

THE ELIMINATION OF SECURITIES HELD IN THE ENTITIES WITHIN THE GROUP. ACCOUNTING APPROACH IN THE CONTEXT OF THE CONSOLIDATION OF ACCOUNTS (II)

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Abstract

The existence of groups of companies is a relatively new issue for professional accountants, the academic environment, as well as for regulatory bodies in the field of accounting in Romania. In this context, the theoretical and practical aspects of the preparation of the consolidated annual financial statements generate extensive debates among accounting specialists, in order to find practical solutions to support the understanding and correct application of accounting regulations in the field of the consolidation of accounts. In two articles, we will present the accounting treatment of the disposal of securities held, within subsidiaries, associates, as well as in jointly controlled companies, by companies that prepare consolidated annual financial statements. The issue of disposal of securities held with entities whose individual financial statements are subject to consolidation will be presented in the form of case studies, structured as follows: Elimination of securities held with affiliated entities (object of previous article); Elimination of securities held in associates and jointly controlled entities (joint ventures) - object of this article.

Key words: consolidation of accounts; removal of titles; affiliated entities; associated entities; joint venture.

JEL Classification

M41

The elimination of securities held in associated and jointly controlled entities

The consolidation of jointly controlled entities as well as associated entities is done through the equity method, so that the interest of the securities holding company in such entities is presented in the consolidated balance sheet separately under the item “*Equity securities*”.

In the case of using the equity method, for the preparation of the consolidated annual financial statements, participation interests are initially recognized at acquisition cost and, depending on post-acquisition changes in the investor's share of the net assets in which he invested, their value will be adjusted.

The share of the profit or loss of associates and jointly controlled entities, attributed to the interest in participating in these entities, is presented separately in the consolidated profit and loss account, under the item “*Profit or loss for the financial year related to associates and controlled entities in common*”.

If the equity method is applied for the first time to an associate or jointly controlled entity, that entity is presented in the consolidated balance sheet at the value of the proportion of equity of the associate or jointly controlled entity represented by that interest. The difference between the carrying amount of the securities (participation interest) held by the investor and his proportion of the consolidated entity's equity

(associated or jointly controlled) is presented separately in the consolidated balance sheet or in its explanatory notes, to the equity elements that make up this difference. That difference shall be calculated on the date on which the equity method is first applied, and where that difference cannot be identified as belonging to assets or liabilities, it shall be treated in accordance with the rules applicable to goodwill.

The case of participation interests acquired at the date of incorporation of the issuing company

Company M holds 20% of the shares of Company C, securities that were acquired at the time of the establishment of Company C, at the acquisition cost of 20,000 lei. Company M exercises a significant influence over Company C. On 31.12.N, Company M prepares consolidated accounts and Company C is retained in the consolidation perimeter.

At 31.12.N, the equity of Company C recorded the following values:

- subscribed and paid-in share capital: 100,000 lei;
- statutory reserves: 50,000 lei;
- the result of the financial year: 10,000 lei.

The determination of the share of Company M in the net assets of Company C:

Equity (net assets) Company „C”	Total	Part that belongs to Company M (20%)
Subscribed and paid-in share capital	100,000	20,000
Statutory reserves	50,000	10,000
The result of the current financial year	10,000	2,000
Total	160,000	32,000

By equivalence, at the end of year N, the securities held by the investor (Company M) in the issuing entity (Company C) will be valued in the consolidated balance sheet at a value equal to the share of Company M in the equity of Company C (32,000 lei).

a) *The equivalence of the issuing company, the disposal of the securities held and registration of the takeover of the share held by the investing company (recorded at the balance sheet level):*

<u>264</u>	=	<u>%</u>	32,000
<i>„Equivalent C titles”</i>		263	20,000
		<i>„Shares held in jointly controlled entities”</i>	
		106	10,000
		<i>„Consolidated reserves”</i>	
		121	2,000
		<i>„Consolidated result”</i>	

c) *Reflection of the share of the result of Company C that belongs to Company M (corrections at the level of “Profit and loss account”):*

<u>121</u>	=	<u>768/analytic</u>	2,000
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„Consolidated result”

„Profit for the financial year related to associated entities and jointly controlled entities”

Note: If the investing company has acquired interest in the issue at the date of incorporation of the issuing company, their acquisition cost is also fair value, and we no longer need to use “goodwill” to reflect any differences between the acquisition cost and the fair value of the investment of the respective interests of participation.

The case when the participation interests are acquired, at a date subsequent to the establishment of the issuing company, at a cost higher than the fair value of the respective securities (positive goodwill).

On 31.12 (N-1), Company M acquired 20% of the shares of Company Y, which it jointly controls with Company Z. At this date, the carrying amounts and fair values of the identifiable assets and liabilities of Company Y are equal, and the equity of Company Y has the following values:

Equity Y at (N-1)	Values
Subscribed and paid-in share capital	100,000
Reserves from re-evaluation	50,000
Statutory reserves	30,000
Total equity	180,000

The acquisition cost of the Y participation interests is 40,000 lei.

On 31.12.N, the result of Company X is 15,000 lei, and the revaluation reserves of this company increase by 10,000 lei following a revaluation operation.

On 31.12.N, Company M prepares consolidated annual financial statements, and Company Y, over which Company M exercises a significant influence, is included in the scope of consolidation.

If the participation interests are acquired at a date subsequent to the formation of the issuing company, the difference in value between the acquisition cost and the fair value, at the date of acquisition of those participation interests, will be recorded as “Goodwill - positive / negative”, according to the case.

In our example, we will consider that the positive goodwill, resulting from the equivalence of Company Y by Company M, is amortized over a period of 4 years.

a) The determination of goodwill - as the difference between the acquisition cost of the participating interests held and the value of the net assets at the acquisition date (N-1):

i) The acquisition cost of securities Y	(N-1)	40,000
Subscribed and paid-in share capital Y	100,000	
Reserves from re-evaluation Y	50,000	
Statutory reserves Y	30,000	
Net assets of company Y evaluated at fair value (on 31.12.N-1)	180,000	
ii) Share of net assets evaluated at fair value on the date of the acquisition of securities (180,000 x 20%)	36,000	36,000
iii) Goodwill (i-ii)		4,000

b) The determination of the share of Company M in the net assets of Company Y at the date of consolidation (31.12.N):

Equity (net assets)	Total	Part that belongs to company M (20%)
Subscribed and paid-in share capital	100,000	20,000
Reserves from re-evaluation (50.000+10.000)	60,000	12,000
Statutory reserves	30,000	6,000
The result of the current financial year (N)	15,000	3,000
Total	205,000	41,000

c) The equivalence of the associated entity, with the reflection of positive goodwill and equity elements, related to the values recognized after the acquisition of the securities, taken over to consolidated equity (recorded at the balance sheet level):

45.000	%	%	45,000
41.000	264	263	40,000
	“Equivalent Y titles”	“Shares held in jointly controlled entities”	
	2071	105	
4.000	“Positive Goodwill”	“Re-evaluation reserves *”	2,000
		121	
		“Consolidated result”	3,000

* The part that belongs to Company M from the reserves of Company Y, recognized after the date of acquisition of the securities ((60,000 lei-50,000 lei) x 20%).

It can be seen that in the case of the consolidation of an associate or jointly controlled entity, only the part of the equity elements obtained after the acquisition of the securities will be taken over. In our case, 20% of the revaluation differences of 10,000 lei and 20% of the profit for the current year.

d) The reflection of the share held by Company M from the result of Company Y (corrections at the level of the “Profit and Loss Account”):

121	=	768/analytic	3,000
“Consolidated result”		“Profit for the financial year related to associated entities and jointly controlled entities”	

e) Depreciation of goodwill on account of current result (4,000 lei x 1/4):

- balance sheet recording:			
121	=	2807	1,000
“Parent company profit or loss”		“Depreciation of goodwill”	
- “Profit and loss account” correction:			
6811	=	121	1,000
“Operating expenses on depreciation of fixed assets”		“Parent company profit or loss”	

Note:

The corrections at the level of the “Profit and loss account” - component of the financial statements, presented figuratively as equities, will influence the respective component according to the established model of the “Profit and loss account”:

- the elements on the right side of equality will be added to the “revenue” part;
- the elements on the left side of equality will influence the “expenditure and profit” part.

The case when the participation interests are acquired at a date subsequent to the establishment of the issuing company, and their cost is lower than the fair value at the date of acquisition of those participation interests (negative goodwill).

On December 31, 2007 (N-1) Company M acquires 30% of the securities issued by Company C. The cost of the purchased participation interests is 30,000 lei.

On 31.12.N Company M prepares consolidated annual financial statements, including in the consolidation perimeter Company C.

The equity of Company C, at the date of acquisition of the participation interests (N-1), respectively the date of inclusion in the consolidation perimeter by Company M, recorded the following values:

Equity of company C	On 31.12.N-1	On 31.12.N
Subscribed and paid-in share capital	100,000	100,000
Reserves from re-evaluation	50,000	60,000
Statutory reserves	20,000	45,000
The result of the current financial year	10,000	30,000
Reported result	0	10,000
The value of net assets	180,000	245,000

a) The determination of goodwill - as the difference between the acquisition cost of participation interests C and the share of the value of the net assets of Company C, at the date of acquisition (N-1) of the respective participation interests by Company M:

i) The acquisition cost of securities C	(N-1)	30,000
Subscribed and paid-in share capital	100,000	
Reserves from re-evaluation C	50,000	
Statutory reserves C	20,000	
The result of the current financial year (N-1)	10,000	
Net assets of company C evaluated at fair value (on 31.12.N-1)	180,000	
ii) Share of net assets evaluated at fair value on the date of the acquisition of securities (180.000 x 30%)	54,000	54,000
iii) Negative Goodwill (i-ii)		-24,000

b) The determination of the share of Company M in the net assets of Company C at the date of consolidation (31.12.N):

Equity (net assets)	Total	Part that belongs to company M (30%)
Subscribed and paid-in share capital	100,000	30,000
Reserves from re-evaluation	60,000	18,000
Statutory reserves	45,000	13,500
The result of the current financial year (N)	30,000	9,000
Reported result	10,000	3,000
Total of net assets on 31.12.N	245,000	73,500

c) *The equivalence of the associated entity, reflecting the negative goodwill and equity elements of Company C, related to the values recognized after the acquisition of the securities, taken over at consolidated equity (recorded at the balance sheet level):*

73,500	264	%	73,500
	<i>“Equivalent C titles”</i>	262	30,000
		<i>“Shares held in jointly controlled entities”</i>	
		105*	
		<i>“Consolidated re-evaluation results”</i>	3,000
		106*	
		<i>“Consolidated statutory reserves”</i>	7,500
		121*	9,000
		<i>“Consolidated result”</i>	
		207.5	24,000
		<i>“Negative Goodwill”</i>	

* Note: The shares of the differences realized in the respective elements after the date of acquisition of the participation interests were taken over at consolidated equity:

- for re-evaluation reserves: (60,000-50,000) x30%);
- for statutory reserves: (45,000-20,000) x30%);
- to the current result: 30,000 x 30%.

d) *Reflection of the share held by Company M from the result of Company C (corrections at the level of the “Profit and loss account”):*

121	=	768/analytic	3,000
<i>“Consolidated result”</i>		<i>“Profit for the financial year related to associated entities and jointly controlled entities”</i>	

e) Transfer of “Goodwill - negative” to consolidated results according to the accounting regulations in force (point 551.1).

207.5	=	121	24,000
<i>“Negative Goodwill”</i>		<i>“Consolidated profit or loss”</i>	

Conclusions

Approaching some practical aspects regarding the preparation of the consolidated annual financial statements by the groups of companies in Romania, through case studies, given that accounting theory and practice do not abound in effective solutions for applying accounting regulations in the field, we consider that it can represent an indicative guide for the application and understanding of those regulations by professional accountants, academic researchers and economics students.

With the confidence that both accounting theory and practice can be permanently updated and improved, I am waiting for proposals or suggestions on the issues discussed in this article.

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