Corporate Accounting

Unit-4

Accounts Of Holding Company

(1) What do you mean by Holding Company and Subsidiary Company?

Answer: The company acquiring the controlling interest (more than one half of the total voting power) in another company is called the Holding Company and the company in which the controlling interest is acquired is called Subsidiary company. Holding Company is also termed as parent company and both the holding company and subsidiary company together is termed as ' Group.'

According to 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.

According to Section 2 (87) of the Act has also defined the term subsidiary company or subsidiary , in relation to any other company (that is to say the holding company) . It states that Subsidiary Company is a company in which the holding company-

- **(A) controls the composition of the Board Of Directors; or**
- **(B) has control over more than one- half of the total voting power of that company.**

(2) What do you mean by Consolidated Financial Statements?

Answer: Financial Statements means Balance sheets and Statements of Profit and Loss of both holding company and its subsidiary. Therefore, consolidation of financial statements mean consolidation of Balance sheets and Statement of profit and loss of both holding company and its subsidiary.

These consolidated financial statements are intended to present financial information about a holding company and its subsidiaries as a single economic entity to show the economic resources controlled by the group , the obligations of the group and results of the group achieved with its resources.

(3) What are the need/ Objectives of preparing Consolidated Financial Statements?

Answer: Following are the need/ objectives of preparing Consolidated Financial Statements:

(a) To provide financial information about a parent and its subsidiaries as a single economic entity.
(b) To show the economic resources controlled by the group.
(c) To show the obligations of the group.
(d) To show the results the group achieved with its resources.
(e) To meet the information need of the investors for taking investment decisions.

(4) What do you mean by minority interest?

Answer: Minority interest is that part of the net results of operations and of the net assets of a subsidiary attributable to interests which are not owned , directly or indirectly through subsidiaries by the parent. Minority interest consists of:

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

(ii) the minority's share of movements in equity since the date the parent – subsidiary relation came into existence.

(5) What do you mean by equity and movements in equity?

Answer= Equity is the residual interest in the assets of an enterprise after deducting all its liabilities. In other words, equity acquired by the holding company is equal to portion of paid up capital of subsidiary held by holding company plus holding company's share in the profits and reserves of the subsidiary, or less share of pre- acquisition losses of the subsidiary , if any, on the date of acquisition of shares by the holding company.

Movement in equity means the profits earned by the subsidiary since the date, the parent- subsidiary relationship came into existence . In other words , post-acquisition profits of the subsidiary is termed as movement in equity.

(6) What are the types of holding companies? Or

Write the situations under which an enterprise can become a holding company.

Answer= Since a company may become a holding company by acquiring more than 50% of the equity shares of another company, called subsidiary , there may be 2 situations such as:

(i) Holding Company which acquires all the equity shares of another company.

(ii) Holding Company which acquires majority of the equity shares of the company.

(7) What are the types of Subsidiary company?

Answer= There are 2 types of subsidiary company:

(i) Wholly owned subsidiary company= Where all the shares of the subsidiary company is held that is owned by the holding company, such subsidiary company is termed as wholly owned subsidiary company. In such a case, all the shares of the subsidiary company are purchased by the holding company.

(ii) Partly owned subsidiary company= Where majority of the shares of the subsidiary are held that is owned by the holding company, such a subsidiary is known as partly owned subsidiary company. In such a case, some of the shares of the subsidiary are owned by persons other than the holding company. The interest of such shareholders other than the interest of the holding company is termed as ' minority interest'.

(8) What do you mean by Cost of Control?

Answer= The profit/ loss on acquisition of shares by the holding company in the subsidiary is termed as capital reserve/ goodwill or cost of control. The calculation of Capital reserve/ goodwill or cost of control is required only for the purpose of preparing the consolidated balance sheet. To calculate capital reserve/ goodwill or cost of control, the amount of cost of acquisition and the amount of interest or equity acquired by the holding company in the subsidiary is required to be ascertained and compared.

Cost of acquisition means the amount paid for acquiring the shares by the holding company in the subsidiary.

Amount of interest or equity acquired= paid up value of shares acquired + holding company's share of pre- acquisition profit—holding company's share of pre-acquisition loss.

Capital reserve= Amount of interest or equity acquired—Cost of acquisition.

Goodwill or Cost of Control= Cost of acquisition – Amount of interest or equity acquired.

In other words , if the amount of equity acquired is more than cost of acquisition, it is termed as capital reserve and if the amount of cost of acquisition is more than equity acquired , it is termed as goodwill.

(9) What do you mean by Intra-group transactions?

Answer= Both the holding company and the subsidiary company are companies having separate legal entity. Therefore, both the companies can enter into normal transactions between them . As the holding company and the subsidiary company together are considered as a group, the transactions taking place within the group are known as intra- group transactions. The following are the different types of intra- group indebtedness which require elimination while preparing CBS of holding and subsidiary company:

- **Debtors and Creditors.**
- **Bills payable and Bills receivable.**
- **Loans and advances.**

- **Debentures and investments in debentures.**
- **Interest Outstanding and accrued interest.**

(10) Write a note on treatment of Fictitious Assets of the subsidiary.

Answer= If fictitious assets such as preliminary expenses, discount on issue of shares and debentures, underwriting commission, etc. appears on the asset side of the Balance sheet of the subsidiary company, then these items are treated as under:

(i) In case of wholly owned subsidiary= The items of fictitious assets must be deducted from the capital profits, if any, before ascertaining the amount of Capital reserve/ goodwill.

(ii) In case of partly owned subsidiary= Where there is Capital profit of the subsidiary , the items of fictitious assets must be deducted from the pre-acquisition profits before allocating the same among the holding company and minority shareholders.

Where there is no pre- acquisition profit of the subsidiary, the items of fictitious assets must be deducted in the ratio of their holding from the paid up value of shares held by the holding company and minority shareholders.

(11) Write a note on treatment of Fictitious assets of the Holding Company.

Answer= If fictitious assets such as preliminary expenses, discount on issue of shares and debentures, underwriting commission ,etc. appears on the asset side of the Balance Sheet of the holding company, then these items are neither added to nor deducted from any other item, these are shown as such in the CBS.

(12) Describe the provisions of Accounting Standard -21 in relation to preparation of Consolidated Financial Statements.

Answer= Section 129(3) of the Companies Act 2013 states that where a company has one or more subsidiaries, it shall, in addition to financial statements provided under sub-section 2, prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and

manner as that of its own which shall also be laid before the AGM of the company along with the laying of its financial statement under sub-section 2:

Provided that the company shall also attach along with its financial statement, a separate statement containing the salient features of the financial statements of its subsidiary or subsidiaries in such form as may be prescribed.

Provided further that the Central Govt. may provide for the consolidation of accounts of companies in such manner as may be prescribed.

Sub section 4 also clarifies that the provisions of this Act applicable to the preparation , adoption , and audit of the financial statements of a holding company shall, mutatis , mutandis, apply to the CFS referred to in sub-section 3.

Hence, it is now mandatory on the part of a holding company to prepare CFS, Consolidated Statement of Profit and Loss and Consolidated Cash Flow Statement. It is also required to have an audit report on these CFS. It is also mandatory that the financial statements , including CFS, if any, shall be approved by the Board Of Directors before they are signed on behalf of the Board [Section 134(1)].

The following steps are taken for Consolidation as per AS-21:

(1) Elimination of investments of the Holding Company in the Subsidiaries and the share capital of subsidiaries.

(2) All the profits and reserves of the subsidiary companies will be divided between the pre and post acquisition profits on the basis of respective date of purchase of shares by the holding company.

(3) Determination of Minority interest.

(4) Presentation of minority interest in the CBS.

(5) In the CBS , the revenue profit , if any, of the holding company and the proportionate share of holding company in the revenue profits of the subsidiary company should be added and is shown under the head ' Reserve and Surplus'.

(6) Intra- company owings between holding company and subsidiary company should be eliminated.

(7) The unrealized profit resulting from intra –group transactions should be eliminated in full.

(8) Both the holding company and the subsidiary company should prepare their respective financial statements on the same reporting date and their CFSs also on the same date.

(9) Uniform accounting policies should be followed in the preparation of CFSs.

(13) What are the steps in the preparation of Consolidated Financial Statements (CFSs) as per AS-21?

Answer: Same as question number 12 (2nd Part).

(14) Write a note on treatment of Contingent Liabilities along with examples.

Answer: Contingent Liability is that liability which may or may not arise that is the company may or may not be required to make payment of such liability. Its payment depends on the occurrence of a future event which is not certain. Such a liability is shown by way of footnote in the Balance Sheet. Examples of Contingent Liabilities are:

(a) Arrears of dividend on cumulative preference shares.

(b) Claims against the company not acknowledged as debt as yet on account of certain disputes remaining pending.

Holding Company :

Section 2(46) of the Companies Act, 2013 defines Holding Company. The company is said to be the holding company if that particular company holds/owns at least 50% of the other companies and has the authority to make management decisions, influences and controls the company's board of directors. A holding company may exist for the sole purpose of controlling and managing subsidiary companies.

Subsidiary Company :

Section 2(87) of the Companies Act, 2013 defines the Subsidiary Company. The subsidiary company is the company that is controlled by the holding or parent company. It is defined as a company/body corporate where the holding company controls the composition of the Board of Directors. As per the Companies Amendment Act, 2017, Section 2(87)(ii), if the holding company have control over more than one-half of the voting power of another company, that particular company will be identified as the subsidiary company.

Advantages of holding company :

1. **Benefits of Amalgamation** : The group as a whole benefited by reaping the fruits of amalgamation keeping their separate entity and goodwill of the individual companies.
2. **Benefits of Decentralization** : By opening subsidiaries in different areas, a holding company reap the benefits of decentralization.
3. **Benefits of Monopolies** : Fruits of monopoly or near monopoly can be enjoyed without making the public aware of the existence of combination of the units.
4. **Tax benefits** : Subsidiary companies maintain their separate identities; therefore, loss can be carried forward for the income tax purpose.
5. **Effective utilization of Resources** : A holding company holding different subsidiary companies may evaluate the functions of each company and takes actions on the basis of their performance.
6. **Separate Financial accounts** : Each subsidiary company prepares separate Trading, Profit and Loss Account and Balance Sheet and ascertains its profitability or otherwise.
7. **Giving up of control** : A holding company may give up its control over the subsidiary company if it is required, by disposing off its shares.
8. **Advantages of vertical combination** : A holding company may hold different subsidiary companies, each performing functions at different stages of production and marketing and may thus derive the benefits of vertical combinations.

<u>Disadvantages of holding company :</u>

1. **Minority interest** : It is alleged that the interest of the minority shareholders is neglected by the holding company.
2. **Manipulation of accounts** : There is a possibility of fraudulent manipulation of accounts specially when the accounts of subsidiary companies are prepared at different dates.
3. **Secret reserve** : Secret reserve may be created in subsidiary companies by understatement of assets.
4. **Valuation of inter-company stocks** : Where inter company transactions are heavy and closing stock is large, problem arises in the valuation of closing stock.
5. Interlocking of loans may create problems
6. A holding company has much power without responsibility.

<u>Post acquisition profit/loss (Revenue profit) :</u> Any profit earned or loss suffered by the subsidiary company after the date of acquisition is called post acquisition profit/loss (revenue profit).

<u>Pre acquisition profit/loss (Capital profit) :</u> Profits appearing in the balance sheet on the day of purchase of shares and the profits earned by the subsidiary company up to the date of acquisition of shares by the holding company is called pre acquisition profit/loss (capital profit)

<u>Cost of control :</u> If the holding company purchases the shares of a subsidiary company at a price higher than the face value, the excess amount paid represents the payment for cost of control or goodwill.

Excess of the cost of investment over the value of proportionate net assets of subsidiary co. is known as goodwill.

Excess of the value proportionate net assets of subsidiary co. over the cost of investment is capital reserve. It is calculated in following manner.

Cost of shares held (Investment)		= *******
Less : Share capital purchased	*******	
Less : Pre acquisition profit	*******	= *******
Goodwill / Capital Reserve		= *******