

# Holding and Subsidiary Companies

## HOLDING COMPANIES –IMPORTANT ISSUES TO SOLVE PROBLEMS

- 1.ANALYS OF CAPTAL PROFIT-
- 2.ANALYSYS OF REVENUE PROFIT
- 3.CALCULATION OF CAPITAL RESERVE/COST OF CONTROL(GOODWILL)
- 4.CALCULATION OF MINORITY INTEREST
- 5.Consolidated Balance sheet

# 1.ANALYSYS OF CAPTAL PROFIT

- MEANING:

PROFIT/RESERVE OF ANY TYPE IN THE SUBSIDIARY COMPANY BEFORE THE DATE OF ACQUISITION

# CAPTAL PROFIT EXAMPLE -I

- **BALANCE SHEET OF SUBSIDIARY LIMITED AS ON  
31-03-2007**

## LIABILITIES

**GENERAL RESERVE**

**(1-4-2006) 5,00,000**

**PROFIT AND LOSS 2,00,000**

**THE BUSINESS WAS ACQUIRED ON**

**01-01-2007**

# ANSWER EX.1

- RESERVE BEFORE ACQUISITION-  
5,00,000

- PROFIT UP TO 01-01-2007

(2,00,000\*9/12) 1,50,000

TOTAL CAPITAL PROFIT 6,50,000

HOW MUCH IS THE REVENUE PROFIT?

# REVENUE PROFIT?

- $2,00,000 - 1,50,000 = 50,000$

## Exercise-2:

- SUPPOSING THE BUSINESS WAS ACQUIRED ON 30-09-2006 HOW MUCH IS CAPITAL PROFIT? /REVENUE PROFIT?

## ANSWER-2

- CAPITAL PROFIT:

- RESERVE(PRE-ACQUISITION)      5,00,000

SHARE OF P/L A/C

(2,00,000\*6/12)                              1,00,000

TOTAL    6,00,000

REVENUE PROFIT:

(2,00,000 \*6/12)                              1,00,000

ENTIRE RESERVE PROFIT EARNED BY THE SUBSIDIARY  
WAS PRE-ACQUISITION PROFIT

# CALCULATION OF CAPITAL RESERVE

- AMOUNT INVESTED BY THE HOLDING COMPANY IN SUBSIDIARY COMPANY(REFLECTED AS INVESTMENT IN THE ASSET SIDE)
- LESS:1.AMOUNT RECEIVED OUT OF CAPITAL PROFIT IN THE FORM OF DIVIDEND  
2.PAID UP VALUE OF THE SHARE(NOMINAL VALUE)  
3. SHARE OF REMAINING CAPITAL PROFIT OF HOLDING COMPANY



Cost of control/goodwill

The holding company purchased shares of subsidiary more than the real worth of the subsidiary

What is the meaning of real worth?

If all assets are sold and third party liabilities are paid what remain to share holders is known as real worth

Real worth = Assets (realisable value) – third party liabilities

Or

Equity shares + reserves and surplus (both capital profit and revenue reserve)

How do you calculate goodwill on the shares acquired by Holding company?

The excess amount paid over real worth to acquire subsidiary company's share is known as goodwill.

### Example-3

4000 shares are purchased for Rs. 50,000.

The nominal value is Rs.10. The excess amount of Rs.10,000 is goodwill. Goodwill is shown in the consolidated balance sheet.

Assumed no profits in the balance sheet

If goodwill appears already in the holding and subsidiary company?

Balance sheet as on 31<sup>st</sup> March 2008

	H Ltd	S Ltd		H Ltd	S Ltd
Equity shares(Rs.100 each)	5,00,000	2,00,000	Goodwill	20,000	10,000
12% preference shares(Rs.100 each)	Nil	1,00,000	Shares in S Ltd (2000 equity shares and 500 preference shares)	3,50,000	
General reserve	1,30,000	60,000(CP)	Preliminary expenses	-----	10,000(CL)
Profit and loss a/c (1-4-2007)	60,000	20,000(CP)			
Profits during the year	80,000	70,000(CP)			

Date of acquisition was 31-3-2008

# 1.Total Capital profits

- General reserve 60,000
  - Profit on 1-4-2007 20,000
  - Profit during the year 2007-08 70,000
  - Total 150,000
  - Less:-Preliminary expenses (10,000)
  - Less: Preference share holders (12,000)
- (cumulative preference shares)

Profit to equity share holders	1,28,000
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Have You observed that all profits are capital profits. Why?

- It is not due to real capital profits. But because profits are earned by subsidiary before the date of acquisition.
- Note:1. General reserve before the date of acquisition, Revenue profit before the date of acquisition and all capital profits after the date of acquisition less all wasteful preliminary expenses(Capital loss) are capital profit.
- Note:2: Any benefits(money,dividend, bonus shares) derived by holding company out of capital profits reduce their cost of control(Investments)

## Capital reserve

If the subsidiary company shares are purchased less than the subsidiary's worth, (**Purchased at cheaper rate**) the benefits earned at the time of acquisition is known as capital reserve. The capital reserve is a capital profit

### Example 4:

If nominal value of shares of subsidiary is Rs.10 and 4000 shares are acquired for Rs. 35,000, then there is a gain of 5000 to holding company is known as capital reserve

What is capital profit? What is the reason of differentiating between Capital profits and revenue profits?

Capital profits:

1. Profits of subsidiary company earned by operation or non-operation prior to holding company's acquisition.
2. Capital profits earned after acquisition

Capital profits are not available for declaration of dividend. After the acquisition date, profits earned by subsidiary company by a normal business operations is a revenue profit. Such profits are available for declaration of dividend.

## Exercise-5

Balance sheet of subsidiary as on  
31<sup>st</sup> March 2008

Equity shares 4,00,000  
(Rs.100 per share)

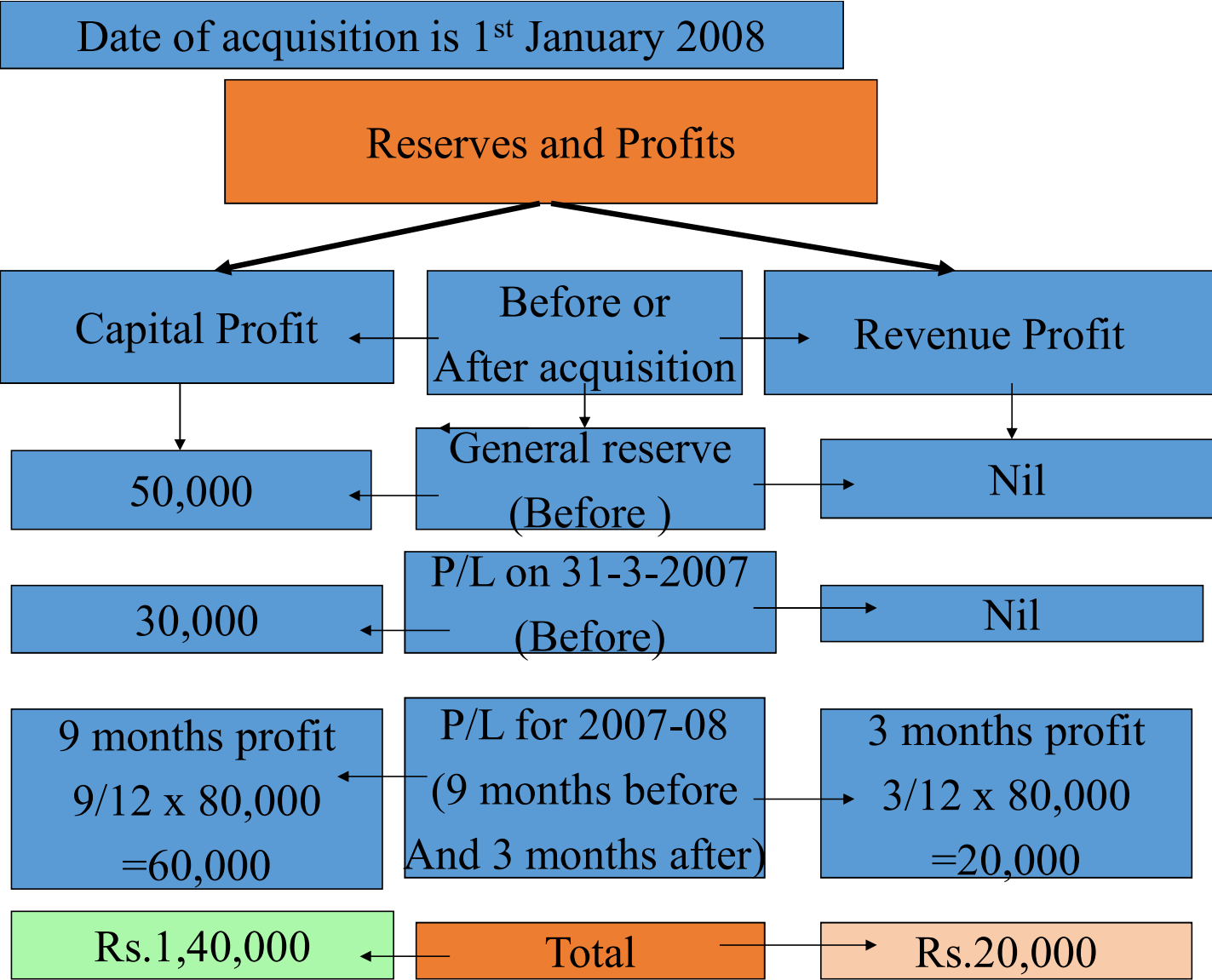
General reserve 50,000

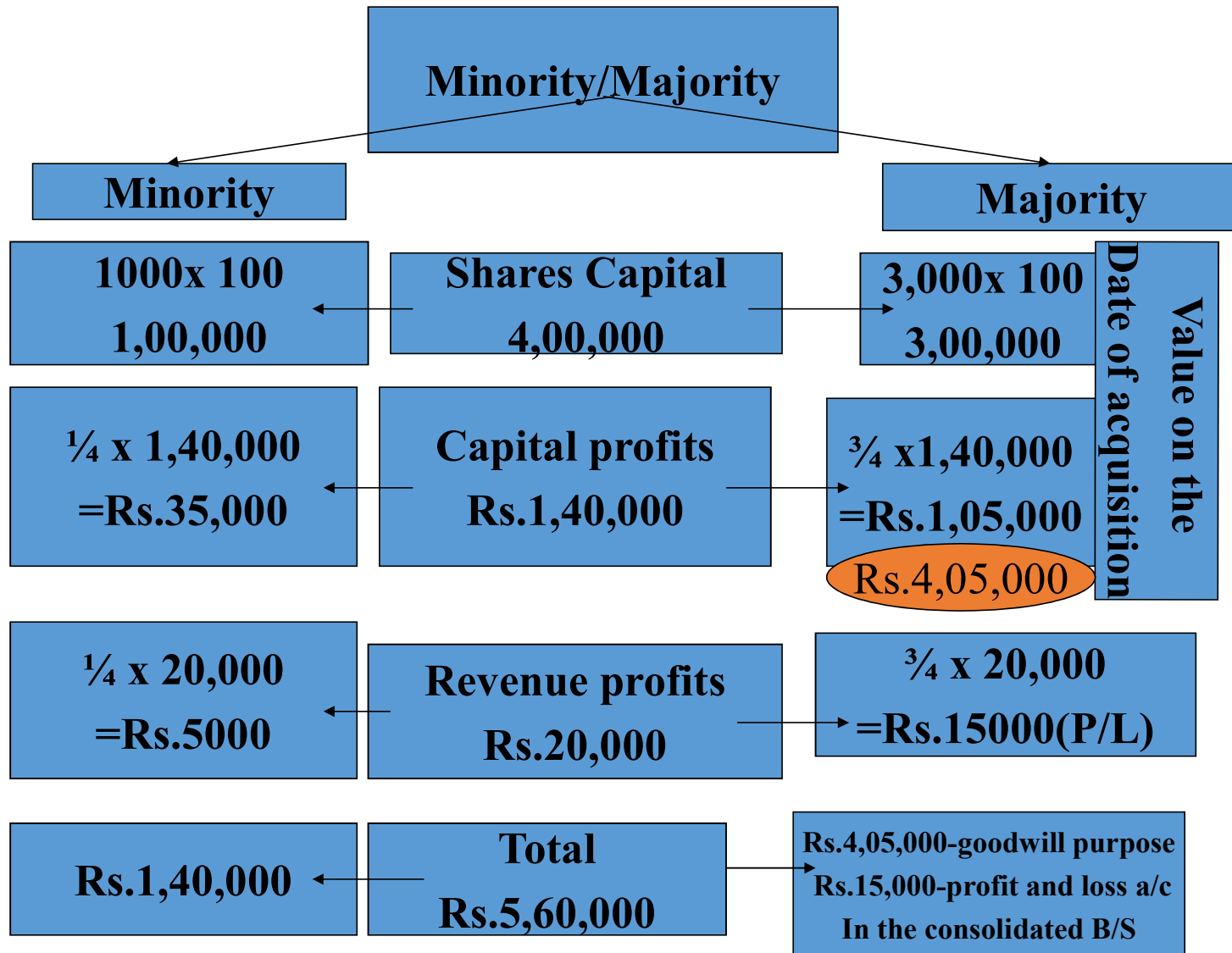
Profit and loss a/c 30,000  
(on 31-3-2007)

Profit and loss a/c 80,000  
(For the year 2007-2008)

3,000 shares were acquired  
by holding company in  
subsidiary company on 1<sup>st</sup>  
January 2008 for  
Rs.4,50,000.







# Good will/Capital reserve

**It is calculated from the point of view of Holding company**

**What is the value of total investment made by Holding company?**

**It is Rs.4,50,000**

**What was it worth on the date of acquisition?**

**It is Rs.4,05,000.**

**Have they invested more than the real worth?**

**Yes. It means they had paid extra for the goodwill of the subsidiary company.**

Suppose subsidiary company declares dividend after the acquisition out of revenue profits which were earned before the date acquisition?

Holding company had invested in subsidiary. If dividend is declared out of pre-acquisition profits of subsidiary, the holding company gets parts of its investments back. Therefore such dividend received to be reduced from investment of the holding company in subsidiary.

Does it affect goodwill/capital reserve of the company?

- Yes. It affects goodwill. It decreases the goodwill.

### Exercise-6

Suppose subsidiary declares dividend out of general reserve (Capital profit because it was earned before acquisition) Rs.40,000 to all share holders, the holding company's share of general reserve is  $\frac{3}{4}$  of 40,000=30,000. Since 30,000 is received by holding out of their investments The investment value decreased to Rs.4,20,000(4,50,000-30,000). Therefore goodwill is Rs.15,000.