Surplus or Profits of the Subsidiary Company

Like reserves, the surplus or profit of subsidiary company is also divided into two parts :

(i) the share or proportion belonging to outsiders is to be included in Minority Interest Account; and

(ii) the proportion. belonging to the holding company is further split .up as under:

  (a) Pre-acquisition profits are treated as capital profits and included in the capital reserves to be adjusted against Goodwill, if any;

  (b) Post-acquisition profits are treated as revenue profits and added to the surplus or profits of holding company.

General Rules

(1) The balance in the general reserve account and surplus account of the subsidiary company appearing at the date of acquisition of shares by holding company in its balance sheet will be regarded as capital profit/ reserves, as the case may be by the holding company.

(2) Capital reserve of holding company should be adjusted with Goodwill, if any, for the simple reason that both capital reserve and goodwill should not be shown simultaneously in the balance sheet.

(3) There is no need to make a distinction between pre-and-post acquisition profits/reserves while calculating the share of the minority interest. For minority interest, this distinction is superficial since they were already members of the company when the holding company acquires control and the surplus in the profit and loss statement and reserves accounts are accumulated from the operating profits so far the outsiders are concerned.

Very Imp!

Illustration 5 1. (Pre-Acquisition Surplus or Profit and Reserves)

From the following information prepare a consolidated balance sheet as on 31 March 2013 :

Equity and Liabilities	H. Ltd. ₹	S. Ltd ₹	*Assets*	H. Ltd. ₹	S. Ltd. ₹
Share Capital (in shares of ₹ 20 each)	2,00,000	1,00,000	Sundry Assets	2,20,000	1,50,000
Reserves	60,000	20,000	Investment in 3,000 shares of S. Ltd.	90,000	
Surplus	20,000	10,000			
Creditors	30,000	20,000			
	3,10,000	1,50,000		3,10,000	3,10,000

H. Ltd acquired its shares in S. Ltd. on 1 April 2012 when S. Ltd.'s reserves stood at ₹ 5,000 and its surplus at ₹ 6,000.

Solution

(1) **H. Ltd.'s share in the Capital Profit and Reserves**

As H. Ltd. acquired control on 1 April 2012, the balances in the reserves and profit and loss accounts on this date are in the nature of capital profits, not available to the shareholders of H. Ltd. for dividend distribution. The ratio of equity acquired and

Regarding minority interest, there is no need for distinction between pre-and-post acquisition losses. The outsiders would *have* to bear their share in losses of the subsidiary company and the same would be deducted from the minority interest.

Very Imp

Illustration 7 (Pre-acquisition loss)

The extracts of balance sheets of H. Ltd., and its subsidiary S. Ltd., as on 31 March 2013, were as follows:

Equity and Liabilities	H. Ltd. ₹	S. Ltd ₹	*Assets*	H. Ltd. ₹	S. Ltd. ₹
Share Capital (shares of ₹ 1 each)	10,000	6,000	Sundry Assets	16,000	10,000
General Reserve	4,000	-	Investments :4,000		
Surplus	4,000	1,800	Shares in S. Ltd.	4,000	—
Creditors	2,000	2,200			
	20,000	10,000		20,000	10,000

The shares were purchased by H. Ltd. in S. Ltd. on 30 September 2012.

On 1 April 2012 the profit and loss statement of S. Ltd. showed a loss of ₹ 3,000 which was written off from out of the profits earned during the year. Profits are earned uniformly over the year 2012-13. Prepare a consolidated balance sheet of H. Ltd. and S. Ltd. as on 31 March 2013 giving all workings. **[B. Com. (Hons.) Delhi, Modified]**

Solution

		₹
Imp (1)	**H. Ltd.'s Share in Pre-acquisition Loss**	
	Total Pre-acquisition Loss	3,000
	H. Ltd.'s share 2/3 of ₹ 3,000	2,000
	Pre-acquisition loss of ₹ 2,000 is a capital loss for H. Ltd. and it would be either added to the cost of control or deducted from the capital reserve.	
Imp (2)	**H. Ltd.'s Share in Post-acquisition Profits**	
	Surplus in the Profit and Loss Statement	1,800
	Add: Pre-acquisition losses written off	3,000
	Total Profits for 2012-13	4,800
	Profit between 1 October 2012 to 31 March 2013	
	1/2 of ₹ 4,800	2,400
	H. Ltd. share 2/3 of ₹ 2,400	1,600
Imp (3)	**H. Ltd.'s Share of Capital Profits**	
	Pre-acquisition profits i.e., from 1.04.2012 to 30.09.2012 :1/2 of ₹ 4,800	2,400
	H. Ltd.'s share 2/3 of ₹ 2,400	1,600
	The Pre-acquisition profit of ₹ 1,600 would be used either to reduce the goodwill or increase the capital reserve	
Imp (4)	**Cost of Control or Goodwill**	
	Investment in the shares of S. Ltd.	4,000
	Less: Paid up value of the shares held	4,000
	Cost of control or Goodwill	—

Example

H. Ltd. has sold goods for ₹ 60,000 to S. Ltd. at profit of 25% on selling price. ₹ 20,000 goods are still lying with S. Ltd. Stock of H. Ltd. includes ₹ 12,000 goods purchased from S. Ltd., which made a profit of 20% on cost. H. Ltd., holds 60% shares of S. Ltd. Now H. Ltd. made ₹ 5,000 (**1/4 of ₹ 20,000**) profit on the stock remaining unsold with S. Ltd. ₹ 5,000 would be deducted from the profit of H. Ltd., and from stock of S. Ltd. Stock of H. Ltd., includes ₹ 12,000 stock purchased from S. Ltd., which has made profit thereon to the extent of ₹ 12,000 x 1/6 (as 1/ 5 Cost = 1/6 S.P.) i.e. ₹ 2,000. Accounting Standard (AS)-21, issued by Institute of Chartered Accountants of India recommends that full provision of the unrealised profit should be made in the profit and loss statement of holding company as profit will be deducted from H. Ltd.' S., share of profit in S. Ltd., stock of H. Ltd., in the consolidated balance sheet.

3 Very Imp.

Illustration 9 (Unrealised Profit on Stock)

A Ltd., acquires all the shares in B. Ltd., at cost of ₹ 1,05,000 on 1 April 2012. The extracts of balance sheets of two companies on 31 March 2013 were as follows:

Equity and Liabilities	A. Ltd. ₹	B. Ltd ₹	*Assets*	A. Ltd. ₹	B. Ltd. ₹
Share Capital :			Fixed Assets :		
Shares of ₹ 10 each	3,00,000	45,000	Freehold Promises	1,65,000	28,000
Reserves & Surplus :			Machinery	70,000	26,000
General Reserve			Investments:		
(1-4-2012)	1,00,000	2,000	Shares in Subsidiary Co.	1,05,000	
Surplus	90,000	36,000	Current Assets :		
Current Liabilities :			Stock	62,000	18,000
Creditors	10,000	14,000	Debtors	35,000	14,000
			Cash	63,000	11,000
	5,00,000	97,000		5,00,000	97,000

(i) The creditors of A Ltd., include ₹ 5,000 due to B Ltd., for purchases on which the latter company made a profit of ₹ 1,000.

(ii) The stock of A. Ltd., includes ₹ 3,000 of the above purchases from B Ltd. Make necessary adjustments and show a consolidated balance sheet as on 31.03-2013.

Solution

	₹
(1) Cost of Control or Goodwill	
Cost of investment in shares of B Ltd.	1,05,000
Less: Nominal value of the equity held	45,000
	60,000
Less: Capital reserve, being the pre-acquisition reserves	2,000
	58,000

(2) Calculation of Unrealised Profit on Stock

Profit made on ₹ 5,000 is ₹ 1,000 (i.e. 20%)

Profit made on unsold stock of ₹ 3,000 would be :

$$\frac{1,000}{5,000} \times 3,000 = ₹\ 600 \text{ (i.e., 20\% of ₹ 3,000)}$$