

DIRECT CONSOLIDATION

Reserves 1
Goodwill

Debit Credit

2 And we do the same for the 3 corresponding impairments.

	Debit	Credit
Equity value	1,026	
Fin. Invest./A		400
Trans. Adjust.	78	
Reserves		704

4 We now reach a critical step. We say 5 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 6 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 7 badwill, so $400 = 500 + (100)$.

By already explaining that approach in Part 2 for the disposal of a 8 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	

9 We now conclude the transaction at 10 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 11 through the P&L. We finally find a loss of disposal for 204 as in the previous method.

	Debit	Credit
Impairment	50	
Goodwill		50

12 The net goodwill of 50 is also eliminated 13 through the P&L.

	Debit	Credit
Gain on disposal	400	
Loss on disposal	204	
Impairment	50	
Reserves		654

14 To reach the conclusion, we would 15 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 1

It is not recommended to use this method alone without verifying the result 2 with one of two other methods.

It says that when disposing shares of a consolidated company to 3rd Parties, 3 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 * 4 company A are aggregated results and so we have to reverse $704 = 2816 \times 20\%$ (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 $50 = 200 \times 20\%$ (20% / 80%) which will become a credit in the P&L.

The net amount in the P&L should then be $(654) = (704) + 50$. 5

This method doesn't indicate clearly which accounts have to be booked in P&L 6 but the net amount is correct.

Consolidation - Year 2 7

Here are the statutory accounts of Year 2 8

				9
Goodwill		Capital	5,000	
(a)	300	Reserves	4,000	
(b)	(150)	(b)	(150)	
Fin. Inv./A	1,500	(e)	654	
(a)	(300)	Result	600	
Other assets	11,500	(e)	(654)	
		Other liabilities	3,400	
		A (CUR)		
Tangible assets	500	Capital	200	
(c)	100	Reserves	300	
(d)	(40)	(c)	100	
		(d)	(30)	
		Result	200	
Other assets	1,000	(d)	(10)	
		Other liabilities	800	

where we see that the financial investment on A in P accounts is now 1500 10 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. 1

Adjustment (b): Total impairments also reduced by one quarter 2

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. 3

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. 4

Adjustment (e): This is the adjustment resulting from our analysis of the transaction. 5

Currency translation of company A accounts 6

For this period, we consider the following rates. 7
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. 9

		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 11

We now apply the global integration method with 60% for the whole Year 2. 12

		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 1

- Consolidated reserves (A) = $3366 = 60\% * [2000 + 2800 + 1000 + (280) + 2200 + (110)] - [1500 + (300)]$ 2
- Minority interests (A) = $3648 = 40\% * [2000 + 2800 + 1000 + (280) + 2200 + (110) + 1400 + 200 + (90)]$
- Translation adjustments = $906 = 60\% * [1400 + 200 + (90)]$

Consolidated reserves evolution 3

	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 5 transfer of 704 from company A to company P corresponds to a quarter of the consolidated reserves $704 = 2816 * (20\% / 80\%)$.

Minority interests evolution 6

	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 8 columns.

$$\text{Year 2 result} = 836 = 40\% * [2200 + (110)] \quad 9$$

$\% \text{ var 1} = 760 = 40\% * [1510 - (390)]$ corresponding to the part of 3rd 10 Parties in the variation of the translation adjustments which are changing from (390) in Year 1 to 1510 in Year 2

$\% \text{ var 2} = 1026 = 20\% * 5130$ corresponding to the impact of the 20% 11 variation on the opening equity, including the translation adjustments.

Translation adjustments evolution 1

	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 3 percentage in the variation of the same period

Column (2) = $78 = (20)\% * (390)$ corresponding to the loss of 20% in the 4 opening translation adjustment of (390).

And finally, do we book translation adjustments in P&L? 5

When we calculate the net amount impacting P&L and Reserves, two of the 6 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 7 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 8 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 9 our three methods.

3.4 Change of consolidation method during the 10 year

The objective of this case study is to see how to handle the balance sheet and 11 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 12

- Disposal of shares with a loss of control 1
- No transaction on shares, but an agreement between shareholders giving the control to one shareholder independently of the number of shares owned.

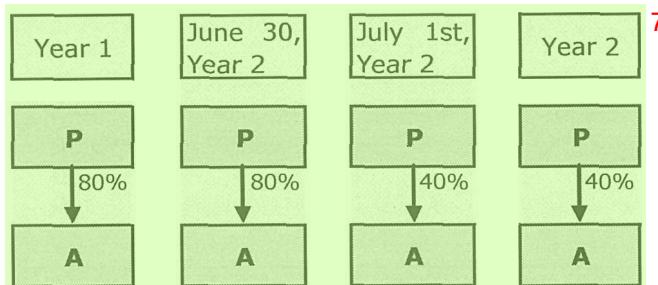
In the case we are presenting hereunder, we will focus on the impact of the 2 consolidation method changes in the balance sheet, the P&L and the evolution of some specific accounts as consolidated reserves, minority interests and equity value.

Description of the situation 3

During Year 1, company P owns 80% of company A which is consolidated with 4 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 5 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, 6 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 8

- 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. 9
- As a consequence, we need a complete detailed P&L of company A corresponding to June 30, Year 2

- Consolidating the first six months by the global integration method, we will have minority interests in the result of the period 1
- 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 2

We start with a Year 1 consolidation without any special event and no 3 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 1

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

2

where 3

- Consolidated reserves (A) = 400 = 80% * [500 + 400 + 100] - 400 4
- Minority interests (A) = 200 = 20% * [500 + 400 + 100]

Consolidation – Year 2 5

We propose to take knowledge of Year 2 statutory accounts, which includes 6 only one consolidation adjustment related to the disposal of 40% of shares of company A.

This time, we will also consolidate the P&L 7

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)

8

In its statutory accounts, company P sells the 40% shares of company A for a 9 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 10 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 1 consolidation gain of 476. That's the role of adjustment (a).

We are now going to consolidate company A with the equity method without 2 booking any adjustment in the following statutory accounts.

A		3	
	Capital	500	
	Reserves	500	
	Result	100	
Other assets	4,000	Other liabilities	2,900

A (December 31 Year 2)		4	
Cost of sales	8,900	Sales	9,000
Result (Group)	100		

Here are the consolidated balance sheet and P&L 5

P + A		6	
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		7	
Cost of sales	4,700	Sales	4,300
Result	116	Gain on disposal	476
		Profit EM	40

With 8

- Consolidated reserves (A) = 240 = 40% * [500 + 500 + 100] - 200 9
- Equity value (A) = 440 = 40% * [500 + 500 + 100]

But this consolidated P&L contains three errors that should be corrected by adjustments 1

Here is the adjusted consolidated P&L with the necessary comments 2

		P + A	3
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) 4

We (or your consolidation software) have consolidated company A at 40% by 5
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 6
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)	7
Cost of sales	4,940	Sales	5,000
Result	60		

Adjustment (c) 8

For this first half-year, company A makes a statutory profit of 60 and, being 9
consolidated at 80% by the global integration method, $12 = 20\% * 60$ is a
part of the profit that belongs to 3rd Parties.

Adjustment (d) 10

We also notice that company A making a 12 months profit of 100 and a first 11
half-year profit of 60, the second half-year profit is 40 which has to be
valuated at 40% as "Profit EM" account, so $16 = 40\% * 40$.

The amount of 40 initially calculated must be reduced by 24. 12

These three adjustments are just reclassifications between P&L accounts. The 13
balance sheet needs no adjustments.