

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

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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 this article); Elimination of securities held in associates and jointly controlled entities (joint ventures) - object of the next article.*

## **Keywords**

consolidation of accounts; removal of titles; affiliated entities; associated entities; joint venture

## **JEL Classification**

M41

## **Elimination of securities held with affiliated entities**

The preparation of the consolidated annual financial statements by the parent company involves the elimination of the carrying amount of the investment made by it in each subsidiary, while eliminating its share of the equity of those subsidiaries. This is, in fact, a compensation of the carrying amount of the shares held in the entities included in the consolidation with the part of their equity, related to those securities (shares). “The offsetting of disposed securities held in subsidiaries is based on the fair values of the identifiable assets and liabilities at the acquisition of the shares or, if the acquisition takes place in several stages, on the date on which the entity became a branch”<sup>1</sup>.

The difference resulting from the offsetting between the book value and the fair value of the securities is presented as a separate element of the consolidated balance sheet, respectively “*Positive or negative goodwill*”, as the case may be.

*The positive goodwill* is an asset that represents future economic benefits that are generated by other assets acquired within a business grouping (acquisitions), but which cannot be individually identified and valued separately. This, as a rule, is recognized

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<sup>1</sup> Accounting Regulations for individual annual financial statements and consolidated annual financial statements approved by OMF no.1802/2014, point 508(1).

on consolidation and represents the difference between the acquisition cost and the fair value at the acquisition date of the part of the net assets related to the acquired securities. Positive goodwill recognized in the consolidation of accounts is included in the category of intangible assets and is usually amortized over a maximum period of 5 years. (...) However, in exceptional cases where the useful life of the goodwill cannot be reliably estimated, entities may amortize goodwill systematically over a period of more than 5 years, provided that this period does not exceed 10 years”<sup>2</sup>.

**The negative goodwill** is the result of anticipating future losses (such as expenses with the restructuring of the acquired company) or the consequence of a good deal (the acquisition of the company’s shares at a low rate due to the passing difficulties it is going through).

The value of the negative goodwill can be transferred to the consolidated profit and loss account, according to the legal regulations in force, only:

- a) “if this difference corresponds to the forecast, at the acquisition date, of unfavourable future results of the entity concerned or to the forecast of costs that the entity will incur, to the extent that such forecast materializes; or
- b) to the extent that the difference corresponds to a gain realized ”<sup>3</sup>

In the context of the disposal of the securities held by the parent company in subsidiaries, “*non-controlling interests*” must also be recognized, when part of the shares of the subsidiaries included in the consolidation are also held by persons other than those subsidiaries and the parent company.

“*Non-controlling interests*” are presented in the consolidated balance sheet in equity, separately from the equity of the parent company.

We specify that the accounting regulations in our country do not make any reference to the way of evaluating the “*non-controlling interests*”, but they can be valued either in proportion to their share of the net assets of the subsidiary measured at fair value, or their fair value<sup>4</sup>. In the examples we present, “*non-controlling interests*” will be valued in proportion to their share of the net assets of the subsidiary measured at fair value.

### **The case when the participation titles are acquired on the date of the establishment of the subsidiary.**

The parent company (SM) holds 60% of the shares of Company F (subsidiary), securities that it acquired on the date of its incorporation, on 01.05.N-1. The acquisition cost of the securities is 1,200 lei.

At 31.12.N, the equity of Subsidiary F recorded the following values:

- capital: 2,000 lei ;
- reserves: 1,000 lei
- the result of the financial year : 500 lei.

At 31.12.N, the parent company prepares for the first time consolidated annual financial statements.

*In order to reflect the accounting of the elimination of the securities held by the parent company at Subsidiary F, the net assets of Subsidiary F will be divided, in the part belonging to the parent company and the part belonging to minorities, as follows:*

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<sup>2</sup> Idem point 183 (1)

<sup>3</sup> Idem point 551 (1)

<sup>4</sup> These two ways of assessing non-controlling interests are provided by IFRS “Business Combinations” (IFRS 3.18)

| Equity(net accounting assets) | Total | The part that belongs to the parent company (60%) | The part that belongs to the non-controlling interests (40%) |
|-------------------------------|-------|---|--|
| Capital                       | 2,000 | 1,200   | 800  |
| Reserves                      | 1,000 | 600   | 400  |
| Result of the financial year  | 500   | 300   | 200  |
| Total                         | 3,500 | 2,100   | 1,400  |

a) *The accounting reflection of the elimination of F-titles*, of the taking over of the shares of equity capital belonging to the parent company and of the non-controlling interests (**recording at the balance sheet level**):

|       |                           |  |       |
|-------|---------------------------|--|-------|
| 3,500 | _____                     | _____  | 3,500 |
|       | %                         | %  |       |
| 2,000 | <b>101</b>                | <b>261</b>                                     | 1,200 |
|       | <i>“Capital F”</i>        | <i>“Shares held by affiliated entities”</i>    |       |
| 1,000 | <b>106</b>                | <b>106</b>                                     | 600   |
|       | <i>„Reserves F”</i>       | <i>„Consolidated reserves”</i>                 |       |
| 500   | <b>121</b>                | <b>121</b>                                     |       |
|       | <i>„Profit or loss F”</i> | <i>„Consolidated result”</i>                   | 300   |
|       |                           | <b>108</b>                                     |       |
|       |                           | <i>„Non-controlling Interests”<sup>5</sup></i> | 1,400 |
|       | _____                     | _____  |       |

*When consolidating the subsidiaries whose securities are held by the parent company from the date of establishment of that subsidiary, the fair value of the assets and liabilities coincides with their carrying amount, so that the elimination of the value of the equity securities on consolidation does not generate goodwill.*

b) *Recording the share of the result of Subsidiary F (corrections at the level of the Profit and Loss Account)*:

|  |  |   |                           |     |
|--|--|---|---------------------------|-----|
|  | _____  | = | _____                     |     |
|  | %  |   | <b>121</b>                | 500 |
|  | <b>121</b>   |   | <i>„Profit or loss F”</i> | 300 |
|  | <i>„Result that belongs to the shareholders of the parent company(consolidated result)</i> |   |                           |     |
|  | <b>1081</b>  |   |                           |     |
|  | <i>„Result- non-controlling interests ”</i>  |   |                           | 200 |
|  | <i>(with the part of the result that belongs to the minorities)</i>                        |   |                           |     |
|  | _____  |   | _____                     |     |

### **The case of the acquisition of securities by the parent company at a date subsequent to the establishment of the issuing company (subsidiary)**

On 31.12.N-3, the parent company acquired 80% of the shares of Company F, which was incorporated at an earlier date. The acquisition cost of the shares is 300,000 lei. The parent company consolidates Subsidiary F for the first time on 31.12.N. In order to consolidate Subsidiary F, the following clarifications will be taken into account:

<sup>5</sup> Non-controlling interests represent a balance sheet item that appears in the consolidated balance sheet only in the case of global integration.

1. We assume that the evolution of the capital of Subsidiary F was as follows:  
lei

| <b>Equity</b>                  | <b>On the acquisition day (N-3)</b> | <b>Values on the consolidation day (31.12.N)</b> |
|--------------------------------|-------------------------------------|--|
| Subscribed and paid-in capital | 200,000                             | 200,000  |
| Reserves                       | 70,000                              | 210,000  |
| Result of the financial year   | 0                                   | 40,000   |
| <b>Total equity</b>            | <b>270,000</b>                      | <b>450,000</b>                                   |

2. The equity of company F, on 31.12.N-3, had the following values: subscribed and paid-in capital 200,000 lei, reserves 70,000 lei. Also, at the date of acquisition of the securities, the fair values of the identifiable assets and liabilities were identical to the accounting ones, except for a building whose fair value was higher than the book value by 80,000 lei. The remaining amortization period of the building, from the moment of acquiring the titles, is 20 years.
3. Goodwill is amortized over a period of 5 years.  
The difference between the acquisition cost and the fair value of the units, determined at the date of acquisition of those securities, represents a *positive / negative "goodwill"*, as the case may be.

a) *The determination of good will<sup>6</sup>:*

|  |         |         |
|--|---------|---------|
| <b>i) The cost of acquiring the securities</b>                                   |         | 300,000 |
| - Capital F  | 200,000 |         |
| - Reserves F   | 70,000  |         |
| - Building value added (valuation reserves)                                      | 80,000  |         |
| - Net assets of company F measured at fair value (on 31.12.N-3)                  | 350,000 |         |
| <b>ii) Share of net assets evaluated at fair acquisition day (350.000 x 80%)</b> | 280,000 | 280,000 |
| <b>iii) Goodwill (i-ii)</b>  |         | 20,000  |

b) *Share of equity of subsidiary F at the date of consolidation (31.12.N):*

| <b>Equity</b>                | <b>Total</b>   | <b>The part that belongs to the parent company SM (80%)</b> | <b>The part that belongs to the "non-controlling interests" (20%)</b> |
|------------------------------|----------------|---|---|
| Capital                      | 200,000        | 160,000   | 40,000  |
| Reserves                     | 210,000        | 168,000   | 42,000  |
| Result of the financial year | 40,000         | 32,000  | 8,000   |
| <b>Total</b>                 | <b>450,000</b> | <b>360,000</b>  | <b>90,000</b>   |

<sup>6</sup> We specify that in the presented examples the part of good will that belongs to the parent company is determined.

c) Elimination of F securities, reflection of goodwill, takeover of the shares in the respective equity elements of the subsidiary, according to the percentage of interest held by the parent company and non-controlling interests (**balance sheet entry**):

|         |                    |   |                                      |         |
|---------|--------------------|---|--------------------------------------|---------|
| 550,000 | <b>%</b>           | = | <b>%</b>                             | 550,000 |
| 200,000 | <b>101</b>         |   | <b>261</b>                           | 300,000 |
|         | „Capital F ”       |   | „Shares held at affiliated entities” |         |
| 210,000 | <b>106</b>         |   | <b>106*</b>                          | 112,000 |
|         | „Reserves F ”      |   | „Consolidated reserves ”             |         |
| 40,000  | <b>121</b>         |   | <b>121*</b>                          | 32,000  |
|         | „Profit or loss F” |   | „Consolidated result ”               |         |
| 20,000  | <b>2071</b>        |   | <b>108**</b>                         | 106,000 |
|         | „Goodwill”         |   | „Non-controlling interests ”         |         |
| 80,000  | <b>212</b>         |   |                                      |         |
|         | „Constructions ”   |   |                                      |         |

\* Represents the share - part of the SM Company from the reserve of Subsidiary F obtained after the date of acquisition of the securities: (210,000 lei - 70,000 lei) x80% = 112,000 and the share of the current result.

\*\* Represents the share that belongs to the minorities from the own capitals of the F Branch from 31.12.N (90,000 lei) + the share - part of the value added afferent to the construction (80,000 lei x 20%).

Note: it can be seen that only the shares that were formed after the acquisition of the securities are taken over from the consolidated equity, and the non-controlling interests are taken over, in addition to the share of the equity belonging to the minorities, and the share of the surplus value related to assets expressed at fair value.

d) Share of the result of company F (**recording at the level of “Profit and loss account” - component of the financial statements**):

|   |   |                    |        |
|---|---|--------------------|--------|
| <b>%</b>  | = | <b>121</b>         | 40.000 |
| <b>121</b>  |   | „Profit or loss F” | 32.000 |
| „Result that belongs to the shareholders of the parent company” |   |                    |        |
| <b>1081</b>   |   |                    |        |
| „Result- part that belongs to non-controlling interests”        |   |                    | 8.000  |

e) Recording the depreciation of the difference (plus) of value related to the construction (annual depreciation 80,000 / 20 = 4,000 lei):

|  | lei   |                                   |
|--|---|-----------------------------------|
| <b>Construction depreciation</b>               | <b>Previous financial years (N-2 and N-1)</b> | <b>Current financial year (N)</b> |
| Part that belongs to SM                        | 4,000 x 2 x 80% = 6,400                       | 4,000 x 80% =3.200                |
| Part that belongs to non-controlling interests | 4,000 x 2 x 20% =1,600                        | 4,000 x20% =800                   |
| <b>Total</b>                                   | <b>8,000</b>                                  | <b>4,000</b>                      |

-recording at the balance sheet level:

|                         |   |                             |        |
|-------------------------|---|-----------------------------|--------|
| <b>%</b>                | = | <b>2812</b>                 | 12,000 |
| <b>106</b>              |   | „Construction depreciation” |        |
| „Consolidated reserves” |   |                             | 6,400  |

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|  |   |            |
|--|---|------------|
| <b>121</b>   |   |            |
| „Consolidated result”  |   | 3,200      |
| <b>108</b>   |   |            |
| „non-controlling interests”  |   | 2,400      |
| <b>-corrections at the level of the „Profit and loss account”:</b> |   |            |
| <b>6811</b>  | = | <b>%</b>   |
| „Operating expenses on depreciation of fixed assets”               |   | <b>121</b> |
|  |   | 4,000      |
|  |   | 3,200      |
|  |   | 800        |
|  |   | 800        |
|  |   | 800        |

f) Amortization of goodwill

|                          |                        |                  |
|--------------------------|------------------------|------------------|
| Amortization of goodwill | 20,000 / 5 x 2 = 8,000 | 20,000/5 = 4,000 |
|--------------------------|------------------------|------------------|

|  |   |   |
|--|---|---|
| - <b>Balance sheet entry</b>                                       |   |   |
| <b>%</b>   | = | <b>2807</b>   |
| <b>106</b>   |   | „Amortization of goodwill”                                      |
| „Consolidated reserves”  |   | 12,000  |
| <b>121</b>   |   | 8,000   |
| „Consolidated result”  |   | 4,000   |
| <b>-corrections at the level of the „Profit and loss account”:</b> |   |   |
| <b>6811</b>  | = | <b>121</b>  |
| „Operating expenses on depreciation of fixed assets”               |   | „Result that belongs to the shareholders of the parent company” |
|  |   | 4,000   |

## 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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