

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).

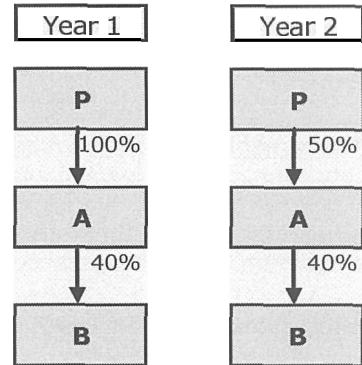
3.2 Disposal of a subgroup

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	1,000
		Reserves	500
Tangible assets	1,000	(c)	500
(c)	500	(d)	(50)
(d)	(100)	Result	200
		(d)	(50)
Other assets	1,500	Other liabilities	1,300
		B	
		Capital	1,000
		Reserves	500
		Result	200
Other assets	2,000	Other liabilities	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
Tangible assets	625	Reserves	1,076
Equity value (B)	400	Result	(84)
Other assets	3,850	Conso. Res.(A)	155
		Conso. Res.(B)	150
		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.