K.T.S.P. Mandal's

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Second Year B.Com

IVth – Sem (CBCS 2019 Pattern)
As per the new Syllabus

Subject – Corporate Accounting

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Topic 1 – Holding Company Account

- **HOLDING COMPANY -**

As per Section 2(46) of the Companies Act, 2013 “holding company”, in relation to one or more other companies, means a company of which such companies are subsidiary companies;

- **SUBSIDIARY COMPANY -**

As per Section 2(87) of the Companies Act, 2013 “subsidiary company” or “subsidiary”, in relation to any other company (that is to say the holding company), means a company in which the holding company–

(i) controls the composition of the Board of Directors; or

(ii) exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies.

- **SOME DECISIONS OF CASES –**

• A holding company is not liable for provident dues of a Subsidiary Company.

• Workmen of subsidiary Company are not workmen of Holding Company.

• It was held that holding company is not liable for wages of its Subsidiary Company which was under winding up.

• A Holding Company can’t be penalized for violation of foreign exchange provisions of Subsidiary Company

• Holding and Subsidiary Companies are independent legal entities, and are to be treated as such.

These can’t be treated as one single unit for all purposes.

• Holding and Subsidiary are separate and distinct legal entities.

- **SHARE-HOLDING OF HOLDING COMPANY BY SUBSIDIARY COMPANY**

A Holding Company can and does hold shares of subsidiary, but a subsidiary can’t hold shares in its holding company. Share allotment made to subsidiary is void.

This restriction applies even if shares are held by nominee of subsidiary Company and not by the subsidiary company itself.

However there are certain cases, subsidiary can be member of its holding Company:-

a) When subsidiary is a legal representative of deceased member of holding Company.

b) When subsidiary is concerned in shares as trustee.

c) Investment held before the Company became subsidiary can continue, but in that case, subsidiary has no voting right in holding Company.

- **Associate company –**

Associate Company, in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company. The purport of significant influence has been clarified in the explanation as control of at least twenty per cent of total share capital, or of business decisions under an agreement. In the case of joint ventures it is always by way an agreement significant influence is used but not necessarily by control over share capital. The meaning of significant influence is in line with AS18.

- **Wholly Owned Subsidiary Company –**

A company in which all the shares with voting rights (i.e. 100%) are owned by the holding company, it is said to be a wholly owned subsidiary company.

- **Partly Owned Subsidiary Company** –

A company in which only the majority of shares (more than 50%) are owned by the holding company, it is said to be a party owned subsidiary

- **Minority Shareholder -**

Small Shareholder: A shareholder who is holding shares of nominal value of INR 20,000 or such other sum as may be prescribed. Minority Shareholder: Equity holder of a firm who does not have the voting control of the firm, by virtue of his or her below fifty percent ownership of the firm's equity capital

- **LEGAL REQUIREMENTS FOR A HOLDING COMPANY –**

Section 129 of the Companies Act, 2013 stipulates that the balance sheet of a holding company has to be accompanied by the below-mentioned documents of relating to each of its subsidiaries:

1. A copy of the Balance Sheet of the subsidiary
2. A copy of the P&L A/c of the subsidiary company
3. A copy of the report of its Board of Directors
4. A copy of the report of its auditors
5. A statement containing the following particulars:

    (i) The nature and extent of holding companies interest in the subsidiary at the end of the last financial year

(ii) The net aggregate amount of profits or losses in the subsidiary so far as it concerns the members of the holding company and is not dealt within the holding company's accounts.

6. If the financial year of the holding company and its subsidiary company coincide with each other subsidiary company's balance sheet and other documents specified above with respect to the same financial year should be attached to the balance sheet of the holding company.

- **CONSOLIDATED FINANCIAL STATEMENTS –**

Consolidated financial statements means the preparation and presentation of profit and loss account and balance sheet of a holding company and its subsidiaries in a single format. According to the companies and, there is not legal provision insisting a holding company to prepare and present 'Group Accounts' consolidated financial statements. Even though there is no statutory provision for a holding company a prepare consolidated financial statements, the ICAI has issued AS-21 on 'consolidated financial statements'. It is not mandatory. The main purpose of the preparation of consolidated statements is to reflect a true and fair view of the position and the profit or loss of the holding company 'group'.

The advantages of consolidation of financial statements are as follows :

1. **Facilitates easy comprehension:**
   Shareholders are in a position to get a clear insight about the financial position of the group (parent and all its subsidiaries)
2. **Assists in ascertaining intrinsic value of share:**
   For various accounting procedures, intrinsic value of shares serve as an essential tool. This can be attained on the basis of consolidated financial statements of companies.
3. **Proper assessment of return on investment:**
   Only consolidated financial statements can provide proper information on the total share of holding company in the revenue profit of its subsidiaries.
4. **Minority interest disclosure:**
   In the consolidated balance sheets, the item shown under the head 'Minority Interest' discloses the total amount payable to outside shareholders. This is liability payable to outsiders, i.e., general public. This factor is the main factor to be considered in the process of acquisition of company.
5. **Helps in the "evaluation" of holding company:**
   As consolidated financial statements reflect a true an fair view of the position of the holding company (parent) as a group, the investors may be able to evaluate the performance of the company. Thereby, it enhances the overall performance of the group.

- **Contents and Format of Consolidated Balance Sheet –**

Section 129 (Clause 3) of the Companies Act, 2013 mandated the companies having one or more subsidiaries, to prepare Consolidated Financial Statements. According to this section, where a company has one or more subsidiaries, it shall, in addition to separate financial statements will prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own.

The Schedule III of the Companies Act, 2013, provides certain general instructions for the preparation of consolidated financial statements.

1. Accordingly, where a company is required to prepare Consolidated Financial Statements, i.e., consolidated balance sheet and consolidated statement of profit and loss, the company shall mutatis mutandis follow the requirements of Schedule III of the Companies Act, 2013, as applicable to a company in the preparation of balance sheet and statement of profit and loss. In addition, the consolidated financial statements shall disclose the information as per the requirements specified in the applicable Accounting Standards including the following:
   - (i) Profit or loss attributable to “minority interest” and to owners of the parent in the statement of profit and loss shall be presented as allocation for the period.
   - (ii) “Minority interests” in the balance sheet within equity shall be presented separately from the equity of the owners of the parent.

Format

Consolidated Balance Sheet

Of

Holding Company and its Subsidiaries as on …….

Format of Consolidated Balance Sheet		
EQUITY AND LIABILITIES	Amount	Amount
SHAREHOLDER’S FUND		xx
a) Share Capital (Holding Company)		
b) Reserves & Surplus		
i) General Reserve (Holding Co.)		
ii) Capital Reserve (Holding Co.) Add: Capital Reserve from Acquisition		
iii) Surplus Surplus of Holding Co. Add: Share in revenue profits of Subsidiary Co. Less: Unrealized Profits		
2. Non-current liabilities		
a) Minority Interest		
b) Holding Co. Subsidiary Co.		
3. Current liabilities		
Holding Co. Subsidiary Co.		

Less: Inter Co. or mutual Owings		
Total		xx
ASSETS		
1. Non-current assets		
a) Fixed Assets:		
i) Tangible assets Holding Co. Subsidiary Co.		
ii) Intangible assets:		
a) Goodwill or Cost of Control: Holding Co. Subsidiary Co. b) Goodwill resulting from acquisition		
b) Non-Current Investment		
Holding Co. (except investment in shares of subsidiary Co.)		
2. Current assets		
Holding Co. Subsidiary Co. Less: Inter Company or Mutual Owings		
Total		

- **Minority Interest –**

Minority interest is that part of the net results of operations and of net assets of a subsidiary attributable to interests which are not owned, directly or indirectly through subsidiaries, by the holding (parent) company. In short, minority interest represents the claims of the outside shareholders of a subsidiary. Minority interests in the net income of consolidated subsidiaries for the reporting period are identified and adjusted against the income of the group in order to arrive at the net income attributable to the shareholders of the holding company

Objectives:

1. The objective of the policy is to protect the rights of the minority shareholders and keep them updated about their rights from time to time.

2. To check that the Shareholder Relationship Committee is redressing the grievance of the minority shareholders.

As per para 13(e) of AS 21, minority interests in the net assets of consolidated subsidiaries should be identified and presented in the consolidated balance sheet separately from liabilities and the equity of the parent’s shareholders. Minority interests in the net assets consist of:

(i) the amount of equity attributable to minorities at the date on which investment in a subsidiary is made; and

(ii) the minorities share of movements in equity since the date the parent subsidiary relationship came in existence.

Minority interest may be computed as follows:

Minority Interest = Share Capital of subsidiary related to outsiders + Minority interest in reserves and profits of subsidiary company

- **Consolidated Profit & Loss Account –**

While preparing the Consolidated Profit and Loss Account of the holding company and its subsidiary, the items appearing in the Profit and Loss Account of the holding and subsidiary companies have to be aggregated. But in doing so, the following adjustments have to be made:

(i) Transfer of goods between the holding company and the subsidiary company should be eliminated both from the purchases and sales appearing in the Consolidated Profit and Loss Account.

(ii) Stock Reserve for unrealised profit in respect of inter-company transactions should be created by debiting Consolidated Profit and Loss Account and crediting Stock Reserve Account.

(iii) The share of profits of the subsidiary company arising before the date of acquisition of shares by the holding company that belongs to the holding company will be debited to the Consolidated Profit and Loss Account and credited to Capital Reserve or Goodwill Account as the case may be. In case of loss the entry will be just reversed.

(iv) The share of profits or losses belonging to the minority shareholders will be respectively credited or debited to Minority Interest Account.

(v) Dividends received from the subsidiary company by the holding company should be eliminated from both the sides of the Consolidated Profit and Loss Account.

(vi) Care should be taken to see that both the companies pass entries for interest accrued and outstanding on debentures of the subsidiary company held by the holding company. The debenture interest should be eliminated from both the sides of the Consolidated Profit and Loss Account to the extent to which it relates to the debentures held by the holding company.

(vii) If the subsidiary company has passed entries for proposed dividend and the holding company has taken credit for its shares of the dividends, the holding company's share should be eliminated from both the sides of the Consolidated Profit and Loss Statement. The necessary changes should also be made on both the sides of the Consolidated Balance Sheet. However, if the holding company has not passed entries for proposed dividends of the subsidiary company, the debit in respect of the proposed dividend should be reduced by the holding company's share in such proposed dividend and obviously, the liability in respect of proposed dividend in the Consolidated Balance Sheet should also be reduced.

(viii) If there are profits and the dividends on cumulative preference shares are in arrears, the arrears of dividends on preference shares held by the Minority shareholders should be debited to the Consolidated Profit and Loss Account and credited to Minority Interest Account.

(ix) If fixed assets of the subsidiary company are revalued at the time of acquisition of shares by the holding company without any alteration in book-values, the excess or short depreciation should be adjusted by debiting or crediting the Consolidated Profit and Loss Account and crediting or debiting the respective Asset Account.

(x) The minority interest will consist of its proportion of total profits after adjustment of excess or short depreciation due to over or under valuation of fixed assets, but before adjusting the proportionate unrealised profit on stock.

- **Cost of Control (or) Goodwill –**

A general, the shares of a subsidiary company are purchased either as a premium or at a discount by a holding company. When the share capital of the subsidiary company held by the holding company is cancelled against investment in share (cost), difference will arise.

1. When the holding company purchases the shares at a price above the nominal value, the excess price paid represents cost of control or goodwill.

   It may be said that "cost of control" is the "excess" paid by the holding company to acquire "Controlling Interest" in the subsidiary company.

   This may be presented in the form of equation as :

Cost of control or goodwill = Investment (at cost) – Face or paid-up value of shares purchased

2. When the holding company purchases shares at a price below the face value, the difference represents ‘capital reserve’. This may be presented in the form of equation as :

   Capital reserve = Face or paid-up value of shares purchased – Investment at cost

Method of ascertaining cost of control (or) reserve :

	Rs.
Step 1 : Amount paid for shares purchased (by the holding company in a subsidiary) …	xx
Add : Holding Company’s Share of Capital Loss	xx
Less :	
(i) Face Value of Shares	
(ii) Holding company’s share of capital loss	
(iii) Holding company’s share of bonus shares issued by subsidiary	
(iv) Holding company’s share of dividend paid out of capital profit	
Step 4 : Goodwill (or) capital reserve :	xx

- **Pre-acquisition Profits/Reserves -**

  The subsidiary company, on the date of acquisition of shares by the holding company, is having balances at the profit and loss and reserves accounts. The holding company not only purchase shares but also entitled to purchase a certain proportion of profit and reserves. Such accumulated profits of the subsidiary company existing on the date of acquisition are known as ‘pre-acquisition profits’ or ‘capital profits’. They include capital reserve, general reserve, share premium, P& L A/c.

  For calculation the share of the holding company, reserves and profits are split into the following :

  1. Pre-acquisition profits / reserve

  (i) Pre-acquisition profits:

Treatment: They are treated as capital profits. They are to be included in capital reserves and adjusted against goodwill.

(ii) Pre-acquisition reserves:

Treatment: Same as pre-acquisition profit

2. Post-acquisition profit/reserve

(i) Post-acquisition profits:

Treatment: They are treated as revenue profits. They are to be added to the surplus or profits of the company.

(iii) Post-acquisition reserves. They are to be added to general reserves.

- **Inter-Company Transactions (Elimination of Common Transactions or Mutual Obligation or Mutual Indebtedness) –**

The companies in a group, i.e. the holding company and the subsidiary company, may trade each other. They owe money to each other on account of common transactions like buying and selling of goods, lending and borrowing of money, rendering service to each other and the like. This will culminate in common accounts appearing in the balance sheets of holding company as well as its subsidiaries. While preparing consolidated balance sheet, all such mutual obligations should be eliminated. For example :

Debtors and creditors

Bill Receivables and Bills Payables

Loan Payable and Receivable

- **Revaluation of Assets –**

When a holding company acquires shares in a subsidiary company, fixed assets of subsidiary company are valued in order to assess its correct value of shares. Any profit or loss on revaluation of assets has to be shown in the consolidated balance sheet.

• Any increase in the value of any fixed assets is to be treated as capital profits, whether it is in pre-or post-acquisition period.

• Such capital profits will be apportioned between capital reserve and minority interests.

• The proportion of increase of the holding company is to be taken to investment account. This will reduce the cost of control/goodwill.

• In case, any decrease in the value of fixed assets is to be treated as capital loss. This will increase the cost of control/goodwill or reduce the capital reserve. But, it is a revenue loss, if the revaluation occurs in the post-acquisition period.

- Adjustment for depreciation.

(i) If the value of fixed assets increases (revaluation profit), depreciation charge also will be increased accordingly. This is to be deducted from the revenue profits of the subsidiary company.

(ii) If the value of fixed assets decreases, depreciation will also be decreased proportionately. This is to be added to the revenue profits of the subsidiary company.

- **Goodwill (Goodwill Appearing in the Balance Sheet of Subsidiary Company) –**

If, the goodwill is shown in the balance sheet of the subsidiary company. That means goodwill already exists.

Accounting Treatment :

Approach I: Add : Goodwill already appearing in the balance sheet of subsidiary company to the goodwill and/or cost of control in the consolidated balance sheet.

Approach II: Add : Only holding company's share to the cost of control/goodwill, from the goodwill of the subsidiary company.

- **Proposed Dividend -**

The amount of proposed dividend, if any, will appear in the balance sheet of subsidiary company. In such a case, the accounting treatment will be :

(i) Such amount should be added to current year's profits of the subsidiary company.

(ii) Then, cost of control and minority interest should be determined.

(iii) Its share in the proposed dividend should be deducted from minority interest.

(iv) Finally, it should be shown as a separate item on the liability side of the consolidated balance sheet under the head ‘Provisions’.

Reference –

“The Institute of Company Secretaries of India (ICSI)”