Basic Rules for Preparing a Consolidated balance Sheet.

Rule 1: Cancellation Investment and Share Capital

The Investment in Subsidiary Company by the holding company, appearing on the asset side of the B/S of the holding company, should cancel out the corresponding Share Capital of the subsidiary Company.

Rule 2: Minority Interest Calculation.

When the holding company acquires more than half but less than all shares of the subsidiary company, those shareholders who have a minority share are referred to as Minority Shareholders.
Minority interest is the proportion of the subsidiary company's net assets/shareholders' fund, which belongs to the minority shareholders. It should be shown separately in Consolidated B/S.

Minority Interest = Face value of share capital + Share of pre acquisition reserves + Share of pre acquisition P/L + Share of post acquisition reserves + Share of post acquisition P/L

Rule 3: Goodwill on Consolidation.

Cost of Investment in the books of Holding Company - receipt of dividend from subsidiary company from pre acquisition profit– Share of pre-acquisition Profit of subsidiary company - Share of pre-acquisition Reserve of subsidiary company – Face value of shares of subsidiary company held by holding company >0, the amount is goodwill which will appear in Consolidated B/S.

Rule 4: Capital Reserve on Consolidation.

Cost of Investment in the books of Holding Company- receipt of dividend from subsidiary company from pre acquisition profit – Share of pre-acquisition Profit of subsidiary company - Share of pre-acquisition Reserve of subsidiary company – Face value of shares of subsidiary company held by holding company < 0, the amount is Capital Reserve which will appear in Consolidated B/S.

Rule 5: Cancellation of Inter Company Debts and Acceptances

If holding and subsidiary companies have business dealings with each other then there may be possibility of mutually exclusive items called Inter-company items. Say for example H company sales Rs.10000 to its subsidiary S on credit. Then in H company's book there will be a Debtor amounting Rs.10000 and simultaneously in S's book there will be a creditor amounting Rs.10000.

These inter-company items, during consolidation shall be cancelled out in consolidated B/S.

e.g. Debtors canceling creditors and vice versa; O/S Bills Receivable canceling O/S Bills Payable, inter company Loans and Advances etc.

But if some of the Bills receivables are discounted then corresponding amount of BR will be no longer O/S even though Bills payable remain. Such types of Bills payable are not inter company cancelable items.

Another problem under this item may be the mismatch of current accounts maintained by H and S meant for recording transactions between each other. Suppose H paid Rs.500 to S and recorded in its books as

Current Account with S…….Dr	Rs.500	
To Cash		Rs.500

But say S did not receive this Rs.500 till the date of consolidation.
At the time of consolidation Current Account with S will appear in B/S of H and no entry under S's books. So consolidated B/S should show an item named "Cash in Transit" amounting Rs.500.

If say out of Rs.500 S received Rs.200. So S recorded the transaction as

Cash……..Dr	Rs.200	
To Current Account with H		Rs.200

At consolidation both the current accounts are required to be cancelled and the difference amount Rs.300 will appear under asset side of the consolidated balance sheet as "Cash in transit" amounting Rs.300.

Rule 6: Reserves and Surplus under Consolidated B/S.

Reserves and Surplus under Consolidated B/S should contain = Balance of Reserves and surplus of Holding company + Share of post acquisition reserves of Subsidiary to majority + Share of post acquisition profit of subsidiary to majority – unrealized profit on unsold stock.

Rule 7: Unrealized profit on unsold stock.

H Company sold Stock-costing Rs.10000 to S. The profit charged is @20% on cost. So in S company's books it will be recoded at Rs(10000+2000) = Rs.12000.

At the time of consolidation the position of H and S is say:

H	S
Stock Rs.50000	Stock Rs.30000

Stock amounting Rs.30000 of S includes Rs.12000, purchased from H. In consolidated B/S Stock will be Rs.50000+ Rs.30000 = Rs.80000 – Rs.2000 = Rs.78000. Actual journal entry will be

Profit and loss A/C……..Dr Rs.2000
To Stock A/C……..Rs.2000

So Consolidated Reserves and Surplus (Refer Rule: 6) there is an item of unrealized profit and stock in CB is simultaneously reduced.

Suppose at the time of consolidation Rs.30000 includes only 80% of the stock purchased from H and balance 20% was already sold. Then unrealized profit will be 80% of Rs.2000 = Rs.1600.

Similarly unrealized profit on sale of fixed asset between H and S will be treated.

Rule 8: Profit on Revaluation of assets of Subsidiary.

If at the time of acquisition assets of S is revalued the entry in S's books will be:

a) For revaluation profit-

Assets A/C……..Dr
To Profit and Loss A/C

b) For revaluation loss-

Profit and Loss A/C…….Dr
To Assets

This revaluation profit or loss will be considered as preaquisition profit or loss and accordingly will be treated as per rule 2,3 and 4.

Now if the assets are revalued Depreciation also will get changed. Excess or deficit depreciation is to adjust from the post acquisition Profit and Loss of Subsidiary company.

Rule 8: Issue Bonus Shares

When bonus shares are issued by S journal entry in the books of S will be

Profit and Loss A/C…….Dr
To Share capital A/c

Now Profit charged above is say Pre-acquisition profit.

Then effect will be:

Refer Rule 2, 3, and 4- Face value of the shares held will be increased and share of pre acquisition of profit will be correspondingly reduced. So net effect will be zero.
But if Profit charged above is say Post-acquisition profit.

Then effect will be:

Refer Rule 2- Face value of the shares will increase and share of post acquisition profit will be correspondingly decreased. Net effect zero.

Refer Rule 3- Face value of the shares will increase and share of post acquisition profit will be correspondingly decreased. Amount of goodwill will be decreased. Amount of Consolidated reserves and surplus as per rule 6 will be decreased.

Refer Rule 3- Face value of the shares will increase and share of post acquisition profit will be correspondingly decreased. Amount of Capital reserve will be increased (as it is negative). Amount of Consolidated reserves and surplus as per rule 6 will be decreased.

Rule 9: Inter company Dividends paid

If S declares dividend out of pre acquisition profit, on receipt it should be recorded by H's majority as

Bank A/C……..Dr
  To Investment in shares of S A/C

Instead if it is recorded as

Bank A/C……..Dr
  To P/L A/C of H

Then it's a wrong and at the time of consolidation a rectifying entry is required as follows:

P/L A/C of H……..Dr
  To Investment in shares of S A/C and accordingly Rule 3,4 and 6 will be adjusted.

If no mistake is done then no rectification is required.

In case S declares dividend out of post acquisition profit, on receipt it should be recorded by H's majority as

Bank A/C……..Dr
  To P/L A/C of H

Rule 10: Proposed Dividends

When a dividend is proposed by H entry will be
P/L A/C……..Dr
  To Proposed Dividend A/C

This proposed dividend is to be shown as current liability of C/B. Before consolidation if proposed dividend already appears then above journal entry is no more required. Only proposed Dividend appearing in individual B/S will be shown also in C/B.

When a dividend is proposed by S entry will be
P/L A/C……..Dr
  To Proposed Dividend A/C

This charging of P/L will be Post acquisition. This means if proposed dividend does not appear in the pre-consolidation B/S of S then post acquisition profit of S will be deducted by the proposed dividend amount. Share of majority out of this will be added to "proposed dividend of H" in H's B/S and the added amount will appear in C/B as current liability. Minority's share will be added to minority interest. Rule 2 and rule 6 will be accordingly adjusted because of reduction of post acquisition profit of S due to declaration of dividend.

If proposed dividend already appears in S's Book before consolidation then it means post acquisition profit is already adjusted. So no further adjustment is required and rule 2 and rule 6 also have no effect on account of this. Proposed dividend quantum will be apportioned between majority and minority only.
