statutory value. Going back to the definition, the equity value of a foreign company is equal to its equity translated at closing rate. An equivalent way to say it is to consider the historical rate equity plus the translation adjustments amount, giving $1026 = 20\% * [2000 + 2000 + 1000 + (200) + 800 + (80) + (300) + (100) + 10]$.

This equity value replaces the statutory financial investment adjusted by the goodwill, so $400 = 500 + (100)$.

By already explaining that approach in Part 2 for the disposal of a consolidation currency company, we know the counterpart is the Reserves account. But, in this situation, reserves do not include these translation adjustments and this is the reason why we have to book them individually as shown in this adjustment with $(78) = 20\% * [(300) + (100) + 10]$.

| | Debit | Credit |
|------------------|-------|--------|
| Cash | 900 | |
| Equity value | | 1,026 |
| Trans. Adjust. | | 78 |
| Loss on disposal | 204 | |

We now conclude the transaction at consolidation level, of course for the same price of 900 but we are selling the equity value. The translation adjustments attached to the shares disposed cannot remain in the consolidated accounts any more and that's the reason why we eliminate them through the P&L. We finally find a loss of disposal for 204 as in the previous method.

| | Debit | Credit |
|------------|-------|--------|
| Impairment | 50 | |
| Goodwill | | 50 |

The net goodwill of 50 is also eliminated through the P&L.

| | Debit | Credit |
|------------------|-------|--------|
| Gain on disposal | 400 | |
| Loss on disposal | 204 | |
| Impairment | 50 | |
| Reserves | | 654 |

To reach the conclusion, we would propose to aggregate all these six adjustments above to get the single one here on the left. It is the same adjustment as in the previous method.

The "expert" method

It is not recommended to use this method alone without verifying the result with one of two other methods.

It says that when disposing shares of a consolidated company to 3rd Parties, all amounts related to these shares and having impacted the group result have to be reversed by impacting the result again.

In our case study, a quarter (20% / 80%) of the consolidated reserves of company A are aggregated results and so we have to reverse $704 = 2816 * \frac{1}{4}$ (20% / 80%) which has to be considered as a debit in the P&L. But we also have a quarter of the impairments that have been booked in the P&L during the life time of the company in the consolidation scope. We speak about the amount of $50 = 200 * \frac{1}{4}$ (20% / 80%) which will become a credit in the P&L.

The net amount in the P&L should then be $(654) = (704) + 50$.

This method doesn't indicate clearly which accounts have to be booked in P&L but the net amount is correct.

Consolidation - Year 2

Here are the statutory accounts of Year 2

| | | P |
|--------------|--------|-------------------------|
| Goodwill | | Capital 5,000 |
| (a) 300 | | Reserves 4,000 |
| (b) (150) | | (b) (150) |
| Fin. Inv./A | 1,500 | (e) 654 |
| (a) (300) | | (e) (654) |
| Other assets | 11,500 | Other liabilities 3,400 |

| | | A (CUR) |
|-----------------|-------|-----------------------|
| Tangible assets | 500 | Capital 200 |
| (c) 100 | | Reserves 300 |
| (d) (40) | | (c) 100 |
| | | (d) (30) |
| | | Result 200 |
| | | (d) (10) |
| Other assets | 1,000 | Other liabilities 800 |

where we see that the financial investment on A in P accounts is now 1500 instead of 2000, reflecting the transaction we just analyzed.

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Adjustment (a): Initial goodwill of 400 reduced by one quarter, so 300.

Adjustment (b): Total impairments also reduced by one quarter

Adjustment (c): Gross amount of goodwill allocation for 100 CUR on fixed tangible assets. This amount reflects an economical value and it wouldn't make any sense to reduce it also by one quarter. An economical value cannot depend on a percentage of participation.

Adjustment (d): Depreciation of that goodwill allocation, so $4 * 10\%$ of 100 CUR corresponding to the periods Year - 1 to Year 2. An amount of (30) CUR is booked on the Reserves and (10) CUR on the P&L.

Adjustment (e): This is the adjustment resulting from our analysis of the transaction.

Currency translation of company A accounts

For this period, we consider the following rates.

The historical rates defined for Year 1, of course, remain unchanged for Year 2.

| | |
|--------------|----|
| Closing rate | 12 |
| Average rate | 11 |

We then get the translated accounts for company A by applying the same rules as for Year 1.

| | | A (EUR) | |
|-----------------|--------|-------------------|-------|
| Tangible assets | 6,000 | Capital | 2,000 |
| (c) | 1,200 | Reserves | 2,800 |
| (d) | (480) | (c) | 1,000 |
| | | (d) | (280) |
| | | Result | 2,200 |
| | | (d) | (110) |
| | | Trans. Adjust. | 1,400 |
| | | (c) | 200 |
| | | (d) | (90) |
| Other assets | 12,000 | Other liabilities | 9,600 |

Consolidation of companies P and A

We now apply the global integration method with 60% for the whole Year 2.

| | | P + A | |
|-----------------|--------|-------------------|--------|
| Goodwill | 150 | Capital | 5,000 |
| Tangible assets | 6,720 | Reserves | 4,504 |
| | | Result | (54) |
| | | Conso. Res.(A) | 3,366 |
| | | Trans. Adjust. | 906 |
| | | Minority int.(A) | 3,648 |
| Other assets | 23,500 | Other liabilities | 13,000 |

where

- Consolidated reserves (A) = $3366 = 60\% * [2000 + 2800 + 1000 + (280) + 2200 + (110)] - [1500 + (300)]$
- Minority interests (A) = $3648 = 40\% * [2000 + 2800 + 1000 + (280) + 2200 + (110) + 1400 + 200 + (90)]$
- Translation adjustments = $906 = 60\% * [1400 + 200 + (90)]$

Consolidated reserves evolution

| | Year 1 reserves | Year 2 result | Dividends | Dividends + | Transfers | Dividends P | Year 2 reserves |
|---|-----------------|---------------|-----------|-------------|-----------|-------------|-----------------|
| P | 3,800 | (54) | | | 704 | | 4,450 |
| A | 2,816 | 1,254 | | | (704) | | 3,366 |
| | 6,616 | 1,200 | 0 | 0 | 0 | 0 | 7,816 |

Each amount comes from Year 1 and Year 2 consolidated balance sheets. The transfer of 704 from company A to company P corresponds to a quarter of the consolidated reserves $704 = 2816 * (20\% / 80\%)$.

Minority interests evolution

| | Year1 reserves | Year2 result | % var 1 | % var 2 | Year2 reserves |
|---|----------------|--------------|---------|---------|----------------|
| A | 1,026 | 836 | 760 | 1,026 | 3,648 |
| | 1,026 | 836 | 760 | 1,026 | 3,648 |

The evolution of the minority interests can be justified with the three following columns.

$$\underline{\text{Year 2 result}} = 836 = 40\% * [2200 + (110)]$$

% var 1 = $760 = 40\% * [1510 - (390)]$ corresponding to the part of 3rd Parties in the variation of the translation adjustments which are changing from (390) in Year 1 to 1510 in Year 2

% var 2 = $1026 = 20\% * 5130$ corresponding to the impact of the 20% variation on the opening equity, including the translation adjustments.

Translation adjustments evolution

| | Year 1 CTA | (1) | (2) | Year 2 CTA |
|---|---------------|-------|-----|---------------|
| A | (312) | 1,140 | 78 | 906 |
| | (312) | 1,140 | 78 | 906 |

Column (1) = 1140 = 60% * [1510 - (390)] corresponding to the Year 2 percentage in the variation of the same period

Column (2) = 78 = (20)% * (390) corresponding to the loss of 20% in the opening translation adjustment of (390).

And finally, do we book translation adjustments in P&L?

When we calculate the net amount impacting P&L and Reserves, two of the three methods explained above do not take into account the translation adjustments. The third method will it comes down to a debit and credit on the same account.

It seems obvious that on the statutory side of the transaction, the negotiation normally takes into account the equity at the date of the transaction, hence includes the translation adjustments. The rationale is not based on the historical value. This also means that the statutory gain on disposal has a component dealing with the translation amounts.

And to get everyone to agree, we would recommend to book the adjustment as we did by booking at least two P&L accounts, one correcting the statutory gain and another one booking an exchange gain or loss.

In all cases, the net impact remains the one we calculated with the help of our three methods.

3.4 Change of consolidation method during the year

The objective of this case study is to see how to handle the balance sheet and the P&L of a group when one company is changing its consolidation method somewhere during the year. The reasons of a change in a consolidation method are rather diversified, but we can identify mainly

- Additional acquisition of shares giving the control to the shareholder

- Disposal of shares with a loss of control
- No transaction on shares, but an agreement between shareholders giving the control to one shareholder independently of the number of shares owned.

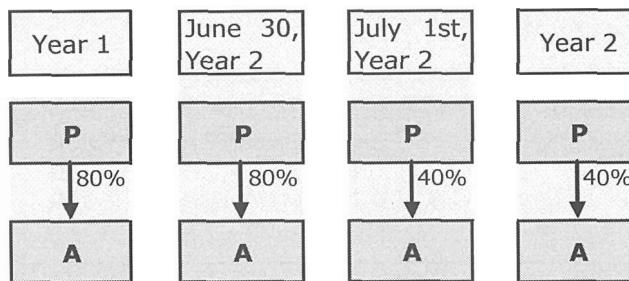
In the case we are presenting hereunder, we will focus on the impact of the consolidation method changes in the balance sheet, the P&L and the evolution of some specific accounts as consolidated reserves, minority interests and equity value.

Description of the situation

During Year 1, company P owns 80% of company A which is consolidated with the global integration method. Company A has been founded by P a few years ago and there is no goodwill.

This situation remains unchanged until June 30, Year 2. At this date, the group still produces a global consolidation of company A.

On July 1st, Year 2, company P sells 40% of its participation to 3rd Parties and, remaining with 40% in A, loses its control. Since this date and, for the first time on December 31, Year 2, company A will be consolidated with the equity method.



Such a situation implies the following remarks

- At the end of Year 2, by consolidating 12 months, we will have to show the P&L of company A with all accounts (expense and income) for the first six months because during this period the group was controlling company A. On the contrary, we cannot show the accounts related to the last six months because the group lost the control.
- As a consequence, we need a complete detailed P&L of company A corresponding to June 30, Year 2

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- Consolidating the first six months by the global integration method, we will have minority interests in the result of the period
- Consolidating the last six months by the equity method, we will have a "Profit from equity company" account
- In the balance sheet, which shows a closing situation as at December 31, Year 2, we should show no Minority interests but an Equity value will appear in the consolidated assets
- The percentage changing during the consolidation period, we will be careful when calculating the group result because it has 80% of the first six months result and only 40% of the last six months result.
- And, finally, we want to inform the reader that most of the consolidation software don't handle such situations correctly because on December 31 Year 2, it will consolidate the whole year with the equity method at 40%, which is completely wrong. Manual adjustments may be required to correct the situation. We will present our case study that way in order to show how to book these adjustments.

Consolidation - Year 1

We start with a Year 1 consolidation without any special event and no adjustments. Company A is consolidated by the global integration method with a percentage of 80%.

| P | | | |
|--------------|-------|-------------------|-------|
| Fin. Inv./A | 400 | Capital | 1,000 |
| | | Reserves | 800 |
| | | Result | 200 |
| Other assets | 3,600 | Other liabilities | 2,000 |

| A | | | |
|--------------|-------|-------------------|-------|
| | | Capital | 500 |
| | | Reserves | 400 |
| | | Result | 100 |
| Other assets | 3,000 | Other liabilities | 2,000 |

Consolidated accounts are the following

| P + A | | | |
|--------------|------------------|-------------------|-------|
| | Capital | 1,000 | |
| | Reserves | 800 | |
| | Result | 200 | |
| | Conso. Res.(A) | 400 | |
| | Minority int.(A) | 200 | |
| Other assets | 6,600 | Other liabilities | 4,000 |

where

- Consolidated reserves (A) = $400 = 80\% * [500 + 400 + 100] - 400$
- Minority interests (A) = $200 = 20\% * [500 + 400 + 100]$

Consolidation – Year 2

We propose to take knowledge of Year 2 statutory accounts, which includes only one consolidation adjustment related to the disposal of 40% of shares of company A.

This time, we will also consolidate the P&L

| P | | | |
|--------------|-------|-------------------|--------------|
| Fin. Inv./A | 200 | Capital | 1,000 |
| | | Reserves | 1,000 |
| | | (a) | 224 |
| | | Result | 300 |
| | | (a) | (224) |
| Other assets | 4,800 | Other liabilities | 2,700 |

| P | | | |
|---------------|--------------|------------------|--------------|
| Cost of sales | 4,700 | Sales | 4,300 |
| Result | 300 | Gain on disposal | 700 |
| (a) | (224) | (a) | (224) |

In its statutory accounts, company P sells the 40% shares of company A for a price of 900 and for a book value of 200, making a gain of 700 as we can see in the P&L above.

In consolidation, we know we have to compare the 900 with 40% of the equity on July 1st Year 2. At that date, company A makes a profit of 60 so we get $424 = 40\% * [500 + 400 + 100 + 60]$ and a gain on disposal equal to $476 = 900 - 424$.

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The statutory gain has to be reduced by 224 to make it equal to the consolidation gain of 476. That's the role of adjustment (a).

We are now going to consolidate company A with the equity method without booking any adjustment in the following statutory accounts.

| | | A | |
|------------------------|-------|-------------------|-------|
| | | Capital | 500 |
| | | Reserves | 500 |
| | | Result | 100 |
| Other assets | 4,000 | Other liabilities | |
| | | | 2,900 |
| A (December 31 Year 2) | | | |
| Cost of sales | 8,900 | Sales | 9,000 |
| Result (Group) | 100 | | |

Here are the consolidated balance sheet and P&L

| | | P + A | |
|------------------|-------|-------------------|-------|
| Equity value (A) | 440 | Capital | 1,000 |
| | | Reserves | 1,224 |
| | | Result | 76 |
| | | Conso. Res.(A) | 240 |
| Other assets | 4,800 | Other liabilities | 2,700 |
| P + A | | | |
| Cost of sales | 4,700 | Sales | 4,300 |
| | | Gain on disposal | 476 |
| Result | 116 | Profit EM | 40 |

With

- Consolidated reserves (A) = 240 = 40% * [500 + 500 + 100] - 200

$$\text{Equity value (A)} = 440 = 40\% * [500 + 500 + 100]$$

But this consolidated P&L contains three errors that should be corrected by adjustments

Here is the adjusted consolidated P&L with the necessary comments

| P + A | | | |
|----------------------|--------------|------------------|--------------|
| Cost of sales | 4,700 | Sales | 4,300 |
| (b) | 4,940 | (b) | 5,000 |
| Result | 116 | Gain on disposal | 476 |
| (b) | 60 | Profit EM | 40 |
| (c) | (12) | | |
| (d) | (24) | | |
| Result (3rd Parties) | | (d) | (24) |
| (c) | 12 | | |

Adjustment (b)

We (or your consolidation software) have consolidated company A at 40% by the equity method over the 12 months of Year 2 and we know that for the first six months we should have consolidated the company with the global integration method.

This means that P&L accounts of company A for the first half-year are missing and must be added in the final consolidated P&L, on the basis of June 30 Year 2 P&L.

| A (June 30 Year 2) | | |
|--------------------|-------|-------|
| Cost of sales | 4,940 | Sales |
| Result | 60 | 5,000 |

Adjustment (c)

For this first half-year, company A makes a statutory profit of 60 and, being consolidated at 80% by the global integration method, $12 = 20\% * 60$ is a part of the profit that belongs to 3rd Parties.

Adjustment (d)

We also notice that company A making a 12 months profit of 100 and a first half-year profit of 60, the second half-year profit is 40 which has to be valued at 40% as "Profit EM" account, so $16 = 40\% * 40$.

The amount of 40 initially calculated must be reduced by 24.

These three adjustments are just reclassifications between P&L accounts. The balance sheet needs no adjustments.

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Consolidated reserves evolution

| | Year 1 reserves | Year 2 result | Dividends | Dividends + | Transfers | Dividends P | Year 2 reserves |
|---|-----------------|---------------|-----------|-------------|-----------|-------------|-----------------|
| P | 1,000 | 76 | | | 224 | | 1,300 |
| A | 400 | 64 | | | (224) | | 240 |
| | 1,400 | 140 | 0 | 0 | 0 | 0 | 1,540 |

In this report we see a profit of 64 for company A as being $80\% * 60 + 40\% * 40$.

The 224 amount of transfer corresponds to the reserves disposed. At the end of June Year 2, reserves of company A are $448 = 400$ (consolidated reserves Year 1) $+ 80\% * 60$ (group profit first-half year). As we sell 40% out of 80%, the amount of transfer is equal to $224 = 448 * (40\% / 80\%)$.

Minority interests evolution

| | Year 1 reserves | Year 2 result | % var 1 | Year 2 reserves |
|---|-----------------|---------------|---------|-----------------|
| A | 200 | 12 | (212) | 0 |
| | 200 | 12 | (212) | 0 |

The evolution of the minority interests can be justified with the two following columns.

Year 2 result = $12 = 20\% * 60$ corresponding to their profit for the first half-year.

% var 1 = $(212) = 20\% * [500 + 400 + 100 + 60]$ corresponding to the part of 3rd Parties in the equity as at June 30 Year 2 that they are loosing considering company A is consolidated by the equity method since that date.

Equity value evolution

| | Equity val. | Year 2 result | (2) | Equity val. |
|---|-------------|---------------|-----|-------------|
| A | 0 | 16 | 424 | 440 |
| | 0 | 16 | 424 | ,440 |

Two columns are also necessary to justify the evolution from zero in Year 1 to 440 in Year 2.

Year 2 result = $16 = 40\% * 40$ corresponding to the equity profit for the second half-year.

$(2) = 424 = 40\% * [500 + 500 + 60]$ corresponding to the equity value of company A on July 1st Year 2.

4 RESTRUCTURATION OF A GROUP

4.1 Internal group disposal of a company

Restructuring a group usually has the following characteristics:

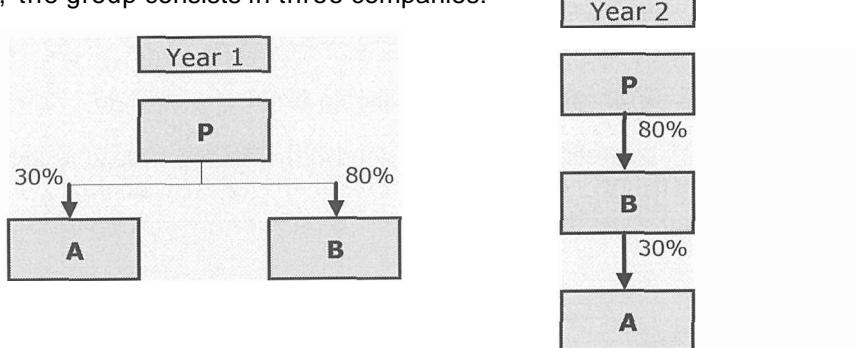
- The companies are maintained in the group, excluding external acquisitions or disposals ;
- Group's shareholders of the companies are changing ;
- The total number of shares owned in a company remains unchanged, even if that total is split into different other group companies.

Taking a "helicopter" view on such a group, we note that there are no cash transactions with 3rd Parties and the total of shares owned by the group in each individual company and their consolidation method are globally unchanged.

Such restructuring gives the impression of having no impact on the consolidated figures. Unfortunately the reality shows that it is often wrong.

Description of the context

Initially, the group consists in three companies:



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- The parent company P
- Company A acquired beginning of last year, with a goodwill of 400 and depreciated on a 20% per year basis
- Company B founded by the group a few years ago.

Beginning of Year 2, parent company P sells its 30% shares of company A to company B.

Consolidation – Year 1

Here are the statutory accounts of these three companies, already adjusted with the goodwill.

| P | | |
|--------------|----------|-------------------------|
| Goodwill/A | | |
| (a) 400 | Capital | 1,000 |
| (b) (160) | Reserves | 500 |
| Fin. Inv./A | | |
| (a) (400) | (b) | (80) |
| 2,000 | Result | 200 |
| Fin. Inv./B | | |
| 800 | (b) | (80) |
| Other assets | 2,200 | Other liabilities 3,300 |

| A | | |
|--------------|----------|-------------------------|
| | Capital | 3,000 |
| | Reserves | 1,500 |
| | Result | 500 |
| Other assets | 6,000 | Other liabilities 1,000 |

| B | | |
|--------------|----------|-------------------------|
| | Capital | 1,000 |
| | Reserves | 400 |
| | Result | 500 |
| Other assets | 3,000 | Other liabilities 1,100 |

Adjustment (a): Gross goodwill at acquisition time, on year ago

Adjustment (b): Depreciations of this goodwill, with the first 20% booked on the Reserves account, corresponding to Year 0 and 20% booked on the P&L for this Year 1.

Consolidated accounts present no difficulties

| | P + A + B | | |
|------------------|------------------|-------------------|-------|
| Goodwill | 240 | Capital | 1,000 |
| | | Reserves | 420 |
| | | Result | 120 |
| Equity value (A) | 1,500 | Conso. Res.(A) | (100) |
| | | Conso. Res.(B) | 720 |
| | | Minority int.(B) | 380 |
| Other assets | 5,200 | Other liabilities | 4,400 |

where

- Consolidated reserves (A) = $(100) = 30\% * [3000 + 1500 + 500] - [2000 + (400)]$
- Consolidated reserves (B) = $720 = 80\% * [1000 + 400 + 500] - 800$
- Minority interests (B) = $380 = 20\% * [1000 + 400 + 500]$
- Equity value (A) = $1500 = 30\% * [3000 + 1500 + 500]$

Some questions before consolidating Year 2

We are typically in a situation where apparently nothing has changed. The two companies A and B are still in the group and owned with the same number of shares. Moreover, their consolidation methods are also unchanged.

Has nothing really changed?

Well, only the indirect financial percentage in company A decreases from 30% to 24% = $80\% * 30\%$

By considering the statutory accounts, we will also notice that the financial investment on company A owned initially by parent company P has been sold with a gain of 500, which of course will have to be eliminated.

But there are some other questions about that group transaction.

What about the goodwill of 400 on company A?

In Year 1, the goodwill was booked in parent company P accounts. Now, the goodwill should be transferred to company B accounts, which is the new owner of company A.

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And the question is : do we maintain the gross goodwill for its initial value of 400 or do we have to maintain only 80% of that goodwill, considering that now it is booked in a 80% owned company ?

Since Year 1, that gross goodwill is an intangible asset shown in the consolidated accounts for an amount of 400. Respecting an economical point of view, there is no reason to adapt this "objective" value, depending on the percentage of the new acquirer company.

What about the depreciations of that goodwill ?

As soon as the gross goodwill is transferred to another company, all depreciation adjustments must also be transferred with the consequence that some historical reserves will also be transferred from company P to company B.

What about the gain on disposal ?

It is a group result that must be eliminated, whatever the gain may be, material or not. But the problem here comes from a transaction between a 100% company (the seller) and a 80% company (the acquirer). We will have to consider a group transaction with a gain of $400 = 80\% * 500$ and a transaction with 3rd Parties for 100, to be maintained in the P&L.

Which percentage to apply for the equity value of company A ?

The answer can easily be understood by applying the stage consolidation. By consolidating company A with a percentage of 30% in company B, the equity value is equal to 30% of company A equity. Then company B is consolidated with the global integration method in company P and a 100% integration percentage applies to the equity value. So the answer is 30%.

Minority interests in company A ?

We have seen in several situations before that when an equity method company is owned by a global integration method owned at less than 100%, there are indirect minority interests in the equity method company. In our case study, the percentage of minority interests is $6\% = 20\% * 30\%$.

Consolidation – Year 2

Let's see how all these problems are booked in the Year 2 consolidation.

| | | P |
|--------------|-------|-------------------------|
| | | Capital 1,000 |
| | | Reserves 700 |
| Fin. Inv./B | 800 | (c) 400 |
| | | Result 200 |
| | | (c) (400) |
| Other assets | 4,600 | Other liabilities 3,500 |

| | | A |
|--------------|-------|-------------------------|
| | | Capital 3,000 |
| | | Reserves 2,000 |
| | | Result 300 |
| Other assets | 6,600 | Other liabilities 1,300 |

| | | B |
|--------------|--------|-------------------------|
| Goodwill/A | | Capital 1,000 |
| (a) 400 | | Reserves 900 |
| (b) (160) | | (b) (160) |
| (e) (65) | | (d) (500) |
| (f) (58) | Result | 200 |
| Fin. Inv./A | 2,500 | (f) (58) |
| (a) (400) | | |
| (d) (500) | | |
| (e) 65 | | |
| Other assets | 1,600 | Other liabilities 2,000 |

Adjustment (a): This is the gross goodwill transferred from company P to company A

Adjustment (b): Two depreciations amounts have been booked corresponding to Year 0 and Year 1, while the goodwill was in company P accounts. These historical values are now booked in company B accounts. To be careful, we don't book now the third 20% depreciation corresponding to Year 2 for some reason explained when considering adjustment (e).

Adjustment (c): The group gain on shares disposal for an amount of $400 = 80\% \times 500$ is eliminated. Company P keeps a gain of $100 = 500 + (400)$ in its P&L, corresponding to the sale to 3rd Parties. Counterpart of this elimination is the Reserves account.

Adjustment (d): The financial investment on company A includes a profit of 500 that we eliminate with a counterpart on the Reserves. After the

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consolidation process, the group amount of $(400) = 80\% * (500)$ will compensate with the amount of 400 booked in company P accounts.

Adjusment (e): This is probably the most surprising and unexpected adjustment. We have indeed to calculate the impact of all these adjustments booked on Reserves and Financial investments, with direct impact on consolidated reserves.

On the financial investment side, the group goes from a value of $1600 = 2000 + (400)$ in Year 1 to a value of $1280 = 80\% * [2500 + (500) + (400)]$ in Year 2. The difference of 320 could be considered as the part of financial investment disposed.

On the equity side, the group goes from a value of $(160) = (80) + (80)$ in Year 1 to $(128) = 80\% * (160)$ in Year 2, concerning the cumulated goodwill depreciations, which represents a gain on equity of $32 = (128) - (160)$.

On the other hand, the group is loosing some company A equity by decreasing from 30% to 24% on an opening equity of 5000, that is $(300) = [24\% - 30\%] * [3000 + 2000]$.

The net loss in equity is $(268) = 32 + (300)$.

Let's summarise the situation. We can consider that the group "sells" an equity of 268 for a "price" of 320, making a "profit" of $52 = 320 - 268$.

We decide to book this gain on the goodwill in order to decrease its value.

However, the amount of 52 is a group amount and we are going to book it in company B which is consolidated at 80%. In order to avoid mixing up closing assets amounts and group assets amounts, we adapt this 52 amount to become $65 = 52 * (100\% / 80\%)$.

Adjusment (f): The net goodwill opening value is now $175 = 400 + (160) + (65)$ and its remaining period of depreciation is three years, so we depreciate it by $58 = 175 / 3$ in Year 2.

Finally, here are the consolidated accounts

| P + A + B | | | |
|------------------|-------|-------------------|-------|
| Goodwill | 117 | Capital | 1,000 |
| | | Reserves | 1,100 |
| | | Result | (200) |
| Equity value (A) | 1,590 | Conso. Res.(A) | (60) |
| | | Conso. Res.(B) | 306 |
| | | Minority int.(A) | 318 |
| | | Minority int.(B) | (57) |
| Other assets | 6,200 | Other liabilities | 5,500 |

where

- Consolidated reserves (A) = $(60) = 24\% * [3000 + 2000 + 300] - 80\% * [2500 + (500) + (400) + 65]$
- Consolidated reserves (B) = $306 = 80\% * [1000 + 900 + (160) + (500) + 200 + (58)] - 800$
- Minority interests (A) = $318 = 6\% * [3000 + 2000 + 300]$
- Minority interests (B) = $(57) = 20\% * [1000 + 900 + (160) + (500) + 200 + (58)] - 20\% * [2500 + (500) + (400) + 65]$
- Equity value (A) = $1590 = 30\% * [3000 + 2000 + 300]$

Consolidated reserves evolution

| | Year 1 reserves | Year 2 result | Dividends | Dividends + | Transfers | Dividends P | Year 2 reserves |
|---|-----------------|---------------|-----------|-------------|-----------|-------------|-----------------|
| P | 540 | (200) | | | 560 | | 900 |
| A | (100) | 72 | | | (32) | | (60) |
| B | 720 | 114 | | | (528) | | 306 |
| | 1,160 | (14) | 0 | 0 | 0 | 0 | 1,146 |

To understand the following report, we need to split the "Transfers" column in four columns as presented hereunder.

| | Transfers | | | | Total |
|---|-----------|------|-------|------|-------|
| | (1) | (2) | (3) | (4) | |
| P | 128 | (20) | 400 | 52 | 560 |
| A | 20 | (20) | (400) | (52) | (32) |
| B | (128) | 0 | 0 | 0 | (528) |
| | 0 | 0 | 0 | 0 | 0 |

Column (1) : 80% of the cumulated goodwill depreciations are transferred from company P to company B, which is $(128) = 80\% * (160)$.

Column (2) : We have already met this situation several times in some other cases. Each time there is a disposal or a decrease in indirect percentage in a company, the corresponding part on the consolidated reserves is transferred from the initial company to the owner of the shares. In our case study, percentage of company A decreases by 6% on 30%, giving a transfer of consolidated reserves for an amount of $(20) = [6\% / 30\%] * (100)$

Column (3) : This amount of $400 = 80\% * 500$ corresponds to the elimination of the group gain on company A shares from company P to company B.

Column (4) : This amount is the group goodwill correction. It has been calculated at group level (company P) but booked in company B. That's the reason of the transfer.

Minority interests evolution

| | Year 1 reserves | Year 2 result | % variations | | | Year 2 reserves |
|---|--------------------|------------------|--------------|-------|-------|--------------------|
| | | | (1) | (2) | (3) | |
| A | 0 | 18 | 300 | | | 318 |
| B | 380 | 28 | | (132) | (333) | (57) |
| | 380 | 46 | 300 | (132) | (333) | 261 |

Year 2 results are just the 3rd Parties part in the adjusted profit of each company and nothing special needs to be said about that. Let's focus rather on the percentages variations.

Column (1): There were no Minority interests in company A at the end of Year 1. But suddenly, on first day of Year 2, the group structure is such that we now have 6% of Minority interests in the opening equity, that is $300 = 6\% * [3000 + 2000]$.

Column (2): In Year 2, 3rd Parties have now 20% of the adjustments (b) and (d) impacting company B equity, that is $(132) = 20\% * [(160) + (500)]$ and nothing in Year 1.

Column (3): In Year 2, 3rd Parties have now 20% of the adjusted financial investment in company A, that is $(333) = 20\% * [2500 + (500) + (400) + 65]$ and nothing in Year 1.

And to conclude, if the first feeling indeed was that nothing has changed in this group, the above explanations show some difficult and technical requirements of the consolidation.

4.2 Absorption of a company

It is important to make a clear distinction between an absorption of a company and the merge of two companies.

The absorption relies on the single fact that the absorbing company owns 100% of the shares of the company that will be absorbed.

A merge of two (or more) companies can result in the ownership by different shareholders at any percentage. The next section will analyze a merge of two companies.

The gain or loss on absorption

Before solving a case of absorption from a consolidation point of view, we would like to analyze how absorption is managed in statutory accounting.

Here are two companies P and A. P owns 100% of the shares of A during Year 1 and is consolidated with the global integration method.

| P | | | |
|--------------|-------|-------------------|-------|
| Fin. Inv./A | 700 | Equity | 2,000 |
| Other assets | 4,300 | Other liabilities | 3,000 |
| A | | | |
| | | Equity | 1,000 |
| Other assets | 3,000 | Other liabilities | 2,000 |
| P + A | | | |
| | | Equity | 2,000 |
| | | Conso. Res.(A) | 300 |
| Other assets | 7,300 | Other liabilities | 5,000 |

The consolidated reserves are equal to $300 = 100\% * 1000 - 700$.

Beginning of Year 2, P decides to absorb company A. This means that all assets and liabilities belonging to company A are brought to company P, except the equity.

The financial investment owned by company P on company A has no reason to be maintained because the affiliate does not exist any more.

We show hereunder the journal entry (1) related to that absorption.

| P | | | |
|--------------|-------|-------------------|-------|
| Fin. Inv./A | 700 | Equity | 2,000 |
| (1) | (700) | Result | |
| | | (1) | 300 |
| Other assets | 4,300 | Other liabilities | 3,000 |
| (1) | 3,000 | (1) | 2,000 |

The booking of assets and liabilities of company A and the elimination of the financial investment is usually not a journal entry in balance. The amount reflecting the difference impacts the P&L and is called the gain or loss on absorption.

In some countries and depending on some local accounting regulations, the loss of absorption may be booked in the balance sheet as an intangible asset.

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In our example, the gain on absorption is 300 which can be detailed as follows :

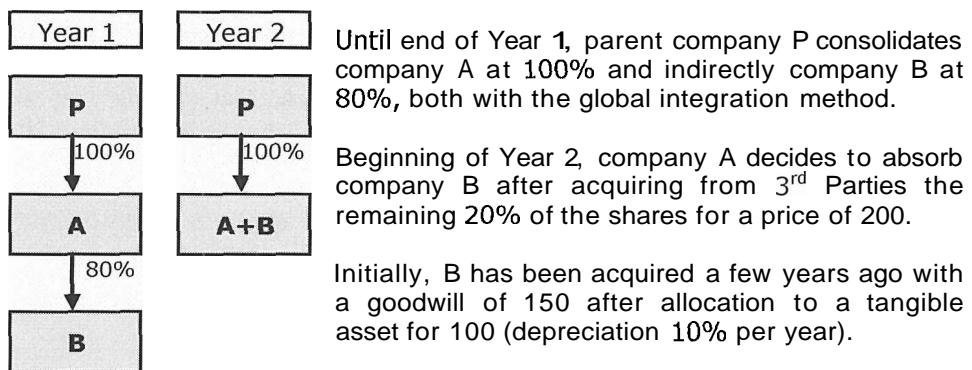
$$300 = 3000 - 2000 - 700 = 1000 - 700 = 100\% * 1000 - 700$$

which represents exactly the consolidated reserves calculated at the end of Year 1!

If we keep the accounts of P as they are and if we go ahead in a consolidation just after the absorption, we obviously will have to face a problem because consolidated reserves for 300 are again booked in the P&L of Year 2 because of this absorption. This cannot be maintained as such and the amount of 300 has to be reversed into Reserves account.

The important message here is that we have to know the result of absorption and the account on which it has been booked in order to reverse the booking correctly.

Description of the absorption case study



Consolidation – Year 1

We provide statutory accounts with the consolidation adjustments.

| P | | | |
|--------------|-------|-------------------|-------|
| Fin. Inv./A | 1,000 | Capital | 2,000 |
| | | Reserves | 1,000 |
| | | Result | 300 |
| Other assets | 5,000 | Other liabilities | 2,700 |

| A | | | |
|--------------|-------|-------------------|-------|
| Goodwill | | Capital | 1,000 |
| (a) 150 | | Reserves | 600 |
| Fin. Inv./B | 700 | Result | 200 |
| (a) (150) | | Other liabilities | 2,200 |
| Other assets | 3,300 | | |

| B | | | |
|-----------------|-------|-------------------|-------|
| Tangible assets | 270 | Capital | 500 |
| (b) 100 | | Reserves | 300 |
| (c) (30) | | (b) 100 | |
| | | (c) (20) | |
| | | Result | (100) |
| | | (c) (10) | |
| Other assets | 1,730 | Other liabilities | 1,300 |

Adjustment (a): Goodwill attached to the initial 80% of shares acquired.

Adjustment (b): Gross value of the asset allocation.

Adjustment (c): Cumulated depreciations of the asset allocation.

The consolidated accounts are set up without any difficulty.

| P + A + B | | | |
|-----------------|--------|-------------------|-------|
| Goodwill | 150 | Capital | 2,000 |
| | | Reserves | 1,000 |
| Tangible assets | 340 | Result | 300 |
| | | Conso. Res.(A) | 800 |
| | | Conso. Res.(B) | 66 |
| | | Minority int.(B) | 154 |
| Other assets | 10,030 | Other liabilities | 6,200 |

with

- Consolidated reserves (A) = 800 = 100% * [1000 + 600 + 200] - 1000

- Consolidated reserves (B) = $66 = 80\% * [500 + 300 + 100 + (20) + (100) + (10)] - [700 + (150)]$
- Minority interests (B) = $154 = 20\% * [500 + 300 + 100 + (20) + (100) + (10)]$

Some questions before consolidating Year 2

In order to prepare the Year 2 consolidation, we should adopt a clear position on the following issues.

What about the 150 goodwill?

This goodwill concerns company B that disappears because of the absorption. Shall we keep it? To answer this question let's return to some basic principles. A goodwill reflects a kind of additional cost to acquire an economic activity through a company. If it is true that the company disappears from a legal point of view, the group still maintains the activity within the absorbing company. The goodwill is fully justified because, basically, nothing has changed and the absorption is a transaction that should have no effect on the consolidated figures.

What about the acquisition of the remaining 20% of shares?

The absorption cannot legally be achieved without being owner of the 100% shares of company B. This implies company A has to acquire them and the logic of a goodwill/badwill must be triggered, independently of the fact that there will be an absorption just after the transaction.

Supposing we calculate a new goodwill, the normal position is to book it additionally to the former one. It will be our choice.

What about the goodwill allocation booked initially in company B accounts?

This allocation concerns a tangible asset in company B accounts. After the absorption, the asset is transferred to company A accounts and does not leave the group. Our position is then to maintain the allocation and the historical depreciations adjustments by booking them in company A accounts which becomes the owner of this tangible asset. Priority has to be given to the economical view.

And don't forget to reverse the statutory result of absorption

As explained above, we should ask company A about the value of that result of absorption and on which P&L account it has been booked.

Consolidation - Year 2

We present the statutory accounts of each company, including the consolidation adjustments.

| | | P |
|--------------|-------|----------------------------------|
| Fin. Inv./A | 1,000 | Capital 2,000 |
| | | Reserves 1,300 |
| | | Result 200 |
| Other assets | 6,000 | Other liabilities 3,500 |

| | | A |
|----------------------------|-------|----------------------------------|
| Goodwill | | Capital 1,000 |
| (a) 150 | | Reserves 800 |
| (d) 46 | | (a) 150 |
| | | (b) 100 |
| | | (c) (30) |
| | | (d) 46 |
| Tangible assets | 240 | Result (200) |
| (b) 100 | | (100) |
| (c) (40) | | (c) (10) |
| | | (e) 200 |
| Other assets | 6,160 | Other liabilities 4,700 |

According to our previous explanations, there are five consolidation adjustments to book.

Adjustment (a): We maintain the goodwill of 150 attached to the initial 80% of shares. However, the counterpart is not the financial investment any more but the reserves.

Adjustment (b): We also maintain the gross value of the goodwill allocation in the same way it has been booked in company B accounts before absorption.

Adjustment (c): This allocation continues its economical life in the group (company A) with an additional depreciation.

Adjustment (d): This entry concerns the additional goodwill related to the acquisition of the 20% of shares. The acquisition price is 200 and the corresponding equity is $154 = 20\% * [500 + 300 + 100 + (20) + (100) + (10)]$, giving a goodwill of $46 = 200 + (154)$. This goodwill being calculated just before the absorption, we consider the Year 1 equity of company B.

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Adjustment (e): As we know the statutory accounts of company B just before absorption, we are able to calculate the result of absorption, which is

| | |
|------------------------------|---------|
| Net value of tangible assets | 270 |
| Other assets | 1,730 |
| Other liabilities | (1,300) |
| Financial investments (80%) | (700) |
| Financial investments 20%) | (200) |
| | (200) |

and we will suppose that loss on absorption has been booked in the P&L.

Here are the corresponding consolidated accounts

| P + A | | |
|-----------------|--------|-------------------------|
| Goodwill | 196 | Capital 2,000 |
| | | Reserves 1,300 |
| Tangible assets | 300 | Result 200 |
| | | Conso. Res.(A) 956 |
| Other assets | 12,160 | Other liabilities 8,200 |

where

- Consolidated reserves (A) = $956 = 100\% * [1000 + 800 + 150 + 100 + (30) + 46 + (200) + (100) + (10) + 200] - 1000$

Consolidated reserves evolution

| | Year 1 reserves | Year 2 result | Dividends | Dividends + | Transfers | Dividends P | Year 2 reserves |
|---|-----------------|---------------|-----------|-------------|-----------|-------------|-----------------|
| P | 1,300 | 200 | | | | | 1,500 |
| A | 800 | 90 | | | 66 | | 956 |
| B | 66 | 0 | | | (66) | | 0 |
| | 2,166 | 290 | 0 | 0 | 0 | 0 | 2,456 |

In Year 1 there are three companies and only two for Year 2. Reserves of company B are just transferred to the reserves of company A.

This case study may look a little bit difficult to solve but, if done correctly, the reserves evolution gives a very clear and comprehensive picture.

4.3 Merge of two companies

When two companies, owned at 100% by a parent company, decide to merge, this transaction has no impact on the consolidated figures because it is a non cash transaction with no interaction with the outside world. The economical activity, initially located in two companies, is centralized in a single company but still remains in the group. Of course, all historical adjustments booked in each individual company must be kept and booked in the merged entity.

Contrary to an absorption where we have explained that the statutory result of absorption had to be reversed, there is nothing to book in a merge transaction.

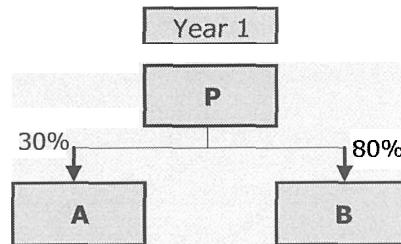
That's for the basic principles.

Unfortunately, some problems arise when the two companies are owned with different percentages and, possibly, with different consolidation methods.

Description of the situation

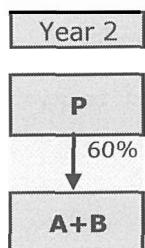
Two companies, A and B, are owned directly by the parent company P.

Company A is owned at 30% and consolidated with the equity method. Company B is owned at 80% and consolidated with the global integration method.



Company A has been acquired a few years ago with a goodwill of 200. Company B has been acquired last year with a goodwill that has been partly allocated to a tangible asset for 1000 (depreciation of 10%/year) leaving a remaining goodwill of 500.

Until now, no impairments have been booked on these goodwills.



On January 1st Year 2, these two companies decide to merge, giving the new following group structure, and just before, company B pays 300 dividends to its shareholders.

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To keep further explanations clear we will consider the merged entity A+B as a new company distinct from A and B. In real life, one of the two companies disappears and we remain with the other, even if its name might possibly change.

The new percentage of 60% will be explained later on.

As usual, we propose

- To consolidate first Year 1
- To analyze this merge transaction
- To consolidate Year 2

and we conclude by justifying the consolidated reserves evolution in order to validate the process.

Consolidation – Year 1

Here are the statutory accounts

| | | P | |
|--------------|-------|-------------------|-------|
| Goodwill/A | | Capital | 3,000 |
| (a) | 200 | Reserves | 1,500 |
| Goodwill/B | | Result | 500 |
| (b) | 500 | | |
| Fin. Inv./A | 1,000 | | |
| (a) | (200) | | |
| Fin. Inv./B | 5,000 | | |
| (b) | (500) | | |
| Other assets | 3,000 | Other liabilities | 4,000 |

| | | A | |
|--------------|-------|-------------------|-------|
| | | Capital | 2,000 |
| | | Reserves | 1,700 |
| | | Result | 300 |
| Other assets | 7,000 | Other liabilities | 3,000 |

| | | B | |
|-----------------|-------|-------------------|-------|
| Tangible assets | 4,000 | Capital | 3,000 |
| (c) | 1,000 | Reserves | 3,000 |
| (d) | (200) | (c) | 1,000 |
| | | (d) | (100) |
| | | Result | 300 |
| | | (d) | (100) |
| Other assets | 6,000 | Other liabilities | 3,700 |

with the following consolidation adjustments

Adjustment (a): Goodwill of 200 on company A

Adjustment (b): Goodwill of 500 on company B

Adjustment (c): Allocation of company B goodwill for a gross amount of 1000

Adjustment (d): This amount is depreciated over two years, one 10% depreciation related to Year 0 and booked on the Reserves and 10% depreciation for Year 1 booked on P&L.

Nothing else has to be booked and hereunder are the corresponding consolidated accounts.

| P + A + B | | | |
|------------------|-------|-------------------|-------|
| Goodwill | 700 | Capital | 3,000 |
| | | Reserves | 1,500 |
| Tangible assets | 4,800 | Result | 500 |
| | | Conso. Res.(A) | 400 |
| Equity value (A) | 1,200 | Conso. Res.(B) | 1,180 |
| | | Minority int.(B) | 1,420 |
| Other assets | 9,000 | Other liabilities | 7,700 |

where

- Consolidated reserves (A) = $400 = 30\% * [2000 + 1700 + 300] - [1000 + (200)]$
- Consolidated reserves (B) = $1180 = 80\% * [3000 + 3000 + 1000 + (100) + 300 + (100)] - [5000 + (500)]$
- Minority interests (B) = $1420 = 20\% * [3000 + 3000 + 1000 + (100) + 300 + (100)]$
- Equity value (A) = $1200 = 30\% * [2000 + 1700 + 300]$

Some questions before consolidating Year 2

Several sets of questions can be raised before going ahead in a consolidation after such a merge.

Concerning the group structure

- We recommend to ask all information about the number of shares and not the percentages. This merge transaction will lead to the creation of new shares for the A+B entity (or the merged company) and

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existing shareholders will exchange their A and B shares against A+B shares.

- Whatever the new percentage will be, the consolidated accounts after the merge
 - Either will integrate company A figures because the merged entity is consolidated by the global method
 - Or company B figures will disappear because we consolidate the merged entity by the equity method. In any case, this merge will lead to a change of structure in the consolidated balance sheet and the P&L.

Concerning the statutory accounts

It is important to analyze and understand the statutory accounts before and after the merge transaction.

In consolidation, the equity of A+B must be equal to the sum of both equity of A and B. If not, there may be dividends paid before the merge. In some countries, local regulations admit revaluation of assets when making the merge with an impact in the merged equity. If so, such revaluation must be reversed.

Concerning the consolidation adjustments

The main question is to decide what to do with all the historical adjustments, initially related to companies A and B, which have disappeared.

On the basis of our example, we recommend the following

Goodwills must be maintained. Moreover, we recommend keeping them separate even if we don't have two companies anymore but only a single one. Why? Because if in the future company A+B sells the activity related to the former A company, the goodwill attached to it should be eliminated.

- Revaluation of assets, and in a more general context, all adjustments booked in the two companies must be kept in the merged company in the same way that would have been the case in the individual companies.

Mergers analysis : The new percentage

We present hereunder the number of shares issued in each company and the corresponding value of the equity in order to evaluate the value of one share.

| | Total equity | #shares issued | Value/share |
|-------------|--------------|----------------|-------------|
| Company A | 4,000 | 2,000 | 2 |
| Company B | 6,000 | 1,500 | 4 |
| Company A+B | 10,000 | 1,000 | 10 |

Notice that company B equity is 6000 and not 6300 because of the dividends of 300 that will be paid to the former shareholders. This means that parent company P will receive $240 = 80\% * 300$ during Year 2.

From this information, we can easily conclude that shareholders of A exchange 5 shares against 1 A+B share and shareholders of B exchange 5 B shares against 2 A+B shares.

In consequence, parent company P receives 120 A+B shares for its $600 = 30\% * 2000$ A shares and receives 480 A+B shares for its 1200 B shares, giving a final percentage in company A+B of $60\% = (120 + 480) / 1000$.

Mergers analysis : The statutory accounts

As shown in the report above, the total equity of both companies A and B is $4000 + 6300$ less the 300 dividends, which is equal to the opening equity of company A+B.

Moreover, it is important to notice that

$$30\% * 4000 + 80\% * 6000 = 1200 + 4800 = 6000 = 60\% * 10000$$

meaning that the exchange of shares is fair for all shareholders.

And so, shall we get some problems in the next consolidation? Unfortunately yes because if the exchange of shares is "fair" when considering the statutory equity, it becomes "unfair" in consolidation because there are some adjustments impacting the equity.

We will come back to this problem when considering the Year 2 figures.

Consolidation - Year 2

Again we consider the statutory accounts of the remaining two companies, including all the consolidation adjustments.

| | | P | |
|---------------|-------|-------------------|-------|
| Goodwill/A+B | | Capital | 3,000 |
| (a) 200 | | Reserves | 2,000 |
| (b) 500 | | (e) 240 | |
| | | (f) 160 | |
| Fin. Inv./A+B | 6,000 | Result | 600 |
| (a) (200) | | (e) (240) | |
| (b) (500) | | (f) (160) | |
| Other assets | 4,000 | Other liabilities | 4,400 |

| | | A + B | |
|-----------------|--------|-------------------|--------|
| Tangible assets | 3,600 | Capital | 10,000 |
| (c) 1,000 | | Reserves | 0 |
| (d) (300) | | (c) 1,000 | |
| | | (d) (200) | |
| Result | | | 700 |
| Other assets | 11,400 | Other liabilities | 4,300 |

Adjustment (a): Goodwill on former company A, now booked on company A+B

Adjustment (b): Goodwill on former company B, now booked on company A+B

Adjustment (c): Revaluation of tangible assets initially booked in company A. This adjustment follows the owner of the asset, that is company A+B

Adjustment (d): Depreciation of the revaluation, two years impacting the Reserves and this year booked in the P&L

Adjustment (e): Let us remind that just before proceeding to the merge, company B pays a dividend of 300 to its shareholder. Company B receives $240 = 80\% * 300$ that has to be eliminated.

Adjustment (f): This adjustment corrects the "unfair" exchange of shares in consolidation. We have seen that, based on statutory accounts, the group was owning the same equity after the merge than before.

In consolidation, because of the goodwill allocation adjustment impacting the equity for $800 = 1000 + (200)$, the group percentage on that amount is 80%

before the merge and 60% just after, giving a "loss" on group equity for $(160) = (20\%) * 800$.

The best comparison we can make is to say that we sell an equity of 160 for a price of zero, which means a loss on disposal.

This adjustment is booked in the parent company.

On the opposite, another merge situation could lead to a gain in equity. For instance, supposing there is a revaluation in company A for the same amount, we would get a gain of $240 = 30\% * 800$ which would be considered as a badwill because we "buy" some additional equity for a price of zero. This badwill would then reduce the existing goodwill.

Here are the consolidated accounts after the merge

| P + A + B | | |
|-----------------|--------|--------------------------|
| Goodwill | 700 | Capital 3,000 |
| | | Reserves 2,400 |
| Tangible assets | 4,300 | Result 200 |
| | | Conso. Res.(A+B) 1,540 |
| Other assets | 15,400 | Minority int.(A+B) 4,560 |
| | | Other liabilities 8,700 |

where

- Consolidated reserves $(A+B) = 1540 = 60\% * [10000 + 1000 + (200) + 700 + (100)] - [6000 + (200) + (500)]$
- Minority interests $(A+B) = 4560 = 40\% * [10000 + 1000 + (200) + 700 + (100)]$

Of course, in these accounts, the company A equity value is not in the assets any more because this company is now merged into company A+B which is consolidated by the global integration method.

Consolidated reserves evolution

| | Year 1 reserves | Year 2 result | Dividends | Dividends + | Transfers | Dividends P | Year 2 reserves |
|-----|-----------------|---------------|-----------|-------------|-----------|-------------|-----------------|
| P | 2,000 | 200 | | 240 | 160 | | 2,600 |
| A | 400 | 0 | | | (400) | | 0 |
| B | 1,180 | 0 | (240) | | (940) | | 0 |
| A+B | 0 | 360 | | | 1,180 | | 1,540 |
| | 3,580 | 560 | (240) | 240 | 0 | 0 | 4,140 |

This report needs the following explanations.

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Companies: As announced, we show the two former companies A and B separately from the new merged company A+B

Dividends: We mention dividends paid and received in the usual way

Transfers: The column is unique but we could use as many transfer columns as needed for clear explanations

- Company A consolidated reserves of 400 are transferred to company A+B
- Company B consolidated reserves of 1180 are also transferred to company A+B, but we have to take into account the fact that dividends are already transferred. The remaining transfer amount is $940 = 1180 + (240)$
- The adjustment (f) consists in booking the reserves of parent company P for 160 and at the same time we notice a loss of equity for (160) in company A+B, giving an additional transfer for that amount.

Minority interests evolution

| | Year 1 reserves | Year 2 result | Dividends | Transfer | % var 1 | % var 2 | Year 2 reserves |
|-----|-----------------|---------------|-----------|----------|---------|---------|-----------------|
| B | 1,420 | 0 | (60) | (1,360) | | | 0 |
| A+B | 0 | 240 | | 1,360 | 1,360 | 1,600 | 4,560 |
| | 1,420 | 240 | (60) | 0 | 1,360 | 1,600 | 4,560 |

In Year 1, only company B was concerned with Minority interests and in Year 2 only company A+B.

Let's analyze these columns.

Dividends: It shows the amount of dividends paid to 3rd Parties, that is 20% * 300

Transfer: This column just consists in transferring Minority interests from company B to company A+B

% var 1 : This amount corresponds to $20\% = 40\% - 20\%$ of new Minority interests in the company B equity brought to company A+B, excluding dividends for 300, that is $1360 = 20\% * [3000 + 3000 + 1000 + (100) + 300 + (100) + (300)]$

% var 2 : This amount corresponds to 40% of new Minority interests in the company A equity brought to company A+B, that is $1600 = 40\% * [2000 + 1700 + 300]$.

4.4 Deconsolidation of a company

The deconsolidation consists in excluding a company from the consolidation scope after having consolidated it during a certain time before.

Clearly, such company is still owned by the group and no shares transaction happened with 3rd Parties.

Why deconsolidation a company?

There are two main reasons to deconsolidate a company.

Temporarily deconsolidation

The company is in a specific situation which makes it impossible to report figures to the consolidation office. We think in particular of companies located in countries

- With a difficult political situation
- In a war situation
- Under embargo
- In which an earthquake took place.

It may also be a company having known a fire disaster or in which the majority of the local employees are placed in a situation of epidemic.

Such situation may last for a limited time, after which reporting goes back to normal.

Definitive deconsolidation

This is typically the case for a company

- Whose figures become lower than some thresholds of materiality
- For which costs to collect the figures are too high with regard to the impact in the consolidated accounts

- Systematically late in producing its reporting and, consequently, being responsible for unacceptable planning delays
- With no internal qualified human resources, implying the need of subcontractors and additional costs

For such situations, decisions to deconsolidate may be either definitive or taken in the long term.

How to process the deconsolidation?

The general approach consists in consolidating the company with the equity method, regardless its previous consolidation method.

The equity accounts at the date of the deconsolidation will remain the basic figures to calculate the equity value in the future and so will not change anymore.

Of course, nothing prevents to book a write-off on that equity value at any time after the deconsolidation.

Most of the time, when a deconsolidation is decided, the management of groups prefers to come back to the book value of the participation instead of keeping for ever an equity value in the consolidated accounts.

If so, there will be a final consolidation adjustment to book which consists in reversing the consolidated reserves of the deconsolidated company.

Let's consider an example.

Until end of Year 1, parent company P was consolidating company A owned at 100%. Financial investment in P is 800 and company A total equity is 1000.

For the last consolidation of A, we have calculated its consolidated reserves as

$$200 = 100\% * 1000 - 800$$

At the end of Year 2, company A being deconsolidated since the beginning of the year, we find a financial asset in the consolidated accounts equal to $1000 - 100\% * 1000$.

To convert this equity value to the historical book value, the write-off amount would be (200) with an impact in P&L the first year.

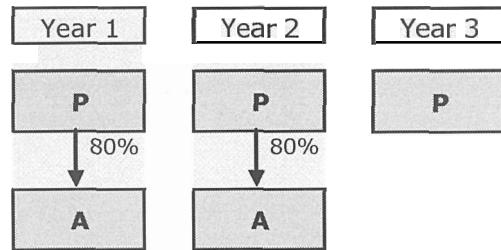
4.5 Liquidation of a company

In this case study we consider a company which disappear from the consolidation scope not because of a disposal or a deconsolidation, but just because the company has no more activity any more and the management decides to legally close it.

We will see that this type of event is closely related to a disposal of a company for a price of zero.

Description of the situation

Company A has been acquired beginning of last year for a price of 2000 and with a goodwill of 500 depreciated over 5 years. At the same time, that goodwill has been partially allocated to a tangible asset in company A accounts for a gross value of 800 depreciated over 8 years.



At the end of Year 1, company A makes an important loss which is supposed to be an exception.

Unfortunately, a new important loss is again expected for the end of Year 2 and parent company P takes three important decisions

- Write-off of the net value of the goodwill
- Write-off of the full acquisition price of 2000
- Booking of a provision for an amount of 240 corresponding to possible payables company A will not be able to face

Finally, beginning of Year 3, company A situation shows no sign of improvement and the shareholders decide to legally liquidate the company.

We will carry on the consolidation over the three years with the necessary comments and we will conclude with a question...

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Consolidation – Year 1

We consider the statutory accounts of companies P and A already adjusted.

| | | P | |
|-----------------|-------|-------------------|-------|
| Goodwill/A | | Capital | 2,000 |
| (a) 500 | | Reserves | 1,000 |
| (b) (200) | | (b) (100) | |
| Fin. Inv./A | 2,000 | Result | 500 |
| (a) (500) | | (b) (100) | |
| Other assets | 3,000 | Other liabilities | 1,500 |
| | | | |
| Tangible assets | 2,000 | Capital | 1,000 |
| (c) 800 | | Reserves | (100) |
| (d) (200) | | (c) 800 | |
| Result | | (d) (100) | |
| Other assets | 1,500 | (d) (100) | (700) |
| | | Other liabilities | 3,300 |

Adjustment (a): Gross goodwill of 500 calculated at time of acquisition of company A after goodwill allocation on a tangible asset in company A.

Adjustment (b): Cumulated depreciation of that goodwill, consisting in 100 corresponding to Year 0 booked in the reserves and 100 booked in the P&L for Year 1.

Adjustment (c): Allocation of the goodwill to tangible assets for a gross value of 800.

Adjustment (d): Depreciation of 200 corresponding to 100 for Year 0 booked in the reserves and 100 booked in the P&L for Year 1.

Here are the corresponding consolidated accounts.

| P + A | | | |
|-----------------|-------|-------------------|-------|
| Goodwill/A | 300 | Capital | 2,000 |
| | | Reserves | 900 |
| Tangible assets | 2,600 | Result | 400 |
| | | Conso. Res.(A) | (860) |
| | | Minority int.(A) | 160 |
| Other assets | 4,500 | Other liabilities | 4,800 |

where

PART 4 SPECIAL CONSOLIDATION TOPICS

- Consolidated reserves (A) = $(860) = 80\% * [1000 + (100) + 800 + (100) + (700) + (100)] - [2000 + (500)]$
- Minority interests (A) = $160 = 20\% * [1000 + (100) + 800 + (100) + (700) + (100)]$

Consolidation - Year 2

The following adjusted accounts reflect what has been explained above.

| | | P | |
|--------------|-------------------------|-------------------|-------------------------|
| Goodwill/A | | Capital | 2,000 |
| | (a) 500 | Reserves | 1,500 |
| | (b) (500) | | (b) (200) |
| | | Result | (1,800) |
| Fin. Inv./A | 0 | | (e) 2,000 |
| | (e) 2,000 | | (f) 240 |
| | (a) (500) | | (b) (300) |
| | | Provision | 240 |
| | | | f (240) |
| Other assets | 3,700 | Other liabilities | 1,760 |

| | | A | |
|-----------------|-------------------------|-------------------|-------------------------|
| Tangible assets | 1,600 | Capital | 1,000 |
| | (c) 800 | Reserves | (800) |
| | (d) (300) | | (c) 800 |
| | | | (d) (200) |
| | | Result | (500) |
| | | | (d) (100) |
| Other assets | 1,100 | Other liabilities | 3,000 |

Adjustment (a): Gross goodwill of 500 calculated at time of acquisition of company A, after goodwill allocation on a tangible asset.

Adjustment (b): Cumulated depreciation of goodwill, consisting in 200 corresponding to Year 0 and Year 1 booked in the Reserves and 100 booked in the P&L for Year 2.

Adjustment (c): Allocation of the goodwill to tangible assets for a gross value of 800.

Adjustment (d): Depreciation of 300 corresponding to 200 for Year 0 and Year 1 booked in the Reserves and 100 booked in the P&L for Year 2.

Adjustment (e): The write-off for 2000 booked in statutory accounts has to be reversed in consolidation, while company A is consolidated.

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Adjustment (f): Parent company P has booked a provision corresponding to possible payables company A will not be able to face. In fact, estimation of these payables is 300 and all shareholders agree to pay their part, that is $240 = 80\% * 300$ for company P. Of course, that amount of 300 is already booked in company A accounts and this leads to a double booking of the same amount, once in A and once in P as a provision. That's the reason why we reverse that amount.

Here are the consolidated accounts.

| | | P | A | |
|-----------------|-------|-------------------|---------|--|
| Goodwill/A | 0 | Capital | 2,000 | |
| | | Reserves | 1,300 | |
| Tangible assets | 2,100 | Result | 140 | |
| | | Conso. Res.(A) | (1,340) | |
| | | Minority int.(A) | 40 | |
| Other assets | 4,800 | Other liabilities | 4,760 | |

where

- Consolidated reserves (A) = $(1340) = 80\% * [1000 + (800) + 800 + (200) + (500) + (100)] - [0 + 2000 + (500)]$
- Minority interests (A) = $40 = 20\% * [1000 + (800) + 800 + (200) + (500) + (100)]$

Consolidated reserves evolution between Year 1 and Year 2

| | Year 1 reserves | Year 2 result | Dividends | Dividends + | Transfers | Dividends P | Year 2 reserves |
|---|-----------------|---------------|-----------|-------------|-----------|-------------|-----------------|
| P | 1,300 | 140 | | | | | 1,440 |
| A | (860) | (480) | | | | | (1,340) |
| | 440 | (340) | 0 | 0 | 0 | 0 | 100 |

During this period, there are six consolidation adjustments, but finally nothing special appears in this report.

The statutory liquidation of the company

It is important to understand how the liquidation is processed from a statutory point of view.

The basic principle is that all assets are sold to 3rd Parties or written-off through P&L if they cannot be sold. On the assets side, the company remains with cash used to reimburse all debts.

The remaining cash after all debts reimbursed are then returned to shareholders.

In company A situation, things do not happen exactly like this. We suppose all "Tangible assets" and "Other assets" are sold for an equivalent of cash amount that is 2700. This cash is used to reimburse the amount of "Other liabilities" which is 3000. The company remains with some payables of 300 that cannot be paid. This explains the Year 2 decision of the shareholders to book a provision in their accounts for their corresponding parts.

Now that the liquidation is in process, parent company P books the following journal entries

| | Debit | Credit |
|----------|-------|--------|
| Result | 240 | |
| Payables | | 240 |

First, parent company P recognizes payables for 240, with an impact on the P&L.

| | Debit | Credit |
|-----------|-------|--------|
| Provision | 240 | |
| Result | | 240 |

Secondly, the provision booked in Year 1 is used to give an impact of zero in the P&L.

Finally, company P remains with payables for 240.

Consolidation - Year 3

There are no companies to consolidate this year. Nevertheless, we still have one consolidation adjustment to book. To determine the adjustment amount, we will proceed step by step as we did for the disposal of shares to 3rd Parties.

Step 1 : We reverse what has been booked in statutory accounts because the figures have no meaning in the consolidation context.

| | Debit | Credit |
|----------|-------|--------|
| Payables | 240 | |
| Result | | 240 |

| | Debit | Credit |
|-----------|-------|--------|
| Result | 240 | |
| Provision | | 240 |

Step 2 : We carry forward all historical adjustments booked until the Year 2 consolidation.

| | Debit | Credit |
|----------------|-------|--------|
| Fin. Invest./A | 2,000 | |
| Reserves | | 2,000 |

Reverse of the financial investment write-off.

| | Debit | Credit |
|----------------|-------|--------|
| Goodwill | 500 | |
| Fin. Invest./A | | 500 |

Goodwill on company A acquisition.

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| | Debit | Credit | Complete depreciation of the goodwill. |
|----------------------|-------|------------|--|
| Reserves Goodwill | | <u>500</u> | |

| | Debit | Credit | |
|-----------------------|-------|------------|-------------------------------------|
| Provision Reserves | 240 | <u>240</u> | Reverse of the statutory provision. |

| | Debit | Credit | |
|--|-------|--------------|---|
| Equity value Fin. Invest./A Reserves | | <u>1,500</u> | We now replace the adjusted financial investment on company A by its equity value and we know since Part 2 that the difference is equal to the consolidated reserves. |

The equity value is $160 = 80\% * [1000 + (800) + 800 + (200) + (500) + (100)]$ and the reserves of debit 1340 are the ones we find in the Year 2 consolidated accounts.

| | Debit | Credit | |
|------------------------|-------|------------|--|
| Result Equity value | 160 | <u>160</u> | At this time, we stay with an equity value as a financial asset that we write-off. |

Step 3 : We process the liquidation at consolidation level by recognizing payables for 240.

| | Debit | Credit |
|--------------------|-------|------------|
| Result Payables | 240 | <u>240</u> |

All these adjustments from step 1 to step 3 can be aggregated in a single journal entry

| | Debit | Credit |
|--------------------|-------|------------|
| Result Reserves | | <u>400</u> |

which is our final consolidation adjustment (g) as shown hereafter

| | P | |
|--------------|----------|-------------------------|
| | Capital | 2,000 |
| | Reserves | (300) |
| | (g) | <u>400</u> |
| | Result | 700 |
| | (g) | <u>(400)</u> |
| Other assets | 4,900 | Other liabilities 2,500 |

Consolidated reserves evolution between Year 2 and Year 3

Figures are extracted from the consolidated accounts above

| | Year 2 reserves | Year 3 result | Dividends | Dividends + | Transfers | Dividends P | Year 3 reserves |
|---|-----------------|---------------|-----------|-------------|-----------|-------------|-----------------|
| P | 1,440 | 300 | | | (1,340) | | 400 |
| A | (1,340) | 0 | | | 1,340 | | 0 |
| | 100 | 300 | 0 | 0 | 0 | 0 | 400, |

We see the transfer of consolidated reserves from A to P for 1340 as a normal disposal of shares to 3rd Parties.

And the final question is ...

Your CFO would like to know what is finally the total cost of acquiring company A and keeping it in the consolidation scope for three years until liquidation in Year 3.

Most of the consolidators, with their technical mind, would proceed by analyzing the impact in P&L of company A during that period.

Company A has been acquired for a price of 2000 and a goodwill of 500. This means that $1500 = 2000 + (500) = 80\%$ of the equity at acquisition. This equity is equal to $1875 = 1500 / 80\%$. But that equity contains 800 of the goodwill allocation. The statutory equity at acquisition date is then $1075 = 1875 + (800)$.

As we can notice in the Year 2 statutory accounts, equity is (300), which means that between acquisition and liquidation dates, company A has generated a cumulated loss of $(1375) = (300) - 1075$, in which the group takes its part of $(1100) = 80\% * (1375)$.

Moreover, the goodwill allocation for 800 has impacted the group P&L for $(240) = 80\% * (300)$, thanks to the depreciations.

In company P accounts, the group had to support (500) charges corresponding to the goodwill depreciation.

And finally, the liquidation leads to a charge of (400).

Adding all these P&L impacts gives a net amount of $(2240) = (1100) + (240) + (500) + (400)$.

Not sure your CFO will listen you all along these technical explanations.

Isn't it easier to just say that one day the group acquired a company for a price of 2000 and at the end of the story, it had to pay an added amount of

240 for some payables that company A couldn't face. And to conclude that (2000) + (240) is also equal to (2240)!

5 SOME PARTICULAR SITUATIONS THAT HAPPEN ONLY TO OTHERS ...

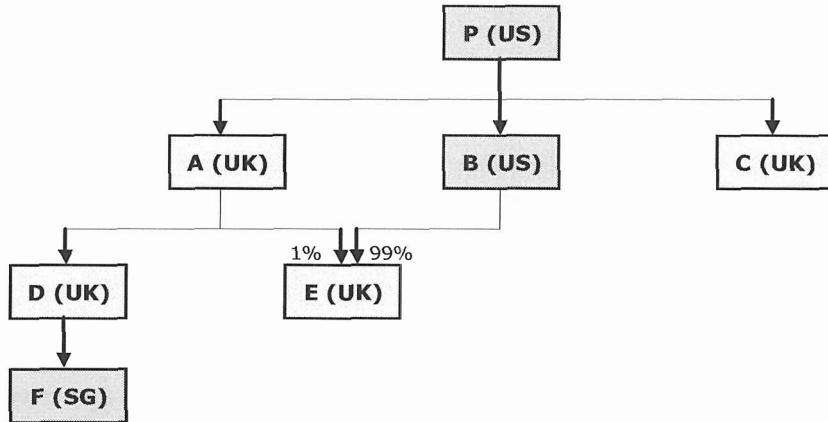
In this Part 5, we will consider some situations that we met in real life, but not very often, we must admit. The problem is that when such situations occur, a consolidator will not find the solution in a book and in most cases the answer is expected urgently.

The following cases will not be analyzed in deep details with figures as we did for the previous case studies. Moreover, we will not be able to give THE solution because these cases are interpretative and the solution is generally not unique.

Only some guidelines can be given.

5.1 Segmented consolidation

The CFO is on a meeting and needs to know as soon as possible what is the contribution of the UK companies in the group?



At a first glance, it seems obvious (for an external observer) that company A is a holding company for UK companies. But looking closer to this group's structure, company E is owned only at 1% by company A and at 99% by a US

company. This fact complicates a little bit the normal approach of considering companies A, D and E as a subgroup to consolidate.

Moreover, company C is owned directly by parent company P, which is also a US company. What do we do with company C?

And finally, we also see that company F, owned by a UK company, is located in Singapore. What do we do with company F?

Is CFO's question relevant, with an easy answer? No, except if this CFO wants a segmented view of the consolidated figures, giving UK on one side and all the other companies on the other side.

What are the basic principles of a segmented consolidation?

We identify three basic principles:

1. We suppose that each company belonging to the consolidation scope can be uniquely identified by a criterion. For instance, a company may belong to a country (our example), may be active in a unique activity, may belong to some geographical region or currency region (EUR, USD, ...), ...
2. For each company, a net equity situation is calculated. This net equity is the difference between the normal equity and the financial investments in other companies, regardless of the criteria in which these companies are.
3. Intercompany amounts are eliminated only between companies belonging to the same segment criteria.

If some companies belong to more than one criterion, this segment consolidation doesn't work except if we proceed to a break down of such company into two separate entities, each entity belonging entirely to a segment.

It is important to notice that the segment consolidation approach does not care about the group's structure because each holding company becomes a normal company, with regard of the fact that its financial investments are eliminated against its own equity. These companies are losing their role of (sub)parent company.

To reconcile the segment figures with the whole consolidated figures, we can just add corresponding figures together, except for intercompany accounts, because some amounts are not eliminated anymore when intercompany positions are declared between two companies belonging to two different segments.

Segmented consolidation may be applied to balance sheet, P&L, cash flow statement and notes to the accounts.

But, in all cases, we must be careful by reading segment consolidated figures for some other reasons.

For instance, if company F (SG) is paying dividends to company A (UK), does it make sense to still eliminate the dividends which represent revenue coming from another segment?

Another disturbing example is the fact that, for instance, company A (UK) is making a group profit with company B (US), which is eliminated in the statutory consolidation. That profit shouldn't be eliminated in the segmented consolidation.

The conclusion is that producing consolidated figures is something easy, certainly with a specialized software, but a human analysis is always necessary.

5.2 Break even price when selling a company

At what price do we have to sell a certain company in order to get no impact in the consolidated P&L?

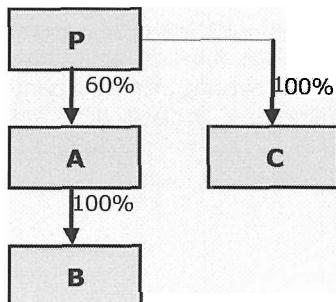
If this question is frequent and most of the time the answer more than urgent, our best recommendation would be to validate your logic more than once before giving your answer.

Why?

Because there are possible gaps of misunderstanding between the question and the possible answers.

Let's consider the following example

In this group, company A is to be sold for a price producing no impact in the P&L.



Is it clear that by selling company A the company B is also sold? Maybe it could be worth to ask a confirmation about company B. And if company was first sold to P or C before making the disposal transaction of A?

Very often, a CEO is not fully aware of the consolidated figures and adjustments and a selling price is estimated starting from the book value of the company.

In this example, we confirm there is a goodwill on company A and a goodwill in company A on company B. Both will be eliminated with a direct impact on the P&L.

There is also a history in consolidated figures. A few years ago, company C sold to company A some tangible fixed assets and made a gain. The gain has been eliminated in company A with depreciation adjustments which are still running today. These adjustments have of course an impact on company A equity.

Without considering too many figures, let's suppose the statutory book value of company A in parent company P accounts is 1000 and the consolidated equity of the subgroup A+B, including all consolidation adjustments and already elimination of both goodwills, is 1200.

On the basis of these figures, we would like to clarify another issue related to the words "... no impact in the P&L" as stated in the initial question.

If we sell company A for 1000, we make no profit in the statutory accounts and we make a loss of (200) = $1000 - 1200$ in the consolidated accounts. This means, we have to book an adjustment for (200). So we have an impact in the P&L.

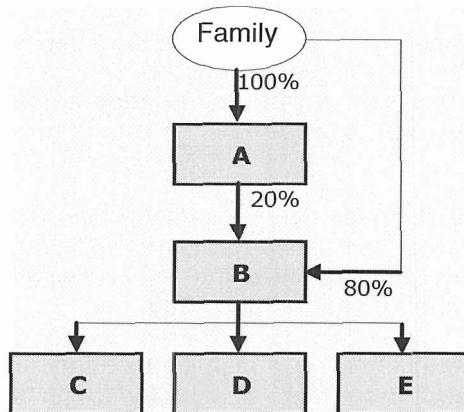
If we sell company A for 1200, statutory accounts shows a profit of 200 but we make a profit of zero in the consolidated accounts which implies an adjustment for (200). So we have an impact in the P&L.

If we sell company A for 1100, statutory accounts shows a profit of 100 but we make a loss of (100) in the consolidated accounts which implies an adjustment for (200). So we have an impact in the P&L.

This short example shows there is always a P&L impact. Make sure this point is clear to the person asking the question.

5.3 Family group consolidating for the first time

Here is a family group with company A as the top company.



Given the importance of the investments and the related loans involved, banks are currently asking for consolidated figures.

But which company should become the consolidation company in such structure?

It could be company A but shall we then consolidate the rest of the group, B and affiliates C, D and E with the equity method? This would be of weak interest for the banks.

We could ignore A and begin the consolidation with B as the parent company. This makes much more sense, but banks wouldn't be happy because it is mainly company A asking for loans.

By analyzing more deeply this group's structure, we can suppose that both companies A and B are controlled by the members of the same family and so both companies are placed under the same control.

This means that we would recommend applying the global integration method for both companies A and B. We would then integrate all assets and liabilities, reaching certainly one of the banks objectives. Of course, the consolidated balance sheet would show Minority interests for 80% not only on the equity of B, but also 80% on the equity of all direct and indirect affiliates of B. The total amount would probably be really important.

By presenting such figures to the management of a group of this type, be ready to have the following conversation:

Question: 'What's this huge amount on the Minority interests line?"

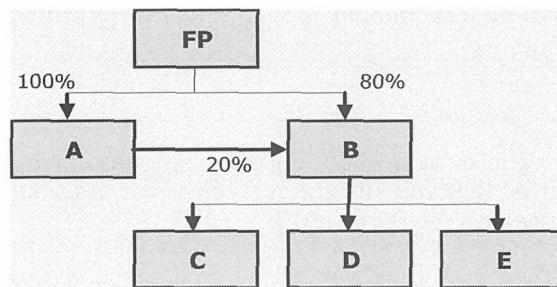
Answer: "It's an amount belonging to 3rd Parties"

Question: "That's not possible, because WE are the 3rd Parties! Can you transfer the amount on the Reserves line?"

If you comply with such request, you will go into some trouble because the first time company B pays a dividend, only 20% will arrive in company A and not 100%.

We could also consider this group as a consortium

Indeed, let's look at this group's structure from another point of view.



We consider companies A and B as being both parent companies in a consortium structure (Refer to Part 2 – Chapter 3 – Section 7).

On the one hand, this structure is not so simple because of the existence of the participation of 20% from A into B. A fictitious consolidating company must also be defined on the top of this structure.

On the other hand, the minority interests disappears, resulting in much more understandable consolidated accounts for external observers.

The two structures are acceptable and we recommend presenting these options to Bankers and Auditors before starting the first consolidation. Keep in mind that such a decision is to be applied in a long term.

5.4 What is the value of a company?

At the end of a consolidation, a question sometimes arises about the value of a company in the group.

But what is the value of a company?

From a consolidation point of view, we cannot give more than what we have, this is the equity value or the financial percentage we own in the equity of a company.

To put it in another way, we suppose we set all company consolidation methods to equity method and most of the main professional consolidation software will be able to produce an alternate version of the consolidation. The expected answer can be found in the contribution view of the consolidated equity value in the financial assets.

Of course, these figures should be carefully interpreted in view of the following comments.

Comment 1

We consider here the easiest situation of a company having a total equity of 1000 and owned at 80% by the parent company. Its value calculated from consolidation figures will be $800 = 80\% * 1000$.

It is important to notice that the equity may include a certain number of adjustments for so many different and historical reasons that the amount of 1000 may differ substantially from the statutory value.

Comment 2

Notice also that it is important to know which accounts are considered as part of the equity of the company. Some accounts like "Currency translation adjustments" (CTA), "Investments grants" (if not IFRS), 'Revaluation reserves', ... should be included in the equity. The CTA, for instance, gives then a present value instead of an historical value.

Comment 3

Referring to the previous structure, we could also have a company B owned by company A at 60%.

Let's suppose company B equity is 3000 and the financial investment on B in company A accounts is 1200.

The value of company B would be $1440 = 80\% * 60\% * 3000$ but this time company A would be valued for $(160) = 80\% * [1000 - 1200]$, a negative value!

Which interpretation can we give to this situation?

Company A is becoming a sub holding. Supposing such a company invests exactly the amount of its capital, its value would be zero and it makes sense because the value of A is completely dependant of the value of B.

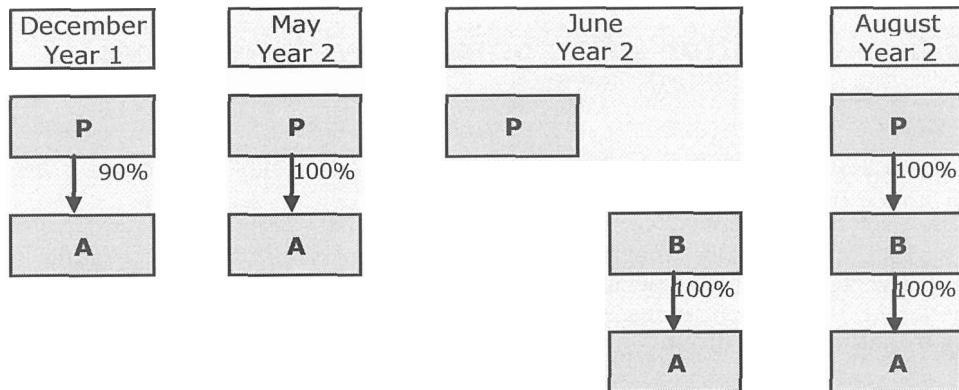
Our message here is that the value of a company depends on its place in the group's structure. For any company not having financial investments in other consolidated companies, we refer to comment 1. For all the others, it is necessary to aggregate their own value with the value of their participations.

Comment 4

On top of these comments, don't forget that the value of a company must be reduced with the net value of the remaining goodwill. This is generally not automatic in consolidation software.

5.5 Disposal and acquisition of the same company within the year

This is a quite surprising and difficult situation as explained with the following structure.



In December Year 1 parent company P owns 90% of company A and in May Year 1, P acquires the remaining 10% of shares of company A in order to sell

the 100% to a 3rd Parties, namely a certain company B. Of course, end of June, company A is not in the consolidation scope any more and there is a consolidation adjustment to correct the statutory gain on disposal.

In August, company P acquires a new company which is ... company B! This acquisition is in fact a sub group acquisition because company B owns 100% of company A. This acquisition leads to a goodwill.

How has this real situation been consolidated as at December Year 2?

We have adopted a logic of continuity by considering that A has not left the group for two months.

The 100% disposal of company A shares to 3rd Parties has been qualified as a group transaction implying the elimination of the gain on disposal in company P accounts and an adjustment of the financial investment in company B accounts for the same amount.

The goodwill that B has booked in its accounts when acquiring company A has been reversed and replaced by the goodwill corresponding to the acquisition of the 10% in May.

Finally, we calculated a goodwill on company B only.

The good point in all this was the fact that we received individual accounts for companies A and B. Receiving consolidated accounts of the subgroup B+A, for instance because B would have been located on another continent, would have resulted in a rather difficult consolidation process.

5.6 Acquisition of a company with negative equity

In non IFRS (Local Gaap) evaluation rules, negative Minority interests are generally not accepted.

This situation usually appears because of cumulated losses generating a negative total. In this specific situation, the first time the equity becomes negative, the part of the loss normally belonging to minority has to be booked as a charge for the group.

When the situation is turning back to profit and as soon as the Minority interests are positive again, these charges are supported by Minority interests.

The idea behind this process is the fact that 3rd Parties have no active role in the management of the company. The group having the control must support all these consequences.

Now, the situation we want to point out is rather different.

We suppose parent company P acquires for a price of 200 60% of a company A presenting a negative equity for (500). This situation leads to a goodwill equal to $500 = 200 - 60\% * (500)$.

In the consolidated equity, Minority interests for this company are equal to $(200) = 40\% * (500)$, which is a negative amount.

How to handle this amount, supposing we apply some Local Gaap not accepting that situation?

We are not in the situation described above of an equity becoming negative because of losses during the period the group operates the company.

The position that has been chosen and accepted by the Auditors was to book the amount of (200) as an additional goodwill.

Each time an adjustment is booked in consolidation, it is important to wonder what will be its future.

In this case, supposing the company remains in a situation of losses, the additional goodwill is maintained as an intangible asset. As soon as the situation is getting profitable, the minority profit is booked on the credit of the goodwill until it disappears.

If the group assumes the company will never turn back to profit in a reasonable delay, this goodwill can either be depreciated or written-off. In both options, this will of course impact the P&L.

5.7 Existence of minority interests when acquiring 100% of a company

This case study has a connection with the previous case.

We are in Year 1 and company A is consolidated at 80% by its parent company P. The particular situation is that company A equity is (200) corresponding to its loss of this year.

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The consolidating process calculates Minority interests equal to $(40) = 20\% * (200)$. Supposing we are in some Local Gaap not accepting negative Minority interests, there will be the following consolidation adjustment

| | Debit | Credit |
|--------------------|-------|--------|
| Result (Group) | 40 | |
| Minority interests | | 40 |

booking the 40 as a charge for the group and consequently reducing Minority interests to zero in the balance sheet.

This adjustment is to be carried forward in the future consolidations during the time company A stays in the group at 80%.

Beginning Year 2, company P acquires the remaining 20% of company A shares for a price of 200. This transaction implies a goodwill calculation that is equal to $240 = 200 - 20\% * (200)$.

While doing this Year 2 consolidation, we don't calculate Minority interests any more but we still find the previous adjustment which has been carried forward as explained above. This means we show Minority interests for 40 which is not acceptable.

We propose three different ways to solve this issue.

Eliminate the Minority interests by booking the P&L

Here is the adjustment in which the two first entries correspond to the opening of Year 1 and the two last entries show an elimination of these Minority interests as a profit for the group. It was a charge last year.

| | Debit | Credit |
|--------------------|-------|--------|
| Reserves | 40 | |
| Minority interests | | 40 |
| Minority interests | 40 | |
| Result (Group) | | 40 |

Eliminate the Minority interests by booking the goodwill

This adjustment is similar to the previous one with the Result (Group) entry being replaced by the goodwill entry.

| | Debit | Credit |
|--------------------|-------|--------|
| Reserves | | |
| Minority interests | | |
| Minority interests | | |
| Goodwill | | |

Eliminate the Minority interests by booking the reserves

This adjustment consists in reversing the opening Year 1 adjustment. It is supposed to be booked just before the acquisition of the remaining 20%, in such a way that the goodwill is now equal to $200 = 200 - 20\% * (200) + 40$

| | Debit | Credit |
|--------------------|-------|--------|
| Reserves | 40 | |
| Minority interests | | 40 |
| Minority interests | 40 | |
| Reserves | | 40 |

What can we conclude about these three approaches?

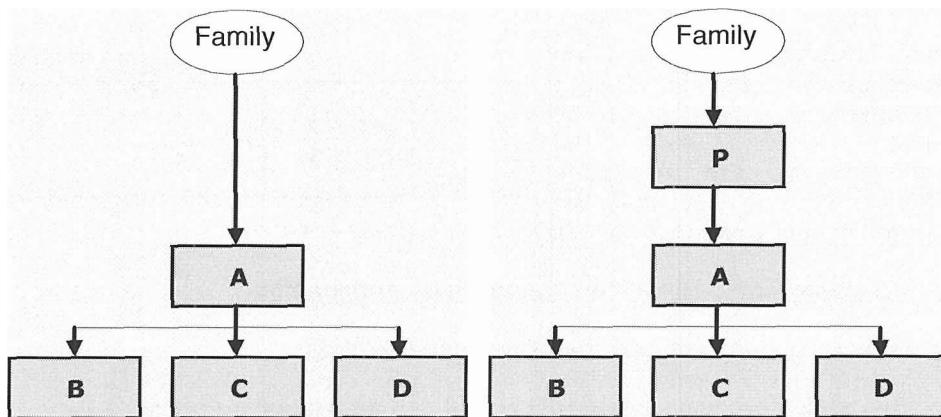
The two last options produce the same goodwill of 200.

The first option produces a goodwill of 240 and an immediate result of 40. But, sooner or later, we know that these goodwills will finally be booked in the P&L.

This first option is maybe a little too "optimistic" and we would recommend to adopt a much more prudential attitude by choosing the third option because we show no profit in the P&L. Moreover, this adjustment must not be kept in the consolidation in the future.

5.8 When a group is changing its parent company

This group has a parent company A whose shares are owned by members of a family. It consolidates since a certain number of years, in particular for banks requirements. We can suppose, without any limitation, that all participations are held at 100%.



Beginning of Year 2, for some private reasons, all members of this family bring their company A shares to a new holding company P.

Considering the new structure, some important questions will arise.

Which company has to consolidate?

The usual position for such situation is that the top holding, we mean company P, must consolidate, supposing it is not located in some 'fiscal paradise' or in a country listed on an international "black list". We assume it is not the case in our situation.

Does company A still have to consolidate?

If company P produces consolidated accounts, all companies included in its consolidation scope are exempted. So A is not required to consolidate any more.

What will be the banks position?

The experience shows that the fact company A doesn't consolidate any more is very often perceived as a problem by the banks. They are used to analyse figures and ratios in relation with existing contracts signed with company A.

Moreover, new assets and new liabilities in company P accounts will probably need some additional reviews from the banks. This to say that, whatever is the choice, the Bankers will probably ask to receive "group A" consolidated accounts.

What about historical adjustments when company P consolidates?

This question appears quite often in this situation and the answer is supposed to be: Yes, we keep in "group P" all historical adjustments booked in "group A".

Our position towards this question is the opposite.

Company P is a new company deciding for the first time this Year 2 to produce consolidated accounts. Moreover, if we suppose that the family has founded this company P this year, all these historical adjustments as goodwill, tangible assets depreciations, provisions, elimination of group profits, ... have no signification from the point of view of new P company.

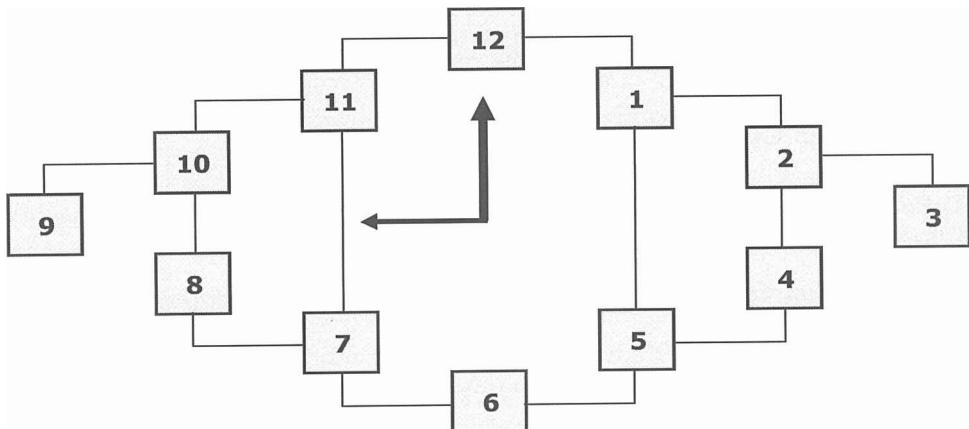
Company P is starting a consolidation and all historical adjustments related to 'Group A" consolidation should be ignored.

With this position, we understand that the Bankers are probably a little bit disoriented and ask to maintain a "Group A" consolidation.

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PART 5

ORGANIZATION OF A CONSOLIDATION AND FAST CLOSE



FIRST CONSOLIDATION OF A GROUP

1.1 The very initial choices

When the management of a group takes the decision to establish consolidated accounts, whatever may be the objective (official publication or restricted use to the attention of the Bankers for example), they should know that it implies a double commitment.

On the one hand, it inaugurates a new picture of their group in a context of continuity and for a long time.

On the other hand, they will have to involve group companies, each company having to play a new role in a logic of planning, reporting, control and follow-up.

And the motivation of these companies will constitute a key element in the organization.

With regard to the importance of the decision to consolidate for the first time, some initial choices appear critical to us to ensure the success of the project.

1.2 The consolidation scope

The companies entering the consolidation scope depend on the comments which are discussed in the three following questions.

Which companies should not enter the consolidation scope?

It is legally admitted that a company presenting figures under some thresholds defined by the group management should not enter the consolidation scope.

These thresholds are generally not defined by law and each group will appreciate it, depending on the basis of its own figures.

The experience shows, however, that a threshold of 1% or 2% of the turnover is usually accepted as a criterion to exclude a company from the consolidation. More often, management will take into account more than one criterion, by considering also the total equity and the total balance sheet. Exclusion will then apply when two out of three criteria are satisfied.

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A particular attention will be brought to the situation where several "small" companies satisfy the set of criteria to be excluded from the consolidation scope. If, together, the total amounts are above the criteria, these companies should be kept in the consolidation.

We also recommend to exclude companies in the following situations

- Companies located in countries in a war situation, in a difficult political or economical situation (embargo)
- Companies having a disaster (fire, epidemic, hurricane, destruction of industry capabilities, ...)
- Company being in the process of a legal liquidation.

On the opposite, the fact that a company has an activity completely different from the main activity of the group is not a reason to exclude it from the consolidation, whatever the consolidation rules are, IFRS or Local Gaap.

We should also say that some companies may be kept outside the consolidation scope because they are not (yet) able to follow the reporting and planning instructions. Including such companies in the consolidation would increase the risk of not closing consolidated accounts in time.

Finally, we would also recommend to be very careful with companies following completely different accounting rules, even with a different chart of accounts, as banks and insurances companies joining industrial groups. For such companies, if the consolidation is required, then, independently of the level of control the group may have, we would recommend to apply the equity method.

We would conclude this first question by a very practical advice. It's better to have a minimalist view on the initial consolidation scope by considering only companies ready to commit with the group requirements. As soon as these excluded companies become ready, they can then be integrated.

Depending on the number of companies to consolidate, shall we apply the state or the direct technique?

The question here makes sense when the group can be organized in different subgroups, in such case a first consolidation could be done by each subgroup. The final parent company would then reduce in an important way the number of companies to be consolidated directly on its level.

The decision for such organization should first be guided by the following comments:

Each subgroup contains a significantly important number of companies, in such a way that the consolidation process would become difficult to manage at parent company level, as a single consolidation site for the whole group.

- The persons in charge of the consolidation at each subgroup level will have an excellent understanding of the group rules of consolidation in order to produce consistent sub consolidated figures.
- The geographical localisation of the subgroup head office and its held companies make difficult to maintain a contact with each entity.
- One subgroup may be recently acquired and consolidated since a number of years. It could be considered as clumsy and delicate to suppress the function of consolidation. It is more a human resources issue than an organizational problem.

These comments brings along some arguments to consolidate subgroups but the management could also consider opposite comments

- There is a limited number of companies consolidated by a subgroup and it is just a non sense to keep this organization.
- Maintaining several consolidation sites may generate some unacceptable over costs.
- The group management prefers to consolidate directly each individual company in order to get a contribution view on all accounts.

Maintaining sub consolidations may present a risk to lengthen the deadlines.

The decision to consolidate by the stage technique or the direct technique is not easy because it implies so many different aspects. Nevertheless, we would recommend the direct technique whenever it is possible, even if some companies are unhappy about it.

What will be the consolidation method of each company?

In Part 2 of this book we have explained how to calculate the control percentage and how to apply the logic to attach the corresponding consolidation method to each company.

We will not come back on these explanations but the message here concerns some "border line" situations.

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Control percentages close to 50%

If there is no specific shareholders agreement, the number of voting rights is the only criterion to consider. 50% of voting rights in hand less one voting right means the equity method and plus one voting right means the global integration method.

When exactly 50%, one needs additional information to choose the consolidation method.

Under IFRS rules, the equity method applies. Under Local Gaap, we need a limited number of shareholders and a shareholder agreement confirming that each one cannot decide on its own without the approval of all the other shareholders. In such case proportional integration method or equity method are the acceptable candidates. The choice of one or the other depends on internal defined rules.

Financial investors

Above the figures, we want to point out a majority shareholder, generally a financial investor, refusing his majority rights because it is just not his business. In such situation, the group accepting the control with less than 50% voting rights will have to consolidate the company by the global integration method.

Presence to annual aeneral meetinos

A group with less than 50% voting rights, attend regularly the annual general meetings of a company while all other shareholders are never present, gives to the group a control "de facto" and the global integration method for that company.

Why insisting on the level of control? For two main reasons.

First, a consolidation method implies for the concerned company a full reporting, if integration or proportional method, or a reduced reporting if equity method. The company should be informed of the group choice as soon as possible in order to organize its own information system.

Secondly, a wrong choice of a consolidation method has two bad consequences. A change of a consolidation method has to be explained in the notes to the accounts and it can become a challenge for a company to be informed sometimes a little late that it has to skip from the reduced to the full reporting package in a short delay.

1.3 The consolidation rules

The basic principle is that the consolidation rules to apply are those of the consolidating parent company.

In most cases, the parent company being just a holding company with no other activities, this principle is becoming non significant.

It makes much more sense to align the consolidation rules to the most important group companies.

However, we highly recommend having a long term view when starting a consolidation process by answering the following questions:

- On which market is the group going to develop the most? If it for instance on the US market, maybe it could be recommended to choose US Gaap instead of Local Gaap.
- If the financial objective of the group is to go public in a medium term, it should start immediately with IFRS
- If the company intends to open its capital to new investors, who maybe will ask for IFRS consolidated figures, we also recommend to start with IFRS.

In any situation, the wrong decision would be to delay the process by starting first with Local Gaap and then migrating some years later to IFRS. It can ask a huge effort in the beginning because most group companies are probably not ready. But, the effort in a few years will be the same and, moreover, the volume of work will increase because of additional reporting to justify all differences between Local Gaap and IFRS figures.

1.4 The Auditors

Consolidated accounts must be audited in the same way as statutory accounts.

Are the Auditors for statutory accounts the same as the Auditors for consolidated accounts?

In most countries, this is the choice of the group's management.

If the Auditors (company) are the same, this normally leads to a better understanding of the group activity.

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Must a unique Audit company be chosen ?

This is also the choice of the group.

It is obviously an advantage to work with a unique Auditors company because of the internal network of information they can offer. It is also important to consider that this choice may optimize the consolidation planning by avoiding receiving signatures from independent Auditors sometimes spread all over the world.

1.5 The information system

There is no consolidation without an information system and a vehicle between subsidiaries and the consolidation office.

The whole construction begins with the inventory of the information to produce in order to comply simultaneously with internal and external requirements and then progressively with the analysis of the input information to ask to each company.

Let's look in more details some important pieces of information.

The chart of accounts

The group chart of accounts is unique, even if companies are located in different countries with legal accounting requirements. They will have to adapt.

In some countries, there exists a national chart of accounts that can be used as initial information to be extended for consolidation needs. This approach will not be so easily applicable for IFRS consolidation rules because no standard exists.

On the basis of a classical chart of accounts, some specific accounts must be added to make the consolidation process operational and some existing accounts will need some comments.

Specific assets accounts

- Goodwill with a necessary distinction between gross value and depreciation or impairments
- Financial investments in consolidated companies to separate from financial investments in non consolidated companies. Four different accounts should be defined:

DIRECT CONSOLIDATION _____

- o Acquisition value
- o Uncalled amounts
- o Revaluations
- o Write-offs

The first two accounts are cash and the last two accounts are non cash. Moreover, the only variations accepted in a consolidation process are acquisitions, disposals and payment of uncalled amounts. Revaluations and write-offs, even if they are naturally booked at statutory level, are amounts to eliminate in the consolidation process.

- Equity value for all companies consolidated with the equity method
- Receivables with companies consolidated by the equity method
- Own shares

Specific liabilities accounts

- Consolidated reserves account such as calculated throughout this book and which are changing from opening to closing only by the group result and the parent company dividend
- Revaluation reserves account which should be maintained separate from the consolidated reserves because these reserves are generally the counterpart of assets revaluations, without P&L impact
- Badwill account for non IFRS consolidations
- Currency translation account
- Minority interests account.

In addition to these accounts, at least two Link accounts should be defined

- A Link account for the intercompany amounts eliminations;
- A Link account for the elimination of financial investments;

Specific P&L accounts

- Goodwill depreciations account that may be considered either as an operating charge or a financial charge
- Goodwill impairments for IFRS consolidations

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- Exchange gains/losses : keep separate realized and unrealized transactions because of their impact on the cash flow statement
- Write-off on financial investments account which must be adjusted to zero in the consolidation
- Dividends received from consolidated account : to use only for that purpose and it will be easy to check that all group dividends are eliminated
- Gain/loss on assets disposals account that will be adjusted for elimination of group gain/loss
- Profit/loss from equity method companies accounts. Two accounts must be defined because profits and losses are shown separately in the consolidated P&L
- Result from minority interests account. Only one account because profits and losses can be netted.

At least one Link account will be defined for intercompany amounts eliminations.

The consolidation bundle

The consolidation bundle is the reporting tool between the consolidation department and the group companies.

Its importance as information vehicle and the efficiency of its structure justify to dedicate the next chapter to it.

However, we mention this tool right now as one of the most important item of our check list while preparing a first consolidation.

Evaluation rules and group procedures

The choice of evaluation rules is a must when starting a consolidation process and a vision on the group evolution will help to choose either Local Gaap or IFRS.

As soon as the choice is decided, each group company should be immediately informed because local accounting will probably need some adaptations consequently. This can be time consuming if some evaluation rules are not compatible with local accounting regulations or if some evaluation rules have to be decided at a Board of Directors level.

It is also important to keep in mind that when a set of evaluation rules is adopted, each company must comply with each rule. No exception is allowed.

In addition to a given set of evaluation rules, we would recommend to remain flexible by defining some materiality threshold.

At least two sets of thresholds should be defined:

- One set for intercompany differences. We always recommend defining some thresholds in order to avoid using too many resources for non material adjustments. For instance, one threshold for balance sheet intercompany differences and another one for the P&L seem realistic. Auditors, sometimes, accept such threshold only for mid-year consolidation, while these thresholds are set to zero for the year-end consolidation.
- Another set for amounts to be adjusted. Most of the time, when an amount is adjusted, the adjustments have to be kept in the consolidation accounting for many years. For instance, adjusting depreciations over a period of 10 years, including the deferred tax effects, implies to keep track of these adjustments during the same period.

Some consolidation procedures are to be defined at group level. One example is the method to be used for the elimination of gain on assets disposals between group companies.

There are basically two methods as explained in Part 2 of this book. The first one consists in booking the gain amount on a Reserves account and the second one on a Deferred income account. It's a group choice but when it has been decided, the group consolidation has to comply with this option.

These consolidation procedures should be written and approved by Auditors. Instead of preparing a thick procedures file including all possible transactions that could happen during the lifetime of the group, we recommend starting such file in a more flexible way. This method consists in adding one new procedure description the first time it happens in the group, after a discussion and approval by Auditors. Maybe, this file will contain only a few procedures at the beginning of the consolidation process but, year after year, this number will certainly increase in a more efficient and cheapest way.

A final comment about this subject concerns the language to use with all group companies.

Whenever that language may be, we recommend using a unique language. The reasons are quite clear. If you start communicate written information in

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the language of company 1, be sure company 2, speaking another language, will ask also a translation.

At the end, the consolidation office will become progressively a 'translation office" and will have to support high translation costs, not only the first time producing the basic materials but also each time there are updates.

1.6 The tasks of the consolidation office

Even if a consolidation is done only twice a year, the people in charge of that job must stay active all along the year.

Here are some examples of tasks to achieve and information to be known :

- Communicate the closing and average rates of group currencies, normally the first day after the closing date in order for each group company to adapt their intercompany amounts.
- Keep updated the consolidation bundle template, the evaluation rules and the procedures.
- Collect all information related to shares transactions, as
 - Acquisitions of new companies or additional shares acquisitions
 - Disposals of companies or partial shares disposals
 - Liquidations of companies
 - Deconsolidations of companies
 - Merges or absorptions of companies
 - Capital increases/decreases
- Be informed in all details about all group dividends paid by subsidiaries.
- Be informed about important transactions between companies, as shares disposals or intangible and tangible assets disposals, which are generating significant group profits/losses to eliminate.

For each of these transactions, there should be a written note to file because most of the time, related adjustments may last for long in the consolidation accounting.

1.7 Human resources

Most of the time, consolidation is considered as a seasonal task for which only one person is partly dedicated. Two reasons make it a risky situation. First, the absence of that person, whatever the reason may be, generates a planning stress. Secondly, the knowledge of the group and capability to solve sometimes rather difficult group situations are concentrated only in one person's head. Moreover, the person is maybe not sufficiently trained to solve such problem on his own. This again leads to some planning stress.

The experience shows that most groups are asking for external help during the critical time of the consolidation. This approach brings expertise and additional training to internal persons and eliminates some planning risks.

For groups of a limited number of companies, the approach of having that activity completely outsourced to expert consultants should be seriously considered.

1.8 Software resources

The planning requirements and the increasing complexity of the consolidation process, because of the increasing number of subsidiaries joining the group, make it necessary to use professional consolidation software.

The software market offers basically four different families of solutions to handle a consolidation process.

The spreadsheets family

A spreadsheet is a tool that everyone knows, easy to use and rather cheap.

For a limited number of subsidiaries, an easy group structure and a few adjustments, a spreadsheet solution will fit the needs the first years.

After a while, a certain complexity will progressively appear by the increasing number of companies, the historical adjustments, foreign currency subsidiaries, additional needs as a consolidated cash flow statement, ...

Facing these changes will become more and more difficult with some risks.

One risk is just related to the wrong view that a consolidation process can be handled in a two dimensional spreadsheet. In fact, consolidation is a multidimensional process with at least three dimensions : one for companies, one for accounts and one for flows. We don't speak here about additional

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multi analytical dimensions to consolidate as required by some IFRS notes to the accounts.

The second risk is related to the increasing complexity of macros developed inside the spreadsheet. Moreover, a new account to add to the balance must be added to each balance of each sheet. One account missing in one sheet and the whole construction becomes inconsistent and wrong.

And finally, the most frequent situation happening is when the person having developed so many complex macro leaves the company.

Here comes the time where Auditors are becoming worried.

In most countries, and particularly in European states, the consolidation process must rely on an accounting approach, with general ledger, balance, journals, booking entries, ... reports which discards definitely the spreadsheet approach.

The standard accountina software family

It must be accepted that most of these software are really not consolidating figures but just adding them.

All calculation as currency translations, minority interests, equity eliminations, equity values, proportional methods, ... have to be prepared manually and keyed in the accounting software.

But we must admit this time we are in an accounting approach.

The consolidation software family, based on a manaaement reportina system

Such software category has originally be developed to solve reporting problems and quite often they contain a few general consolidation features as intercompany reconciliation and some standard eliminations.

Most of all other specialised features are just not developed as imbedded functions and it is the user job to parameterize these functions, when it is possible and with the help of consultants.

Of course, if such consolidation functions are developed in a satisfactory way, when working with this family of software, it becomes easier to reconcile figures between statutory consolidation and reporting.

The consolidation software family, based on a statutory approach

Professional software belonging to this family offer a large set of imbedded consolidation functions which, most of the time, rely on an international customer base experience.

If such software also includes efficient reporting facilities, then our opinion is that this software family brings the most accurate and efficient solution.

1.9 Consequences of a first consolidation for subsidiaries

With respect to the group companies, the consolidation department plays a triple role of information, planning and training.

The companies themselves will have to adapt their accounting system in order to comply with the parent company requirements in the shortest time with a minimum of efforts and a maximum of quality.

The role of information

When a group decides to produce a first consolidation, all companies concerned should be personally informed as soon as possible in order to enable them to organize in the most efficient way.

If the first consolidated figures are to be produced at the end of Year 1, the information should be sent to companies before the end of Year 0 so as to give them the possibility to take into account all requirements in the Year 1 accounting.

Moreover, we feel important to explain to all companies the reason to consolidate. Becoming a public company, producing consolidated figures for banks in order to finance important investments are reasons that any subsidiary can understand.

It is also a good opportunity to explain to companies that some of these reasons are also to finance ... some of them. When a subsidiary needs additional financing, belonging to a group can really help. It becomes normal that the group is also asking something in return: a consolidated reporting.

From a more technical point of view, we recommend to communicate to each company the following information:

- Name and additional information of all members of the consolidation department

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Name and additional information of correspondents in each group company

The list of all companies belonging to the consolidation scope, with the consolidation method. Theoretically, it makes no sense to mention intercompany amounts with equity method companies, except if the consolidation department asks for it.

- In the future, all changes in the consolidation scope (acquisitions, disposals, merges, ...) will be communicated to all companies.
- When organizing a first consolidation, the group should analyze each individual company situation to make sure it will be able to produce the required reporting within the required delays. Keep in mind that some small companies, sometimes located quite far away from the parent company, have just no internal accounting office. This matter is maybe outsourced to a fiduciary with which there is no agreement to fill in a consolidation bundle.
- Is the local accounting system able to answer to group requirements within the delays and with reasonable costs?
- Local Auditors will also be informed of the group decision to consolidate because there will be some additional services not included in the current agreement.

Behind all this information, one final objective of the consolidation team is to develop a "group spirit".

The role of planning

The planning should be sent to each company within an appropriate delay in order to be sure they can identify all risks of not being able to comply with these requirements.

The most important information is the date (and time) to communicate a final consolidation bundle to the parent company.

It must be clearly explained to each entity that it becomes normal that the figures included in the bundle are not the final local accounting ones. For instance, if figures are required for consolidation as at January 31 but the company locally closes its accounts with an Annual General Meeting in April, all entries after January 31 will be booked at consolidation level in the next consolidation, probably June 30. This situation can be felt as a severe cultural shock.

The role of training

Even if a consolidation bundle relies on an accounting logic, we think necessary to explain its structure and content to group companies before using it for the first time.

To do so we would recommend a training session with all company correspondents. One excellent approach consists in explaining first the content of the consolidation bundle and in proposing afterwards a bundle already filled-in with errors to be corrected.

Such a training should be extended to some other following topics we can suggest:

- Why has the group decided to consolidate?
- What are the basic principles of a consolidation process? Most of the correspondents probably don't know how it works and behind the explanations they will understand why all the requested information is needed.
- Explanation about the most specific evaluation rules, including an example.
- Presentation of the next consolidation planning.

As a conclusion for each attendee, they will be convinced their local accounting system will need some updates and improvements in order to improve the consolidation reporting.

Here are some of the main issues:

- Addition in the local chart of accounts of some specific accounts needed for consolidation reporting, as
 - Details on financial investments
 - Specific accounts for intercompanies through the whole balance sheet
 - Dividends received from consolidated companies
 - Specific gain/loss on disposals when group transactions are concerned
 - Distinction between cash and non cash for all P&L accounts

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- Considering that a consolidation bundle asks for explanations between opening and closing amounts for all balance sheet accounts, it will imply some adaptations in the way accounts are being booked in order to facilitate the collection of the necessary information (flows).
- Development of mapping tables between local balances and the consolidation bundle if an automatic function to import local accounts is available.

Obviously, the first consolidation will ask some investments for each group company. Moreover, it should be announced that a consolidation reporting is in a constant evolution process for internal and external reasons. This will have some consequence at group company level. Allow enough time to each company for reacting in a professional and efficient way.

THE CONSOLIDATION BUNDLE

We have already said that the consolidation bundle is a vehicle of information between each group company and the consolidating parent company.

Thanks to its unique structure, the same for each company, this vehicle brings homogenous information, complete and validated in line with the group requirements.

We propose to explain with some details the way a consolidation bundle should be developed by covering

- Basic principles of a structured consolidation bundle
- Description of the main sets of information to be reported
- List of the main validation rules on this information

2.1 Basic principles and structure

Whatever the technical background may be, we mean spreadsheet, web or other specific software development, a professional consolidation bundle should meet the following criteria.

Accounting approach and tree structure

A consolidation bundle should be developed on the basis of a standard group chart of accounts, considered as the skeleton of the structure. All

complementary reports of information are then linked in some way to that chart of accounts on a tree structure. By tree structure, we mean that one amount of one report may need additional information that will be asked in another report linked to the previous one.

The accounting approach applies also to a consolidation bundle allowing to adjust some local amounts. Keeping in mind that most group correspondents have an accounting background, these adjustments should be written as debits and credits instead of signed amounts in a single column.

Amounts in cents instead of rounded amounts

We are completely aware of the fact that cents make no sense when considering consolidated amounts. In most countries, and certainly for large groups, consolidated amounts are produced in thousands of currency units and even in millions.

However, our position is to ask all information in cents because local accounting amounts are booked in cents.

Asking local figures in units of currency (or in thousands) implies rounded calculations that will lead to unbalanced balance sheet and, most of the time, unbalanced justifications on flows between opening and closing. We are aware of the fact that working with cents or not is really not a strategic issue speaking about figures. That's not the problem. The real trouble we have with this option is the time lost by company correspondents to produce a consolidation bundle with no errors, considering that an unjustified difference of 1 cent is a mistake.

And for the reader who would need more arguments to be convinced, we mention the automatic import of figures from an accounting system that generally provides a simple mapping account by account, without rounding the amounts.

Amounts in local currency

The currency translation, as processed during a consolidation, is based in particular on the knowledge of closing rates, average rates and historical rates. The technique behind is generally not mastered by local correspondents.

It is the reason why we recommend asking for local currency figures. Moreover it enables a much easier communication between the consolidation team and the local correspondent. Local Auditors are also in a more comfortable position to approve the consolidation bundle.

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This option will avoid loss of time and mistakes that will appear year after year from foreign companies while this translation process is fully automatic in professional consolidation software

Consolidation evaluation rules

A company produces its local accounts on the basis of local evaluation rules which generally do not comply with group evaluation rules.

In order to keep a clear situation clear, we recommend building a consolidation bundle in which local figures are first keyed in and where separately, additional adjustments are booked in order to adapt the accounts to the group evaluation rules.

We then get a "three columns" presentation, that is

- Column 1 : Local amounts
- Column 2 : Impact of adjustments
- Column 3 : Adjusted amounts equal to Column 1 + Column 2

This presentation offers all audit trails views by explaining how we evolve from statutory accounts to adjusted accounts.

Consolidation bundle language

As already discussed, we highly recommend using a unique language with all group companies.

The reasons therefore have also been developed above and we can summarize them by the following advice: don't transform the consolidation office into a translator office.

Consolidation bundle validation

The more severe are the validation rules, the highest quality consolidation you get.

A consolidation bundle should include a maximum of validation rules in such a way that the combination of accounts and flows can produce automatically a statutory cash flow statement without any additional human intervention.

From this point of view, the cash flow statement is considered as a high level guarantee on quality of the bundle content.

Our experience over so many years has shown that a large number of validation rules are appreciated twice

- Once by the consolidation team thanks to the quality received
- Secondly by the company who reaches a "zero fault" bundle and has the satisfaction of having achieved a task correctly done that will not generate further questions on the next days.

One final recommendation is to develop a non blocking bundle meaning that when some errors, even severe errors, cannot be corrected locally by the correspondent the bundle can still be sent to the parent company for help.

A spreadsheet bundle or a web bundle ?

Thanks to the internet technologies, a web bundle is progressively replacing spreadsheet bundles despite the fact that both solutions are relatively equivalent.

It must also be pointed out that using spreadsheet bundles generally requires more manual preparations that giving a web access to each subsidiary.

When using a spreadsheet bundle, it is easy for Auditors to receive a copy for approval. The same advantage should be maintained when using a web bundle by giving them a "read only" access.

2.2 Content

A consolidation bundle generally presents a tree structure consisting in about five different levels and a set of validation rules.

Level 1

This level concerns some general information

- The current consolidation period
- The reference consolidation period
- Company name and additional coordinates
- Company currency
- Correspondent name and additional coordinates
- Optionally, the CFO approval
- Optionally, the Auditors approval

Level 2

This level usually contains balance sheet, P&L closing amounts of the reference period (read only) and the current year amounts.

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It is important not to forget contingencies accounts with the same presentation.

If the option consists in asking separate local accounts and adjustments to comply with group evaluation rules, it is recommended to use debit/credit adjustments. For such presentation, the adjusted amounts are consolidated.

Level 3

This level is dedicated to information related to partners, mainly financial investments and intercompany amounts.

For each of these accounts, a net amount in the balance sheet is split with the contribution corresponding to each partner.

We recommend that such balance sheet accounts present two components: one with a total for all corresponding subsidiaries and another one for 3rd Parties. At the end of the consolidation process, an easy validation can be done because the group component should be set to zero.

Level 4

This level asks the evolution of balance sheet amounts by mean of flows.

Two remarks about this point.

Generally, only non current assets and liabilities are explained with detailed flows as acquisitions, disposals, depreciations, ... while current assets and liabilities need only a net variation flow to explain the evolution.

It wouldn't be correct not to mention some special situations of transfer of amounts, entry in the consolidation scope, merge, exit from the consolidation scope for which some specific flows must be used on each and every account, non current and current.

A special care will be brought to accounts defined in level 3, with partners, because flows will first be mentioned on the net account (Group + 3rd Parties) and then on each partner.

Level 5

In most of the usual bundles proposed today, this level contains some specific reports bringing additional and useful information to the consolidation team.

Here are the most important requests.

Memo sheet

Sometimes forgotten but so useful is just a white sheet in which the correspondent will mention free (but probably very important) information, which cannot be coded in the bundle cells.

Dividends received

- Company paying the dividend
- Number of shares giving right to dividend
- Unitary gross dividend and net dividend received

Group disposal of assets

- Identification of the company acquiring the asset
- Asset description
- Account on which is booked the gross value and the amount
- Account on which are booked the depreciations and the amount
- Depreciation duration
- Selling price
- Gain/loss on disposal
- Account on which gain/loss is booked

Group acquisition of assets

- Identification of the company selling the asset
- Asset description
- Account on which is booked the gross value and the amount
- Account on which are booked the depreciations and the amount
- Depreciation duration
- Acquisition price

Detailed explanations on accounts

The consolidation office may ask for some written description about the content of some accounts. Amongst the most 'popular' accounts, we will mention

- Provisions
- Deferred charges and income
- Exceptional income and charges

Staff information

Depending on the notes to the accounts, we find generally the following requests as a minimum

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- Directors
- Employees (or white collars)
- Workers (or blue collars)
- Others

That information may be given as an average number for the consolidation period and will be consolidated with the usual rules of elimination just as amounts.

Turnover information

A turnover split by countries, by activity, by products is generally requested in most countries. This information can be difficult to collect as it relies sometimes on the use of analytical dimensions.

The classical situation is a split of the turnover by countries of export. For instance, a company based in UK making a turnover of 100 but exporting its products in the US for 60 and in France for 30 will have to mention a turnover of 10 in UK and not 100.

Information about non consolidated companies

Non consolidated companies owned directly and indirectly by the parent company must be listed with some information as

- Turnover
- Equity
- Result

Miscellaneous information

This information depends on the evaluation rules, on the specific group willing to make public such information but also to comply with local regulations.

In most cases, we find

- Amounts paid to Directors
- Amounts paid to Auditors
- Pensions plans
- Important loans

A consolidation bundle is more and more playing a key role in the consolidation process. It is easy to understand that all that information described above is highly linked together and validation rules offer the guarantee to receive an accurate and reliable input.

Moreover, the technology of expert systems is becoming more and more present and time is not so far when, on the basis of complete and detailed information, consolidation software will be able to generate automatically number of adjustments that are booked manually today by the consolidation team.

Classical and easy situations as dividends, write-off on consolidated participations, stocks margins eliminations, goodwill calculations are already processed automatically by professional software.

More difficult situations as deconsolidation, change of functional currency, disposal of subgroups, some complex capital increases with percentage variations are prepared in the R&D departments of software editors.

Automating all these adjustments will become possible not only with a professional consolidation software but also with a "smart" bundle.

2.3 Validation rules

Validation rules depend on the different sheets defined in a bundle and we can only mention a few ideas.

The important thing is that when an error passes through the consolidation process, it should be prevented in the bundle for the next consolidation like we do for a virus patch.

We have grouped validations rules into several categories.

Validations on closing amounts

Even if to all accountants around the world, it is worthwhile to mention

- Total assets = Total liabilities
- Result deducted from P&L account = Result in Equity, because accounts are reported before appropriation

Validations on accounts with partners

The book value of financial investments accounts in the balance sheet must be equal to the total of the contribution given by companies owned. All other non consolidated amounts should be booked on another account.

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The reason for this approach is rather simple. Financial investments on consolidated companies are translated at historical rate while other financial investments remain at closing rate.

For intercompany accounts, a validation should be done on the total of contributed amounts which should be less or equal to the net balance account. If the net balance account includes only transactions with partners, which is our recommendation, then validation would be made only on the equality.

Validations of variations between opening and closing amounts

If the group has decided to produce a consolidated cash flow statement, flows must be defined on every balance sheet account. This implies to validate that "opening value + total of flow amounts = closing value".

These validations must also be extended to accounts with partners.

Special care has to be brought to the following situation.

| | Total | Partner B | Consolidated |
|---------------|-------|-----------|--------------|
| Opening value | 100 | 50 | 50 |
| Increase | 30 | 40 | (10) |
| Decrease | (10) | | (10) |
| Closing value | 120 | 90 | 30 |

We consider company A reporting its receivables account. The "Total" column represents the evolution of the total balance sheet account between opening and closing, including intercompany amounts with the partner B.

In addition to this information, there must be similar information concerning each partner, as shown here for partner B.

This situation gives a problem after the elimination process because we remain in particular with a negative increase of (10), thanks to the fact that the intercompany increase is higher than the balance (group + 3rd Parties) increase.

This is something to validate for every intercompany account in the balance sheet.

Validations between flows and P&L accounts

These validations are much more accounting oriented than the previous ones.

The objective is to be sure all notes to the accounts, including the cash flow statement, will be consistent.

The background of these validations is to verify that some non cash variations on balance sheet accounts are equal to the corresponding amounts booked in the P&L.

Without being necessarily complete, here are the main accounts to verify

- Variation of depreciations on depreciation assets accounts
- Variation of provisions
- Write-offs and write-backs booked on financial investments (consolidated and not consolidated)
- Same for non current and current receivables
- Unrealized exchange gain and loss on all accounts, including intercompany amounts
- Gain/loss on assets disposal
- Variations of assets and liabilities deferred taxes

Depending on local accounting rules, we could also mention

- Capitalization of works
- Use of investment grants
- Untaxed reserves booked in P&L

Validations between flows

Some account variations have no impact on P&L but, referring to the double entry accounting, once a flow of a certain type is booked, there must be a counterpart on a flow of the same type on another account.

The transfer of an amount between two accounts is a good example.

Here are some other situations to consider

- Revaluation of assets having an impact on Revaluation reserves in equity
- Difference on opening amounts is booked on a specific flow and, of course, total impact on assets and liabilities must be equal

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- Entry of a company in the consolidation scope. All flows correspond to the balance sheet accounts on the day it joins the group.
- Exit of a company from the consolidation scope. All flows correspond to the balance sheet accounts on the day it leaves the group.
- Merge of two companies or absorption of a company by another one. All flows corresponding to the balance sheet accounts of one company must be equal to the same flows on same accounts in the other company, but with the opposite sign.
- The part of the non distributed result is transferred from the Result to Retained earnings and Reserves accounts.
- After currency translation, we have seen that a translation adjustment flow is generated on each balance sheet account. Considering the fact that different rates, average or transaction rates, may be used in a single balance sheet, a validation rule should verify that the total of assets and liabilities translation adjustment flows are equal, including the flow corresponding to the evolution of the translation adjustment account in the equity.

Validations of sign of accounts and flows

Depending on the level of sophistication the group wishes to develop in its consolidation bundle, our opinion is that controlling the sign of some accounts and flows increases the consolidation quality likewise.

Here are two examples to justify our position

- A large number of accounts are, with no discussion, either debtor or creditor, as financial investments (acquisition value) or financial investments (write-off). On the other hand, result may have both signs and cannot be validated.
- In order to produce consistent notes to the accounts, we recommend validating the sign of a maximum of flows, amongst which
 - Acquisition flows (+)
 - Disposal flows (-)
 - Capital increase (+)/decrease (-)
 - Payment of dividends (-)
 - Depreciation flows, write-off flows (-)
 - Write-back flows (+)

FAST CLOSE

For groups closing their consolidation quite late and wishing to fasten the process next year, motivations can be found in some of the following reasons

- To comply with legal requirements
- To anticipate future and most severe regulations
- To improve a financial reputation
- To give a better image of the management
- To do better than competitors.

However, we have met so many times difficult situations just because the group management didn't anticipate the arrival of new investors in the capital, or asked to reduce drastically the consolidation delays while imposing new consolidation evaluation rules and four consolidations a year instead of only one.

And don't reply "it will not be possible" because others will do it at your place!

In the three next sections, we will give some "tips and tricks" in order to optimize the whole consolidation process and to gain not only a few days but a few weeks.

But be aware of the fact that these tips and tricks will only be efficient if the group management is willing to improve the planning.

3.1 Before the consolidation

It's too late to think about planning optimization when you just received all the bundles and you are ready to start the consolidation.

A lot of tasks can be prepared a long time ahead.

Prepare all events having an impact on consolidated accounts

All along the period to consolidate, stay informed of all events impacting the consolidation.

The list of these events can be rather long and we think about

- New company acquisition
- Disposal of a company
- All shares transactions (acquisitions and disposals) concerning consolidated companies

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- Capital increase/decrease
- Liquidation of a company
- Deconsolidation of a company
- Merge or absorption of companies
- Split of a company
- Dividends paid by subsidiaries.

For all these events, try to collect the most complete information and anticipate the corresponding adjustments, even if you don't have the final figures. Calculate the impact on "school case" figures that you will just need to replace at consolidation time.

Inform Auditors with situations needina a decision

Some situations will not be so simple. Let's just consider the following example.

The acquisition of a company is concluded on October 17. Of course, accounts will not be available at that date and probably not as at September 30 either. Do your Auditors agree to consider the acquisition on June 30?

Plannina information to group companies

Communicate new planning to all group companies the sooner the better in order to give them enough time to adapt. Check each company about its capability to comply with the new planning and give help if you feel it necessary.

Define clear procedures

In most cases procedures will be written in English which is probably not the usual language of most group correspondents. That's the reason why we recommend writing these procedures in a clear way with simple words.

Examples always help the understanding.

Take special care of new companies acauired

New companies joining the group know nothing about the group procedures and the group culture. Moreover, for some of these companies, it is maybe the first time they will have to fill in a consolidation bundle.

Such situation requires special assistance from your side.

Send closing and average rate to companies

In order to reduce the number of intercompany adjustments, send to each company the closing rates and the average rates you will use for the next consolidation.

This can be done on the second day after the closing date.

Dedicated system for intercompany reconciliation

Most of the software companies are offering specialized web solutions for groups to communicate their intercompany positions and to reconcile them without any intervention from the central consolidation team.

Once such software is installed, it can be used several times during the year with a marginal cost. Experience shows that this approach reduces drastically the number of intercompany differences.

By solving themselves these intercompany differences, each correspondent becomes aware of the importance of booking correctly intercompany amounts.

This topic gives us the opportunity to clarify one point: such specialized intercompany web software does not necessarily eliminate all intercompany differences but sometimes explains why there is a difference. As an example, company A sells some services to company B which booked them as R&D in the assets. The turnover in A accounts is not matched with a purchase in B accounts, but a comment is helping to book a consolidation adjustment.

Prepare the next consolidation before receiving the bundles

Consolidation data consist in local currency accounts and consolidation adjustments.

These adjustments are usually kept in the consolidation because they impact the result the first year and then the reserves for a certain number of years. On the contrary, some others are impacting the result one year but must be reversed the next year.

Depending on the consolidation software used, it is important to check that all these adjustments are managed correctly in the next consolidation. To do so, we suggest to proceed as follows

- Prepare the new consolidation by importing statutory equity and participations amounts of all companies.

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- Maintain the same closing and average rates as in the previous consolidation
- Maintain the same group structure as in the previous consolidation
- Make a consolidation run and validate the consolidated reserves evolution.

If everything seems correct, this means that all adjustments are correctly carried forward in the next consolidation and you are ready to import the bundles.

Prepare and send the consolidation bundles

Consolidation bundles will integrate all comments and additional validation rules resulting from the previous consolidation experience.

The more checks you add in the bundle, the higher quality of figures you get back and the maximum of time you gain during the consolidation process.

One single error in one bundle turns into a mail to the concerned company. Misunderstanding of the question, correspondent on a meeting or abroad or on vacation, some delay because time difference are as many reasons to delay a final correct answer sometimes a few days.

Such situation can put you in a difficult planning position.

Define a cut-off date

For intercompany purpose, the group should define a cut-off date in order to avoid the issuing of any group transactions such as invoices and payments between this date and the closing date for the consolidation.

It is interesting to describe the following existing situation.

This group defines a cut-off date for the year-end consolidation which is respected by each company.

For June consolidation, there is no cut-off date. Company A issues an invoice to company B for some products. The problem is that, because of the consolidation planning, company B reports its bundle without the corresponding purchase. There is an intercompany to adjust.

But more than that!

The products are not booked in company B assets. They are still in the truck somewhere on a highway! This implies the booking of another adjustment and, considering the stocks margins, we finally need to eliminate it as well.

The conclusion is to propose a cut-off date for each consolidation, regardless whether it is a fiscal year consolidation or not.

Use mapping tables when possible

Avoid all data entry because it is time consuming and it is a source of errors (wrong amounts, wrong accounts, wrong flows, wrong partners, ...). Each time data import is possible, use that facility including mapping tables for conversion of codes.

Such feature can be applied for

- Importing data into the consolidation bundle or in the consolidation software if no bundle
- Importing currency rates for large international groups, which avoid to key in rates with sometimes up to eight decimals
- Importing intercompany positions with partners, which may come from a separate dedicated software

and, in a more general situation, for any set of data that would take too much time if processed manually. This could include some sets of adjustments.

Avoid stage consolidations

Stage consolidations appear when the group can be decomposed in several independent sub-groups without implying technical problems at consolidation level.

It is clear that in a group of 50 companies which can be separated into two subgroups of about the same size of 25 companies, it could be interesting at the final level to ask to consolidate the two subgroups first. The final consolidation scope would then consist in only three companies: the parent company and the head of the two subgroups.

This "push down" policy, unfortunately, presents some disadvantages

- A lack of transparency on both sub-group consolidations concerning the respect of the final group evaluation rules
- A difficulty for any contribution view over the fifty companies in the consolidated accounts

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- A difficulty to get a segmented information at once with a complete contribution view again (if IFRS).

For fast close, the risk to create two bottlenecks is real. Both subgroups could put the group planning in problem with a difficulty to react because these subgroups could maybe be located far away from the parent company.

3.2 During the consolidation

Fix a deadline to receive the consolidation bundles

By deadline, we mean a date and time, the latest, to receive the consolidation bundles. This doesn't mean all bundles have to arrive on that date. The message should be that a bundle should be sent as soon as it is ready and error-free.

Do not accept different versions of a bundle

The sooner the date we receive the bundles, the more risk we have to receive temporary figures. Very often companies feel guilty to send such bundles and prefer to send an improved version some days later. Unless the changes are really material, do not accept these new versions.

Why?

In the meantime, you may have done some slight changes like reclassification of accounts and flows. Maybe you already gave the bundle to the consolidation Auditors. That's the best way to enter into a messy situation with planning problems at the end.

Process the consolidation step by step

We know a consolidated reporting is a construction where at a certain date everything must stick together in a consistent way.

However, we recommend to consolidate by fixing a particular attention first to the consolidated equity which must be reconciled in an accounting way.

Then, one should process the consolidation of all variations in order to produce a valid cash flow statement.

When both equity and cash flow statement are correctly produced, an analysis of consolidated figures by someone knowing well the group but not being involved in the process of consolidation is necessary to conclude the work.

Only after these three steps, consolidated accounts may be given to the Auditors.

Use professional software for consolidation

We have seen above there exist four different categories of software that may bring a more or less accurate answer to statutory consolidation.

Depending on the size of the group and its complexity, be sure to make the right choice. The one that gives you not only the capability to process the consolidation in a short delay but also the one bringing all means to answer unexpected questions when new shareholders enter the parent company capital .

Without entering the difficult logic of consolidation software selection, some features are just to be considered as a must

- Integrated consolidation bundle (spreadsheets)
 - Personalized figures for each company
 - Complete set of validation rules
 - Possibility to book local adjustments
- Automatic calculation of complex group structures with distinction between control and financial percentages
- Fully automatic currency translation of all bundles, including historical rates management
- Intercompany matching based on transaction currency and not only matching analysis after currency translation, in order to generate automatically translation adjustments corrections
- Capability to generate automatic adjustments for a large set of situations (goodwill, dividends, stocks margins, deferred taxes, ...)
- Possibility to consolidate by ignoring some categories of adjustments, in order to produce consolidated figures complying with different evaluation rules with a minimum of effort
- All eliminations must be generated automatically with a maximum of accounting and audit transparency
- Full consolidation process must be achieved in a reasonable time : less than one minute for 10 companies, a few minutes for less than 100 companies.

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Define some thresholds

In order to reduce the number of consolidation adjustments, get the Auditors' agreement on some thresholds whether for intercompany differences or events related to group transactions.

Be sure to aet some assistance from expert consultant

For a group having an oversized consolidation team with a high level of expertise it makes no sense for one or two consolidations a year. It is much more efficient to manage a reasonable number of persons having a strong knowledge of all group companies and all events related to them. Of course these few people must also have a rather good knowledge of consolidation techniques.

This is a minimum.

Now, these persons can leave the company, can be temporarily ill or just be faced to some difficult consolidation problems. The wise situation in order to avoid planning delay is to be able to count on the assistance of an external expert consultant, in such situations.

This is also a way to secure the planning.

3.3 After the consolidation

When the consolidation process is achieved there are still so many things to complete.

Maximize automatic production of disclosures

The most important task between the end of the 'technical" step of the consolidation and the Auditors conclusions is the production of the consolidated disclosures (notes to the accounts).

There are two issues if we want to optimize the process.

First, as the disclosures consist mainly in figures in Excel spreadsheets and comments in Word documents, the final product is a merge of both. Today, some consolidation software offer solutions to link these spreadsheets directly to the consolidation data base and give the assurance that when opening these documents all figures are refreshed with the last version.

Moreover, it is also possible to imbed all these spreadsheets in a Word document.

Secondly, we are convinced that a large part of the comments on the accounts can be prepared before the consolidation is actually done. This means that part of this task should be prepared in December the latest before the closing.

The experience pictured from some groups has shown that taking these two issues into account has reduced the disclosures task from two or three weeks to a couple of days.

Optimize communication with Auditors

At the end of the consolidation process, Auditors receive the consolidated accounts on a support agreed beforehand (paper, Excel, pdf reports, read-only access to the consolidation software).

After having received a "Reporting Version 1", some Auditors communicate their first remarks and ask to receive a "Reporting Version 2" so they can visualize the impact of the requested changes. Of course, this second reporting is to be compared with the first one and not with the reference consolidation. And the situation may be repeated several times.

We would recommend negotiating with Auditors to produce a 'temporary version" for audit purpose on which they hand over all their remarks. They receive then a "final version".

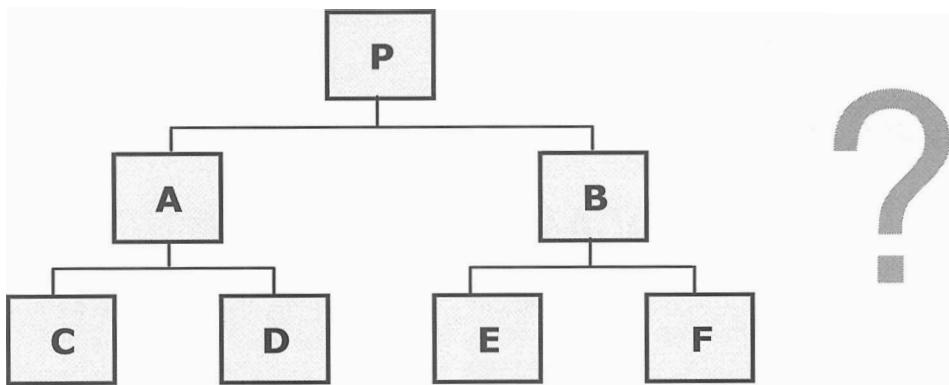
If possible, ask also to get some guarantee that the same team will audit the next consolidations, otherwise you will have to repeat the story each time.

This is also a way to avoid wasting time.

PART 6

CONSOLIDATION

CASE STUDY



1 OBJECTIVES OF THIS CASE STUDY

The objective of this case study is to apply the methodology explained in this book by consolidating a group over two years, and to solve and to document completely with all the necessary explanations.

More precisely, it consists in the following steps

- Consolidation of Year 1
- Consolidation of Year 2
- Justification of reserves and minority interests evolution
- Production of the consolidated cash flow statement.

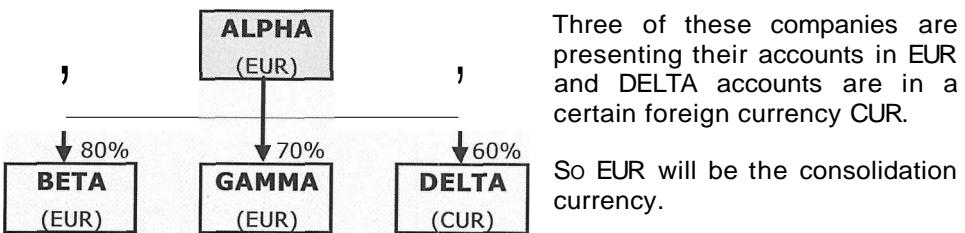
By presenting this case study, we take also the opportunity to show how the work is organized. We don't use a consolidation software. All data will be structured with a spreadsheet approach.

Moreover, all adjustments will be booked completely in each company, including the eliminations. The same methodology will be applied when producing the cash flow statement where the booking of flows will respect the "debit" and "credit" principle.

This consolidation will be done in EUR and, to keep the writing clear, all amounts without a currency are supposed to be in EUR.

2 THE GROUP TO CONSOLIDATE

In Year 1, the ALPHA group consists in four companies, including the parent company, as shown here below.



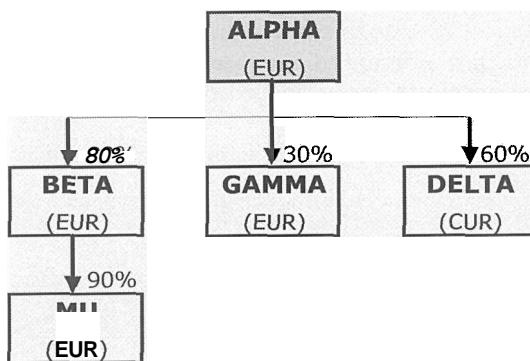
Considering the percentages (control % = financial %), all three subsidiaries are consolidated with the global integration method.

For this first year, following events should be known:

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- Company BETA has been acquired in January three years ago with a goodwill of 500. This goodwill is depreciated with a rate of 20% a year. At the end of Year 1, we thus have a depreciation amount of (300) in the assets.
- When acquiring BETA, the due diligence identified a tangible asset to be revaluated for an amount of 1000. It is depreciated by 10% each year. At the end of Year 1, we so have a total depreciation of (300) in the assets.
- Company GAMMA was acquired also in January four years ago with a goodwill of 700. This goodwill is depreciated with a rate of 20% a year. At the end of Year 1, we thus have a depreciation amount of (560) in the assets.
- DELTA statutory accounts include a provision of 300 CUR which is not compatible with the group evaluation rules. This provision has been eliminated for the first time this year and booked in the statutory P&L.
- DELTA accounts are translated into EUR with the following rates (CUR/EUR) :
 - Closing rate : 1 CUR = 0.8 EUR
 - Average rate : 1 CUR = 0.7 EUR
 - Historical rate for capital account : 1 CUR = 0.9 EUR
 - Historical rate for retained earnings : 1 CUR = 0.85 EUR

In Year 2, some structure changes transform the ALPHA group slightly, as shown here below.



40% of company GAMMA shares have been disposed to 3rd Parties and, as a consequence, the company is now consolidated with the equity method. The transaction occurred on January 1st, Year 2.

Company MU has been acquired on July 1st, Year 2.

What else to know?

- The 40% of company GAMMA shares initially booked for 1200 have been sold for a price of 800, giving a loss of disposal of (400)
- The provision of 300 CUR which is not accepted in the consolidation is still booked in company DELTA statutory accounts in Year 2. This means that this consolidation adjustment has to be maintained.
- There is an intercompany transaction between receivables of ALPHA and payables of DELTA. This intercompany transaction has been issued in EUR by company ALPHA.
- While selling 40% of company GAMMA shares, the remaining goodwill is totally eliminated against P&L
- Company DELTA pays dividends of 400 CUR to its shareholders
- Company ALPHA pays dividends of 300 to its shareholders
- Company ALPHA sells a land to company BETA for a price of 1500, giving a group profit of 500.

CONSOLIDATION OF YEAR 1

For this consolidation, we will use one spreadsheet per company, the first column corresponding to its statutory accounts and the next columns on the right are used for consolidation adjustments and eliminations.

The last column on the right is the contribution of the company to the consolidated balance.

Each column is identified by a number referencing to additional explanations.

For practical reasons, these accounts are presented on a left page with an even number. If necessary, the same accounts are repeated on the next even page depending on the number of columns needed.

PART 6 CONSOLIDATION CASE STUDY

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DIRECT CONSOLIDATION

| ALPHA | (1) | (2) | (3) | (4) | (5) | (6) | (7) |
|-----------------------------|---------|-------|-------|-------|-------|-------|---------|
| Goodwill (gross val.) | | | | | | | 1,200 |
| Goodwill (deprec.) | | | | | | | (860) |
| Lands | 1,000 | 500 | (300) | 700 | (560) | | 1,000 |
| Tangible assets (acq. val.) | | | | | | | 0 |
| Tangible assets (deprec.) | | | | | | | 0 |
| Fin.invest./BETA | 5,000 | (500) | | | | | 0 |
| Fin.invest./GAMMA | 2,100 | | | (700) | | | 0 |
| Fin.invest./DELTA | 3,600 | | | | | | 0 |
| Receivables/3rd Parties | 1,500 | | | | | | 1,500 |
| Cash | 800 | | | | | | 800 |
| Link account(Fin.Inv.) | | | | | | 9,500 | 9,500. |
| | 14,000 | 0 | (300) | 0 | (560) | 0 | 13,140 |
| | | | | | | | |
| Capital | 5,000 | | | | | | 5,000 |
| Retained earnings | 3,000 | | | | | | 3,000 |
| Reserves | | | | | | | (620) |
| Result | 400 | | (200) | | | | 160 |
| Consolidated reserves | | | (100) | | | | 0 |
| Translation adjustments | | | | | | | 0 |
| Minority interests | | | | | | | 0 |
| Provisions | 1,000 | | | | | | 1,000 |
| Payables/3rd Parties | 4,600 | | | | | | 4,600 |
| | 14,000 | 0 | (300) | 0 | (560) | 0 | 13,140 |
| | | | | | | | |
| Turnover/3rd Parties | 10,000 | | | | | | 10,000 |
| Purchases | (9,600) | | | | | | (9,600) |
| Depreciations | | | (100) | | | | (240) |
| Provisions | | | | | | | 0 |
| Result | 400 | 0 | (100) | 0 | (140) | 0 | 160 |
| Group result | | | | | | | 160 |
| Minority result | | | | | | | 0 |

PART 6 CONSOLIDATION CASE STUDY

ALPHA - Column (1)

Statutory accounts in EUR.

ALPHA - Column (2)

A gross goodwill of 500 on BETA company has been calculated at time of acquisition in January Year -1.

| | Debit | Credit |
|-----------------------|-------|--------|
| Goodwill (gross val.) | 500 | |
| Fin.invest./BETA | | 500 |

ALPHA - Column (3)

At the end of Year 1, this goodwill is depreciated for 60% of its value, which is 300, 200 being booked on the Reserves, corresponding to Year -1 and Year 0, and 100 on the P&L for this Year 1.

| | Debit | Credit |
|--------------------|-------|--------|
| Reserves | 200 | |
| Goodwill (deprec.) | | 300 |
| Depreciations | 100 | |

ALPHA - Column (4)

A gross goodwill of 700 on GAMMA company has been calculated at time of acquisition in January Year -1.

| | Debit | Credit |
|-----------------------|-------|--------|
| Goodwill (gross val.) | 700 | |
| Fin.invest./GAMMA | | 700 |

ALPHA - Column (5)

At the end of Year 1, this goodwill is depreciated for 80% of its value, which is 560, 420 being booked on the Reserves, corresponding to Year -2, Year -1 and Year 0, and 140 on the P&L for this Year 1.

| | Debit | Credit |
|--------------------|-------|--------|
| Reserves | 420 | |
| Goodwill (deprec.) | | 560 |
| Depreciations | 140 | |

ALPHA - Column (6)

we first eliminate the Financial investments by using a Link account.

| | Debit | Credit |
|------------------------|-------|--------|
| Link account(Fin.Inv.) | 9,500 | |
| Fin.invest./BETA | | 4,500 |
| Fin.invest./GAMMA | | 1,400 |
| Fin.invest./DELTA | | 3,600 |

ALPHA - Column (7)

The amounts of this column are the totals from column (1) to column (6) of each line. Column (7) represents the contribution for company ALPHA in the consolidated balance.

DIRECT CONSOLIDATION

| BETA | (1) | (2) | (3) | (4) | (5) | (6) | (7) |
|-----------------------------------|----------|-------|-------|-------|-------|---------|---------|
| Goodwill (gross val.) | | | | | | | 0 |
| Goodwill (deprec.) | | | | | | | 0 |
| Lands | | | | | | | 0 |
| Tangible assets (acq.val.) | 3,000 | 1,000 | (300) | | | | 4,000 |
| Tangible assets (deprec.) | (1,200) | | | | | | (1,500) |
| Fin.invest./BETA | | | | | | | 0 |
| Fin.invest./GAMMA | | | | | | | 0 |
| Fin.invest./DELTA | | | | | | | 0 |
| Receivables/3rd Parties | 5,000 | | | | | | 5,000 |
| Cash | 1,200 | | | | | | 1,200 |
| Link account(Fin.Inv.) | | | | | | (4,500) | (4,500) |
| | 8,000 | 1,000 | (300) | 0 | 0 | (4,500) | 4,200 |
| Capital | 3,000 | | | | | | 0 |
| Retained earnings | 2,000 | | | | | | 0 |
| Reserves | | | | | | | 0 |
| Result | 300 | 1,000 | (200) | (100) | (600) | (2,400) | 0 |
| Consolidated reserves | | | | | (400) | (1,600) | 0 |
| Translation adjustments | | | | | (160) | (640) | 0 |
| Minority interests | | | | | (40) | (160) | 0 |
| Provisions | 500 | | | | | 4,800 | 300 |
| Payables/3rd Parties | 2,200 | | | | | | 500 |
| | 8,000 | 1,000 | (300) | 0 | 0 | (4,500) | 2,200 |
| Turnover/3rd Parties | 20,000 | | | | | | 1,200 |
| Purchases | (18,900) | | | | | | 500 |
| Depreciations | (300) | | | | | | 200 |
| Provisions | (500) | | | | | | 200 |
| Result | 300 | 0 | (100) | 0 | 0 | 0 | 160 |
| Group result | | | | | | | 40 |
| Minority result | | | | | | | 200 |

PART 6 CONSOLIDATION CASE STUDY

BETA - Column (1)

Statutory accounts in EUR.

BETA - Column (2)

When BETA has been acquired, some tangible assets have been revaluated for a gross amount of 1000.

| | Debit | Credit |
|----------------------------|-------|--------|
| Tangible assets (acq.val.) | 1,000 | |
| Reserves | | 1,000 |

BETA - Column (3)

This revaluation is depreciated on the basis of 10% each year. The total depreciation at the end of

| | Debit | Credit |
|---------------------------|-------|--------|
| Reserves | 200 | |
| Tangible assets (deprec.) | | 300 |
| Depreciations | 100 | |

Year 1 is 300, with 200 on the Reserves account and 100 on the P&L.

BETA - Column (4)

Reclassification of 20% of all equity accounts to Minority interests.

| | Debit | Credit |
|--------------------|-------|--------|
| Capital | 600 | |
| Retained earnings | 400 | |
| Reserves | 160 | |
| Result | 40 | |
| Minority interests | | 1,200 |

BETA - Column (5)

Reclassification of 80% of all equity accounts on the Consolidated reserves account.

| | Debit | Credit |
|-----------------------|-------|--------|
| Capital | 2,400 | |
| Retained earnings | 1,600 | |
| Reserves | 640 | |
| Result | 160 | |
| Consolidated reserves | | 4,800 |

BETA - Column (6)

The amount used in this adjustment is the adjusted financial investment on BETA in ALPHA accounts.

| | Debit | Credit |
|------------------------|-------|--------|
| Consolidated reserves | 4,500 | |
| Link account(Fin.Inv.) | | 4,500 |

BETA - Column (7)

This is the BETA contribution to the consolidated balance. The result of 200 is split into a Group result for $160 = 80\% * 200$ and a Minority result for $40 = 20\% * 200$.

DIRECT CONSOLIDATION

| GAMMA | (1) | (2) | (3) | (4) | (5) |
|----------------------------|----------|-------|---------|---------|----------|
| Goodwill (gross val.) | | | | | 0 |
| Goodwill (deprec.) | | | | | 0 |
| Lands | 1,000 | | | | 1,000 |
| Tangible assets (acq.val.) | 4,000 | | | | 4,000 |
| Tangible assets (deprec.) | (800) | | | | (800) |
| Fin.invest./BETA | | | | | 0 |
| Fin.invest./GAMMA | | | | | 0 |
| Fin.invest./DELTA | | | | | 0 |
| Receivables/3rd Parties | 2,000 | | | | 2,000 |
| Cash | 800 | | | | 800 |
| Link account(Fin.Inv.) | | | | (1,400) | (1,400) |
| | 7,000 | 0 | 0 | (1,400) | 5,600 |
| Capital | 2,000 | | | | 0 |
| Retained earnings | (500) | (600) | (1,400) | | 0 |
| Reserves | | 150 | 350 | | 0 |
| Result | (400) | 120 | 280 | | 0 |
| Consolidated reserve:> | | | 770 | (1,400) | (630) |
| Translation adjustments | | | | | 0 |
| Minority interests | | 330 | | | 330 |
| Provisions | | | | | 0 |
| Payables/3rd Parties | 5,900 | | | | 5,900 |
| | 7,000 | 0 | 0 | (1,400) | 5,600 |
| Turnover/3rd Parties | 30,000 | | | | 30,000 |
| Purchases | (30,100) | | | | (30,100) |
| Depreciations | (300) | | | | (300) |
| Provisions | | | | | 0 |
| Result | (400) | 0 | 0 | 0 | (400) |
| Group result | | | | | (280) |
| Minority result | | | | | (120) |

PART 6 CONSOLIDATION CASE STUDY

GAMMA - Column (1)

Statutory accounts in EUR.

GAMMA - Column (2)

Reclassification of 30% of all equity accounts to Minority interests.

| | Debit | Credit |
|--------------------|-------|--------|
| Capital | 600 | |
| Retained earnings | | 150 |
| Result | | 120 |
| Minority interests | | 330 |

GAMMA - Column (3)

Reclassification of 70% of all equity accounts on the Consolidated reserves account.

| | Debit | Credit |
|-----------------------|-------|--------|
| Capital | 1,400 | |
| Retained earnings | | |
| Result | | 280 |
| Consolidated reserves | | 770 |

GAMMA - Column (4)

The amount used in this adjustment is the adjusted Financial investment on GAMMA in ALPHA accounts.

| | Debit | Credit |
|------------------------|-------|--------|
| Consolidated reserves | 1,400 | |
| Link account(Fin.Inv.) | | 1,400 |

GAMMA - Column (5)

This is the GAMMA contribution to the consolidated balance. The result of (400) is split into a group result for (280) = 70% * (400) and a minority result for (120) = 30% * (400).

DIRECT CONSOLIDATION

| DELTA | (1) (CUR) | (2) | (3) | (4) | (5) |
|----------------------------|-----------|----------|-------|-------|----------|
| Goodwill (gross val.) | | | | | 0 |
| Goodwill (deprec.) | | | | | 0 |
| Lands | | | | | 0 |
| Tangible assets (acq.val.) | 8,000 | 6,400 | | | 6,400 |
| Tangible assets (deprec.) | (4,000) | (3,200) | | | (3,200) |
| Fin.invest./BETA | | | | | 0 |
| Fin.invest./GAMMA | | | | | 0 |
| Fin.invest./DELTA | | | | | 0 |
| Receivables/3rd Parties | 8,000 | 6,400 | | | 6,400 |
| Cash | 6,000 | 4,800 | | | 4,800 |
| Link account(Fin.Inv.) | | | | | 0 |
| | 18,000 | 14,400 | 0 | 0 | 14,400 |
| | | | | | |
| Capital | 8,000 | 6,400 | 800 | | 7,200 |
| Retained earnings | 4,000 | 3,200 | 200 | | 3,400 |
| Reserves | | | | | 0 |
| Result | 600 | 480 | (60) | 210 | 630 |
| Consolidated reserves | | | | | 0 |
| Translation adjustments | | | (940) | 30 | (910) |
| Minority interests | | | | | 0 |
| Provisions | 1,400 | 1,120 | | (240) | 880 |
| Payables/3rd Parties | 4,000 | 3,200 | | | 3,200 |
| | 18,000 | 14,400 | 0 | 0 | |
| | | | | | |
| Turnover/3rd Parties | 30,000 | 21,000 | | | 21,000 |
| Purchases | (28,600) | (20,020) | | | (20,020) |
| Depreciations | (800) | (560) | | | (560) |
| Provisions | | | | 210 | 210 |
| Result | 600 | 420 | 0 | 210 | 630 |
| Group result | | | | | |
| Minority result | | | | | |

DELTA - Column (1)

Statutory accounts in local currency CUR.

DELTA - Column (2)

We first translate all balance sheet accounts with the closing rate of 0.8 and all the P&L accounts with the average rate of 0.7.

DELTA - Column (3)

By processing like this way, we introduce some mistakes because

- The capital amount should be translated with the historical rate of 0.9 instead of the closing rate, which gives an adjustment of $800 = [0.9 - 0.81] * 8000$
- The retained earnings amount should be translated with the historical rate of 0.85 instead of the closing rate, which gives an adjustment of $200 = [0.85 - 0.81] * 4000$
- The result amount has to be translated with the average rate of 0.7 instead of the closing rate, which gives an adjustment of $(60) = [0.7 - 0.81] * 600$

This leads to the following adjustment.

| | Debit | Credit |
|-------------------------|-------|--------|
| Capital | | 800 |
| Retained earnings | | 200 |
| Result | 60 | |
| Translation adjustments | 940 | |

DELTA - Column (4)

This column concerns the provision of 300 CUR booked in the statutory accounts, which is not compatible with the group rules.

| | Debit | Credit |
|----------------------------|-------|--------|
| Provisions (Balance sheet) | 240 | |
| Provisions (P&L) | | 210 |
| Translation adjustments | | 30 |

The debit amount of 240 corresponds to the provision at closing rate for $240 = 300 \text{ CUR} * 0.8$ and the P&L counterpart is $210 = 300 \text{ CUR} * 0.7$ (average rate). The difference of 30 is a translation adjustment amount.

DELTA - Column (5)

Because of the number of columns, this spreadsheet is split into two parts and column (5) is a subtotal for columns (2) to (4).

DIRECT CONSOLIDATION

| DELTA | (5) | (6) | (7) | (8) | (9) |
|----------------------------|----------|---------|---------|---------|----------|
| Goodwill (gross val.) | 0 | | | | 0 |
| Goodwill (deprec.) | 0 | | | | 0 |
| Lands | 0 | | | | 0 |
| Tangible assets (acq.val.) | 6,400 | | | 6,400 | |
| Tangible assets (deprec.) | (3,200) | | | (3,200) | |
| Fin.invest./BETA | 0 | | | | 0 |
| Fin.invest./GAMMA | 0 | | | | 0 |
| Fin.invest./DELTA | 0 | | | | 0 |
| Receivables/3rd Parties | 6,400 | | | 6,400 | |
| Cash | 4,800 | | | 4,800 | |
| Link account(Fin.Inv.) | 0 | | (3,600) | (3,600) | |
| | 14,400 | 0 | 0 | (3,600) | 10,800 |
| Capital | 7,200 | (2,880) | (4,320) | | 0 |
| Retained earnings | 3,400 | (1,360) | (2,040) | | 0 |
| Reserves | 0 | | | | 0 |
| Result | 630 | (252) | (378) | | 0 |
| Consolidated reserves | 0 | | 6,738 | | 3,138 |
| Translation adjustments | (910) | 364 | | (3,600) | (546) |
| Minority interests | 0 | 4,128 | | | 4,128 |
| Provisions | 880 | | | | 880 |
| Payables/3rd Parties | 3,200 | | | | 3,200 |
| | | 0 | 0 | (3,600) | 10,800 |
| Turnover/3rd Parties | 21,000 | | | | 21,000 |
| Purchases | (20,020) | | | | (20,020) |
| Depreciations | (560) | | | | (560) |
| Provisions | 210 | | | | 210 |
| Result | 630 | 0 | 0 | 0 | 630 |
| Group result | | | | | 378 |
| Minority result | | | | | 252 |

PART 6 CONSOLIDATION CASE STUDY

DELTA - Column (5)

We continue by referencing to the subtotal column (5).

DELTA - Column (6)

Reclassification of 40% of all equity accounts to Minority interests, including the translation adjustments.

| | Debit | Credit |
|-------------------------|-------|--------|
| Capital | 2,880 | |
| Retained earnings | 1,360 | |
| Result | 252 | |
| Translation adjustments | | 364 |
| Minority interests | | 4,128 |

DELTA - Column (7)

Reclassification of 60% of all equity accounts on the Consolidated reserves account, excluding the translation adjustments.

| | Debit | Credit |
|-----------------------|-------|--------|
| Capital | 4,320 | |
| Retained earnings | 2,040 | |
| Result | 378 | |
| Consolidated reserves | | 6,738 |

DELTA - Column (8)

The amount used in this adjustment is the adjusted financial investment on DELTA in ALPHA accounts.

| | Debit | Credit |
|------------------------|-------|--------|
| Consolidated reserves | 3,600 | |
| Link account(Fin.Inv.) | | 3,600 |

DELTA - Column (9)

This is the GAMMA contribution to the consolidated balance. The result of 630 is split into a group result for $378 = 60\% * 630$ and a minority result for $252 = 40\% * 630$.

DIRECT CONSOLIDATION

| CONTRIBUTION | ALPHA | BETA | GAMMA | DELTA | CONSO |
|-----------------------------|---------|----------|----------|----------|----------|
| Goodwill (gross val.) | 1,200 | 0 | 0 | 0 | 1,200 |
| Goodwill (deprec.) | (860) | 0 | 0 | 0 | (860) |
| Lands | 1,000 | 0 | 1,000 | 0 | 2,000 |
| Tangible assets (acq. val.) | 0 | 4,000 | 4,000 | 6,400 | 14,400 |
| Tangible assets (deprec.) | 0 | (1,500) | (800) | (3,200) | (5,500) |
| Fin.invest./BETA | 0 | 0 | 0 | 0 | 0 |
| Fin.invest./GAMMA | 0 | 0 | 0 | 0 | 0 |
| Fin.invest./DELTA | 0 | 0 | 0 | 0 | 0 |
| Rec. es | 1,500 | 5,000 | 2,000 | 6,400 | 14,900 |
| Cash | 800 | 1,200 | 800 | 4,800 | 7,600 |
| Link account(Fin.Inv.) | 9,500 | (4,500) | (1,400) | (3,600) | 0 |
| | 13,140 | 4,200 | 5,600 | 10,800 | 33,740 |
| | | | | | |
| Capital | 5,000 | 0 | 0 | 0 | 5,000 |
| Retained earnings | 3,000 | 0 | 0 | 0 | 3,000 |
| Reserves | (620) | 0 | 0 | 0 | (620) |
| Result | 160 | 0 | 0 | 0 | 160 |
| Consolidated reserves | 0 | 300 | (630) | 3,138 | 2,808 |
| Translation adjustments | 0 | 0 | 0 | (546) | (546) |
| Minority interests | 0 | 1,200 | 330 | 4,128 | 5,658 |
| Provisions | 1,000 | 500 | 0 | 880 | 2,380 |
| Payables/3rd parties | 4,600 | 2,200 | 5,900 | 3,200 | 15,900 |
| | 13,140 | 4,200 | 5,600 | 10,800 | 33,740 |
| | | | | | |
| Turnover/3rd Parties | 10,000 | 20,000 | 30,000 | 21,000 | 81,000 |
| Purchases | (9,600) | (18,900) | (30,100) | (20,020) | (78,620) |
| Depreciations | (240) | (400) | (300) | (560) | (1,500) |
| Provisions | 0 | (500) | 0 | 210 | (290) |
| Result | 160 | 200 | (400) | 630 | 590 |
| Group result | 160 | 160 | (280) | 378 | 418 |
| Minority result | 0 | 40 | (120) | 252 | 172 |

PART 6 CONSOLIDATION CASE STUDY

This contribution spreadsheet gives a good overview of this first consolidation with the following comments

- Goodwills are booked only in ALPHA company. It is normal because it is the unique shareholder in this group.
- All financial investments in consolidated companies have been eliminated. Moreover, the Link account is equal to zero at the end of the consolidation process.
- Consolidated equity includes only ALPHA equity and Consolidated reserves appear only for the three subsidiaries.
- The translation adjustment amount corresponds to the group part (60%) in the translation adjustment initially booked in DELTA company.
- All the amounts in this contribution are of course supposed to be adjusted amounts.

4 CONSOLIDATION OF YEAR 2

When receiving individual consolidation bundle of each company, it is worth checking if the announced events are indeed reflected in these accounts.

Moreover, validation of financial investments and equity evolution is the first step to undertake before entering into the consolidation process.

And finally, analyzing these figures can reveal some transactions that the consolidation office may just not simply be aware of.

Let's consider these figures.

DIRECT CONSOLIDATION

| | ALPHA | | BETA | | GAMMA | | MU | | DELTA (CUR) | |
|----------------------------|--------|---------|----------|----------|----------|----------|---------|---------|-------------|----------|
| | Year 1 | Year 2 | Year 1 | Year 2 | Year 1 | Year 2 | Year 1 | Year 2 | Year 1 | Year 2 |
| Lands | 1,000 | | | | 1,500 | 1,000 | | | | |
| Tangible assets (acq.vat.) | | | 3,000 | 4,000 | 4,000 | 5,000 | 6,000 | 8,000 | 8,000 | |
| Tangible assets (deprec.) | | | (1,200) | (1,800) | (800) | (1,300) | (3,000) | (4,000) | | (4,800) |
| Fin.invest./BETA | 5,000 | 7,400 | | | | | | | | |
| Fin.invest./GAMMA | 2,100 | 900 | | | | | | | | |
| Fin.invest./DELTA | 3,600 | 3,600 | | | | | | | | |
| Receivables/3rd Parties | 1,500 | 1,600 | 5,000 | 7,000 | 2,000 | 3,000 | 3,000 | 8,000 | 14,000 | |
| Receivables/DELTA | | 1,000 | | | | | | | | |
| Cash | 800 | 1,500 | 1,200 | 1,000 | 800 | 1,300 | 2,000 | 6,000 | 4,800 | |
| | 14,000 | 16,000 | 8,000 | 15,700 | 7,000 | 8,000 | 8,000 | 18,000 | 22,000 | |
| Capital | 5,000 | 5,000 | 3,000 | 6,000 | 2,000 | 2,000 | 3,000 | 8,000 | 8,000 | |
| Retained earnings | 3,000 | 3,100 | 2,000 | 2,300 | (500) | (900) | 1,000 | 4,000 | 4,200 | |
| Result | 400 | 800 | 300 | 900 | (400) | (200) | 500 | 600 | 1,000 | |
| Provisions | 1,000 | 1,200 | 500 | 600 | 5,900 | 7,100 | 3,500 | 1,400 | 2,000 | |
| Payables/3rd Parries | 4,600 | 5,900 | 2,200 | 5,900 | | | | 4,000 | 5,550 | |
| Payables/ALPHA | | | | | | | | | 1,250 | |
| | 14,000 | 16,000 | 8,000 | 15,700 | 7,000 | 8,000 | 8,000 | 18,000 | 22,000 | |
| Turnover/3rd Parties | 10,000 | 12,000 | 20,000 | 30,000 | 30,000 | 35,000 | 10,000 | 30,000 | 40,000 | |
| Turnover/DELTA | | 3,000 | | | | | | | | |
| Dividends/DELTA | | 150 | | | | | | | | |
| Gain on disposals | | 500 | | | | | | | | |
| Purchases/3rd Parties | | (9,600) | (14,250) | (18,900) | (28,400) | (30,100) | 300 | (8,900) | (28,600) | (32,400) |
| Purchases/ALPHA | | | | | | (35,000) | | | | (5,800) |
| Depreciations | | | | | | | | | | (600) |
| Provisions | | | | | | | | | | |
| Loss on disposals | | | | | | | | | | |
| Result | 400 | 800 | 300 | 900 | (400) | (200) | 500 | 600 | 1,000 | |

PART 6 CONSOLIDATION CASE STUDY

Comeanv ALPHA

- The lands for **1000** in Year **1** have been sold to company BETA for a price of **1500**, giving a group profit of **500** that should be eliminated.
- There is an increase of **2400** in the financial investment in BETA. This corresponds to a subscription of $2400 = 80\% * 3000$ in the capital increase of company. It is important to notice that each shareholder subscribes in the proportion of its participation and that transaction should not imply consolidation adjustments.
- ALPHA has reduced its participation in company GAMMA from **70%** to **30%** by selling for a price of **800** **40%** of shares at a book value of **1200**. This transaction gives a loss on disposal for **400** as it can be seen in the P&L
- There are intercompany receivables with company DELTA for an amount of **1000**. The P&L shows also intercompany turnover for **3000** with the same company. These figures will require a special care because the partner DELTA closes its accounts in CUR.
- Analysis of equity shows a distribution of gross dividends for **300**. These dividends have been paid during Year **2**, which means such transaction should appear in the cash flow statement.
- The dividends for **150** in the P&L have been paid by company DELTA on the basis of $240 \text{ CUR} = 60\% * 400 \text{ CUR}$. These dividends are related to Year **1** profit and paid during Year **2**.

Comeanv BETA

- The lands for **1500** have been acquired from company ALPHA. This book value includes a group profit for **500** to be eliminated.
- BETA acquires 90% of shares of company MU for a price of **4000**. This acquisition occurs on July 1st, Year **2**. This will imply a goodwill calculation at that date. Moreover, we must consolidate only the last six months of the new company.
- We notice indeed a capital increase for an amount of **3000**.

Company GAMMA

- All transactions reflected in these accounts occur with the outside world and need no consolidation adjustments. Of course, this company is now consolidated with the equity method.

DIRECT CONSOLIDATION

| | ALPHA | | BETA | | GAMMA | | MU | | DELTA (CUR) | |
|----------------------------|---------|----------|----------|----------|----------|----------|---------|----------|-------------|---------|
| | Year 1 | Year 2 | Year 1 | Year 2 | Year 1 | Year 2 | Year 1 | Year 2 | Year 1 | Year 2 |
| Lands | 1,000 | | | | 1,500 | 1,000 | | | | |
| Tangible assets (acq.vai.) | | | 3,000 | 4,000 | 4,000 | 5,000 | 6,000 | 8,000 | 8,000 | |
| Tangible assets (deprec.) | | | (1,200) | (1,800) | (800) | (1,300) | (3,000) | (4,000) | (4,000) | (4,800) |
| Fin.invest./BETA | 5,000 | 7,400 | | | | | | | | |
| Fin.invest./GAMMA | 2,100 | 900 | | | | | | | | |
| Fin.invest./DELTA | 3,600 | 3,600 | | | 4,000 | | | | | |
| Receivables/3rd Parties | 1,500 | 1,600 | 5,000 | 7,000 | 2,000 | 3,000 | 3,000 | 8,000 | 8,000 | 14,000 |
| Receivables/DELTA | | | 1,000 | | | | | | | |
| Cash | 800 | 1,500 | 1,200 | 1,000 | 800 | 1,300 | 2,000 | 6,000 | 6,000 | 4,800 |
| | 14,000 | 16,000 | 8,000 | 15,700 | 7,000 | 8,000 | 8,000 | 18,000 | 18,000 | 22,000 |
| Capital | 5,000 | 5,000 | 3,000 | 6,000 | 2,000 | 2,000 | 3,000 | 8,000 | 8,000 | |
| Retained earnings | 3,000 | 3,100 | 2,000 | 2,300 | (500) | (900) | 1,000 | 4,000 | 4,000 | 4,200 |
| Result | 400 | 800 | 300 | 900 | (400) | (200) | 500 | 600 | 600 | 1,000 |
| Provisions | 1,000 | 1,200 | 500 | 600 | | | | 1,400 | 1,400 | 2,000 |
| Payables/3rd Parties | 4,600 | 5,900 | 2,200 | 5,900 | 5,900 | 7,100 | 3,500 | 4,000 | 4,000 | 5,550 |
| Payables/ALPHA | | | | | | | | | | 1,250 |
| | 14,000 | 16,000 | 8,000 | 15,700 | 7,000 | 8,000 | 8,000 | 18,000 | 18,000 | 22,000 |
| Turnover/3rd Parties | 10,000 | 12,000 | 20,000 | 30,000 | 30,000 | 35,000 | 10,000 | 30,000 | 30,000 | 40,000 |
| Turnover/DELTA | | 3,000 | | | | | | | | |
| Dividends/DELTA | | 150 | | | | | | | | |
| Gain on disposals | | 500 | | | | | | | | |
| Purchases/3rd Parties | (9,600) | (14,250) | (18,900) | (28,400) | (30,100) | (35,000) | (8,900) | (28,600) | (32,400) | (5,200) |
| Purchases/ALPHA | | | | | | | (600) | (800) | (800) | (600) |
| Depreciations | | | | | | | | | | |
| Provisions | | (200) | (300) | (600) | (300) | (500) | | | | |
| Loss on disposals | | (400) | (500) | (100) | | | | | | |
| Result | 400 | 800 | 300 | 900 | (400) | (200) | 500 | 600 | 600 | 1,000 |

PART 6 CONSOLIDATION CASE STUDY

Company MU

- This is a new company acquired by company GAMMA on July 1st, Year 2. On that date, the company's result was already 200. Here are the accounts giving that result :
 - Turnover 6000
 - Purchases 5500
 - Depreciations 300
- The due diligence concludes to no goodwill allocation.

Company DELTA

- Equity analysis confirms the payment of dividends for 400 CUR. As stated before, company ALPHA receives 240 CUR = $60\% * 400$ CUR booked for a value of 150 EUR.
- We remind that the provisions still include an amount of 300 CUR to be eliminated. These provisions have already been adjusted during Year 1 consolidation. This means that the adjustment has to be maintained.
- The intercompany payables of 1250 CUR with partner ALPHA correspond to the intercompany receivables booked in ALPHA accounts. This means the difference that will be noticed after currency translation is to be considered as an exchange gain or loss.
- The same comment can be made for the intercompany purchases with ALPHA for an amount of 5200 CUR.

Let's now proceed to the consolidation of Year 2 like we did for Year 1.

DIRECT CONSOLIDATION

| ALPHA | (1) | (2) | (3) | (4) | (5) | (6) | (7) |
|----------------------------|----------|-------|-------|-------|-------|-------|----------|
| Goodwill (gross val.) | | 500 | (400) | 300 | (300) | | 800 |
| Goodwill (deprec.) | | | | | | | (700) |
| Lands | | | | | | | 0 |
| Tangible assets (acq.val.) | 7,400 | (500) | | | | | 0 |
| Tangible assets (deprec.) | 900 | | | | | | 0 |
| Fin.invest./BETA | 3,600 | | | (300) | | | 6,900 |
| Fin.invest./GAMMA | | | | | | | 600 |
| Fin.invest./DELTA | | | | | | | 3,600 |
| Fin.invest./MU | | | | | | | 0 |
| Equity value | 1,600 | | | | | | 0 |
| Receivables/3rd Parties | 1,000 | | | | | | 1,600 |
| Receivables/DELTA | 1,500 | | | | | | 1,000 |
| Cash | | | | | | | 1,500 |
| Link account(Intercos) | | | | | | | 0 |
| Link account(Fin.Inv.) | | | | | | | 0 |
| | 16,000 | 0 | (400) | 0 | (300) | 0 | 15,300' |
| Capital | 5,000 | | | | | | 5,000 |
| Retained earnings | 3,100 | | | | | | 3,100 |
| Reserves | | | | | | | (372) |
| Result | 800 | | (300) | | (240) | 168 | 472 |
| Consolidated reserves | | | (100) | | (60) | (168) | 0 |
| Translation adjustments | | | | | | | 0 |
| Minority interests | | | | | | | 0 |
| Provisions | 1,200 | | | | | | 1,200 |
| Payables/3rd Parties | 5,900 | | | | | | 5,900 |
| Payables/ALPHA | | | | | | | 0 |
| | 16,000 | 0 | (400) | 0 | (300) | 0 | 15,300 |
| Turnover/3rd Parties | 12,000 | | | | | | 12,000 |
| Turnover/DELTA | 3,000 | | | | | | 3,000 |
| Dividends/DELTA | 150 | | | | | | 0 |
| Exchange gain(unrealized) | | | | | | | 0 |
| Gain on disposals | 500 | | | | | | 500 |
| Purchases/3rd Parties | (14,250) | | | | | | (14,250) |
| Purchases/ALPHA | | | | | | | 0 |
| Depreciations | | | | | | | (160) |
| Provisions | (200) | | (100) | | (60) | | (200) |
| Exchange loss(realized) | | | | | | | (18) |
| Loss on disposals | (400) | | | | | | (400) |
| Loss on equity cies | | | | | | | 0 |
| Link account(Intercos) | | | | | | | 0 |
| Result | 800 | 0 | (100) | 0 | (60) | (168) | 472 |

PART 6 CONSOLIDATION CASE STUDY

ALPHA - Column (1)

Statutory accounts.

ALPHA - Column (2)

Historical goodwill of 500 related to the acquisition of company BETA in beginning of Year -1.

| | Debit | Credit |
|-----------------------|-------|--------|
| Goodwill (gross val.) | 500 | |
| Fin.invest./BETA | | 500 |

ALPHA - Column (3)

This goodwill is now depreciated for an amount of (400) corresponding to (300) impacting the Reserves and a depreciation of (100) to book in P&L.

| | Debit | Credit |
|--------------------|-------|--------|
| Reserves | | |
| Goodwill (deprec.) | | |
| Depreciations | | |

ALPHA - Column (4)

Initially, we had a gross goodwill of 700 corresponding to the 70% acquisition of GAMMA. In January this year, ALPHA has sold 40% of these shares, remaining with a participation of 30%. The remaining gross goodwill kept in the consolidation is than $300 = 700 * [30\% / 70\%]$.

| | Debit | Credit |
|-----------------------|-------|--------|
| Goodwill (gross val.) | 300 | |
| Fin.invest./GAMMA | | 300 |

ALPHA - Column (5)

Same comment can be made for the goodwill depreciations which opening value is $(240) = (560) * [30\% / 70\%]$. After this transaction, the net value of the goodwill is now 60 and the group decides to depreciate it totally.

| | Debit | Credit |
|--------------------|-------|--------|
| Reserves | 240 | |
| Goodwill (deprec.) | | 300 |
| Depreciations | 60 | |

ALPHA - Column (6)

Company DELTA is paying dividends for 400 CUR valued at Year 1 average rate of 0.7. ALPHA should then receive $168 = 60\% * 400 \text{ CUR} * 0.7$ but, on the basis of the bank receipt, books only 150. The difference is considered as a realized exchange loss.

| | Debit | Credit |
|-------------------------|-------|--------|
| Dividends/DELTA | 150 | |
| Exchange loss(realized) | 18 | |
| Reserves | | 168 |

DIRECT CONSOLIDATION

| ALPHA | (7) | (8) | (9) | (10) | (11) | (12) |
|----------------------------|----------|-------|-------|---------|---------|----------|
| Goodwill (gross val.) | 800 | | | | | 800 |
| Goodwill (deprec.) | (700) | | | | | (700) |
| Lands | 0 | | | | | 0 |
| Tangible assets (acq.val.) | 0 | | | | | 0 |
| Tangible assets (deprec.) | 0 | | | | | 0 |
| Fin.invest./BETA | 6,900 | | | | (6,900) | 0 |
| Fin.invest./GAMMA | 600 | | | | (600) | 0 |
| Fin.invest./DELTA | 3,600 | | | | (3,600) | 0 |
| Fin.invest./MU | 0 | | | | | 0 |
| Equity value | 0 | | | | | 0 |
| Receivables/3rd Parties | 1,600 | | | | | 1,600 |
| Receivables/DELTA | 1,000 | | | (1,000) | | 0 |
| Cash | 1,500 | | | | 1,000 | 1,500 |
| Link account(Intercos) | 0 | | | | | 1,000 |
| Link account(Fin.Inv.) | 0 | | | | | 11,100 |
| | 15,300 | 0 | 0 | 0 | 0 | 15,300 |
| Capital | 5,000 | | | | | 5,000 |
| Retained earnings | 3,100 | | | | | 3,100 |
| Reserves | (372) | | | | | (652) |
| Result | 472 | | 400 | (680) | | 752 |
| Consolidated reserves | 0 | | (400) | 680 | | 0 |
| Translation adjustments | 0 | | | | | 0 |
| Minority interests | 0 | | | | | 0 |
| Provisions | 1,200 | | | | | 1,200 |
| Payables/3rd Parties | 5,900 | | | | | 5,900 |
| Payables/ALPHA | 0 | | | | | 0 |
| | 15,300 | 0 | 0 | | 0 | 15,300 |
| Turnover/3rd Parties | 12,000 | | | | | 12,000 |
| Turnover/DELTA | 3,000 | | | | | 0 |
| Dividends/DELTA | 0 | | | | | 0 |
| Exchange gain(unrealized) | 0 | | | | | 0 |
| Gain on disposals | 500 | | | | | 380 |
| Purchases/3rd Parties | (14,250) | | | | | (14,250) |
| Purchases/ALPHA | 0 | | | | | 0 |
| Depreciations | (160) | | | | | (160) |
| Provisions | (200) | | | | | (200) |
| Exchange loss(realized) | (18) | | | | | (18) |
| Loss on disposals | (400) | | | | | 0 |
| Loss on equity cies | 0 | | | | | 0 |
| Link account(Intercos) | 0 | | | 3,000 | | 3,000 |
| Result | 472 | (400) | 680 | 0 | 0 | 752 |
| Group result | | | | | | 752 |
| Minority result | | | | | | 0 |

PART 6 CONSOLIDATION CASE STUDY

ALPHA - Column (7)

We continue by referencing to the subtotal column (7).

ALPHA - Column (8)

We have already noticed that the disposal of lands for a price of 1500 generates a group profit of 500. This transaction being concluded with the 80% owned company BETA implies we recognize a group profit for only $400 = 80\% * 500$ which has to be eliminated and we keep a profit of $100 = 20\% * 500$ with the 3rd Parties.

| | Debit | Credit |
|-------------------|-------|--------|
| Gain on disposals | 400 | |
| Reserves | | 400 |

In statutory accounts, the 40% GAMMA shares valued at 1200 are disposed for a price of 800 giving a loss of 400.

In consolidated accounts, the value of these shares is $440 = 40\% * [2000 + (900)]$ where figures between brackets are the equity at time of disposal. Moreover, a corresponding part of the remaining goodwill has also to be eliminated against the P&L. We speak about $80 = [40\% / 70\%] * [700 + (560)]$. Compared to the disposal price of 800, the consolidated gain is $280 = 800 - 440 - 80$.

The final adjustment eliminates the statutory loss for 400 and book a complementary gain of 280.

| | Debit | Credit |
|-------------------|-------|--------|
| Reserves | 680 | |
| Loss on disposals | | 400 |
| Gain on disposals | | 280 |

ALPHA - Column (10)

We eliminate the intercompany positions with DELTA on the receivables and turnover accounts against the Link account.

| | Debit | Credit |
|------------------------|-------|--------|
| Link account(Interkos) | 1,000 | |
| Receivables/DELTA | | |
| Turnover/DELTA | 3,000 | |
| Link account Interkos | | 3 000 |

ALPHA - Column (11)

Elimination of each Financial investment via the Link account.

| | Debit | Credit |
|------------------------|--------|--------|
| Link account(Fin.Inv.) | 11,100 | |
| Fin.invest./BETA | | 6,900 |
| Fin.invest./GAMMA | | |
| Fin.invest./DELTA | | 3 600 |

DIRECT CONSOLIDATION

| BETA | (1) | (2) | (3) | (4) | (5) | (6) | (7) |
|----------------------------|----------|-------|-------|-------|-----|------|----------|
| Goodwill (gross val.) | | | | | | | |
| Goodwill (deprec.) | | | | | | | |
| Lands | 1,500 | | | | | | |
| Tangible assets (acq.val.) | 4,000 | 1,000 | | | | | |
| Tangible assets (deprec.) | (1,800) | | (400) | | | | |
| Fin.invest./BETA | | | | | | | |
| Fin.invest./GAIYMA | | | | | | | 0 |
| Fin.invest./DELTA | | | | | | | 0 |
| Fin.invest./MU | | | | | | | 0 |
| Equity value | 4,000 | | | | | | 3,780 |
| Receivables/3rd Parties | 7,000 | | | | | | 7,000 |
| Receivables/DELTA | | | | | | | 0 |
| Cash | 1,000 | | | | | | 1,000 |
| Link account(Intercos) | | | | | | | 0 |
| Link account(Fin.Inv.) | | | | | | | 0 |
| | 15,700 | 1,000 | (400) | (500) | 0 | (22) | 15,778 |
| Capital | | | | | | | |
| Retained earnings | 6,000 | | | | | | 6,000 |
| Reserves | 2,300 | | | | | | 2,300 |
| Result | 900 | 1,000 | (300) | (500) | | | 200 |
| Consolidated reserves | | | (100) | | | | 778 |
| Translation adjustments | | | | | | | 0 |
| Minority interests | | | | | | | 0 |
| Provisions | 600 | | | | | | 600 |
| Payables/3rd Parties | 5,900 | | | | | | 5,900 |
| Payables/ALPHA | | | | | | | 0 |
| | 15,700 | 1,000 | (400) | (500) | 0 | (22) | 15,778 |
| Turnover/3rd Parties | | | | | | | |
| Turnover/DELTA | 30,000 | | | | | | 30,000 |
| Dividends/DELTA | | | | | | | 0 |
| Exchange gain(unrealized) | | | | | | | 0 |
| Gain on disposals | | | | | | | 0 |
| Purchases/3rd Parties | (28,400) | | | | | | 0 |
| Purchases/ALPHA | | | | | | | (28,400) |
| Depreciations | (600) | | | | | | 0 |
| Provisions | (100) | | | | | | (722) |
| Exchange loss(realized) | | | (100) | | | | (100) |
| Loss on disposals | | | | | | | 0 |
| Loss on equity rises | | | | | | | 0 |
| Link account(Intercos) | | | | | | | 0 |
| Result | 900 | 0 | (100) | 0 | 0 | (22) | 778 |
| Group result | | | | | | | |
| Minority result | | | | | | | |

PART 6 CONSOLIDATION CASE STUDY

BETA - Column (1)

Statutory accounts.

BETA - Column (2)

At time of acquisition in Year -1, the initial goodwill has been partially allocated to some tangible assets for an amount of 1000. These tangible assets are still in the company and so we keep the adjustment.

| | Debit | Credit |
|----------------------------|-------|--------|
| Tangible assets (acq.val.) | 1,000 | |
| Reserves | | 1,000 |

BETA - Column (3)

A new depreciation is booked in the P&L.

| | Debit | Credit |
|---------------------------|-------|--------|
| Reserves | 300 | |
| Tangible assets (deprec.) | | 400 |
| Depreciations | 100 | |

BETA - Column (4)

Lands account includes a group profit of 500 we eliminate against the Reserves account. We did the same in APLHA by eliminating the group profit for 400 also against the Reserves. The impact in BETA being taken at 80%, Reserves accounts between the two companies will be netted to zero.

| | Debit | Credit |
|----------|-------|--------|
| Reserves | 500 | |
| Lands | | 500 |

BETA - Column (5)

Acquisition of company MU is done with a goodwill corresponding to the difference between the acquisition price of 4000 and $3780 = 90\% * [3000 + 1000 + 200]$. Figures between brackets are the MU equity on July 1st, Year 2, 200 representing the first six months profit.

| | Debit | Credit |
|----------------|-------|--------|
| Goodwill | 220 | |
| Fin.invest./MU | | 220 |

BETA - Column (6)

This goodwill is depreciated over 5 years, starting at acquisition date. The corresponding depreciation for Year 2 is $22 = 20\% * 220 * [6/12]$.

| | Debit | Credit |
|---------------|-------|--------|
| Depreciations | 22 | |
| Goodwill | | 22 |

DIRECT CONSOLIDATION

| BETA | (7) | (8) | (9) | (10) | (11) | (12) |
|----------------------------|----------|---------|---------|------|---------|----------|
| Goodwill (gross val.) | 220 | | | | | 220 |
| Goodwill (deprec.) | (22) | | | | | (22) |
| Lands | 1,000 | | | | | 1,000 |
| Tangible assets (acq.val.) | 5,000 | | | | | 5,000 |
| Tangible assets (deprec.) | (2,200) | | | | | (2,200) |
| Fin.invest./BETA | 0 | | | | | 0 |
| Fin.invest./GAMMA | 0 | | | | | 0 |
| Fin.invest./DELTA | 0 | | | | | 0 |
| Fin.invest./MU | 3,780 | | (756) | | (3,024) | 0 |
| Equity value | 0 | | | | | 0 |
| Receivables/3rd Parties | 7,000 | | | | | 7,000 |
| Receivables/DELTA | 0 | | | | | 0 |
| Cash | 1,000 | | | | | 1,000 |
| Link account(Intercos) | 0 | | | | | 0 |
| Link account(Fin.Inv.) | 0 | | | | | (3,876) |
| | 15,778 | (756) | 0 | 0 | (6,900) | 8,122 |
| Capital | 6,000 | (1,200) | (4,800) | | | 0 |
| Retained earnings | 2,300 | (460) | (1,840) | | | 0 |
| Reserves | 200 | (40) | (160) | | | 0 |
| Result | 778 | (156) | (622) | | | 0 |
| Consolidated reserves | 0 | | 7,422 | | (6,900) | 522 |
| Translation adjustments | 0 | | | | | 0 |
| Minority interests | 0 | 1,100 | | | | 1,100 |
| Provisions | 600 | | | | | 600 |
| Payables/3rd Parties | 5,900 | | | | | 5,900 |
| Payables/ALPHA | 0 | | | | | 0 |
| | 15,778 | (756) | 0 | 0 | (6,900) | 8,122 |
| Turnover/3rd Parties | 30,000 | | | | | 30,000 |
| Turnover/DELTA | 0 | | | | | 0 |
| Dividends/DELTA | 0 | | | | | 0 |
| Exchange gain(unrealized) | 0 | | | | | 0 |
| Gain on disposals | 0 | | | | | 0 |
| Purchases/3rd Parties | (28,400) | | | | | (28,400) |
| Purchases/ALPHA | 0 | | | | | 0 |
| Depreciations | (722) | | | | | (722) |
| Provisions | (100) | | | | | (100) |
| Exchange loss(realized) | 0 | | | | | 0 |
| Loss on disposals | 0 | | | | | 0 |
| Loss on equity cies | 0 | | | | | 0 |
| Link account(Intercos) | 0 | | | | | 0 |
| Result | 778 | 0 | 0 | 0 | 0 | 778 |
| Group result | | | | | | 622 |
| Minority result | | | | | | 156 |

PART 6 CONSOLIDATION CASE STUDY

BETA - Column (7)

We continue by referencing to the subtotal column (7).

BETA - Column (8)

We calculate Minority interests by reclassifying 20% of each equity account.

We also consider 20% of Minority interests in the Financial investment, as explained in Part 2 of this book.

| | Debit | Credit |
|--------------------|-------|--------|
| Capital | 1,200 | |
| Retained earnings | 460 | |
| Reserves | 40 | |
| Result | 156 | |
| Fin.invest./MU | | 756 |
| Minority interests | | 1,100 |

BETA - Column (9)

We then eliminate the group part of 80% in the equity and book the counterpart on the Consolidated reserves account.

| | Debit | Credit |
|-----------------------|-------|--------|
| Capital | 4,800 | |
| Retained earnings | 1,840 | |
| Reserves | | |
| Result | 622 | |
| Consolidated reserves | | 7,422 |

BETA - Column (10)

The net financial investment on company MU is eliminated via the Link account.

| | Debit | Credit |
|------------------------|-------|--------|
| Link account(Fin.Inv.) | 3,024 | |
| Fin.invest./MU | | 3,024 |

BETA - Column (11)

We finally pick up the adjusted financial value on company BETA in ALPHA accounts and book it on the Consolidated reserves via the Link account.

| | Debit | Credit |
|------------------------|-------|--------|
| Consolidated reserves | 6,900 | |
| Link account(Fin.Inv.) | | 6,900 |

DIRECT CONSOLIDATION

| GAMMA | (1) | (2) | (3) | (4) | (5) |
|----------------------------|----------|----------|-------|-------|-------|
| Goodwill (gross val.) | | | | | 0 |
| Goodwill (deprec.) | | | | | 0 |
| Lands | | | | | 0 |
| Tangible assets (acq.val.) | 5,000 | (5,000) | | | 0 |
| Tangible assets (deprec.) | (1,300) | 1,300 | | | 0 |
| Fin.invest./BETA | | | | | 0 |
| Fin.invest./GAMMA | | | | | 0 |
| Fin.invest./DELTA | | | | | 0 |
| Fin.invest./MU | | | | | 0 |
| Equity value | | 270 | | | 270 |
| Receivables/3rd Parties | 3,000 | (3,000) | | | 0 |
| Receivables/DELTA | | | | | 0 |
| Cash | 1,300 | (1,300) | | | 0 |
| Link account s) | | | | | 0 |
| Link account(Fin.Inv.) | | | (600) | (600) | |
| | 8,000 | (7,730) | 0 | (600) | (330) |
| Capital | 2,000 | (1,400) | (600) | | 0 |
| Retained earnings | (900) | 630 | 270 | | 0 |
| Reserves | | | | | 0 |
| Result | (200) | 140 | 60 | | 0 |
| Consolidated reserves | | | 270 | (600) | (330) |
| Translation ddjustments | | | | | 0 |
| Minority interests | | | | | 0 |
| Provisions | | | | | 0 |
| Payables/3rd Parties | 7,100 | (7,100) | | | 0 |
| Payables/ALPHA | | | | | 0 |
| | 8,000 | (7,730) | 0 | (600) | (330) |
| Turnover/3rd Parties | 35,000 | (35,000) | | | 0 |
| Turnover/DELTA | | | | | 0 |
| Dividends/DELTA | | | | | 0 |
| Exchange gain(unrealized) | | | | | 0 |
| Gain on disposals | 300 | (300) | | | 0 |
| Purchases/3rd Parties | (35,000) | 35,000 | | | 0 |
| Purchases/ALPHA | | | | | 0 |
| Depreciations | (500) | 500 | | | 0 |
| Provisions | | | | | 0 |
| Exchange loss(realized) | | | | | 0 |
| Loss on disposals | | | | | 0 |
| Loss on equit / cies | | (60) | | | (60) |
| Link account(Interco) | | | | | 0 |
| Result | (200) | 140 | 0 | 0 | (60) |
| Group result | | | | | (60) |
| Minority result | | | | | 0 |

PART 6 CONSOLIDATION CASE STUDY

GAMMA – Column (1)

Company GAMMA is consolidated with the equity method this year and its sole equity would be sufficient for the consolidation. However we suppose we still receive a full consolidation bundle.

GAMMA – Column (2)

This adjustment eliminates all amounts that cannot be integrated in the consolidated accounts. It concerns the balance sheet and the P&L. In the balance sheet, we eliminate all assets and liabilities accounts, but only 70% of the equity account. To balance this adjustment, we book the Equity value as 30% of that equity.

We apply the same approach with the P&L accounts and book the Loss on equity companies account.

| | Debit | Credit |
|----------------------------|--------|--------|
| Tangible assets (acq.val.) | | 5,000 |
| Tangible assets (deprec.) | 1,300 | |
| Equity value | 270 | |
| Receivables/3rd Parties | | 3,000 |
| Cash | | 1,300 |
| Capital | 1,400 | |
| Retained earnings | | 630 |
| Payables/3rd Parties | 7,100 | |
| Turnover/3rd Parties | 35,000 | |
| Gain on disposals | 300 | |
| Purchases/3rd Parties | | 35,000 |
| Depreciations | | 500 |
| Loss on equity cies | 60 | |

GAMMA – Column (3)

We eliminate 30% of the Equity accounts and book the total amount on the Consolidated reserves account.

| | Debit | Credit |
|------------------------------|-------|------------|
| Capital | 600 | |
| Retained earnings | | 270 |
| Result | | 60 |
| Consolidated reserves | | 270 |

GAMMA – Column (4)

The amount in this adjustment is the Financial investment value of company GAMMA owned by ALPHA.

| | Debit | Credit |
|------------------------|-------|--------|
| Consolidated reserves | 600 | |
| Link account(Fin.Inv.) | | 600 |

DIRECT CONSOLIDATION

| DELTA | (1) (CUR) | (2) | (3) | (4) | (5) | (6) |
|----------------------------|-----------|----------|-----|-------|-------|----------|
| Goodwill (gross val.) | | | | | | 0 |
| Goodwill (deprec.) | | | | | | 0 |
| Lands | | | | | | 0 |
| Tangible assets (acq.val.) | 8,000 | 7,200 | | | | 7,200 |
| Tangible assets (deprec.) | (4,800) | (4,320) | | | | (4,320) |
| Fin.invest./BETA | | | | | | 0 |
| Fin.invest./GAMMA | | | | | | 0 |
| Fin.invest./DELTA | | | | | | 0 |
| Fin.invest./MU | | | | | | 0 |
| Equity value | | | | | | 0 |
| Receivables/3rd Parties | 14,000 | 12,600 | | | | 12,600 |
| Receivables/DELTA | | | | | | 0 |
| Cash | 4,800 | 4,320 | | | | 4,320 |
| Link account(Intercos) | | | | | | 0 |
| Link account(Fin.Inv.) | | | | | | 0 |
| | 22,000 | 19,800 | 0 | 0 | 0 | 19,800 |
| Capital | 8,000 | 7,200 | 800 | (800) | | 7,200 |
| Retained earnings | 4,200 | 3,780 | 140 | (380) | | 3,540 |
| Reserves | | | | | 210 | 210 |
| Result | 1,000 | 900 | | (300) | | 600 |
| Consolidated reserves | | | | | | 0 |
| Translation adjustments | | | | (940) | 1,480 | 600 |
| Minority interests | | | | | | 0 |
| Provisions | 2,000 | 1,800 | | | | 1,530 |
| Payables/3rd Parties | 5,550 | 4,995 | | | | 4,995 |
| Payables/ALPHA | 1,250 | 1,125 | | | | 1,125 |
| | 22,000 | 19,800 | 0 | 0 | 0 | 19,800 |
| Turnover/3rd Parties | 40,000 | 24,000 | | | | 24,000 |
| Turnover/DELTA | | | | | | 0 |
| Dividends/DELTA | | | | | | 0 |
| Exchange gain(unrealized) | | | | | | 0 |
| Gain on disposals | | | | | | 0 |
| Purchases/3rd Parties | (32,400) | (19,440) | | | | (19,440) |
| Purchases/ALPHA | (5,200) | (3,120) | | | | (3,120) |
| Depreciations | (800) | (480) | | | | (480) |
| Provisions | (600) | (360) | | | | (360) |
| Exchange loss(realized) | | | | | | 0 |
| Loss on disposals | | | | | | 0 |
| Loss on equity stakes | | | | | | 0 |
| Link account(Intercos) | | | | | | 0 |
| Result | 1,000 | 600 | 0 | 0 | 0 | 600 |
| Group result | | | | | | |
| Minority result | | | | | | |

PART 6 CONSOLIDATION CASE STUDY

DELTA - Column (1)

Statutory accounts in local currency CUR.

DELTA - Column (2)

Accounts translated at closing rate of 0.9 for the balance sheet and at average rate of 0.6 for the P&L.

DELTA - Column (3)

We carry forward the corresponding translation adjustment booked in Year 1 consolidation. The Result impact is transferred to the Retained earnings account.

| | Debit | Credit |
|-------------------------|-------|--------|
| Capital | | 800 |
| Retained earnings | | 140 |
| Translation adjustments | 940 | |

DELTA - Column (4)

A new translation adjustment is necessary because of the historical value of the equity. Where those amounts come from?

| | Debit | Credit |
|-------------------------|-------|--------|
| Capital | 800 | |
| Retained earnings | 380 | |
| Result | 300 | |
| Translation adjustments | | 1,480 |

- Capital must be valued finally at a historical value of $7200 = 8000 \text{ CUR} * 0.9$. After column (3) adjustment, its value is $6400 = 7200 + (800)$. This explains the debit amount of $800 = 7200 - 6400$.
- Historical value of Retained earnings is $3540 = 4000 \text{ CUR} * 0.85 + 200 \text{ CUR} * 0.7$. After column (3) adjustment, its value is 3920. This explains the debit amount of $380 = 3920 - 3540$.
- Correct value for the Result is $600 = 1000 \text{ CUR} * 0.6$ instead of 900, giving a correction of $300 = 900 - 600$.

DELTA - Column (5)

The Year 1 provision for 300 CUR must be maintained in the consolidation. The local currency adjustment is

| | Debit | Credit |
|-------------------------|-------|--------|
| Provisions | 270 | |
| Reserves | | 210 |
| Translation adjustments | | 60 |

Provisions Debit 300 and Reserves Credit 300. After translation, Provisions is translated at closing rate of 0.9 and Reserves must be translated at the historical rate (= average rate of Year 1) of 0.7. The difference between the two amounts is booked on the Translation adjustment account.

DIRECT CONSOLIDATION

| DELTA | (6) | (7) | (8) | (9) | (10) | (11) | (12) | (13) |
|-----------------------------|----------|-------|-----|---------|---------|---------|---------|----------|
| Goodwill (gross val.) | 0 | | | | | | | 0 |
| Goodwill (deprec.) | 0 | | | | | | | 0 |
| (Lands) | 0 | | | | | | | 0 |
| Tangible assets (acq.val.) | 7,200 | | | | | | | 7,200 |
| Tangible assets (deprec.) | (4,320) | | | | | | | (4,320) |
| Fin.invest./BETA | 0 | | | | | | | 0 |
| Fin.invest./GAMMA | 0 | | | | | | | 0 |
| Fin.invest./DELTA | 0 | | | | | | | 0 |
| Fin.invest./MU | 0 | | | | | | | 0 |
| Equity value | 0 | | | | | | | 0 |
| Receivables/3rd Patties | 12,600 | | | | | | | 12,600 |
| Receivables/DELTA | 0 | | | | | | | 0 |
| Cash | 4,320 | | | | | | | 4,320 |
| Link account(Intercos) | 0 | | | (1,000) | | | | (1,000) |
| Link account(Fin.Inv.) | 0 | | | | | (3,600) | | (3,600) |
| | 19,800 | 0 | 0 | (1,000) | 0 | 0 | (3,600) | 15,200 |
| Capital | | | | | | | | |
| Retained earnings | 7,200 | | | | (2,880) | (4,320) | | 0 |
| Reserves | 3,540 | | | | (1,416) | (2,124) | | 0 |
| Result | 210 | | | | (84) | (126) | | 0 |
| Consolidated reserves | 600 | 125 | | | (290) | (435) | | 0 |
| Translation adjustments | 0 | | | | (240) | 7,005 | (3,600) | 3,405 |
| Minority interests | 600 | | | | 4,910 | | | 360 |
| Provisions | 0 | | | | | | | 4,910 |
| Payables/3rd Parties | 1,530 | | | | | | | 1,530 |
| Payables/ALPHA | 4,995 | | | | | | | 4,995 |
| | 1,125 | (125) | | (1,000) | | | | 0 |
| | 19,800 | 0 | 0 | (1,000) | 0 | 0 | (3,600) | 15,200 |
| Turnover/3rd Parties | | | | | | | | |
| Turnover/DELTA | 24,000 | | | | | | | 24,000 |
| Dividends/DELTA | 0 | | | | | | | 0 |
| Exchange gain(unrealized) | 0 | | | | | | | 125 |
| Gain on disposals | 0 | 125 | | | | | | 0 |
| Purchases/3rd Parties | (19,440) | | | | | | | (19,440) |
| Purchases/ALPHA | (3,120) | | | | | | | 0 |
| Depreciations | (480) | | | | | | | (480) |
| Provisions | (360) | | | | | | | (360) |
| Exchange loss(realized) | 0 | | | | | | | (120) |
| Loss on disposals | 0 | | | | | | | 0 |
| Loss on equity cies | 0 | | | | | | | 0 |
| Link account(Intercos) | 0 | | | (3,000) | | | | (3,000) |
| Result | 600 | 125 | 0 | 0 | 0 | 0 | 0 | 725 |
| Group result | | | | | | | | 435 |
| Minority result | | | | | | | | 290 |

PART 6 CONSOLIDATION CASE STUDY

DELTA - Column (7)

The intercompany being identified as 1000 EUR, we adapt the Payables side by considering an exchange gain for the difference of 125 = 1125 – 1000.

| | Debit | Credit |
|---------------------------|-------|--------|
| Payables/ALPHA | 125 | |
| Exchange gain(unrealized) | | 125 |

DELTA - Column (8)

We apply the same principle for the intercompany Purchases but this time it is just a reclassification between P&L accounts.

| | Debit | Credit |
|-------------------------|-------|--------|
| Exchange loss(realized) | 120 | |
| Purchases/ALPHA | | 120 |

DELTA - Column (9)

We can eliminate both intercompany amounts via a Link account, the first one in the balance sheet and the second one in the P&L.

| | Debit | Credit |
|------------------------|-------|--------|
| Payables/ALPHA | 1,000 | |
| Link account(Intercos) | | 1,000 |
| Link account(Intercos) | 3,000 | |
| Purchases ALPHA | | |

DELTA - Column (10)

Elimination of 40% of each equity account and transfer to the Minority interests.

| | Debit | Credit |
|-------------------------|-------|--------|
| Capital | 2,880 | |
| Retained earnings | 1,416 | |
| Reserves | 84 | |
| Result | 290 | |
| Translation adjustments | 240 | |
| Minority interests | | 4,910 |

DELTA - Column (11)

Elimination of 60% of each equity account and transfer to the Consolidated reserves account.

| | Debit | Credit |
|-----------------------|-------|--------|
| Capital | 4,320 | |
| Retained earnings | 2,124 | |
| Reserves | 126 | |
| Result | 435 | |
| Consolidated reserves | | 7,005 |

DELTA - Column (12)

This amount is the Financial investment value booked in ALPHA accounts on company DELTA.

| | Debit | Credit |
|------------------------|-------|--------|
| Consolidated reserves | 3,600 | |
| Link account(Fin.Inv.) | | 3,600 |

DIRECT CONSOLIDATION

| MU | (1) | (2) | (3) | (4) | (5) | (6) |
|----------------------------|---------|---------|-------|---------|---------|---------|
| Goodwill (gross val.) | | | | | | 0 |
| Goodwill (deprec.) | | | | | | 0 |
| Lands | | | | | | 0 |
| Tangible assets (acq.val.) | 6,000 | | | | | 6,000 |
| Tangible assets (deprec.) | (3,000) | | | | | (3,000) |
| Fin.invest./BETA | | | | | | 0 |
| Fin.invest./GAMMA | | | | | | 0 |
| Fin.invest./DELTA | | | | | | 0 |
| Fin.invest./MU | | | | | | 0 |
| Equity value | | | | | | 0 |
| Receivables/3rd Parties | 3,000 | | | | | 3,000 |
| Receivables/DELTA | | | | | | 0 |
| Cash | 2,000 | | | | | 2,000 |
| Link account(Intercos) | | | | | | 0 |
| Link account(Fin.Inv.) | | | | | | (3,024) |
| | 8,000 | 0 | 0 | 0 | (3,024) | 4,976 |
| | | | | | | |
| Capital | 3,000 | | | | | 0 |
| Retained earnings | 1,000 | | | | | 0 |
| Reserves | | 200 | | | | 0 |
| Result | 500 | (200) | | | | 0 |
| Consolidated reserves | | | (840) | (2,160) | | 0 |
| Translation adjustments | | | (280) | (720) | | 0 |
| Minority interests | | | (56) | (144) | | 0 |
| Provisions | | | (84) | (216) | | 0 |
| Payables/3rd Parties | 3,500 | | | 3,240 | | 216 |
| Payables/ALPHA | | | | | (3,024) | 1,260 |
| | 8,000 | 0 | 0 | 0 | (3,024) | 0 |
| | | | | | | 3,500 |
| | | | | | | 0 |
| Turnover/3rd Parties | | | | | | 4,000 |
| Turnover/DELTA | | | | | | 0 |
| Dividends/DELTA | | | | | | 0 |
| Exchange gain(unrealized) | | | | | | 0 |
| Gain on disposals | | | | | | 0 |
| Purchases/3rd Parties | 10,000 | (6,000) | | | | 0 |
| Purchases/ALPHA | | | | | | 0 |
| Depreciations | | | | | | 0 |
| Provisions | | | | | | 0 |
| Exchange loss(realized) | | | | | | 0 |
| Loss on disposals | | | | | | 0 |
| Loss on equity cies | | | | | | 0 |
| Link account(Intercos) | | | | | | 0 |
| Result | 500 | (200) | 0 | 0 | 0 | 300 |
| Group result | | | | | | 216 |
| Minority result | | | | | | 84 |

PART 6 CONSOLIDATION CASE STUDY

MU – Column (1)

Statutory accounts of this new company entering the consolidation scope. Notice that these accounts show a profit of 500 for the 12 months of Year 2.

MU – Column (2)

The company having a profit of 200 at the date of acquisition, it must be reversed to the Reserves and all P&L accounts contributing to this result must

| | Debit | Credit |
|-----------------------|-------|--------|
| Reserves | | 200 |
| Turnover/3rd Parties | 6,000 | |
| Purchases/3rd Parties | | 5,500 |
| Depreciations | | 300 |

also be eliminated. On the basis of the information given at the beginning of this case study, we have the adjustment, as opposite.

MU – Column (3)

Elimination of 28% = 100% - [80% * 90%] of each equity account and transfer to the Minority interests.

| | Debit | Credit |
|--------------------|-------|--------|
| Capital | 840 | |
| Retained earnings | 280 | |
| Reserves | 56 | |
| Result | 84 | |
| Minority interests | | 1,260 |

MU – Column (4)

Elimination of 72% = 80% * 90% of each equity account and transfer to the Consolidated reserves account

| | Debit | Credit |
|--------------------|-------|--------|
| Capital | 840 | |
| Retained earnings | 280 | |
| Reserves | 56 | |
| Result | 84 | |
| Minority interests | | 1,260 |

MU – Column (5)

This amount is the adjusted Financial investment value booked in ALPHA accounts on company MU.

| | Debit | Credit |
|------------------------|-------|--------|
| Consolidated reserves | | |
| Link account(Fin.Inv.) | 3,024 | 3,024 |

DIRECT CONSOLIDATION

| CONTRIBUTION | Year 2 | | | | | | Year 1 |
|----------------------------|----------|----------|-------|----------|---------|----------|---------|
| | ALPHA | BETA | GAMMA | DELTA | MU | CONSO | CONSO |
| Goodwill (gross val.) | 800 | 220 | 0 | 0 | 0 | 1,020 | 1,200 |
| Goodwill (deprec.) | (700) | (22) | 0 | 0 | 0 | (722) | (860) |
| Lands | 0 | 1,000 | 0 | 0 | 0 | 1,000 | 2,000 |
| Tangible assets (acq.val.) | 0 | 5,000 | 0 | 7,200 | 6,000 | 18,200 | 14,400 |
| Tangible assets (deprec.) | 0 | (2,200) | 0 | (4,320) | (3,000) | (9,520) | (5,500) |
| Fin.invest./BETA | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Fin.invest./GAMMA | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Fin.invest./DELTA | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Fin.invest./MU | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Equity value | 0 | 0 | 270 | 0 | 0 | 270 | 0 |
| Receivables/3rd Parties | 1,600 | 7,000 | 0 | 12,600 | 3,000 | 24,200 | 14,900 |
| Receivables/DELTA | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Cash | 1,500 | 1,000 | 0 | 4,320 | 2,000 | 8,820 | 7,600 |
| Link account(Interkos) | 1,000 | 0 | 0 | (1,000) | 0 | 0 | 0 |
| Link account(Fin.Inv.) | 11,100 | (3,876) | (600) | (3,600) | (3,024) | 0 | 0 |
| | 15,300 | 8,122 | (330) | 15,200 | 4,976 | 43,268 | 33,740 |
| Capital | 5,000 | 0 | 0 | 0 | 0 | 5,000 | 5,000 |
| Retained earnings | 3,100 | 0 | 0 | 0 | 0 | 3,100 | 3,000 |
| Reserves | (652) | 0 | 0 | 0 | 0 | (652) | (620) |
| Resu.. | 752 | 0 | 0 | 0 | 0 | 752 | 160 |
| Consolidated reserves | 0 | 522 | (330) | 3,405 | 216 | 3,813 | 2,808 |
| Translation adjustments | 0 | 0 | 0 | 360 | 0 | 360 | (546) |
| Minority interests | 0 | 1,100 | 0 | 4,910 | 1,260 | 7,270 | 5,658 |
| Provisions | 1,200 | 600 | 0 | 1,530 | 0 | 3,330 | 2,380 |
| Payables/3rd Parties | 5,900 | 5,900 | 0 | 4,995 | 3,500 | 20,295 | 15,900 |
| Payables/ALPHA | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| | 15,300 | 8,122 | (330) | 15,200 | 4,976 | 43,268 | 33,740 |
| Turnover/3rd Parties | 12,000 | 30,000 | 0 | 24,000 | 4,000 | 70,000 | 81,000 |
| Turnover/DELTA | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Dividends/DELTA | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Exchange gain(unrealized) | 0 | 0 | 0 | 125 | 0 | 125 | 0 |
| Gain on disposals | 380 | 0 | 0 | 0 | 0 | 380 | 0 |
| Purchases/3rd Parties | (14,250) | (28,400) | 0 | (19,440) | (3,400) | (65,490) | 178,620 |
| Purchases/ALPHA | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Depreciations | (160) | (722) | 0 | (480) | (300) | (1,662) | (1,500) |
| Provisions | (200) | (100) | 0 | (360) | 0 | (660) | (290) |
| Exchange loss(realized) | (18) | 0 | 0 | (120) | 0 | (138) | 0 |
| Loss on disposals | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Loss on equity cies | 0 | 0 | (60) | 0 | 0 | (60) | 0 |
| Link account(Interkos) | 3,000 | 0 | 0 | (3,000) | 0 | 0 | 0 |
| Result | 752 | 778 | (60) | 725 | 300 | 2,495, | 590 |
| Group result | 752 | 622 | (60) | 435 | 216 | 1,965 | 418 |
| Minority result | 0 | 156 | 0 | 290 | 84 | 530 | 172 |

PART 6 CONSOLIDATION CASE STUDY

Both Year 2 contribution and Year 1 consolidated accounts are displayed for comparison reasons.

Here are the most important comments we can make:

- The gross value goodwill has decreased because of the disposal of the 40% shares of GAMMA
- However, there is a new goodwill booked in BETA accounts concerning the acquisition of company MU
- Lands account is changing from 2000 to 1000 thanks to the fact that GAMMA is now consolidated with the equity method. Moreover, the group disposal from ALPHA to BETA has no impact on the Year 2 consolidated accounts.
- There is now an equity value in the assets again because of the Equity method applied to GAMMA
- All intercompany receivables and payables, including Link accounts, are set to zero
- There is an important increase of the translation adjustments account from (546) to 360 because closing rate is increasing from 0.7 to 0.9. this is a quick check to realise that the consolidated figures behave globally as expected.
- GAMMA contribution to the consolidated accounts in Year 2 is zero, except for Equity value, Consolidated reserves and Loss on equity method companies.

5 EVOLUTION OF CONSOLIDATED ACCOUNTS

In this chapter, we successively analyse the evolution of

- Consolidated reserves
- Minority interests
- Translation adjustments
- Equity value in the assets

for the following reasons

- Notes to the accounts are required for IFRS and most of the Local Gaap
- Justifying evolution of these items by giving a financial or economical signification to each element provides a certain guarantee that the consolidation is "technically" correct and auditable
- All Auditors require this information, even if we must sometimes admit, particularly for Minority interests and Translation adjustments, that the exercise asked is more to demonstrate that the consolidation is mastered rather than to prove the importance of the information content.

Consolidated reserves evolution

Here is the classical report we produce for our case study.

| | Reserves Year 1 | Result Year 2 | Dividends paid | Dividends received | Transfers | Parent dividends | Total | Reserves Year 2 | Check |
|-------|--------------------|------------------|-------------------|-----------------------|-----------|---------------------|-------|--------------------|-------|
| ALPHA | 2,540 | 752 | | 168 | 40 | (300) | 3,200 | 3,200 | 0 |
| BETA | 300 | 622 | | | (400) | | 522 | 522 | (0) |
| GAMMA | (630) | (60) | | | 360 | | (330) | (330) | 0 |
| DELTA | 3,138 | 435 | (168) | | 0 | | 3,405 | 3,405 | 0 |
| MU | 0 | 216 | | | 0 | | 216 | 216 | 0 |
| | 5,348 | 1,965 | (168) | 168 | 0 | (300) | 7,013 | 7,013 | (0) |

Reserves Year 1

The amounts of this column can be found in the Year 1 contribution report on line "Consolidated reserves" for each subsidiary. For company ALPHA, the amount is the sum of Retained earnings, Reserves and Result accounts for

PART 6 CONSOLIDATION CASE STUDY

$2540 = 3000 + (620) + 160$. Of course, company MU is not consolidated in Year 1 and so its consolidated reserves appear for zero.

Result Year 2

These amounts will be found in the Year 2 contribution on the "Group result" line, just one line before the last line.

Dividends paid

The only subsidiary paying dividends is DELTA for $(168) = 60\% * (400) * 0.7$. It is the group part of the dividends translated at average rate of Year 1 that we show in this column.

Dividends received

We know that these dividends are received by company ALPHA and for the same amount of 168, even if the amount of cash received is different, as 150 in our case study.

These two last columns together must be equal to zero. It is a check to make.

Transfers

This column may include many transfers of reserves, depending on the consolidation complexity.

We recommend to keep a single column so as to maintain a reasonable size for this report and to link another report with as many columns of single transfers as necessary.

Here is this linked report which shows two transfers.

| | Transfer (1) | Transfer (2) | Total transfers |
|-------|-----------------|-----------------|--------------------|
| ALPHA | 400 | (360) | 40 |
| BETA | (400) | | (400) |
| GAMMA | | 360 | 360 |
| DELTA | | | 0 |
| MU | | | 0 |
| | 0 | 0 | 0 |

Transfer (1) concerns the elimination of the group profit made by selling lands from ALPHA to BETA with a group profit of 500.

We booked an elimination of profit for $400 = 80\% * 500$ in ALPHA accounts with a counterpart in the Reserves. At the same time, we eliminated a profit of 500 on the Lands account of BETA, again with a counterpart in the Reserves.

By proceeding this way, ALPHA Reserves account increases by 400 and BETA Reserves account decreases by (400).

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Transfer (2) concerns the disposal of 40% shares of GAMMA to 3rd Parties. Each time there is a disposal of consolidated shares, a corresponding part of consolidated reserves of the company disappears and the counterpart is found in the "seller" company.

In our case study, the Year 1 consolidated reserves of GAMMA are (630) and a part of $360 = 630 * [40\% / 70\%]$ disappears and is transferred on ALPHA line.

Parent dividends

This column shows the dividends paid by parent company ALPHA to its shareholders for 300. This amount of cash is leaving the group, on the contrary of subsidiary dividends which move from one company to another but remain in the group.

Total

This column is just totalizing the amounts of each line starting with Year 1 reserves.

Reserves Year 2

These amounts can be found in the Year 2 contribution like we explained for Year 1.

Check

We usually add this column which calculates the difference between 'Reserves Year 2" and "Total". We must find zero on each line.

This is the final check to conclude that the consolidation is technically correct and auditable, speaking about the consolidated reserves.

Minority interests evolution

Most of the time, the Minority interests evolution appears to be more technical and difficult to explain. The number of columns depends on the group transactions and the changes in structure.

Let's consider its application to our case study.

PART 6 CONSOLIDATION CASE STUDY

| | Minority interests Year 1 | Result Year 2 | Dividends paid | CTA | Change in conso method | Entry in conso scope | Others | Total | Minority interests Year 2 | Check |
|-------|---------------------------------|------------------|-------------------|-----|------------------------------|----------------------------|--------|-------|---------------------------------|-------|
| | Year 1 | Year 2 | | | | | | | | |
| BETA | 1,200 | 156 | | | | | (256) | 1,100 | 1,100 | 0 |
| GAMMA | 330 | 0 | | | | | | 0 | 0 | 0 |
| DELTA | 4,128 | 290 | (112) | 604 | (330) | | | 4,910 | 4,910 | 0 |
| MU | 0 | 84 | | | | 1,176 | | 1,260 | 1,260 | 0 |
| | 5,658 | 530 | (112) | 604 | (330) | 1,176 | (256) | 7,270 | 7,270 | 0 |

Minority interests Year 1

The corresponding amounts can be found in the Year 1 contribution report on the line "Minority interests".

Result Year 2

These amounts can be found on the last line of the Year 2 contribution report.

Dividends paid

This amount is the dividends paid to 3rd Parties as **(112) = 40% * (400) * 0.7**. Of course, as we don't consolidate the 3rd Parties group, we don't have a similar presentation as for consolidated reserves.

CTA

We know that 3rd Parties are taking their percentage in the currency translation adjustments, including opening, closing and evolution amount.

In our case study, this evolution amount is **604 = 40% * [600 - (910)]**, where **600** is the closing amount and **(910)** is the opening amount. These two amounts can be found in Year 2 and Year 1 DELTA consolidation adjustments explained above.

Changes in consolidation method

This amount represents the Year 1 contribution of company GAMMA that disappears because the company is not consolidated by the global integration method any more.

Entry in consolidation scope

The new company MU is entering the consolidation scope with the global integration method and a minority percentage of **28% = 100% - [80% * 90%]**. This percentage applies to the equity at the date of entering the scope, giving **1176 = 28% * [3000 + 1000 + 200]**.

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Others

This column concerns different variations that are split in the following report which is linked to the main one. As we are going to see, the amounts are related to some consolidation adjustments.

| | Others (1) | Others (2) | Others (3) | Total |
|-------|---------------|---------------|---------------|-------|
| BETA | (100) | (756) | 600 | (256) |
| GAMMA | | | 0 | 0 |
| DELTA | | | 0 | 0 |
| MU | (100) | (756) | 600 | (256) |

Others (1) shows the minority interests taken in the adjustment eliminating the group profit of 500 in the Lands account. That is $(100) = 20\% * (500)$.

Others (2)

We know that if a company is consolidated by the global integration method for less than 100%, i.e. with minority interests, there is a percentage of minority interests to calculate in the financial investments which are deducted from the minority interests on the liabilities side.

In our case study, company BETA in Year 2 owns a financial investment on company MU for 4000. A goodwill of 220 impacts this amount and gives finally a minority interests contribution of $(756) = -20\% * [4000 + (200)]$.

Others (3)

Company BETA increases its capital by 3000, each shareholder contributing on the basis of its percentage. This means that the minority interests increase by $600 = 20\% * 3000$.

Total

This column is just totalizing the amounts of each line starting with Year 1 minority interests.

Minority interests Year 2

These amounts can be found in the Year 2 contribution like we explained for Year 1.

Check

We usually add this column which calculates the difference between "Minority interests Year 2" and "Total". We must find zero on each line.

PART 6 CONSOLIDATION CASE STUDY

Translation adjustments evolution

This is a rather difficult report to produce because the content depends on each individual company, on the currencies and not only on statutory accounts but also on local currency adjustments.

In our case study, hopefully we have only company DELTA generating a translation adjustment amount.

Let's first start by considering figures at 100%.

In Year 1, we have calculated a translation adjustment of (940) based on statutory accounts and 30 related to the provision elimination for 300 CUR. The gives an opening translation adjustment of (910) = (940) + 30.

In Year 2, the same analysis shows 540 = (940) + 1480 at statutory level and 60 for the adjustment, so a closing translation adjustment of 600 = 540 + 60.

We have to justify an evolution of 1510 = 600 - (910).

| Closing rates | Accounts in local currency | | | Accounts in conso currency | | |
|------------------------------------|----------------------------|-------|--------|----------------------------|--------|--------|
| | 0.8 | | 0.9 | | Year 1 | Year 2 |
| Statutory accounts | Year 1 | | Year 2 | | Year 1 | Year 2 |
| Capital | 8,000 | | 8,000 | | 6,400 | 7,200 |
| <i>Translation adjustment flow</i> | | | | | 800 | |
| Retained earnings | 4,000 | 200 | 0.7 | 4,200 | 3,200 | 3,780 |
| <i>Transfer flow</i> | | | | | 140 | |
| <i>Translation adjustment flow</i> | | | | | 440 | |
| Result | 600 | (200) | 0.7 | 1,000 | 480 | 900 |
| <i>Transfer flow</i> | | | | | (140) | |
| <i>Dividends flow</i> | | | | | (280) | |
| <i>Result Year 2 flow</i> | | (400) | 0.7 | | 600 | |
| <i>Translation adjustment flow</i> | | 1,000 | 0.6 | | 240 | |
| Adjustments | | | | | | |
| Elimination of provisions | 300 | | 300 | | 240 | 270 |
| <i>Translation adjustment flow</i> | | | | | 30 | |
| Translation adjustment flow | | | | | 1,480 | |
| <i>on statutory accounts</i> | | | | | 30 | |
| <i>on adjustments</i> | | | | | | |

We remind Year 1 and Year 2 local currency statutory and adjustments figures in this report, including the flows and the currency rates used.

The right hand side shows the translated figures with the translation adjustment flow for each account and for both statutory accounts and adjustments.

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The total of all translation adjustments flows gives $1510 = 1480 + 30$, for statutory accounts and for adjustments respectively, which is the evolution amount to justify.

So we explain $1510 = 600 - (910)$.

The evolution appearing in the consolidated balance is $906 = 360 - (546)$ and is just the previous relation on which we have applied 60%.

Eauity value evolution

Evolution of the Equity value account is similar in difficulty to the evolution of Minority interests because we have seen that Equity value and Minority interests are both sides of the same mirror.

Here is the report used to justify such evolution.

| Equity value Year 1 | Result Year 2 | Dividends paid | CTA | Capital increase | Others | Entry in conso scope | Total | Equity value Year 2 | Check |
|---------------------|---------------|----------------|-----|------------------|--------|----------------------|-------|---------------------|-------|
| GAMMA | 0 | (60) | | | | 330 | 270 | 270 | 0 |
| | 0 | (60) | | | | 330 | 270 | 270 | 0 |

We have presented the most frequently used columns although they are not present in our case study.

Eauity value Year 1

This value is zero because GAMMA was not consolidated by the equity method in Year 1.

Result Year 2

It is $(60) = 30\% * (200)$.

Entry in consolidation scope

As an equity method company, GAMMA is entering the consolidation scope on July 1st, Year 2 with an equity of $1100 = 2000 + (900)$ in which the group part is $330 = 30\% * 1100$.

Total

This column is just totalizing the amounts of each line starting with Year 1 minority interests.

Eauity value Year 2

These amounts can be found in the Year 2 contribution on the Equity value line.

Check

We usually add this column which calculates the difference between "Equity value Year 2" and "Total". We must find zero on each line.

6 CONSOLIDATED CASH FLOW STATEMENT

The consolidated cash flow statement will be produced by first building the statutory cash flow statement for each individual company, that will be added together. Based on this approximation of the consolidated cash flow statement, we are going to book a certain number of adjustments to converge to the final consolidated cash flow statement.

The basic information consists in the statutory flows which is a new information it was not necessary to provide in the first part of our case study, excepted for the translation adjustments evolution.

For each company, we give Year 1 and Year 2 accounts and the flows explaining their evolution. The exercise consists in picking "cash" flows and to introduce them in the cash flow statement.

We are not giving the P&L which can be seen in the previous chapters. We will assume all validations are satisfied and, for instance, consider a depreciation flow as resulting from a depreciation account booked for the same amount in the P&L. The same comments can be made for provisions and gains/losses on disposals flows.

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| ALPHA | Year 1 | Disposal | Gain on disposals | Loss on disposals | Capital increase | Net variation | Year 2 |
|-------------------------|--------|----------|-------------------|-------------------|------------------|---------------|--------|
| Lands | 1,000 | (1,500) | 500 | | | | 0 |
| Fin.invest./BETA | 5,000 | | | | | | 7,400 |
| Fin.invest./GAMMA | 2,100 | (800) | | (400) | | | 900 |
| Fin.invest./DELTA | 3,600 | | | | | | 3,600 |
| Receivables/3rd Parties | 1,500 | | | | | 100 | 1,600 |
| Receivables/DELTA | 800 | | | | | 1,000 | 1,000 |
| Cash | | | | | | 700 | 1,500 |
| | | | | | | | 16,000 |
| | 14,000 | | | | | | |

| ALPHA | Year 1 | Dividends | Approp. | Result | Provisions | Net variation | Year 2 |
|----------------------|--------|-----------|---------|--------|------------|---------------|--------|
| Capital | 5,000 | | | | | | 5,000 |
| Retained earnings | 3,000 | | | | | | 3,100 |
| Result | 400 | | | | | | 800 |
| Provisions | 1,000 | | | | | | 1,200 |
| Payables/3rd Parties | 4,600 | | | | | | 5,900 |
| | 14,000 | | | | | | 16,000 |

| ALPHA | |
|---------------------------------|---------|
| Result | 800 |
| Depreciations | 0 |
| Provisions | 200 |
| Gain/disposals | (500) |
| Loss/disposals | 400 |
| Cash flow | 900 |
| Net v s | (1,100) |
| Net variation of payables | 1,300 |
| Cash from operating activities | 1,100 |
| Investments | |
| Tangibles assets acquisitions | 0 |
| Financial assets acquisitions | (2,400) |
| Disinvestments | |
| Tangibles assets disposals | 1,500 |
| Financial assets disposals | 800 |
| Cash from investment activities | (100) |
| Capital increase | 0 |
| Dividends paid (M) | (300) |
| Dividends paid (other cies) | 0 |
| Cash from financial activities | (300) |
| Net cash variation | 700 |
| Cash variation from balance | 700 |

ALPHA - Statutory cash flow statement

Most of the figures in this cash flow statement are just picked up from the flows justifying the accounts evolution.

However, here are some additional comments.

- We are aware of the fact that there are intercompany receivables with company DELTA for 1000, but at this moment we just think "statutory" and we consider the evolution of this account, including the intercompany, as $1100 = [1600 + 1000] - 1500$.
- The subscription to BETA capital increase appears as a financial investment. At consolidation level, we will have to come back to this booking.
- We know ALPHA sold lands to company BETA for a price of 1500, making a profit of 500. Two flows are used to describe the transaction: one flow showing the price paid (cash item and one flow showing the gain (non cash item). It is the amount of 1500 that appears in the cash flow statement while the amount of 500 is just ignored.
- The same comment is made for the selling of GAMMA shares for a book value of 1200. In fact, we show the price received of 800 (cash item) and the loss on disposal for 400 (non cash item), separately.
- Dividends paid is a cash out for the group.

Notice that finally the "Appropriation flow" which can be considered as a "Transfer flow" is the only one that does not appear in the cash flow statement.

The net cash variation of 700 corresponding to the addition of "Cash from operating activities", "Cash from investment activities" and "Cash from financial activities" is equal to the cash variation deducted from the balance evolution.

This is a mandatory technical validation.

DIRECT CONSOLIDATION

| BETA | Year 1 | Acquisitions | Disposals | Deprec. | Net variation | Year 2 |
|-----------------------------|---------|--------------|-----------|---------|---------------|---------|
| Lands | 0 | 1,500 | | | | 1,500 |
| Tangible assets (acq. val.) | 3,000 | 1,800 | (800) | (600) | | 4,000 |
| Tangible assets (deprec.) | (1,200) | | | | | (1,800) |
| Fin.invest./DELTA | | 4,000 | | | | 4,000 |
| Receivables/3rd Parties | 5,000 | | | | 2,000 | 7,000 |
| Cash | 1,200 | | | | (200) | 1,000 |
| | 8,000 | | | | | 15,700 |

| BETA | Year 1 | Approp. | Result | Capital increase | Provisions! | Net variation | Year 2 |
|----------------------|--------|---------|--------|------------------|-------------|---------------|--------|
| Capital | 3,000 | | | 3,000 | | | 6,000 |
| Retained earnings | 2,000 | | 300 | | | | 2,300 |
| Result | 300 | | (300) | | | | 900 |
| Provisions | 500 | | | | 100 | | 600 |
| Payables/3rd Parties | 2,200 | | | | | 3,700 | 5,900 |
| | 8,000 | | | | | | 15,700 |

| BETA | |
|---------------------------------|---------|
| Result | 900 |
| Depreciations | 600 |
| Provisions | 100 |
| Gain/disposals | 0 |
| Loss/disposals | 0 |
| Cash Flow | 1,600 |
| Net variation of receivables | (2,000) |
| Net variation of payables | 3,700 |
| Cash from operating activities | 3,300 |
| Investments | |
| Tangibles assets acquisitions | (3,300) |
| Financial assets acquisitions | (4,000) |
| Disinvestments | |
| Tangibles assets disposals | 800 |
| Financial assets disposals | 0 |
| Cash from investment activities | (6,500) |
| Capital increase | 3,000 |
| Dividends paid (M) | 0 |
| Dividends paid (other cies) | 0 |
| Cash from financial activities | 3,000 |
| Net cash variation | (200) |
| Cash variation From balance | (200) |

BETA – Statutory cash flow statement

Again, all statutory flows, except 'Appropriation flow", find their place in the cash flow statement.

- The investments in tangible assets for 3300 include Lands for 1500 and Tangible assets for 1800
- The lands have been disposed by ALPHA at a price of 1500, including the gain of 500. At statutory level, we keep this price as it is but in the final consolidated cash flow statement, the amount will not appear anymore because it is a group transaction.
- The disposal of tangible assets for an amount of 800 has been made without a gain or loss, otherwise we would see a corresponding flow
- The increase in capital by 3000 appears on the correct line, but in the consolidated cash flow statement this amount will show only the cash brought by the 3rd Parties. The subscription of 2400 by ALPHA will be eliminated.

DIRECT CONSOLIDATION

| GAMMA | Year 1 | Acquisitions | Disposals | Gain on disposals | Deprec. | Net variation | Year 2 |
|-----------------------------|--------|--------------|-----------|-------------------|---------|---------------|---------|
| Lands | 1,000 | | | 300 | | | 0 |
| Tangible assets (acq. val.) | 4,000 | | (1,300) | | | | 5,000 |
| Tangible assets (deprec.) | (800) | 2,000 | (1,000) | | | (500) | (1,300) |
| Receivables/3rd Parties | 2,000 | | | | | 1,000 | 3,000 |
| Cash | 800 | | | | | 500 | 1,300 |
| | 7,000 | | | | | | 8,000 |

| GAMMA | Year 1 | Approp. | Result | Net variation | Year 2 |
|----------------------|--------|---------|--------|---------------|--------|
| Capital | 2,000 | | | | 2,000 |
| Retained earnings | (500) | (400) | | (900) | |
| Result | (400) | 400 | (200) | (200) | |
| Payables/3rd Parties | 5,900 | | 1,200 | 7,100 | |
| | 7,000 | | | | 8,000 |

| GAMMA | |
|---------------------------------|---------|
| Result | (200) |
| Depreciations | 500 |
| Provisions | 0 |
| Gain/disposals | (300) |
| Loss/disposals | 0 |
| Cash Flow | 0 |
| Net variation of receivables | (1,000) |
| Net variation of payables | 1,200 |
| Cash from operating activities | 200 |
| Investments | |
| Tangibles assets acquisitions | (2,000) |
| Financial assets acquisitions | |
| Disinvestment's | |
| Tangibles assets disposals | 2,300 |
| Financial assets disposals | |
| Cash from,investment activities | 300 |
| Capital increase | 0 |
| Dividends paid (M) | 0 |
| Dividends paid (other cies) | 0 |
| Cash from financial activities | 0 |
| Net cash variation | 500 |
| Cash variation from balance | 500 |

PART 6 CONSOLIDATION CASE STUDY

GAMMA - Statutory cash flow statement

This presentation may look unusual because **GAMMA** is now consolidated by the equity method and all that information is not necessary.

We will see later on that like for closing amounts, nearly all flows in the statutory cash flow statement will also be eliminated.

- The disposal of lands is supposed to have been made with 3rd Parties and the gain is maintained as it is.
- The disposal of tangible assets for 1000 gives no gain or loss.

Be sure to always validate the "Net cash variation" that must be equal to the cash variation in the balance sheet.

DIRECT CONSOLIDATION

| DELTA (CUR) | Year 1 | Deprec. | Net variations | Dividends | Year 2 |
|----------------------------|---------|---------|----------------|-----------|---------|
| Tangible assets (acq.val.) | 8,000 | | | | 8,000 |
| Tangible assets (deprec.) | (4,000) | (800) | | | (4,800) |
| Receivables/3rd Parties | 8,000 | | 6,000 | | 14,000 |
| Cash | 6,000 | | (800) | (400) | 4,800 |
| | 18,000 | | | | 22,000 |

| DELTA (CUR) | Year 1 | Dividends | Approp. | Result | Provisions | Net variation | Year 2 |
|----------------------|--------|-----------|---------|--------|------------|---------------|--------|
| Capital | 8,000 | | | | | | 8,000 |
| Retained earnings | 4,000 | | | | | | 4,200 |
| Result | 600 | | | | | | 1,000 |
| Provisions | 1,400 | | | | | | 2,000 |
| Payables/3rd Parties | 4,000 | | | | | | 5,550 |
| Payables/ALPHA | | | | | | | 1,250 |
| | 18,000 | | | | | | 22,000 |

| DELTA (EUR) | Year 1 | Deprec. | Net variations | Dividends | Trans. adjust. | Year 2 |
|----------------------------|---------|---------|----------------|-----------|----------------|---------|
| Tangible assets (acq.val.) | 6,400 | | | | 800 | 7,200 |
| Tangible assets (deprec.) | (3,200) | (480) | | | (640) | (4,320) |
| Receivables/3rd Parties | 6,400 | | 3,600 | | 2,600 | 12,600 |
| Cash | 4,800 | | (480) | (280) | 280 | 4,320 |
| | 14,400 | | | | 3,040 | 19,800 |

| DELTA (EUR) | Year 1 | Dividends | Approp. | Result | Provisions | Net variation | Trans. adjust. | Year 2 |
|----------------------|--------|-----------|---------|--------|------------|---------------|----------------|--------|
| Capital | 7,200 | | | | | | | 7,200 |
| Retained earnings | 3,400 | | | | | | | 3,540 |
| Result | 420 | | | | | | | 600 |
| Trans. adjust. | (940) | (280) | 140 | (140) | 600 | | | 540 |
| Provisions | 1,120 | | | | | | | 1,800 |
| Payables/3rd Parties | 3,200 | | | | | | | 4,995 |
| Payables/ALPHA | | | | | | | | 1,125 |
| | 14,400 | | | | | | | 3,040 |
| | | | | | | | | 19,800 |

DELTA - Statutory cash flow statement

Here we start with flow information in local currency.

Only one item needs a comment: the flow dividends on the cash account. The general principle for flows is to apply the Year 2 average rate for their translation into EUR. But there are some exceptions as for the dividends flow on the equity side which is translated at the Year 1 average rate.

Considering the fact these dividends are valued with such rate, then the payment must also be valued with the same rate. That's the reason why we extract a flow dividends for (400) from the net variation of cash for (1200). The remaining (800) is supposed to represent cash operations with the outside world and valued at Year 2 average rate.

The main principles for the translation are

- Year 1 amounts at Year 1 closing rate 0.8
- Year 2 amounts at Year 2 closing rate 0.9
- All flows at Year 2 average rate 0.6, except "Dividends" and "Appropriation" flows at Year 1 average rate 0.7.

To balance in EUR the relation 'Opening + Sum of flows = Closing' for each line, we need to introduce a "Translation adjustment" flow.

One important check consists in verifying that the sum of this flow must be equal on assets and liabilities sides. This is the case with a total of 3040. If the payment of the dividends would have been translated at Year 2 average rate, for sure we would have found a mistake already in the statutory cash flow statement which would have been carried over in the consolidated cash flow statement.

DIRECT CONSOLIDATION

| DELTA (EUR) | Year 1 | Deprec. | Net variation | Dividends | Trans. adjust. | Year 2 |
|----------------------------|---------|---------|---------------|-----------|----------------|---------|
| Tangible assets (acq.val.) | 6,400 | | | | 800 | 7,200 |
| Tangible assets (deprec.) | (3,200) | (480) | | | (640) | (4,320) |
| Receivables/3rd Parties | 6,400 | | 3,600 | | 2,600 | 12,600 |
| Cash | 4,800 | | (480) | (280) | 280 | 4,320 |
| | 14,400 | | | | 3,040 | 19,800 |

| DELTA (EUR) | Year 1 | Dividends | Approp. | Result | Provisions | Net variation | Trans. adjust. | Year 2 |
|----------------------|--------|-----------|---------|--------|------------|---------------|----------------|--------|
| Capital | 7,200 | | | | | | | 7,200 |
| Retained earnings | 3,400 | | | | | | | 3,540 |
| Result | 420 | | | | | | | 600 |
| Trans. adjust. | (940) | | | | | | | 540 |
| Provisions | 1,120 | | | | | | | 1,800 |
| Payables/3rd Parties | 3,200 | | | | | | | 4,995 |
| Payables/ALPHA | | | | | | | | 1,125 |
| | 14,400 | | | | | | | 3,040 |
| | | | | | | | | 19,800 |

| DELTA | |
|---------------------------------|---------|
| Result | 600 |
| Depreciations | 480 |
| Provisions | 360 |
| Gain/disposals | 0 |
| Loss/disposals | 0 |
| Cash Flow | 1,440 |
| Net variation of receivables | (3,600) |
| Net variation of payables | 1,680 |
| Cash from operating activities | (480) |
| Investments | |
| Tangibles assets acquisitions | 0 |
| Financial assets acquisitions | 0 |
| Disinvestments | |
| Tangibles | 0 |
| Financial | 0 |
| Cash from investment activities | 0 |
| Capital increase | 0 |
| Dividends paid (M) | 0 |
| Dividends paid (other cies) | (280) |
| Cash from financial activities | (280) |
| Net cash variation | (760) |
| Cash variation from balance | (760) |

PART 6 CONSOLIDATION CASE STUDY

Here are the main comments for this cash flow statement

- There are intercompany payables with company ALPHA, which are ignored at the statutory level. So we consider an evolution of these payables from 3200 to 6120 = 4995 + 1125, taking into account the existence or a translation adjustment flow for 1240 = 865 + 375.
- As for the previous companies, "Appropriation" flows are ignored
- The "Dividends" flow appears for (280) = (400) CUR * 0.7, the Year 1 average rate
- There are no transactions on Tangible assets accounts (investments) nor on Financial assets accounts
- All translation adjustments flows are considered as non cash items and are ignored in the cash flow statement.

DIRECT CONSOLIDATION

| MU | Year 1 | Entering conso. | Acquisitions | Disposals | Deprec. | Net variation | Year 2 |
|----------------------------|--------|--------------------|--------------|-----------|---------|------------------|---------|
| Tangible assets (acq.val.) | | 4,000 | | 3,500 | (1,500) | | 6,000 |
| Tangible assets (deprec.) | | (2,700) | | | | | (3,000) |
| Receivables/3rd Parties | | 2,500 | | | | | 3,000 |
| Cash | | 3,200 | | | | | 2,000 |
| | 0 | | | | | | 8,000 |

| MU | Year 1 | Entering conso. | Approp. | Result | Net variation | Year 2 |
|----------------------|--------|--------------------|---------|--------|------------------|--------|
| Capital | | 3,000 | | | | 3,000 |
| Retained earnings | | 1,200 | (200) | 300 | | 1,000 |
| Result | | | 200 | | | 500 |
| Payables/3rd Parties | | 2,800 | | 700 | | 3,500 |
| | 0 | | | | | 8,000 |

| MU | |
|--|----------------|
| Result | 300 |
| Depredations | 300 |
| Provisions | |
| Gain/disposals | |
| Loss/disposals | |
| Cash Flow | 600 |
| Net variation of receivables | (500) |
| Net variation of payables | 700 |
| Cash from operating activities | 800 |
| Investments | |
| Tangibles assets acquisitions | (3,500) |
| Financial assets acquisitions | |
| Disinvestments | |
| Tangibles assets disposals | 1,500 |
| Financial assets disposals | |
| Cash from Investment activities | (2,000) |
| Capital increase | 0 |
| Dividends paid (M) | 0 |
| Dividends paid (other cies) | 0 |
| Cash from financial activities | 0 |
| Net cash variation | (1,200) |
| Cash variation from balance | (1,200) |

MU – Statutory cash flow statement

This company enters the consolidation scope on July 1st, Year 2. This means that we don't have the Year 1 closing amounts.

In such situation, the balance sheet accounts existing at that date are booked on a special flow "Entering conso".

Here are our comments on the cash flow

- Retained earnings account is equal to 1200, already including the 200 profit of the first half year.
- However, the Result in the Year 2 closing amounts is still 500 but the flow splits into 200 for 1st half year and 300 for 2nd half year.
- The flow "Entering conso" has no impact on the cash flow statement because it contains information about the period preceding the life time of the company in the group.
- Investments transactions reflect transactions with the outside world and, in particular, the disposals generate no gain or loss.

We can check again that the 'Net cash variation' deducted from the cash flow statement is equal to the net cash variation in the balance sheet.

DIRECT CONSOLIDATION

| | ALPHA | BETA | GAMMA | DELTA | MU | TOTAL |
|--|---------|---------|---------|---------|---------|---------|
| Result | 800 | 900 | (200) | 600 | 300 | 2,400 |
| Depreciations | 0 | 600 | 500 | 480 | 300 | 1,880 |
| Provisions | 200 | 100 | | 360 | 0 | 660 |
| Gain/disposals | (500) | 0 | (300) | 0 | 0 | (800) |
| Loss/disposals | 400 | 0 | 0 | 0 | 0 | 400 |
| Cash Flow | 900 | 1,600 | 0 | 1,440 | 600 | 4,540 |
| Net variation of receivables | (1,100) | (2,000) | (1,000) | (3,600) | (500) | (8,200) |
| Net variation of payables | 1,300 | 3,700 | 1,200 | 1,680 | 700 | 8,580 |
| Cash from operating activities | 1,100 | 3,300 | 200 | (480) | 800 | 4,920 |
| Investments | | | | | | |
| Tangibles acquisitions | 0 | (3,300) | (2,000) | 0 | (3,500) | (8,800) |
| Financial assets acquisitions | (2,400) | (4,000) | 0 | 0 | 0 | (6,400) |
| Disinvestments | | | | | | |
| Tangibles assets disposals | 1,500 | 800 | 2,300 | 0 | 1,500 | 6,100 |
| Financial assets disposals | 800 | 0 | 0 | 0 | 0 | 800 |
| Cash from investment activities | (100) | (6,500) | 300 | 0 | (2,000) | (8,300) |
| Capital increase | 0 | 3,000 | 0 | 0 | 0 | 3,000 |
| Dividends paid (M) | (300) | 0 | 0 | 0 | 0 | (300) |
| Dividends paid (other cies) | 0 | 0 | 0 | (280) | 0 | (280) |
| Cash from financial activities | (300) | 3,000 | 0 | (280) | 0 | 2,420 |
| Net cash variation | 700 | (200) | 500 | (760) | (1,200) | (960) |

PART 6 CONSOLIDATION CASE STUDY

Addition of statutory cash flow statements

The next step consists in adding line by line the five statutory cash flow statements previously built. This new cash flow statement is supposed to converge to the consolidated one.

Obviously, there are some advantages to proceed like this.

- All transactions declared at statutory level are reflected as real cash transactions and are kept unchanged in this "temporary" cash flow
- In particular, the cash transactions on consolidated financial investments are also kept and we know that at consolidation level they are eliminated
- Consolidation goodwills, which appear at consolidation level as intangible assets, have no place at statutory level. This is a good point because they cannot appear at consolidation level.
- All flows related to translation adjustments have already been ignored at statutory level.

But there is quite a distance before achieving our work for some of the main following reasons

- The result on the first line is not equal to the consolidated result, because we didn't take care of the consolidation adjustments
- Some gains/losses have been adjusted and are presently not in line with the P&L gains/losses
- Intercompany amounts have also been ignored
- The increase in capital in GAMMA should ignore the subscription of ALPHA which is a group flow
- Dividends paid are too high because the amount includes the payment to ALPHA, corresponding to a group transaction

And on top of these few comments, we cannot forget that we added the GAMMA cash flow statement corresponding to an equity method company!

The next pages show how we are going to take care of all these issues.

DIRECT CONSOLIDATION

| ALPHA | (1) | (2) | (3) | (4) | (5) | (6) |
|--|--------------|--------------|----------|----------|----------|--------------|
| Result | | | | | | |
| Depreciations | 800 | (168) | (400) | (100) | (60) | 72 |
| Provisions | 0 | | | 100 | 60 | 160 |
| Exchange gain(unrealized) | 200 | | | | | 200 |
| Gain/disposals | 0 | | 400 | | | 0 |
| Loss/disposals | (500) | | | | | (100) |
| Loss from e thod cies | 400 | | | | | 400 |
| Cash Flow | 900 | (168) | 0 | 0 | 0 | 732 |
| Net variation or receivables | (1,100) | | | | | (1,100) |
| Net variation of payables | 1,300 | | | | | 1,300 |
| Link flow | | | | | | |
| Cash from operating activities | 1,100 | (168) | 0 | 0 | 0 | 932 |
| Investments | | | | | | |
| Tangibles assets acquisitions | 0 | | | | | 0 |
| Financial assets acquisitions | (2,400) | | | | | (2,400) |
| Disinvestments | | | | | | |
| Tangibles assets disposals | 1,500 | | | | | 1,500 |
| Financial assets disposals | 800 | | | | | 800 |
| Cash from investment activities | (100) | 0 | 0 | 0 | 0 | (100) |
| Capital increase | 0 | | | | | 0 |
| Subscription by the group | (300) | | | | | 0 |
| Dividends paid (M) | 0 | 168 | | | | (300) |
| Dividends paid (other cies) | | | | | | 168 |
| Cash from financial activities | (300) | 168 | 0 | 0 | 0 | (132) |
| Net cash variation | 700 | 0 | 0 | 0 | 0 | 700 |

PART 6 CONSOLIDATION CASE STUDY

ALPHA - Contribution to consolidated cash flow statement

We start with the statutory cash flow statement that will be adapted considering two aspects

- On one side we must evaluate the impact of each consolidation adjustment on the cash flow statement
- On the other side, we must adopt a "helicopter" view on the amounts to estimate their compliance with the financial situation.

Column (1)

Statutory cash flow statement.

Column (2)

The elimination of the DELTA dividends for an amount of 168 has an impact on the result. Moreover the line "Dividends paid (other cies)", in the added version of the cash flow statement, is presently too high because these 168 remain in the group. We must show only $(112) = 40\% * (400) * 0.7$ corresponding to the dividends paid to 3rd Parties.

Column (3)

We have booked an adjustment to eliminate the gain on lands disposal to BETA for an amount of 400. The profit must be reduced by this amount with the Gain line as counterpart. Indeed, the ALPHA contribution to the final consolidated P&L is only a gain of 100 for this transaction.

Column (4)

The goodwill depreciation adjustment for 100 related to BETA participation reduces the group profit. The counterpart is booked on the "Depreciations" line of the cash flow statement.

Column (5)

When selling the 40% shares in GAMMA, we decided to book the remaining goodwill in the P&L, for an amount of 60. This gives the same reclassification as the one before.

Column (6)

This column is the addition of columns (1) to (5), giving a contributed cash flow statement with an improved picture with regard to the statutory one in column (1).

DIRECT CONSOLIDATION

| ALPHA | (6) | (7) | (8) | (9) | (10) | TOTAL |
|--|--------------|----------|----------------|---------|----------|----------------|
| Reult | 72 | 680 | | | | 752 |
| Depredations | 160 | | | | | 160 |
| Provisions | 200 | | | | | 200 |
| Exchange gain(unrealized) | 0 | | | | | 0 |
| Gain/disposals | (100) | (280) | | | | (380) |
| Loss/disposals | 400 | (400) | | | | 0 |
| Loss from equity method cies | 0 | | | | | 0 |
| <u>Cash Flow</u> | <u>732</u> | <u>0</u> | <u>0</u> | | <u>0</u> | <u>732</u> |
| Net variation of receivables | (1,100) | | | | | |
| Net variation of payables | 1,300 | | | | | |
| Link flow | | | | 1,500 | (1,000) | 500 |
| <u>Cash from operating activities</u> | <u>932</u> | <u>0</u> | <u>0</u> | | <u>0</u> | <u>2,432</u> |
| Investments | | | | | | |
| Tangibles assets acquisitions | 0 | | | | | 0 |
| Financial assets acquisitions | (2,400) | | 2,400 | | | 0 |
| Disinvestments | | | | | | |
| Tangible assets disposals | 1,500 | | | (1,500) | | 0 |
| Financial assets disposals | 800 | | | | | 800 |
| <u>Cash from investment activities</u> | <u>(100)</u> | <u>0</u> | <u>2,400</u> | | <u>0</u> | <u>800</u> |
| Capital increase | 0 | | | | | 0 |
| Subscription by the group | 0 | | (2,400) | | | (2,400) |
| Dividends paid (M) | (300) | | | | | (300) |
| Dividends paid (other cies) | 168 | | | | | 168 |
| <u>Cash from financial activities</u> | <u>(132)</u> | <u>0</u> | <u>(2,400)</u> | | <u>0</u> | <u>(2,532)</u> |
| <u>Net cash variation</u> | <u>700</u> | <u>0</u> | <u>0</u> | | <u>0</u> | <u>700</u> |

PART 6 CONSOLIDATION CASE STUDY

Column (7)

This column deals with the adjustment concerning the loss on disposal of the 40% shares owned on GAMMA. The net impact was an improvement of the profit for 680 with two counterparts, an elimination of the statutory loss for 400 and a consolidated gain for 280.

Column (8)

The subscription of ALPHA to the BETA capital increase is 2400. We reclassify this amount in the "Cash from financial activities" in order to reduce the capital increase of 3000. Besides the fact we still show both amounts, the net value of 600 is the cash brought by the 3rd Parties, which is the only cash in.

Column (9)

The Tangible assets disposal for 1500 corresponds to the lands acquired by BETA. This group transaction cannot appear in the consolidated cash flow statement. Notice the use of a "Link flow" line that must become zero at the end.

Column (10)

We know there were intercompany receivables with partner DELTA for an amount of 1000. Up to now, we ignored this situation by starting with a statutory situation. We have now to eliminate the flow via a link flow like for intercompany closing amounts.

Column TOTAL

This column becomes the contribution of company ALPHA in the final consolidated cash flow statement.

DIRECT CONSOLIDATION

| BETA | (1) | (2) | (3) | TOTAL |
|---------------------------------|---------|-------|---------|---------|
| Result | 900 | (100) | (22) | 778 |
| Depreciations | 600 | 100 | 22 | 722 |
| Provisions | 100 | | | 100 |
| Exchange gain(unrealized) | 0 | | | 0 |
| Gain/disposals | 0 | | | 0 |
| Loss/disposals | 0 | | | 0 |
| Loss from equity method cies | 0 | | | 0 |
| Cash flow | 1,600 | 0 | | 1,600 |
| Net variation of receivables | (2,000) | | | (2,000) |
| Net variation of payables | 3,700 | | | 3,700 |
| Link Row | | | (1,500) | (1,500) |
| Cash from operating activities | 3,300 | 0 | (1,500) | 1,800 |
| Investments | | | | |
| Tangibles assets acquisitions | (3,300) | | 1,500 | (1,800) |
| Financial assets acquisitions | (4,000) | | | (4,000) |
| Disinvestments | | | | |
| Tangibles assets disposals | 800 | | | 800 |
| Financial assets disposals | 0 | | | 0 |
| Cash from investment activities | (6,500) | 0 | 1,500 | (5,000) |
| Capital increase | 3,000 | | | 3,000 |
| Subscription by the group | 0 | | | 0 |
| Dividends paid (M) | 0 | | | 0 |
| Dividends paid (other cies) | 0 | | | 0 |
| Cash from financial activities | 3,000 | 0 | 0 | 3,000 |
| Net cash variation | (200) | 0 | 0 | (200) |

PART 6 CONSOLIDATION CASE STUDY

BETA - Contribution to consolidated cash flow statement

Column (1)

Statutory cash flow statement.

Column (2)

We adjust the profit by the depreciation of the tangible assets revaluation for 100.

Column (3)

This adjustment concerns the new goodwill depreciation related to company MU.

Column TOTAL

This column becomes the contribution of company BETA in the final consolidated cash flow statement.

DIRECT CONSOLIDATION

| GAMMA | (1) | (2) | (3) | TOTAL |
|---------------------------------|---------|---------|------|-------|
| Result | | | | |
| Depreciations | (200) | 200 | (60) | (60) |
| Provisions | 500 | (500) | 0 | 0 |
| Exchange gain(unrealized) | | | | 0 |
| Gain/disposals | (300) | 300 | 0 | 0 |
| Loss/disposals | | | 0 | 0 |
| Loss from equity method cies | | | 60 | 60 |
| Cash Flow | 0 | 0 | 0 | 0 |
| Net variation of receivables | (1,000) | 1,000 | | 0 |
| Net variation of payables | 1,200 | (1,200) | | 0 |
| Link flow | | | 0 | 0 |
| Cash from operating activities | 200 | (200) | 0 | 0 |
| Investments | | | | |
| Tangibles assets acquisitions | (2,000) | 2,000 | | 0 |
| Financial assets acquisitions | 0 | | 0 | 0 |
| Disinvestments | | | | |
| Tangibles assets disposals | 2,300 | (2,300) | | 0 |
| Financial assets disposals | 0 | | 0 | 0 |
| Cash from investment activities | 300 | (300) | 0 | 0 |
| Capital increase | 0 | | | 0 |
| Subscription by the group | 0 | | | 0 |
| Dividends paid (M) | 0 | | | 0 |
| Dividends paid (other cies) | 0 | | | 0 |
| Cash from financial activities | 0 | 0 | 0 | 0 |
| Net cash variation | 500 | (500) | 0 | 0 |

PART 6 CONSOLIDATION CASE STUDY

GAMMA - Contribution to consolidated cash flow statement

Column (1)

Statutory cash flow statement.

Column (2)

The company being consolidated by the equity method, we eliminate all accounts and flows. Of course, by doing that, nothing remains about that company in the consolidated cash flow statement.

Starting with the result, we must book the 30% owned in the result of the company. That's the reason of the loss of $(60) = 30 * (200)$.

But we also know that the loss of an equity method company is not a cash item and that it must be reversed from the result. This explains the impact on the "Loss from the equity method cies" line.

Column TOTAL

This column becomes the contribution of company BETA in the final consolidated cash flow statement.

DIRECT CONSOLIDATION

| DELTA | (1) | (2) | (3) | TOTAL |
|---------------------------------|---------|-------|---------|---------|
| Result | 600 | 125 | | 725 |
| Depreciations | 480 | | | 480 |
| Provisions | 360 | | | 360 |
| Exchange gain(unrealized) | 0 | (125) | | (125) |
| Gain/disposals | 0 | | | 0 |
| Loss/disposals | 0 | | | 0 |
| Loss from equity method cies | 0 | | | 0 |
| Cash Flow | 1,440 | 0 | 0 | 1,440 |
| Net variation af receivables | (3,600) | | | (3,600) |
| Net variation af payables | 1,680 | | (1,000) | 680 |
| Link flow | | | 1,000 | 1,000 |
| Cash from operating activities | (480) | 0 | 0 | (480) |
| Investments | | | | |
| Tangibles assets acquisitions | 0 | | | 0 |
| Financial assets acquisitions | 0 | | | 0 |
| Disinvestments | | | | |
| Tangibles assets disposals | 0 | | | 0 |
| Financial assets disposals | 0 | | | 0 |
| Cash from investment activities | 0 | 0 | 0 | 0 |
| Capital increase | 0 | | | 0 |
| Subscription by the group | 0 | | | 0 |
| Dividends paid (M) | 0 | | | 0 |
| Dividends paid (other aces) | (280) | | | (280) |
| Cash from financial activities | (280) | 0 | 0 | (280) |
| Net cash variation | (760) | 0 | 0 | (760) |

PART 6 CONSOLIDATION CASE STUDY

DELTA - Contribution to consolidated cash flow statement

Column (1)

This column contains the statutory cash flow statement in consolidation currency.

Column (2)

When reconciling intercompany positions between ALPHA and DELTA, we noticed that Payables in DELTA were 125 too high in comparison with the Receivables in ALPHA accounts. An adjustment for 125 has been booked and considered as an unrealized exchange gain.

This P&L impact must now be booked in this cash flow.

Column (3)

After that adjustment, we still have the Payables that we ignored by starting from the statutory figures. We have now to eliminate the 1000 intercompany flow via a link flow.

Column TOTAL

This column becomes the contribution of company BETA in the final consolidated cash flow statement.

MU - Contribution to consolidated cash flow statement

The statutory cash flow statement we have considered previously shows the cash activity for the 2nd half year only, the 1st half year having been already booked on the "Entering conso" flow.

Moreover, there is no adjustment for this company. The statutory cash flow statement will then be the contribution to the consolidated cash flow statement.

DIRECT CONSOLIDATION

| | ALPHA | BETA | GAMMA | DELTA | MU | TOTAL |
|---------------------------------|---------|---------|-------|---------|---------|---------|
| Result | 752 | 778 | (60) | 725 | 300 | 2,495 |
| Depreciations | 160 | 722 | 0 | 480 | 300 | 1,662 |
| Provisions | 200 | 100 | 0 | 360 | 0 | 660 |
| Exchange gain(unrealized) | 0 | 0 | 0 | (125) | 0 | (125) |
| Gain/disposals | (380) | 0 | 0 | 0 | 0 | (380) |
| Loss/disposals | 0 | 0 | 0 | 0 | 0 | 0 |
| Loss from equity method cies | 0 | 0 | 60 | 0 | 0 | 60 |
| Cash Flow | 732 | 1,600 | 0 | 1,440 | 600 | 4,372 |
| Net variation of receivables | (100) | (2,000) | 0 | (3,600) | (500) | (6,200) |
| Net variation of payables | 1,300 | 3,700 | 0 | 680 | 700 | 6,380 |
| Link flow | 500 | (1,500) | 0 | 1,000 | 0 | 0 |
| Cash from operating activities | 2,432 | 1,800 | 0 | (480) | 800 | 4,552 |
| Investments | | | | | | |
| Tangibles assets acquisitions | 0 | (1,800) | 0 | 0 | (3,500) | (5,300) |
| Financial assets acquisitions | 0 | (4,000) | 0 | 0 | 0 | (4,000) |
| Disinvestments | | | | | | |
| Tangibles assets disposals | 0 | 800 | 0 | 0 | 1,500 | 2,300 |
| Financial assets disposals | 800 | 0 | 0 | 0 | 0 | 800 |
| Cash from investment activities | 800 | (5,000) | 0 | 0 | (2,000) | (6,200) |
| Capital increase | 0 | 3,000 | 0 | 0 | 0 | 3,000 |
| Subscription by the group | (2,400) | 0 | 0 | 0 | 0 | (2,400) |
| Dividends paid (M) | (300) | 0 | 0 | 0 | 0 | (300) |
| Dividends paid (other cies) | 168 | 0 | 0 | (280) | 0 | (112) |
| Cash from financial activities | (2,532) | 3,000 | 0 | (280) | 0 | 188 |
| Net cash variation | 700 | (200) | 0 | (760) | (1,200) | (1,460) |

PART 6 CONSOLIDATION CASE STUDY

The consolidated cash flow statement with its contribution view

When reaching this step we would recommend undertaking three validations before delivering the information to persons outside the consolidation office.

Cash validation

This cash flow statement shows a "Net cash variation" of $(1460) = 4552 + (6200) + 188$, the three main components of this report.

This amount of (1460) should also be equal to the cash variation of the cash (and cash equivalent) account in the balance sheet.

How can we check that?

| | |
|--------------------------------|---------|
| Opening amount | 7,600 |
| Net variation | (1,460) |
| Translation adjustments | 280 |
| Entry in consolidation scope | 3,200 |
| Change in consolidation method | (800) |
| Closing amount | 8,820 |

First, we pick up the consolidated value of the Cash account, that is 7600 and 8820 respectively, in Year 1 and Year 2 balance sheets.

We then allocate the (1460) net variation coming from the consolidated cash flow statement.

The "Translation adjustments" variation for 280 is coming from the DELTA accounts with flows explanations. Fortunately, we have only one foreign company, otherwise we would need to sum up flows for all foreign companies.

The "Entry in the consolidation scope" amount is the cash of company MU at the date it enters the group.

The "Change in consolidation method" amount is the cash of GAMMA company in Year 1 consolidation which disappears because of changing from global integral consolidation method to equity method.

P&L accounts validation

By calculating the cash flow, we use all P&L non cash accounts. Usually, these accounts can be seen distinctly in the P&L. In our case study, it is indeed the situation. And we confirm the validation is correct.

Consistency validation

It is somehow important to dedicate the task of researching inconsistencies in a cash flow statement, even if it looks technically correct to someone external to the process, but knowing all group transactions and figures.

The main areas to validate are

- Net variation of current assets and liabilities (Receivables and Payables in our case study). Both amounts could be too high because elimination of some intercompany flows could have been forgotten.
- Investments and disinvestments are much easier to validate because most of the time there are only a few transactions and they are well known. In our case study, we recognize easily in particular the acquisition of shares for 4000, the disposal price of 800 for the 40% shares of GAMMA.
- The net capital increase is also well identified.
- Dividends paid by the parent company need no comment ...
- But special care should be brought to dividends paid to 3rd Parties, certainly if the group structure is complex.

CONCLUSION

Even if this case study dealt with a rather small group of five companies, the number of transactions and events happening during Year 2 makes it a sufficiently realistic case anyway.

In spite of the small size, we had the opportunity to pragmatically show how to practically organize a consolidation process which requires precision.

The probability to face unexpected mistakes is very high and the resources to find and solve these mistakes are time consuming.

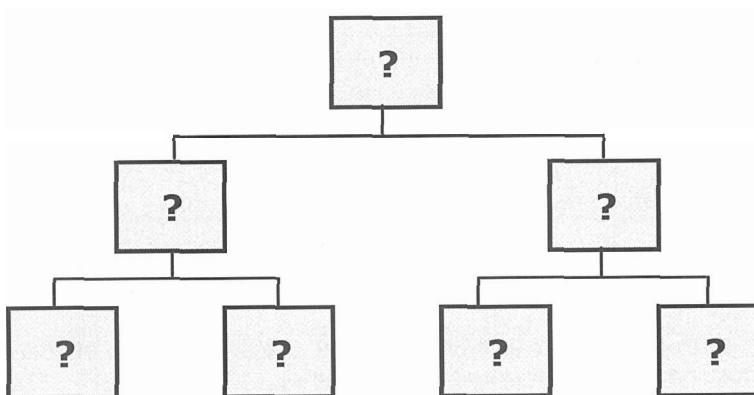
This is one important reason why we have organized the process step by step in such a way that each step can be justified and with sufficient security not to break the "building".

Groups of larger size may not resist easily to such spreadsheet approach. Professional software becomes a major option for them.

BART 7

CONSOLIDATION

QUIZZ



This Part 7 is dedicated to the reader wishing to test its acquisition of knowledge.

We propose three different sets of questions increasing in complexity (+, ++, ++++) and presented as a quizz or multiple choice questions. For each question we give four different answers amongst which only one is correct.

Here are some recommendations before starting one set of questions

- You are required to solve a set of 10 questions in a maximum of
 - 60 minutes for Quizz 1
 - 90 minutes for Quizz 2
 - 120 minutes for Quizz 3
- Be sure to have enough time to solve a set of 10 questions at once and without being disturbed
- Of course feel free to find help in this book
- Feel also free to use a spreadsheet or a pocket calculator, but not a professional consolidation software!
- When answering, select only one answer
- All amounts are supposed to be in EUR (consolidation currency). If not, it is explicitly specified.
- Currency rates are always given by **1 CUR = ... EUR**
- Negative amounts are always written between brackets as (5) for minus 5.

To evaluate your score you can have a look at the second part of this Part 7 where we give the correct answer to each question.

1 QUIZZ 1 (+)

Question 1.01

The capital of a certain company A is represented by three different types of shares

- Type 1 : 1000 shares with one voting right each
- Type 2 : 1000 shares with no voting rights
- Type 3 : 1000 shares with two voting rights each

The parent company owns directly the following number of shares

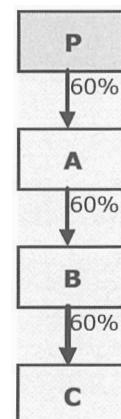
- Type 1 : 800 shares
- Type 2 : 200 shares
- Type 3 : 500 shares

What is the control percentage owned by the parent company on company A and with which consolidation method will A be consolidated?

| | | |
|---|-----|--------------------------|
| a | 50% | Proportional integration |
| b | 75% | Global integration |
| c | 60% | Global integration |
| d | 50% | Global integration |

Question 1.02

In this group all percentages are financial and control percentages.



What is the indirect financial percentage in company C and with which method will the company be consolidated?

| | | |
|---|--------|--------------------|
| a | 60% | Global integration |
| b | 21.60% | Global integration |
| c | 21.60% | Equity method |
| d | 36% | Equity method |

Question 1.03

| | In CUR | Rates |
|-------------------|--------|-------|
| Capital | 1000 | 1.3 |
| Retained earnings | 600 | 1.4 |
| Profit | 100 | |

| | |
|--------------|-----|
| Closing rate | 1.5 |
| Average rate | 1.6 |

Here are the equity accounts of a foreign company whose currency is CUR.

This company is consolidated by the global integration method with an indirect financial percentage of 80%.

Rates 1.3 and 1.4 are historical rates.

What is the contribution of the company in the « Translation adjustments » account in the consolidated equity?

| | | |
|---|--------|-----|
| a | Debit | 200 |
| b | Debit | 250 |
| c | Credit | 200 |
| d | Credit | 250 |

Question 1.04

The evolution of the Tangible assets account of a foreign company is given here below in local currency CUR.

| | | |
|---------------------------|------------|-----|
| Opening value | 100 | 0.5 |
| Acquisitions Disposals | 30 (10) | |
| Closing value | 120 | 0.7 |

The rate 0.5 is the closing rate to apply for the opening value and 0.7 for the closing value.

The Acquisitions and Disposals flows are translated at the average rate 0.6.

What will be the value of the Translation adjustment flow after currency conversion?

| | |
|---|------|
| a | 20 |
| b | 0 |
| c | 22 |
| d | (20) |

PART 7 CONSOLIDATION QUIZZ

Question 1.05

A group consists in a parent company P owning directly three companies: A, B and C with financial percentages and consolidated with consolidation methods as presented hereunder.

| Company | Consolidation method | Financial % | Closing value |
|---------|--------------------------|-------------|---------------|
| P | Parent company | | 2,000 |
| A | Global integration | 80% | 1,000 |
| B | Proportional integration | 50% | 600 |
| C | Equity method | 30% | 800 |

The statutory closing value of the Bank account of each of these companies is also given here.

What will be the consolidated value of this Bank account?

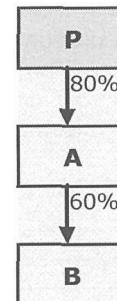
| | |
|---|-------|
| a | 3,300 |
| b | 4,400 |
| c | 3,340 |
| d | 3,100 |

Question 1.06

Company P consolidates A and B by the global integration method.

Total equity of companies A and B and the financial investment from A in B are given here below.

| | |
|----------------------------------|-------|
| Total equity of A | 1,000 |
| Financial investment from A in B | 800 |
| Total equity of B | 1,000 |



What will be the value of the Minority interests account in the consolidated balance sheet?

| | |
|---|-----|
| a | 720 |
| b | 600 |
| c | 440 |
| d | 560 |

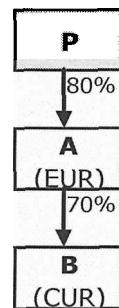
Question 1.07

The structure of this group remains unchanged in Year 1 and Year 2.

Company B is a foreign company with currency CUR.

At the end of Year 1, company B decides to pay dividends of 1000 CUR and local laws require company B to withhold a tax of 25% on these dividends.

Company A receives a cash amount of $525 \text{ CUR} = 70\% * [75\% * 1000 \text{ CUR}]$ which corresponds to 470 EUR on the Bank receipt and book for that amount on the Financial income account.



Last information: average rate of currency CUR of Year 1 is 0.8 and of Year 2 is 0.7.

What is the amount of dividends to eliminate in company A accounts, that is to transfer from profit to reserves?

| | | |
|---|--|-----|
| a | | 600 |
| b | | 560 |
| c | | 800 |
| d | | 470 |

Question 1.08

A company P acquires 80% of shares of a company A for a price of 1000.

At the date of acquisition, company A total statutory equity is 800 and, after the due diligence process, it is decided to reevaluate a building for 200.

If this transaction leads to a goodwill, what would be its value?

| | | |
|---|--|-----|
| a | | 160 |
| b | | 0 |
| c | | 200 |
| d | | 40 |

PART 7 CONSOLIDATION QUIZZ

Question 1.09

Here is the consolidated P&L of a group.

| | |
|--------------------------------|---------|
| Turnover | 2,000 |
| Cost of sales | (1,600) |
| Depreciations | (200) |
| Provisions | (100) |
| Financial income | 150 |
| Profit from equity method comp | 50 |
| Consolidated profit | 300 |
| 3rd Parties profit | 60 |
| Group profit | 240 |

What is the consolidated cash flow statement of this group?

| | |
|---|-----|
| a | 300 |
| b | 550 |
| c | 490 |
| d | 600 |

Question 1.10

A few years ago, the following consolidation adjustment has been booked in local currency in a company consolidated by the proportional method at 50%.

| | Debit | Credit |
|--------------------------------|-------|--------|
| Write-off on receivables (P&L) | 100 | |
| Receivables (Balance sheet) | | 100 |

For this consolidation, the closing rate was 2.3 and the average rate 2.5.

This year, the adjustment is maintained in the consolidation and the closing and average rates are 1.8 and 1.7 respectively.

What is the contribution of the adjustment in the consolidated Translation adjustment account?

| | |
|---|-----------|
| a | Debit 35 |
| b | Debit 70 |
| c | Credit 35 |
| d | Credit 70 |

2 QUIZZ 2 (++)

Question 2.01

We consider the three following companies belonging to a consolidation scope, with their consolidation method as specified here below.

| | |
|-----------|-----------------------|
| Company P | Consolidating company |
| Company A | Global integration |
| Company B | Equity method |

We also give the Payables account of each company, with the intercompany details.

| | | |
|-----------|---------------------------------------|-------------------|
| Company P | 3rd parties Company A Company B | 500 200 300 |
| Company A | 3rd parties Company P | 700 100 |
| Company B | 3rd parties Company P | 100 400 |

Supposing all intercompany accounts are correctly reconciled, what will be the consolidated value of this Payables account?

| | | |
|---|--|-------|
| a | | 1,300 |
| b | | 1,200 |
| c | | 1,700 |
| d | | 1,500 |

PART 7 CONSOLIDATION QUIZZ

Question 2.02

At the beginning of the year, company A is owned with a financial percentage of 90%.

On July 1st, the group sells 20% of shares and company A is now owned at 70%.

The 12 months statutory profit of 200 splits into 120 for the first half year and 80 for the second half year.

Moreover, there is a consolidation adjustment booked for 40 corresponding to an additional depreciation.

What is the contribution of the company in the consolidated profit of the group?

| | |
|---|-----|
| a | 112 |
| b | 128 |
| c | 132 |
| d | 136 |

Question 2.03

Parent company P owns 80% of company A, for a statutory value of 1000.

P decides to sell 20% of its participation to 3rd Parties for a price of 400, making a gain of 150.

At the date of disposal, the company A total adjusted equity is 1500.

What will be the amount of the consolidation adjustment correcting the statutory gain in P&L?

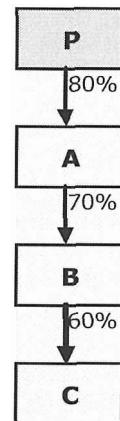
| | |
|---|------------|
| a | Debit 50 |
| b | Credit 150 |
| c | Credit 50 |
| d | Debit 150 |

Question 2.04

In this group, P is the consolidating company and A, B and C are consolidated with the global integration method.

Here below is some information on some accounts. All amounts are in consolidation currency.

| | |
|----------------------------------|-------|
| Total equity of A | 2,000 |
| Total equity of B | 1,000 |
| Total equity of C | 1,000 |
| Financial investment from A in B | 900 |
| Financial investment from B in C | 700 |



What is the amount of Minority interests in the consolidated equity?

| | |
|---|-------|
| a | 1,016 |
| b | 1,500 |
| c | 1,100 |
| d | 1,520 |

Question 2.05

We show below the statutory equity of the consolidating company and the consolidated equity of its group.

| | Statutory equity | Consolidated equity |
|-------------------------|------------------|---------------------|
| Capital | 1,000 | 1,000 |
| Reserves | 800 | (300) |
| Translation adjustments | | 100 |
| Minority interests | | 200 |
| | 1,800 | 1,000 |

Considering these figures, which of the four following proposals is the correct one?

| | |
|---|---|
| a | If Reserves are negative (Debit), it should be the same for Minority interests |
| b | At least one company is making more losses than profits since its first consolidation |
| c | Reserves cannot be negative (debit) |
| d | Consolidated equity is always greater than statutory equity of parent company |

PART 7 CONSOLIDATION QUIZZ

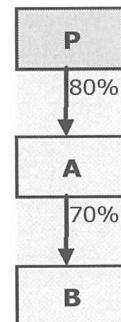
Question 2.06

In this group,

- P pays dividends of 300
- A pays dividends of 200
- B pays dividends of 100

These dividends are all related to previous year, paid and booked in the corresponding Financial income accounts during the first months of this year.

What will be the total amount of dividends paid in the consolidated cash flow statement?



| | | |
|---|--|-------|
| a | | (600) |
| b | | (530) |
| c | | (384) |
| d | | (370) |

Question 2.07

Company A is consolidated by the equity method with a percentage of 30%.

This company decides to increase its capital by 1000 and each shareholder subscribes with respect to its participation percentage. Thus, the parent company subscribes 300 and the other shareholders, all together, subscribe 700.

What will be the amount appearing in the consolidated cash flow statement concerning this capital increase?

| | | |
|---|--|-------|
| a | | 0 |
| b | | 700 |
| c | | (300) |
| d | | 1,000 |

Question 2.08

We consider a group of two companies, the consolidating company P and a subsidiary A owned at 80% (global integration).

Here is the consolidated reserves evolution report.

| | Reserves Year 1 | Result Year 2 | Dividends paid | Dividends received | Transfers | Appropriation | Reserves Year 2 |
|---|--------------------|------------------|-------------------|-----------------------|-----------|---------------|--------------------|
| P | 2,000 | 500 | | 100 | 150 | (200) | 2,550 |
| A | 1,000 | 300 | (100) | | (150) | | 1,050 |
| | 3,000 | 800 | (100) | 100 | 0 | (200) | 3,600 |

Which of the following proposals is not correct?

- | | |
|---|------------------------------------|
| a | A pays a gross dividend of 125 |
| b | P pays a gross dividend of 200 |
| c | This report is technically correct |
| d | A pays an interim dividend of 150 |

Question 2.09

The parent company P owns 60% of company A and the statutory book value of this participation is 1000. Company A statutory equity is 2000.

In consolidation, we have booked the following adjustments

| | | Debit | Credit |
|---------------|------------------------|-------|--------|
| In P accounts | Financial investment/A | 200 | |
| | Reserves | | 200 |

| | | Debit | Credit |
|---------------|-----------------|-------|--------|
| In A accounts | Tangible assets | 500 | |
| | Reserves | | 500 |

| | | |
|------------|-----|-----|
| Reserves | 200 | |
| Provisions | | 200 |

This second adjustment in company A accounts is booked 100% on group accounts.

| | |
|---|-----|
| a | 180 |
| b | 100 |
| c | 300 |
| d | 500 |

What are the consolidated reserves of company A?

Question 2.10

We present here the evolution of the statutory equity of a foreign company.

| | Year 1 | Flows | Year 2 |
|---------------------|--------|-------|--------|
| Capital | 1,000 | | 2,000 |
| Increase in capital | | 1,000 | |
| Retained earnings | 800 | | 700 |
| Dividends paid | | (100) | |
| Result | 200 | | 300 |
| Dividends paid | | (200) | |
| Year 2 profit | | 300 | |
| Total | 2,000 | 1,000 | 3,000 |

The different rates used for Year 1 and Year 2 consolidations are given hereunder

| | | |
|--------|--|------------|
| Year 1 | Historical rate for the capital | 3.0 |
| | Average rate | 3.5 |
| | Retained earnings for 800 consist in 300 at historical rate of 500 at historical rate of | 3.1 3.2 |
| | | |
| Year 2 | Closing rate | 3.7 |
| | Average rate | 3.4 |
| | Rate for the capital increase | 3.6 |

Notice that the dividends for 100 are coming from the 500 part of the Retained earnings amount of 800.

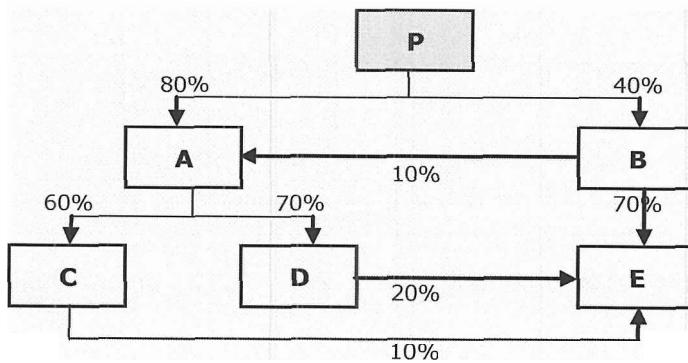
What is the amount of translation adjustments for this company?

| | |
|---|-------------|
| a | Debit 900 |
| b | Credit 900 |
| c | Debit 1270 |
| d | Credit 1270 |

3 QUIZZ 3 (+++)

Question 3.01

In this group, the percentages represent both financial and voting rights.



Company A has signed a shareholders agreement with the owner of the 40% shares in C, giving to him the control on that company.

With which indirect financial percentage and indirect control percentage will company E be consolidated?

| | | | |
|---|--|-------|-----|
| a | | 44.8% | 70% |
| b | | 28% | 70% |
| c | | 44.8% | 20% |
| d | | 28% | 20% |

Question 3.02

Parent company P decides to sell its 80% participation owned in company A.

The book value in P statutory accounts of these shares is 3000 and, in consolidation, there is still a goodwill whose net value is 300.

The last year total equity of company A was 4000. However, the transaction occurs in July this year when the profit of A is 400.

| | | |
|---|--|-------|
| a | | 3,200 |
| b | | 3,700 |
| c | | 3,720 |
| d | | 4,020 |

At which price should these shares be sold to show a gain of 200 in the consolidated accounts?

PART 7 CONSOLIDATION QUIZZ

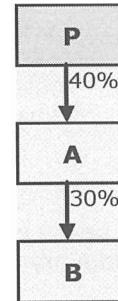
Question 3.03

This group consolidates two companies A and B with the equity method.

We give you also a simplified balance sheet for each company and we will suppose they have been founded by the group a few years ago.

There is so no goodwill or badwill to calculate.

| P | | |
|--------------|--------|-------------------------|
| Fin. Inv./A | 1,500 | Capital 5,000 |
| | | Reserves 3,000 |
| | | Result 500 |
| Other assets | 11,500 | Other liabilities 4,500 |



| A | | |
|--------------|-------|-------------------------|
| Fin. Inv./B | 500 | Capital 3,000 |
| | | Reserves 1,000 |
| | | Result 400 |
| Other assets | 7,500 | Other liabilities 3,600 |

| B | | |
|--------------|-------|-------------------------|
| | | Capital 1,000 |
| | | Reserves |
| | | Result 200 |
| Other assets | 5,000 | Other liabilities 3,000 |

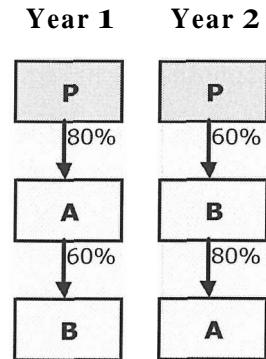
What is the value of the "Financial investments at equity value" account in the consolidated balance sheet?

| | | |
|---|--|-------|
| a | | 2,000 |
| b | | 1,616 |
| c | | 2,560 |
| d | | 1,800 |

Question 3.04

This group is restructuring in the following way

- All transactions occur on January 1st, Year 2
- A sells to P its 60% shares in B
- P sells to B its 80% shares in A
- These disposals of shares are done at the book value, generating no gain or loss.



Here below we give some balance sheet accounts as at December 31, Year 1 and January 1st, Year 2 just after the group transactions.

| Year 1 | | | Year 2 | | |
|-------------|-------|--------|-------------|-------|--------|
| Fin. Inv./A | 2,000 | P | Fin. Inv./B | 800 | P |
| Fin. Inv./B | 800 | A | Fin. Inv./A | 2,000 | B |
| | | Equity | | | Equity |
| | | 2,000 | | | 1,000 |
| | | | | | |
| | | B | | | A |
| | | Equity | | | Equity |
| | | 1,000 | | | 2,000 |

What is the impact of these transactions on the consolidated reserves of A and B between the situation "before" and the situation "after".

This impact will be given as the variation amount of consolidated reserves as "Year 2 – Year 1".

| | | |
|---|--|-------|
| a | | 120 |
| b | | (120) |
| c | | 0 |
| d | | (440) |

PART 7 CONSOLIDATION QUIZZ

Question 3.05

During Year 1, a company A was consolidated with the equity method.

On January 1st, Year 2, the group acquires 40% additional shares of A for a price of 500. In consolidation, this transaction gives a goodwill of 100.

Since this date, company A is consolidated with the global integration method.

Which of the four following proposals is the correct one?

| | |
|---|---|
| a | All assets and liabilities of Year 1 closing amounts will appear in the cash flow statement because of the change in the consolidation method |
| b | A goodwill of (100) appears in the consolidated cash flow statement |
| c | An investment of (400) appears in the consolidated cash flow statement |
| d | An investment of (500) appears in the consolidated cash flow statement |

Question 3.06

Company A is consolidated with the proportional method at 50%.

The book value of the financial investment in the parent company P is 1800.

P decides to deconsolidate A on the basis of the following statutory equity of A

| | |
|----------|-------|
| Capital | 2,000 |
| Reserves | 1,000 |
| Result | (300) |
| | 2,700 |

and wants to show now the 1800 book value as a financial investment in a not consolidated company.

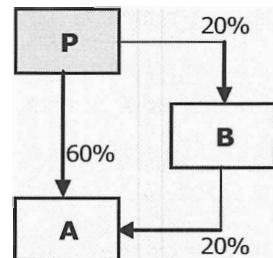
What will be the impact of this transaction on the consolidated result?

| | |
|---|-------------|
| a | Debit 450 |
| b | Credit 450 |
| c | Debit 1350 |
| d | Credit 1350 |

DIRECT CONSOLIDATION _____

Question 3.07

In this group, company A is consolidated with the global integration method and company B with the equity method.



We also give a simplified balance sheet for each of these three companies.

| P | | |
|--------------|--------|-------------------------|
| Fin. Inv./A | 1,800 | Capital 5,000 |
| Fin. Inv./B | 800 | Reserves 3,000 |
| | | Result 1,000 |
| Other assets | 11,400 | Other liabilities 5,000 |

| A | | |
|--------------|--------|-------------------------|
| | | Capital 3,000 |
| | | Reserves 2,000 |
| | | Result 500 |
| Other assets | 10,000 | Other liabilities 4,500 |

| B | | |
|--------------|-------|-------------------------|
| Fin. Inv./A | 600 | Capital 2,000 |
| | | Reserves 1,000 |
| | | Result 200 |
| Other assets | 6,400 | Other liabilities 3,800 |

Among the four following proposals, which one is showing correct amounts for "Financial investments at equity value" and for "Minority interests"?

| | Fin.inv. at equity value | Minority interests |
|---|--------------------------|--------------------|
| a | 640 | 1,980 |
| b | 640 | 2,200 |
| c | 520 | 1,980 |
| d | 520 | 2,200 |

PART 7 CONSOLIDATION QUIZZ

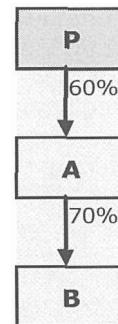
Question 3.08

Parent company P owns a subgroup of two companies A and B.

P decides to sell this subgroup in one single transaction to 3rd Parties.

This transaction will be evaluated on the basis of the following simplified balance sheet accounts. They include goodwill adjustments indicated in bold characters.

Company B balance sheet has been already translated into consolidation currency, showing translation adjustments of (400).



| P | | | |
|--------------|--------------|-------------------|-------|
| Goodwill/A | 500 | Capital | 5,000 |
| Fin. Inv./A | 3,000 | Reserves | 3,000 |
| | (500) | Result | 1,000 |
| Other assets | 12,000 | Other liabilities | 6,000 |

| A | | | |
|--------------|--------------|-------------------|-------|
| Goodwill/B | 100 | Capital | 3,000 |
| Fin. Inv./B | 1,500 | Reserves | 2,000 |
| | (100) | Result | 1,000 |
| Other assets | 9,500 | Other liabilities | 5,000 |

| B | | | |
|--------------|-------------|-------------------|-------|
| | Capital | 2,000 | |
| | Reserves | 500 | |
| | Result | 100 | |
| | Trans. Adj. | (400) | |
| Other assets | 6,000 | Other liabilities | 3,800 |

At which price this subgroup should be sold in order to show a net gain of 300 in the consolidated P&L?

| | |
|---|-------|
| a | 4,592 |
| b | 4,652 |
| c | 4,485 |
| d | 4,424 |

DIRECT CONSOLIDATION _____

Question 3.09

Company A has been consolidated by the global integration method at 80% until end of Year 1.

Beginning Year 2, the group sells 20% of shares of that company

Here is the evolution of the consolidated reserves report, partially completed.

| | Reserves Year 1 | Result Year 2 | Dividends paid | Dividends received | Transfers of reserves | Appropriation | Reserves Year 2 |
|-----|--------------------|------------------|-------------------|-----------------------|-----------------------------|---------------|--------------------|
| ... | | | | | | | |
| A | 200 | 40 | (20) | | ? | | |
| ... | | | | | | | |

What would be the amount to write in the "Transfers of reserves" column at the place of the "?" to take this transaction into account?

| | | |
|---|--|------|
| a | | (45) |
| b | | (60) |
| c | | (40) |
| d | | 0 |

PART 7 CONSOLIDATION QUIZZ

Question 3.10

Parent company P owns 40% of shares of company A.

Here are the simplified statutory balance sheets of these two companies at the end of Year 1.

| | | P | |
|-------------|-------|--------|-------|
| Fin. Inv./A | 1,000 | Equity | 3,000 |
| Cash | 4,000 | Debts | 2,000 |
| | | A | |
| | | Equity | 2,000 |
| Cash | 4,000 | Debts | 2,000 |

At which price (paid in cash) should company P acquire 30% of additional shares in company A in order to obtain the ratio "Debts / Consolidated equity" equals to 2, just after the transaction?

Notice the following points

- Consolidated equity includes Minority interests
- There is no existing goodwill attached to the first 40% of shares
- When considering the above ratio, Bankers are always reducing the equity by consolidation goodwills.

| | |
|---|----------------------------------|
| a | That transaction is not possible |
| b | 1,400 |
| c | 2,000 |
| d | 750 |

4 CORRECT ANSWERS: SUMMARY

| QUIZZ 1 (+) | |
|--------------------|---|
| 1.01 | c |
| 1.02 | b |
| 1.03 | b |
| 1.04 | c |
| 1.05 | a |
| 1.06 | d |
| 1.07 | b |
| 1.08 | c |
| 1.09 | b |
| 1.10 | c |

| QUIZZ 2 (++) | |
|---------------------|---|
| 2.01 | d |
| 2.02 | c |
| 2.03 | a |
| 2.04 | a |
| 2.05 | b |
| 2.06 | d |
| 2.07 | c |
| 2.08 | d |
| 2.09 | b |
| 2.10 | d |

| QUIZZ 3 (+++) | |
|----------------------|---|
| 3.01 | c |
| 3.02 | d |
| 3.03 | d |
| 3.04 | a |
| 3.05 | d |
| 3.06 | b |
| 3.07 | c |
| 3.08 | b |
| 3.09 | a |
| 3.10 | c |

5 CORRECT ANSWERS: QUIZZ 1

Answer 1.01

Number of voting rights owned is $1800 = 800 * 1 + 200 * 0 + 500 * 2$.
 Number of voting rights issued is $3000 = 1000 * 1 + 1000 * 0 + 1000 * 2$.
 The control percentage is $60\% = 1800 / 3000$ with a global integration method.

Answer 1.02

The indirect financial percentage is $21.6\% = 60\% * 60\% * 60\%$ and parent company P is controlling indirectly company C at 60%, giving the global integration method.

Answer 1.03

| | In CUR | At closing rate | Historical rate | Average rate | Adjustment |
|-------------------------|--------|-----------------|-----------------|--------------|-------------|
| Capital | 1000 | 1500 | 1300 | | (200) Debit |
| Retained earnings | 600 | 900 | 840 | | (60) Debit |
| Profit | 100 | 150 | | 160 | 10 Credit |
| Translation adjustments | | | | | 250 Credit |

Answer 1.04

| | | | | |
|-------------------------|------|-----|-----|--|
| Opening value | 100 | 0.5 | 50 | |
| Acquisitions | 30 | 0.6 | 18 | |
| Disposals | (10) | 0.6 | (6) | |
| Translation adjustments | | | 22 | |
| Closing value | 120 | 0.7 | 84 | |

Answer 1.05

| Company | Consolidation method | Financial % | Closing value | Consolidated value |
|---------|--------------------------|-------------|---------------|--------------------|
| P | Parent company | | 2,000 | 2,000 |
| A | Global integration | 80% | 1,000 | 1,000 |
| B | Proportional integration | 50% | 600 | 300 |
| C | Equity method | 30% | 800 | 0 |
| | | | | 3,300 |

Answer 1.06

Minority interests in company A: $40 = 20\% * [1000 - 800]$

Minority interests in company B: $520 = 52\% * 1000$

The consolidated Minority interests are $560 = 40 + 520$.

Answer 1.07

Gross dividends paid by company B are valued for $800 = 1000 \text{ Cur} * 0.8$ (average rate of Year 1).

Company A receives $560 = 70\% * 800$ which is the amount to eliminate from the profit and to transfer to the reserves.

Answer 1.08

The adjusted equity of the acquired company is $1000 = 800 + 200$.

The goodwill is the difference between the acquisition price of 1000 and $800 = 80\% * 1000$ which is 200.

Answer 1.09

The cash flow is equal to the consolidated result + non cash charges - non cash incomes.

From our situation, we get a cash flow of $550 = 300 + 200 + 100 + (50)$, considering the only non cash items are "Depreciations", 'Provisions' and 'Profit from equity method company'.

Answer 1.10

The first year, the P&L impact was $250 = 100 * 2.5$ and this amount must be kept unchanged in the Reserves.

Considering a closing rate of 1.8 this year, the adjustment after translation becomes

| | Debit | Credit |
|-----------------------------|-------|--------|
| Write-off receivables (P&L) | 250 | |
| Receivables (Balance sheet) | | 180 |
| Translation adjustments | | 70 |

and the company being consolidated with the proportional method at 50%, the correct answer is Credit 35.

6 CORRECT ANSWERS: QUIZZ 2

Answer 2.01

| | | | |
|-----------|-------------|-----|-------|
| Company P | 3rd parties | 500 | 500 |
| | Company A | 200 | 0 |
| | Company B | 300 | 300 |
| Company A | 3rd parties | 700 | 700 |
| | Company P | 100 | 0 |
| Company B | 3rd parties | 100 | 0 |
| | Company P | 400 | 0 |
| | | | 1,500 |

Company P/Company A is eliminated for 200.

Company P/Company B for an amount of 300 is not eliminated because B is consolidated with the equity method.

Company A/Company P is eliminated for 100.

All amounts in company B accounts are not integrated because of the equity method.

Answer 2.02

The annual profit of 200 splits into 120 and 80 for the two mid-year periods.

Moreover, we have to consider an adjustment of (40) corresponding to an additional depreciation. This amount of (40) must be split into (20) and (20) for the two periods considered.

Finally, the contribution to the consolidated profit is $132 = 90\% * [120 + (20)] + 70\% * [80 + (20)]$

Answer 2.03

In statutory accounts, the 20% of shares disposed correspond to a value of $250 = 1000 * [20\% / 80\%]$, giving a gain of $150 = 400 - 250$.

In consolidation, we sell for a price of 400 shares valued for $300 = 20\% * 1500$, giving a gain of 100.

DIRECT CONSOLIDATION

The consolidation adjustment will consist in decreasing that gain for 50 by a Debit 50.

Answer 2.04

3rd parties percentages are

- 20% in company A
- 44% in company B
- 66.4% in company C

Considering Minority interests are calculated in the net equity = equity less financial investments in consolidated companies, we find

- For company A: $220 = 20\% * [2000 - 900]$
- For Company B: $132 = 44\% * [1000 - 700]$
- For Company C: $664 = 66.4\% * 1000$

giving a total of 1016.

Answer 2.05

Option a: Not correct

We can have a company owned at 100% giving negative consolidated reserves and a single company with 3rd Parties with a positive equity, so giving positive Minority interests.

Option b: Correct

... and the cumulated losses are greater than the consolidated reserves of all the other companies of the group.

Option c: Not correct

In consolidation, reserves can be negative because one company makes huge cumulative losses since a number of years.

Option d: Not correct

Suppose parent company reserves are equal to zero and the only consolidated company is making losses since its first year consolidation. In such case we would get consolidated equity lower than statutory equity.

PART 7 CONSOLIDATION QUIZZ

Answer 2.06

The contribution of the paid dividends will be

- (300) for company P
- (40) = 20% * (200) for company A
- (30) = 30% * (100) for company B

giving a total of (370).

Answer 2.07

Bank account of parent company is consolidated at 100% and we show a cash out of (300).

Bank account of company A being consolidated by the equity method, we don't have any cash in the cash flow statement.

So the net impact is (300).

Answer 2.08

The amount of 150 in the transfer column has nothing to do with dividends or interim dividends. We have seen several times that this column was used mainly for two reasons, either a decrease in percentage in company A or some elimination of group profit via the Reserves account.

The option d is not correct.

Answer 2.09

Consolidated reserves of company A are

$$60\% * [2000 + 500] + (200) - [1000 + 200] = 100.$$

Answer 2.10

Capital account at closing rate is $7400 = 2000 * 3.7$ and at historical rate is $6600 = 1000 * 3.0 + 1000 * 3.6$. This implies a debit on Capital for 800 and a credit on Translation adjustments for 800.

DIRECT CONSOLIDATION

Retained earnings account at closing rate is $2590 = 700 * 3.7$ and at historical rate is $2210 = 300 * 3.1 + 400 * 3.2$. This implies a debit on Retained earnings for 380 and a credit on Translation adjustments for 380.

Result account at closing rate is $1110 = 300 * 3.7$ and at average rate is $1020 = 300 * 3.4$. This implies a debit on Result for 90 and a credit on Translation adjustments for 90.

The total impact on Translation adjustments account is Credit 1270.

7 CORRECT ANSWERS: QUIZZ 3

Answer 3.01

Indirect financial percentage

- P -> A -> C -> E : $80\% * 60\% * 10\% = 4.8\%$
- P -> A -> D -> E : $80\% * 70\% * 20\% = 11.2\%$
- P -> B -> A -> C -> E : $40\% * 10\% * 60\% * 10\% = 0.24\%$
- P -> B -> A -> D -> E : $40\% * 10\% * 70\% * 20\% = 0.56\%$
- P -> B -> E : $40\% * 70\% = 28\%$

giving a total of 44.8%.

Indirect control percentage

Company E is owned by

- Company B: Not controlled by P because B owned at only 40%
- Company C: Not controlled by P because of shareholders agreement
- Company D: Controlled indirectly by P at 70%

The only voting rights to take into account are the 20% owned by company D.

Answer 3.02

Let's set the selling price to X.

The consolidated value of the 80% shares is $3520 = 80\% * [4000 + 400]$.

At this moment, the consolidated gain is $X - 3520$. But we also have to eliminate the goodwill for 300, giving a net consolidated gain of $X - 3520 - 300$ which must be equal to 200.

The value of X is 4020.

Answer 3.03

Equity value of company A is $1560 = 40\% * [3000 + 1000 + 400 - 500]$.
Equity value of company B is $240 = 12\% * [1000 + 800 + 200]$.

Consolidated equity value is 1800.

DIRECT CONSOLIDATION _____

Answer 3.04

Consolidated reserves before transaction

- For company A : $(400) = 80\% * 2000 - 100\% * 2000$
- For company B : $(160) = 48\% * 1000 - 80\% * 800$

giving a total of $(560) = (400) + (160)$

Consolidated reserves after transaction

- For company A : $(240) = 48\% * 2000 - 60\% * 2000$
- For company B : $(200) = 60\% * 1000 - 100\% * 800$

giving a total of $(440) = (240) + (200)$

The impact on A and B consolidated reserves is $120 = (440) - (560)$

Answer 3.05

Option a: Not correct

Year 1 closing assets and liabilities will not impact the cash flow statement because they have not been acquired. The only cash out to show is the acquisition price of the shares giving the control on that company.

Option b: Not correct

A goodwill never appears in a cash flow statement. A goodwill is only a part of the transaction amount.

Option c: Not correct

This amount of 400 corresponding to the acquisition price less the goodwill is also a part of the acquisition price. It doesn't appear in the cash flow statement.

Option d: Correct

Whatever the consolidation method may be or the percentage acquired, the only amount impacting the cash flow statement is the acquisition price.

PART 7 CONSOLIDATION QUIZZ

Answer 3.06

The first step when deconsolidating a company is to consolidate that company with the equity method.

The equity value would be $1350 = 50\% * [2000 + 1000 + (300)]$.

The second step consists in modifying the value to bring it to the statutory financial investment of **1800**. This can be done by a debit **450** on the equity value and a credit **450** on a profit account. This last booking is the answer.

Answer 3.07

Equity value of company B = $520 = 20\% * [2000 + 1000 + 200 - 600]$.

The indirect group financial percentage in company A is $64\% = 60\% + 20\% * 20\%$ and 3rd Parties indirect percentage is $36\% = 100\% - 64\%$.

Minority interests are $1980 = 36\% * [3000 + 2000 + 500]$.

Answer 3.08

We first have to evaluate the consolidated equity of the subgroup which is

- Capital of company A = **3000**
- Reserves of company A = **2000**
- Result of company A = **1000**
- Consolidated reserves of company B = $420 = 70\% * [2000 + 500 + 100] - [1500 + (100)]$

that is a total of **6420**.

Considering a selling price of X, company P would make a profit of $X - 60\% * 6420 = X - 3852$.

But this profit has to be decreased by the 500 goodwill attached to the 60% shares, which gives a final profit of $X - 3852 - 500$ that must be equal to **300**.

We find **X = 4652**.

DIRECT CONSOLIDATION _____

Answer 3.09

We have seen several times through our different examples that when a company is consolidated with a percentage X until a shareholder decides to sell a percentage of Y, the following part of consolidated reserves, that is "consolidated reserves * (Y / X)" are transferred from the concerned company to the shareholder.

In our case, we speak about a ratio of $1/4 = 20\% / 80\%$ which applies to the remaining consolidated reserves $180 = 200 + (20)$. Indeed, dividends paid must be deducted because already transferred (paid) to the shareholder.

The correct answer is $(45) = - 180 * (20\% / 80\%)$.

Answer 3.10

Let's suppose the unknown acquisition price for the 30% is X and the resulting goodwill is G.

We are now able to calculate the consolidated equity used in the ratio, which is

- Equity of parent company = 3000
- Consolidated reserves of company A = $70\% * 2000 - [1000 + X - G]$
 $= 400 - P + X$
- Minority interests of company A = $600 = 30\% * 2000$

giving a total of $4000 - X + G$.

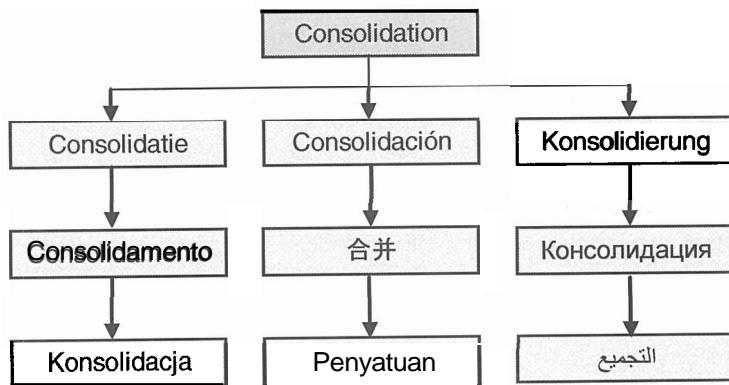
But, in order to comply with Bankers requests, we have to reduce the equity by the goodwill. Consolidated equity becomes $4000 - X$.

After global integration, debts become $4000 = 2000 + 2000$ and the ratio "Debts/Consolidated equity" is $4000 / [4000 - X] = 2$.

We easily find $X = 2000$.

PART 8

INTERNATIONAL CONSOLIDATION GLOSSARY



ENGLISH / FRENCH

| English | Français |
|----------------------------------|-----------------------------|
| 3rd Parties | Tiers |
| Absorption | Absorption |
| Acquisition | Acquisition |
| Adjustments | Retraitemet |
| Average rate | Cours moyen |
| Badwill | Badwill |
| Balance sheet | Bilan |
| Cash flow statement | Tableau de financement |
| Closing rate | Cours de clôture |
| Consolidated reserves | Reserves consolidées |
| Consolidation | Consolidation |
| Consolidation bundle | Liasse de consolidation |
| Consolidation scope | Perimetre de consolidation |
| Control percentage | Pourcentage de clôture |
| Currency rate | Cours de change |
| Currency translation | Conversion monétaire |
| Currency translation adjustments | Ecart de conversion |
| Deconsolidation | Deconsolidation |
| Disposal | Cession |
| Elimination | Elimination |
| Equity method | Mise en equivalence |
| Financial investment | Participation |
| Financial percentage | Pourcentage financier |
| Flow | Flux |
| Global integration method | Integration globale |
| Goodwill | Goodwill |
| Goodwill allocation | Affectation du goodwill |
| Historical rate | Cours historique |
| Income statement | Compte de resultats |
| Indirect percentage | Pourcentage indirect |
| Intercompany account | Compte intersociete |
| Liquidation | Liquidation |
| Merge | Fusion |
| Minority interests | Intérêts des minoritaires |
| Notes to the accounts | Annexes aux comptes |
| Own shares | Actions propres |
| P&L | Compte de resultats |
| Proportional integration method | Integration proportionnelle |
| Statutory accounts | Comptes statutaires |
| Subgroup | Sous-groupe |
| Subsidiary | Filiale |

ENGLISH / NEDERLANDS

| English | | Nederlands |
|----------------------------------|--|-----------------------------------|
| 3rd Parties | | Derden |
| Absorption | | Absorptie |
| Acquisition | | Acquisitie |
| Adjustments | | Herwerkingen |
| Average rate | | Gemiddelde koers |
| Badwill | | Badwill |
| Balance sheet | | Balans |
| Cash flow statement | | Kasstroomtabel |
| Closing rate | | Slotkoers |
| Consolidated reserves | | Geconsolideerde reserves |
| Consolidation | | Consolidatie |
| Consolidation bundle | | Consolidatiebundel |
| Consolidation scope | | Consolidatiekring |
| Control percentage | | Controlepercentage |
| Currency rate | | Wisselkoers |
| Currency translation | | Wisselkoersomrekeningen |
| Currency translation adjustments | | Wisselkoersomrekeningsverschillen |
| Deconsolidation | | Deconsolidatie |
| Disposal | | Overdracht |
| Elimination | | Eliminatie |
| Equity method | | Vermogensmutatiemethode |
| Financial investment | | Participatie |
| Financial percentage | | Financieel percentage |
| Flow | | Stroom |
| Global integration method | | Globale integratiemethode |
| Goodwill | | Goodwill |
| Goodwill allocation | | Toewijzing van goodwill |
| Historical rate | | Historische koers |
| Income statement | | Resultatenrekening |
| Indirect percentage | | Indirect percentage |
| Intercompany account | | Intragroepsrekening |
| Liquidation | | Liquidatie |
| Merge | | Fusie |
| Minority interests | | Minderheidsbelangen |
| Notes to the accounts | | Toelichting van de rekeningen |
| Own shares | | Eigen aandelen |
| P&L | | Resultatenrekening |
| Proportional integration method | | Proportionele integratiemethode |
| Statutory accounts | | Statutaire rekeningen |
| Subgroup | | Subgroep |
| Subsidiary | | Dochteronderneming |

3 ENGLISH / GERMAN

| English | German |
|----------------------------------|-----------------------------------|
| 3rd Parties | Dritte Parteien |
| Absorption | Absorption |
| Acquisition | Akquisition |
| Adjustments | Anpassungen |
| Average rate | Mittelkurs |
| Badwill | Badwill |
| Balance sheet | Bilanz |
| Cash flow statement | Kapitalflussrechnung |
| Closing rate | Schlusskurs |
| Consolidated reserves | Konsolidierte Reserven |
| Consolidation | Konsolidierung |
| Consolidation bundle | Konsolidierungsbündel |
| Consolidation scope | Konsolidierungskreis |
| Control percentage | Kontrollprozentsatz |
| Currency rate | Währungskurs |
| Currency translation | Währungsumrechnung |
| Currency translation adjustments | Währungsumrechnungsdifferenzen |
| Deconsolidation | Dekonsolidierung |
| Disposal | Übertragung |
| Elimination | Eliminierung |
| Equity method | Equity-Methode |
| Financial investment | Finanzinvestition |
| Financial percentage | Finanzieller Prozentsatz |
| Flow | Fluss |
| Global integration method | Globale Integrationsmethode |
| Goodwill | Goodwill |
| Goodwill allocation | Zuweisung von Goodwill |
| Historical rate | Historischer Kurs |
| Income statement | Ergebnisrechnung |
| Indirect percentage | Indirekter Prozentsatz |
| Intercompany account | Kostenabrechnungskonto |
| Liquidation | Liquidation |
| Merge | Fusion |
| Minority interests | Minderheitsbeteiligung |
| Notes to the accounts | Anhang zur Bilanz |
| Own shares | Eigene Aktien |
| P&L | Ergebnisrechnung |
| Proportional integration method | Proportionale Integrationsmethode |
| Statutory accounts | Satzungsmäßige Konten |
| Subgroup | Untergruppe |
| Subsidiary | Tochterunternehmen |

4 ENGLISH / ITALIAN

| English | Italiano |
|----------------------------------|--|
| 3rd Parties | Azionisti di minoranza |
| Absorption | Assorbimento |
| Acquisition | Acquisizione |
| Adjustments | Rettifiche |
| Average rate | Cambio medio |
| Badwill | Differenza negativa da consolidamento |
| Balance sheet | Stato Patrimoniale |
| Cash flow statement | Rendiconto finanziario |
| Closing rate | Cambio di chiusura |
| Consolidated reserves | Riserve consolidate |
| Consolidation | Consolidamento |
| Consolidation bundle | Fascicolo di consolidamento |
| Consolidation scope | Area di consolidamento |
| Control percentage | Percentuale di controllo |
| Currency rate | Tasso di cambio |
| Currency translation | Traduzione monetaria |
| Currency translation adjustments | Differenze di traduzione monetaria |
| Deconsolidation | Deconsolidamento |
| Disposal | Cessione |
| Elimination | Eliminazione |
| Equity method | Metodo del patrimonio netto |
| Financial investment | Partecipazione |
| Financial percentage | Percentuale finanziaria |
| Flow | Flusso |
| Global integration method | Metodo di consolidamento integrale |
| Goodwill | Differenza da consolidamento |
| Goodwill allocation | Allocazione della differenza da consolidamento |
| Historical rate | Cambio storico |
| Income statement | Conto economico |
| Indirect percentage | Percentuale indiretta |
| Intercompany account | Conto infragruppo |
| Liquidation | Liquidazione |
| Merge | Fusione |
| Minority interests | Interessenze di terzi |
| Notes to the accounts | Nota integrativa |
| Own shares | Azioni proprie |
| P&L | Conto economico |
| Proportional integration method | Metodo di consolidamento proporzionale |
| Statutory accounts | Bilancio |
| Subgroup | Sub-holding |
| Subsidiary | Società controllata |

5 ENGLISH / SPANISH

| English | Español |
|----------------------------------|------------------------------------|
| 3rd Parties | Terceros |
| Absorption | Absorcion |
| Acquisition | Adquisicion |
| Adjustments | Ajustes |
| Average rate | Cambio medio |
| Badwill | Badwill |
| Balance sheet | Balance de situación |
| Cash flow statement | Cuadro de los flujos de tesoreria |
| Closing rate | Cambio de cierre |
| Consolidated reserves | Reservas consolidadas |
| Consolidation | Consolidación |
| Consolidation bundle | Medidas de consolidación |
| Consolidation scope | Ámbito de la consolidación |
| Control percentage | Porcentaje de control |
| Currency rate | Tipo de cambio |
| Currency translation | Conversion de moneda |
| Currency translation adjustments | Ajustes de conversion de moneda |
| Deconsolidation | Desconsolidacion |
| Disposal | Cesion |
| Elimination | Eliminación |
| Equity method | Método de puesta en equivalencia |
| Financial investment | Inversion financiera |
| Financial percentage | Porcentaje financiero |
| Flow | Flujo |
| Global integration method | Método de integración global |
| Goodwill | Fondo de comercio |
| Goodwill allocation | Asignacion de fondos de comercio |
| Historical rate | Tasa historica |
| Income statement | Cuenta de resultados |
| Indirect percentage | Porcentaje indirecto |
| Intercompany account | Cuenta interempresarial |
| Liquidation | Liquidación |
| Merge | Fusion |
| Minority interests | Intereses minoritarios |
| Notes to the accounts | Anexos de las cuentas |
| Own shares | Acciones propias |
| P&L | Cuenta de resultados |
| Proportional integration method | Método de integracion proporcional |
| Statutory accounts | Cuentas estatutarias |
| Subgroup | Subgrupo |
| Subsidiary | Filial |

6 ENGLISH / CHINESE

| English | 华语 |
|----------------------------------|--------|
| 3rd Parties | 第三方 |
| Absorption | 吸收 |
| Acquisition | 购置 |
| Adjustments | 调整 |
| Average rate | 平均汇率 |
| Badwill | |
| Balance sheet | 资产负债表 |
| Cash flow statement | 现金流量表 |
| Closing rate | 期末汇率 |
| Consolidated reserves | 合并储备 |
| Consolidation | 合并 |
| Consolidation bundle | 合并数据包 |
| Consolidation scope | 合并范围 |
| Control percentage | 控制股权比例 |
| Currency rate | 汇率 |
| Currency translation | 货币换算 |
| Currency translation adjustments | 货币换算调整 |
| Deconsolidation | 拆分 |
| Disposal | 处置 |
| Elimination | 抵消 |
| Equity method | 权益法 |
| Financial investment | 金融投资 |
| Financial percentage | 财务权比例 |
| Flow | NIL |
| Global integration method | 全球整合法 |
| Goodwill | 商誉 |
| Goodwill allocation | 商誉分配 |
| Historical rate | 历史汇率 |
| Income statement | 收入表 |
| Indirect percentage | 间接的百分比 |
| Intercompany account | 内部往来帐户 |
| Liquidation | 清算 |
| Merge | 合并 |
| Minority interests | 少数股东权益 |
| Notes to the accounts | 附注账户 |
| Own shares | 拥有股 |
| P&L | 损益 |
| Proportional integration method | 比例积分法 |
| Statutory accounts | 法定账户 |
| Subgroup | 子集团 |
| Subsidiary | 子公司 |

7 ENGLISH / MALAYSIAN

| English | Bahasa Melayu |
|----------------------------------|--|
| 3rd Parties | Pihak Ketiga |
| Absorption | Penyerapan |
| Acquisition | Pengambilalihan |
| Adjustments | Pelarasan |
| Average rate | Kadar Purata |
| Badwill | Muhibah Negatif |
| Balance sheet | Kunci Kira-Kira/ Penyata-Penyata Kedudukan Kewangan |
| Cash flow statement | Penyata-Penyata Aliran Tunai |
| Closing rate | Kadar Penutup |
| Consolidated reserves | Rizab Penyatuan |
| Consolidation | Penyatuan |
| Consolidationbundle | Berkas Penyatuan |
| Consolidation scope | Skop Penyatuan |
| Control percentage | Peratus Kawalan |
| Currency rate | Kadar Pertukaran Matawang Asing |
| Currency translation | Pertukaran matawang asing |
| Currency translation adjustments | Pelarasan pertukaran matawang asing |
| Deconsolidation | Pemisahan |
| Disposal | Pelupusan |
| Elimination | Penyingkiran |
| Equity method | Perakaunan Ekuiti |
| Financial investment | Pelaburan Aset Kewangan |
| Financial percentage | Peratus Aset Kawalan |
| Flow | Aliran |
| Global integration method | Penyatuan Global |
| Goodwill | Muhibah |
| Goodwill allocation | Peruntukan Muhibah |
| Historical rate | Kadar Sejarah |
| Income statement | Penyata Pendapatan/Penyata-penyata Pendapatan Komprehensif |
| Indirect percentage | Peratusan Tidak Langsung |
| Intercompany account | Akaun antara Kumpulan |
| Liquidation | Pembubaruan |
| Merge | Penggabungan |
| Minority interests | Kepentingan bukan kawalan/Kepentingan Minoriti |
| Notes to the accounts | Nota-Nota Kepada Penyata Kewangan |
| Own shares | Saham Dimiliki |
| P&L | Untung Rugi |
| Proportional integration method | Penyatuan berkadar |
| Statutory accounts | Akaun Berkanun |
| Subgroup | Subkumpulan |
| Subsidiary | Subsidiari |

8 ENGLISH / ARABIC

| English | Arabic |
|----------------------------------|----------------------------|
| 3rd Parties | جهات خارجية |
| Absorption | إدماج |
| Acquisition | عمليات الشراء |
| Adjustments | تسوييات |
| Average rate | معدل المتوسط |
| Badwill | التقويم اللامادي |
| Balance sheet | الميزانية |
| Cash flow statement | LAG التتفق النقدي |
| Closing rate | سعر الإغلاق |
| Consolidated reserves | احتياطيات مجمعة |
| Consolidation | باتقة التجميع |
| Consolidationbundle | مجال التجميع |
| Consolidationscope | نسبة المراقبة |
| Control percentage | سعر الصرف |
| Currency rate | تقويم العملة |
| Currency translation | تسوييات تقويم العملة |
| Currency translation adjustments | تقسيم الشحنات المجمعة |
| Deconsolidation | التنازل |
| Disposal | الإسقاط |
| Elimination | نظيرية حقوق المساهمين |
| Equity method | الاستثمار المالي |
| Financial investment | النسبة المالية |
| Financial percentage | التفق |
| Flow | طريقة الدمج الشامل |
| Global integration method | التقويم المادي |
| Goodwill | اعتماد التقويم المادي |
| Goodwill allocation | السعر الفعلي |
| Historical rate | قائمة الدخل |
| Income statement | النسبة غير المباشرة |
| Indirect percentage | حساب الشركات المرتبطة معًا |
| Intercompany account | التصفيية |
| Liquidation | الدمج |
| Merge | حصص الأقلية |
| Minority interests | ملحوظات على الحسابات |
| Notes to the accounts | الأسهم الخاصة |
| Own shares | الربح والخسارة |
| P&L | طريقة الدمج المناسب |
| Proportional integration method | الحسابات القانونية |
| Statutory accounts | المجموعة الفرعية |
| Subgroup | فرعي |
| Subsidiary | |

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When considering a company within the economic landscape, it is usually either a parent company or the subsidiary of another company. When reading financial and economic literature, words such as 'group' and 'consolidation' belong to the common parlance. Knowledge of consolidation is now a must when searching for a job in the financial, reporting and accounting areas.

"DirectConsolidation" introduces up-to-date pedagogical, and practical approaches.

Pedagogical, because the author has trained and assisted hundreds of international groups, introducing them to the necessary methodology with which to face unpredictable and difficult group situations.

Up-to-date because the methodology explained in this book is applied in today's consulting activity and within Sigma Conso software, one of the most recent and complete international consolidation, reporting and planning softwares (including all IFRS requirements).

Practical for two reasons. The case studies are not theoretical but rather real life examples and each case study is solved completely with the necessary justifications.

"Direct consolidation" is written for anyone wanting to acquire a solid knowledge and a correct understanding of statutory consolidation techniques. For experienced readers, additional case studies are introduced and solved in completion in order to "Consolidate your expertise".

Allen White has dedicated 30 years of his career to giving professional advice and assisting international groups by setting up consolidation information systems.

This expertise, acquired throughout his career has given him the opportunity to cover a large range of activities and different aspects of consolidation such as the organisation of first consolidations, assistance in the consolidation process, advice on group restructuring, group financial evaluation, consolidation software development, public and school trainings, book;, articles and various published work...