The adjustment – Year 2 [1]

Here is the consolidation adjustment to book in P accounts of Year **2.** [2]

	Debit	Credit	[3]
Financial income (dividends)	8		
Resewes		8	

Taking advantage of this transaction concerning dividends, we would like to [4] 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 [5]

Let's go back to the statutory accounts [6]

P (Year 1)				[7]	A (Year 1)				[8]
Fin. Invest./A	80	Capital	200				Capital	100	
		Reserves	100				Reserves	50	
		Result	30				Result	20	
Other assets	420	Other liabilities	170		Other assets	400	Other liabilities	230	

which do not include adjustments. [9]

Based on the global integration method, here is the consolidated balance [10] sheet

P + A (Year 1)			[11]
		Capital	200
		Reserves	100
		Result	30
		Conso. Reserves (A)	56
		Minor. Interests (A)	34
Other assets	820	Other liabilities	400

in which [12]

- Consolidated reserves = **56** = 80% * [100 **+** 50 **+** 20] – **80** [13]

- Minority interests = **34** = 20% * [100 **+** 50 **+** 20]

other assets and other liabilities being just the addition of the corresponding A [14] and P accounts.

Consolidation of Year 2 [1]

This time we consolidate adjusted accounts for P as follows [2]

[3]

P (Year 2)		
Fin. Invest./A	80	Capital	200
		Reserves	115
		(a)	*8*
		Result	45
		(a)	*(8)*
Other assets	530	Other liabilities	250

[4]

A (Year 2)		
		Capital	100
		Reserves	60
		Result	30
Other assets	540	Other liabilities	350

which give, after global integration again, the following consolidated balance sheet [5]

[6]

P + A (Year 2)		
	Capital	200
	Reserves	123
	Result	37
	Conso. Reserves (A)	72
	Minor. Interests (A)	38
Other assets	1,070	Other liabilities	600

where [7]

[8]

- 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 [9]

One difficult issue while processing a consolation is to validate that equity, [10] 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. [11]

[12]

	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

The number of lines of this report is the number of companies in the consolidation scope. 1

Column (1) contains the contribution of each company in the Year 1 consolidated reserves. 2

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). 3

Column (3) shows the group part of dividends paid by each company (A pays a group dividend of 8) 4

Column (4) shows the part of dividends received from group companies (P receive a group dividends of 8) 5

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. 6

Column (6) is similar to Column (1), but for Year 2 7

At this stage, we make the following checks: 8

- 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. 9

- 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. 10

Justification of minority interests evolution 11

The same question arises for the Minority interests evolution which is summarized in another report, different from the previous one, as follows 12

	Year **1** Minor. Int.	Year 2 Result	Divid. (–) paid	Divid. (+)	Year 2 Minor. Int.	
Company A	34	6	(2)		38	1

The principles are quite similar. 2

On each line appear companies for which there are minority interests. 3

Column (1) contains the contribution of each company in the Year **1** Minority 4
interests.

Column (2) shows the minority result of each company (6 = 20% * 30) 5

Column (3) shows the dividends paid by A to the 3rd Parties (20% * 10) 6

Column (4) is not used for our example, but **it** could be used for more 7
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 8
equal to the Year 2 Minority interests.

We will come back later with a deeper approach about this methodology in a 9
specific chapter.

8.8 Elimination of dividends paid by a foreign company 10

The situation 11

The situation is similar to the previous one, except for company A whose 12
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 13
shareholders while P pays a gross dividend of 150 EUR.

Why is this situation different from the previous one with a classical dividend ? 14

The amount of 100 CUR was part of the economical profit of A in Year **1** 15
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

(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.

Adjustment (3) reclassifies 40 to translation adjustment because profit must 1 be translated at average rate 1.3 instead of closing rate 1.5.

Currency conversion of company A accounts – Year 2 2

A (Year 2)			3
	Capital	1,000	
	Reserves	600	
	Result	300	
Other assets	5,400	Other liabilities 3,500	

A (Year 2) in EUR			4
	Capital	1,600	
	(4)	(400)	
	Reserves	960	
	(5)	(280)	
	Result	480	
	(6)	(60)	
	Trans. Adj.		
	(4)	400	
	(5)	280	
	(6)	60	
Other assets	8,640	Other liabilities 5,600	

After translation of the whole balance sheet at closing rate 1.6, we adjust 5 equity accounts as follows

Adjustment (4) reclassifies 400 to translation adjustment because historical 6 rate for this account is 1.2 instead of 1.6.

Adjustment (5) reclassifies 280 to translation adjustment because the amount 7 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 8 be translated at average rate 1.4 instead of closing rate 1.6.

Consolidation of Year 1 9

Here are the parent statutory company accounts and the consolidated 10 accounts

P (Year 1)			11
Fin. Invest./A	800	Capital	2,000
		Reserves	1,000
		Result	300
Other assets	4,200	Other liabilities	1,700

DIRECT CONSOLIDATION

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

1

where 2

- Consolidated Reserves (A) = 808 = 80% * [1500 + (300) + 750 + 3 (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 4 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. 5

Consolidation of Year 2 6

With the same arguments as for the classical dividend seen in previous 7 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 CUR * 1.3 = 104 EUR.

But P has received an amount of dividend of 110 EUR as mentioned initially. 8 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 9

	Debit	Credit
Financial income (dividends)	110	
Exchange gain		6
Reserves		104

10

and we can see that we eliminate the 110 from the Financial income but we 11 reclassify 6 on the Exchange gain, corresponding to a correct view for

consolidation. Reserves are impacted only by the dividend amount valuated at average rate of Year **1**. [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. [2]

Let's now consider parent statutory accounts and the consolidated accounts, including that adjustment. [3]

[4]

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

[5]

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 [6]

- Consolidated Reserves (A) = 1040 = 80% * [1600 + (400) + 960 + (280) + 480 + (60)] - 800 [7]

- 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 [8]

Let's check if consolidated reserves evolution can be justified in an accounting way by using the same report as for the classical dividend. [9]

	Year 1 Reserves	Year 2 Result	Divid, (-)	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 1

Column (5) is the contribution in the translation adjustments variation 2 between Year **1** and Year 2 for 40 = 20% * [[400 $+$ 280 $+$ 60] – [300 $+$ 200 $+$ 40]].

8.9   Elimination of interim dividends 3

The situation 4

Interim dividend is a dividend decided during the current year instead of a 5 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 6 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 7 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' 8 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 9 on how to book that interim dividend in both company A accounts and shareholders' accounts.

We suppose interim dividends are paid 10

Here are the accounts of company A owned by parent company P with a 11 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.