THE PREPARATION OF CONSOLIDATED BALANCE SHEETS

By

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PREFACE

The development of the accounting technique for holding companies started only a few decades ago and, in reality, is still in the kindergarten stage. With the advent of the holding company and its subsequent growth into our present-day intricate organizations, individual company balance sheets became "passe". The inter-relation of the capital structure of each legal unit became so involved that with the individual balance sheets only an accountant or a financier could interpret the situation. Accounting paralleled the new business organization growth by the inception of the consolidated balance sheet.

Although the consolidated balance sheet is a new idea, conceived for a unique situation, and beset by an almost infinite number of variations, authors have been surprisingly slow in covering the subject with originality. The textbook authors seem to consistently feel that the general principles are sufficient for the student, and they accomplish this largely by a voluminous supply of examples which before long will create the impression of an impregnable science. Magazine articles on consolidated balance sheets deal practically one hundred percent with special problems of consolidating which are too technical for any except the professional. The field could well afford to receive contributions that would cross the two extremes into clear and concise discussions of the underlying principles with a working knowledge of the variations that may be expected.

This work, though no radical departure from the conventional, first presents a complete discussion around the investment account which should lay the foundation for any of the variations likely to be encountered. After a general survey of the variations with theoretical opinions interdispersed, an illustrative problem with representative variations and its solution is given. Comments on the problem refer by page number to the discussions in the first sections.

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INTRODUCTION

The broad field of accounting readily embraces three main sub-divisions; namely, (1) the gathering of financial data, (2) the presentation of data compiled, and (3) the interpretation of the data. Often the first sub-division is termed the function of the bookkeeper, the second sub-division the narrowed function of the accountant, and the third sub-division the function of the business executive. Even though this detailed functioning is often the prevailing idea of the layman, even a cursory examination of the technical phases of each function by any business man would reveal such an inter-relation that the accountant must necessarily be expertly schooled in each class. The bookkeeper may still be an expert in gathering data, the executive an expert in interpretation, yet the accountant must have sound knowledge of both, together with his sound principles of correlation necessitated in the presentation work.

To illustrate somewhat the correlation required of the accountant, assume that the business executive in the execution of his managerial duties realized the necessity of having certain statistical data for the intelligent solution of his problems. The situation, an outline of the desired facts, would be placed in the hands of the accountant. Simply speaking, a report of such facts would be requested of the accountant. If the facts for such report were unobtainable in the ordinary bookkeeping procedures, the accountant must rearrange or reclassify the obtainable data until the desired facts are available. This may even necessitate the rearrangement of the bookkeeping procedures in order to obtain such data economically for future reports. The reclassification process or the installation of the new bookkeeping system could only be accomplished by one thoroughly familiar with what was to be presented, and one could not clearly present or even understand what was to be presented unless he knew the situation that called for such information. The present-day significance of the accountant in the huge modern industrial organizations is such that he often occupies the position of adviser to the executives, offering them the advantage of the detailed knowledge of the clerical routines and an understanding of the operations of the general business policies.

It is the purpose of this thesis to analyze and discuss some of the problems necessitated by and peculiar to the modern interrelation of corporations. A corporation is a legal entity and as such must keep its own system of books; yet, we may have one corporation legally owning another - a situation likely to cause the executives to request a picture of all corporations as one composite company, particularly if such two or more corporations are cooperating as one enterprise. This would require the accountant not only to understand thoroughly the records of each legal unit, but also to realize what type of picture (balance sheet) should be presented, together with all the legal phases involved. The presentation of consolidated statements, then, deals not with the correlation of the integrate parts of one company, but with the correlation of several companies.

Our modern industrial machinery seems unable to operate without its "large-scale" methods. During the last half-century, we have witnessed the growth of individual units of our industrial machinery to undreamed proportions; even the billion-dollar capitalization having been surpassed. This individual unit growth has taken place by many methods. We have seen the companies expanding by normal growth (reinvestment of profits) from the small unit to what could be termed the large-scale company, a process which must necessarily be relatively slow. More often, however, our large capitalizations are the result of the combining of existing companies with or without reorganization of the capital structure. Combinations which are technically termed consolidations and mergers are handled, after the initial transactions effecting the change, with one set of books and the accounting problems involved are complicated only by the size increase of the company - its greater variety of properties and enlargement of functions. In contrast, the combination effected by a holding company does not alter the number of sets of books. In a holding company the dealings are with the stockholders, one legal unit controlling another legal unit by actually being a stockholder or owning its stock, and the normal accounting problems of the individual companies remain unchanged. When a "Consolidated Statement" of the several inter-related units is desired, the presentation of such a statement does not necessitate an actual book recording, but is accomplished by the analysis of the accounting results of the individual books.

"If we view the several (affiliated) companies as separate corporations, the balance sheet of each company should clearly present the facts of its financial condition." * Yet, this could not be true of the

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* Finney, H.A., Principles of Accounting, Chapter 48, page 2

holding company (the parent company or the company with the controlling interests) since an intelligent reading of its investment accounts (the company may or may not be an operating unit) would entirely depend on the financial condition of the subsidiaries represented. Also an inter-relation of the subsidiaries is likely to exist, particularly since the policies of all the subsidiaries are dictated and controlled by the one governing body, which would in itself cause any individual statement to be distorted and meaningless. The solution to the inherent imperfections caused by these relationships is to disregard legal structure and to present a balance sheet of the entire affiliation as one operating unit. If this is done, the consolidated balance sheet obtained would present a coherent and logical picture of the fictitious corporation, the same picture that would be presented were the subsidiary companies actually operating under one charter. "The consolidated balance sheet represents the true position of the whole group of the constituent companies to the outside world, and is thus not the balance sheet of a corporation, but of a condition after eliminating all the relations of the constituent companies one to another." *

Realizing the complexities of affiliations and the possible juggling between companies, Section 45 of the Revenue Act of 1928 reads as follows:

ALLOCATION OF INCOME AND DEDUCTIONS

> In any case of two or more trades or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or

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* Paton, W. A., Accountants' Handbook, page 1017, Ronald Press Company, as quoted from Dickinson.

indirectly by the same interests, the Commissioner is authorized to distribute, apportion, or allocate gross income or deductions between or among such trades or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such trades or businesses."

This section, which was retained verbatim in the Revenue Act of 1932, was evidently included to permit the Commissioner to alter his usual procedures if it "is necessary in order to prevent evasion of taxes or clearly to reflect the income" of the businesses making the returns. The section in itself admits the possibility of misrepresentation of facts if the usual individual reports were made. It forms the background for allowing, for tax purposes, consolidated returns to be prepared for an "affiliated group",as defined in the law,instead of the usual individual returns.

REVENUE ACT OF 1928, Section 141 (d)

Definition of "affiliated group". As used in this section an "affiliated group" means one or more chains of corporations connected through stock ownership with a common parent corporation if -

(1) At least 95 per centum of the stock of each of the corporations (except the common parent corporation) is owned directly by one or more of the other corporations; and

(2) The common parent corporation owns directly at least 95 per centum of the stock of at least one of the other corporations.

As used in this sub-section the term "stock does not include non-voting stock which is limited and preferred as to dividends.

The above section was retained verbatim in the Revenue Act of 1932. For income tax purposes in the State of Virginia, the Tax Code of 1930, paragraph 58 (c), defines the term "affiliated group" substantially the same as follows:

For the purpose of this section two or more corporations shall be deemed to be affiliated; (1) if one corporation owns at least ninety-five per centum of the voting stock of the other or others; (2) if at least ninety-five per centum of the voting stock of two or more corporations is owned by the same interests.

Thus it is that the governments in some cases require several companies to report, for tax purposes, their conditions or their operations as one unit. Even though the governments do not require combined returns of many affiliated companies that actually have only one controlling board, a consolidated balance sheet is often desired as a matter of business management and interpretation.

I. General Procedure of Consolidating Balance Sheets

Substitution in Investment Account:- The most obvious and often the most difficult problem in presenting a consolidated balance sheet of a holding company and its subsidiaries is in connection with the investment account. The entire idea behind the consolidation of balance sheets is to substitute in the investment accounts of the holding company the classified and valued properties represented by such investment. This work would remain a simple substitution problem if the ownership of the subsidiary were 100%, if the investment account of the holding company were the same in amount as the net assets of the subsidiary, and if no unusual inter-company transactions took place. Such, however, is not often the case. The dynamic organism of industry continuously alters the existing conditions while variances of opinion and variations of procedure work in their share of complications. To illustrate the substitution process in its simplest form, assume Company H to own 100% of the stock of Company S and the balance sheets of the two companies at date of acquisition to be as follows:

Company H
Balance Sheet
December 31, 1933

Assets		Liabilities & Capital	
Cash	$ 5,000	Accounts Payable	$15,000
Investment in Co.S	50,000		
Furniture & Fixtures	10,000		
Buildings	20,000	Capital & Surplus	70,000
	$85,000		$85,000

Company S
Balance Sheet
December 31, 1933

Assets		Liabilities & Capital	
Cash	$ 4,000	Accounts Payable	$20,000
Furniture & Fixtures	18,000		
Buildings	48,000	Capital & Surplus	50,000
	$70,000		$70,000

The balance sheet of Company S is complete in itself and lends itself to analysis, while the balance sheet of Company H is complicated by the uncertain "Investment in Company S - $50,000", and the uncertainty could not be cleared without analysing Company S. If, however, the balance of Company H had the actual asset and liability classifications of Company S inserted in place of the "Investment in Company S", the resulting balance sheet of Company H (but we now must call it the "Consolidated Balance Sheet of Company H and Its Subsidiary Company S") would present a full view, so to speak, as follows:

Consolidated Balance Sheet
of
Company H and Its Subsidiary Company S
December 31, 1933

Assets		Liabilities & Capital	
Cash	$ 9,000	Accounts Payable	$ 35,000
Furniture & Fixtures	28,000		
Buildings	68,000	Capital & Surplus	70,000
	$105,000		$105,000

This example illustrates both the advantage of consolidated statements (note the presentation is as of one company with only the capital in the hands of outsiders shown) and the mechanical procedure involved in preparing the statement. As mentioned, however, the facts that were assumed for this example were ideal for the consolidation.

Variations which complicate the consolidating procedure:- The variances that may be encountered in practice and which necessitate considerations in procedure, the principle, of course, remaining the same, may be classed as follows:

1. Ownership relationship
   a. Holding company complete owner of subsidiary
   b. Holding company owning two or more subsidiaries
   c. Holding company partially owning subsidiary (or subsidiaries)
   d. Holding company completely or partially owning another holding company
2. Stock cost and subsidiary net worth relationship
   a. Cost price of stock of subsidiary owned by holding company equal in amount to portion of the net assets of the subsidiary represented
   b. Cost price of stock in excess of net assets - acquisition of goodwill
   c. Cost price of stock less than net assets - acquisition of surplus or negative goodwill

3. Relationship changes effected after consolidation
    a. Changes in ownership relationship due to capital stock transactions
    b. Changes in net worth of subsidiaries due to dividend declarations, profits, and losses
4. Operating relationship
    a. Inter-company receivables and payables
    b. Inter-company profits

Since the procedure in consolidating two statements is the substitution of net assets of the subsidiary in place of the investment account of the holding company, such variances naturally require the maintenance of complete records pertaining to stock and the subsidiary relationship. The passing of time and the consequent changes in the net worth of all companies push into the background the statistical data as of the date of the consolidation, yet such data are necessary for the preparation of all future statements. Visualize the complexity of the problem of the accountant that is called upon to prepare the first consolidated balance sheet of an affiliation that has existed for ten years or so when capital stock transactions and net worth changes have been numerous. Even if all of the information were available, the classifying and analysing would likely be tedious. If, however, advance knowledge of the preparation of consolidated statements is obtained, the accounts may be so kept as to facilitate the procedure.

II. Investment Account Valuation

Principles of valuation:- The general principle in the valuation of assets is to record the asset acquired at full cost and to leave the asset at such valuation until loss through use (depreciation) or a sale requires adjustment. This is based upon the realization that no profit or loss can theoretically be determined, nor does one exist, until the sale is actually consummated. When stock of corporations is purchased for temporary investment, the arguments for such valuation coincide with the arguments for the valuation of the other usual assets. The purchase of stock for permanent control as is the case in a holding company presents a different situation. Fixed assets depreciate, and such change is noted in the accounts; current assets may fluctuate, but the conversion into cash is expected in the near future; permanent stock investments may never be converted into cash except as dividends are received, yet fluctuations are continuous since the subsidiary represented by the stock is fluctuating. If, then, such permanent stock investment is maintained at cost, the future may likely cause a wide gap to exist between the stock valuation and either its real value, book value, or market value. Because of such conditions, some accountants, notably H. A. Finney, recommend a procedure of constant change in the investment account, as will be discussed later, in order to maintain a definite relationship between the investment account valuation and the net worth represented. The valuation at cost, however, can yet be justifiable, and as some accountants claim, advisable. If it is generally admitted that the individual balance sheet of the holding company is incomplete and worthless without the data of the subsidiaries (and such is the case when the percentage of ownership is high), it does not matter at what figure the investment accounts are carried. Moreover, when a consolidated balance sheet is prepared, the investment account is dropped from the statement, leaving in its place the current valuations of the subsidiary properties. The investment account valuation method proves to be meaningless.

In his discussion of the valuation of permanent investments*, Roy B. Kester states that where ownership is controlling, one of two valuations should be used: by presenting a consolidated balance sheet; or, if ownership is partial and a consolidated balance sheet is inadvisable, the profits and losses of the subsidiary should be absorbed by the investment account. Since he is actually considering the consolidated balance sheet as one method of valuation, he is thereby inferring that it is of no consequence (in so far as valuation for interpretation is concerned) which method is employed when consolidated balance sheets are to be prepared. The final result would, in either case, be the same.

Sometimes what may be termed an "arbitrary method of valuation" is likely to be encountered. This method merely eliminates the gap between the investment account and the net worth of the subsidiary by adjustments to surplus, and at such times as they may seem fit. This seems to be a haphazard attempt at the method of absorbing the profits and losses, but the slovenly manner employed seems to defeat its own attempts and to make the eradication of the cost valuation weakness somewhat questionable.

Regardless of what theoretical arguments can be advanced for this or that method of valuation, the accountant must, of course, be

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* Kester, Roy B., Accounting: Theory and Practice, Volume II, page 194

prepared to work with any method; and each method requires a separate procedure.

Valuation at cost:- This method of valuing the investment account maintains at all times the actual cost to the holding company of the subsidiary securities. No attempt is made to consider the profits or losses of the subsidiary. If and when a sale is made, the difference between the income and the proportionate cost is carried to surplus. Dividends received are handled as other financial income items. For all apparent purposes, the stock is handled as if it were owned solely for the investment returns, and the controlling feature of the subsidiary is in no manner reflected in the accounts as a financial factor of importance.

Valuation by absorbing profits and losses of the subsidiary:- Assuming that no difference existed between the cost of the subsidiary stock and the subsidiary net worth when the purchase was made, this method maintains the current book value of the subsidiary stock in the investment account. Accordingly, all transactions affecting the net worth of the subsidiary (or those changes of the net worth which would alter the book value of the stock) must be recorded in the investment account of the holding company. This valuation is based upon the theory that since the company owning the stock has among its rights the power to control the policies of the owned company, the association is so close as to actually justify the profits of the subsidiary to be handled as profits of the holding company. Controlling interests enable the dictation of dividend policy; hence, the holding company could, at its will, legally receive in cash the profits of its subsidiary. If, then, the holding company could convert into cash the profit as made by the subsidiary, why could it not reflect such increased value in its investment account and leave it as such until it deems it advisable from the standpoint of both companies (likely to be operating as one) to have a dividend declaration?

The book value of the stock of any company normally changes only by profits (from operation and otherwise), losses, and dividend declarations. In order to illustrate how these net worth changes are reflected in the investment account, journal entries will be given as an example of each necessary adjustment.

When the purchase of the stock of the subsidiary is first consummated, the following journal entry is, of course, made to record the transaction:

Investment in stock of Company X	$ xxx	
Cash (sundry assets)		$ xxx

When the books of the subsidiary are closed and a profit is determined, such information is obtained by the holding company. The holding company would make the following entry in order to bring into the original agreement the investment account and the subsidiary net worth:

Investment in stock of Company X	$ xxx	
Income from Company X		$ xxx

This operating account "Income from Company X" would be closed into Profit and Loss with the other financial operating accounts; thus, in reality recording in the surplus of the holding company the increased surplus of the subsidiary. A loss, being naturally based on the same theory, would necessitate a decrease in the investment account as follows:

Loss of Company X	$ xxx	
Investment in stock of Company X		$ xxx

A dividend declaration by the subsidiary creates a receivable for the holding company. When such receivable is realized, it is no more than a conversion into cash of the increase in the investment account as shown above. The journal entry, then, would decrease the investment account:

Dividend of Company X receivable	$ xxx	
Investment in stock of Company X		$ xxx

The receipt of the cash would be applied against the receivable:

Cash	$ xxx	
Dividend of Company X receivable		$ xxx

Normally the dividend receivable account would be used only if the books are to be closed and statements prepared before the receipt of the cash; otherwise, no record would be made until the following entry is necessitated by the receipt of the cash:

Cash	$ xxx	
Investment in stock of Company X		$ xxx

Thus, by actually recording in the investment account the changes of the net worth of the subsidiary represented, the investment account is maintained in the same relative position as originally. If, as assumed at the beginning of this section, the cost and book value were the same, the investment account balance and the current book value would be maintained as the same. When a difference existed between the original cost and the book value of the subsidiary at the time of purchase, such difference should always exist. This condition is discussed in a later section.

Arbitrary valuation:- This method, if it can be termed a method, is operated by arbitrarily increasing or decreasing the investment account when desired so as to approximate a relationship with the book value of the subsidiary. Since it maintains neither the cost value nor the current book value, adjustments must be made to correct to one of the other two valuations. These adjustments become necessary in calculating goodwill as is discussed later.

III. Investment Account Elimination

Goodwill from consolidation:- When a holding company purchases the stock of another company, it is very unlikely that the cost of the stock will be identical with the book value of the stock. In most cases, it seems, the price paid by the holding company is in excess of the book valuation placed upon the portion of the net assets represented. When such a variance is true, the first thought is likely to be that such excess is due to the existence of goodwill, but the vague and little understood term may or may not be the true explanation. Whenever such a variance occurs,a thorough investigation and analysis should be made to determine, if possible, why such excess is paid; and if the excess is due to the undervaluation of the assets of the subsidiary, the records of the subsidiary should be adjusted accordingly. The entire consolidation of the two statements would be considerably weakened if the assets of the two companies being consolidated were valued on different bases. Possibly the subsidiary has been ultra-conservative in handling its depreciation charges, or possibly actual appreciation of the assets has taken place. In either case, the subsidiary should bring its rightful profits on the books. Since controlling interest is being purchased and the financial conditions are to be shown in consolidated statements, the correct valuation for the assets of the subsidiary would seem to be current replacement values less accrued depreciation. This would allow the property value increase to be shown for the minority interest (later in this section) and would eliminate the amount of the excess of the stock cost over the book value due to property valuations.

It is frequently impossible to determine exactly why a difference exists between price and book values. Market conditions sometimes explain the situation; pure speculation, a desire for the controlling interest, or even just a poor investment may be the real reason. Then again, of course, goodwill, the ability to make above normal profits, may actually be an acquired asset. Some accountants, because of the usual vagueness, advocate merely terming the excess a "Debit from Consolidations", but since the almost universal custom is to forego the uncertainty and to accept the term goodwill, this discussion concerning consolidations will term it such. Under any circumstances, however, property values must first be adjusted.

In Section I, General Procedure of Consolidating, the principle of substituting the net assets of the subsidiary in the investment account of the holding company was illustrated, which procedure resulted in presenting a new balance sheet with combined assets and liabilities and without the investment account of the holding company or the net worth section of the subsidiary. In cases where goodwill exists, that is to say, if the investment account is in excess of the net assets to be substituted, such excess should be set up on the new balance sheet as "Consolidated Goodwill". If the consolidation is made as of the day the holding company acquired the subsidiary, the existence of goodwill does very little in complicating the substitution problem. The difference between the investment account which is eliminated (that is, not shown on the consolidated statement) and the capital stock and surplus of the subsidiary which is eliminated is in amount the goodwill; and the remaining assets and liabilities are merely combined. On the other hand, however, when preparing consolidated balance sheets after the date of acquisition, the procedure would depend upon the method used by the holding company in valuing its investment account (see Section II, Investment Account).

When the investment account is maintained at cost, eliminations are complicated since operations change the amount of the surplus of the subsidiary with the investment account remaining the same. Since the goodwill must be in amount the same as it was on the date of acquisition (assuming, of course, no further stock transactions), the current capital stock and surplus of the subsidiary must be in amount as follows:

The amount of the investment account (at cost)
Minus goodwill from consolidation
Plus profits, minus losses, minus dividends

which is the same as saying

Capital stock and surplus at acquisition
Plus profits, minus losses, minus dividends

The procedure of consolidating, in this case, naturally requires that the current net worth of the subsidiary be divided into two parts: (1) as it was at acquisition; and (2) the plus or minus since acquisition. Part (1) would be eliminated, as in the case discussed in the preceding paragraph, with the investment account being eliminated and goodwill set up; part (2) would be combined with the surplus of the holding company and thus shown on the consolidated balance sheet.

When the investment account is maintained by absorbing the profits and losses of the subsidiary, the "plus profits, minus losses, minus dividends" of the subsidiary has already been reflected in the surplus of the holding company. The capital and surplus of the subsidiary will be in amount

The amount of the investment account

Minus goodwill from consolidation

since the valuation method itself maintains this condition. The procedure, then, is to eliminate the investment account, to eliminate the current capital stock and surplus of the subsidiary, and to set up the difference as goodwill from consolidation. The same result must be accomplished regardless of what bookkeeping procedure is maintained for valuing the investment account. The consolidating procedure varies with respect to the "after acquisition changes" in the surplus of the subsidiary. These changes which must be reflected in the consolidated balance sheet are determined and added to the surplus of the holding company when the investment account is maintained at cost; when the investment account is maintained by absorbing profits and losses, the changes referred to are made to the surplus account of the holding company as they occur, and require no alteration at the date of the consolidated balance sheet.

When the investment account is maintained by arbitrary valuation, it simply means that some of the changes in the surplus of the subsidiary have been reflected in the surplus of the holding company and some have not. This necessitates calculating what amount has not been so reflected and in some manner to have this added or deducted to the surplus of the holding company. The best procedure would be to analyse the account, to adjust it to one of the other valuation methods, then follow the usual course of that method.

Surplus from consolidation (negative goodwill):- When the net assets of the subsidiary acquired are in excess of the amount paid by the holding company for the stock, surplus from consolidation is created. Some accountants claim that it is almost inconceivable that assets of sound value may be acquired in excess of the amount paid. Accountants concurring in this opinion refuse to accept the term "Surplus from Consolidation" and consider the excess as negative goodwill. In the consolidation process negative goodwill is applied against any existing goodwill (purchased goodwill of subsidiaries or of the holding company or goodwill from consolidation) and if no goodwill exists, some appropriate credit account other than surplus would be titled and used.

Although it quite frequently happens that a company maintains water in its stock, it also seems very plausible that a purchase of stock may acquire assets of current value above the cost of the stock. Market conditions may affect the price of the stock considerably, or the owners of the stock may, because of poor management, be willing and desirous of selling low to new owners for new management. Whatever the cause, if the currently appraised net assets of the subsidiary are in excess of the cost to the holding company of the stock, a true surplus from consolidation would seem to exist and would be appropriately shown in the net worth section of the consolidated statement.

If, however, it cannot be established that the property values of the subsidiary were legitimate, and if an uncertain goodwill existed from one cause or another, the practice of canceling one against another cannot be criticised. Whether or not one is applicable for cancellation against the other or whether or not they have any association may matter but very little; the resulting balance sheet is clearer because of the elimination of two uncertain, debatable, and probably meaningless items.

The procedure of handling the consolidation process with surplus from consolidation differs very little from the discussion on goodwill from consolidation. The eliminations are based on the same principles, the methods of investment account valuation control the accounting procedure, and the amount left over which is a credit rather than a debit is either

Applied against an existing goodwill or

Combined with the capital surplus of the consolidated statement.

Minority interest in subsidiaries:- In discussing the valuations of the investment account of the holding company (Section II) and the goodwill or surplus from consolidation, the assumption was maintained that 100% of the subsidiary stock was owned by the holding company. This, of course, need not be true. The law often requires consolidated returns if the subsidiary is 95% owned (Introduction, page 5) and business executives may even require such statements when only 51% of the subsidiary is owned. When the holding company, then, does not own 100%, the procedure of consolidating must be altered so as to present that portion of the affiliation not owned by the controlling interest.

The impossibility of endeavoring to present on the consolidated balance sheet the actual properties owned by the holding company is obvious when it is once reflected that units are being combined and the ownership in a unit is a proportion rather than certain specific properties. Then again, if the assets and liabilities of the subsidiaries were only partially presented, the magnitude of the affiliation would not be shown. Without complete inventories, for example, certain ratios used for interpretative purposes would be erroneous, and the statement presentation would defeat its purpose. It is necessary for the fulfillment of the purpose of consolidating statements to present on the consolidated balance sheet the total assets at the command of the affiliation and the total outside claims against these assets. This means that the minority stockholders of the subsidiary would have an ownership equity in the net assets of the consolidated balance sheet and that such equity must be shown in the net worth section.

If, then, a holding company only partially owns the subsidiary, the procedure of eliminating the investment account of the holding company against the capital and surplus of the subsidiary must deal only with the majority interest. When determining the goodwill or surplus from consolidation, the investment account must be compared with only that portion of the capital stock and surplus that it represents. That portion of the capital stock and surplus remaining after elimination with the investment account is carried to the net worth section of the consolidated statement as "Minority Interest".

IV. Miscellaneous Adjustments and Eliminations

Adjustments in general:- The actual process of combining the balance sheets of the individual companies of an affiliation commences with the individual adjusted trial balances. The individual companies adjust their books, record closing journal entries, etcetera, in accordance with the regular principles of accounting, and then submit to the accountant, who is preparing the consolidated statements, the necessary information pertaining to the affiliation. Although the trial balances of the individual companies so submitted are termed "adjusted", they are referred to as such only with respect to the one company, further adjustments becoming necessary before the facts can be combined into one statement.

Notes receivable discounted:- When a company transfers one of the notes of its customers to the bank or to another company, the usual procedure is to keep the item "alive" because of the contingency of a liability by crediting notes receivable discounted. The company receiving the transferred note merely debits notes receivable as the offset to cash. If both companies to this transfer were companies of the affiliation, an adjustment must be made when presenting the affiliation as one enterprise. Since the note is still held by the affiliation, the adjustment would cancel the notes receivable discounted account credit of the transferor and the notes receivable account debit of the transferee. If the accounts were combined without the adjustment, the notes receivable account of both transferor and transferee would contain the same note, and the notes receivable discounted account of the transferor would reflect a contingent liability that did not exist.

A contingency does not exist when one company of an affiliation gives its own note to another company which in turn discounts the note at the bank. The affiliation has an actual liability and the notes receivable discounted account of the second company must be shown on the consolidated statement as a notes payable.

Treasury stock:- Treasury stock on the books of subsidiaries present a debatable problem. Although the affiliation has control of the sale of this potential asset through its control of the companies, and as such should probably show it on the consolidated statement, the clear presentation on the balance sheet presents a peculiar situation. The only outstanding capital stock of the majority interest of the affiliation is the capital stock of the holding company, and a deduction from this account would be confusing with the treasury stock of the holding company. The inclusion of the treasury stock as an asset would likely be confusing since the probable intention of the controlling interest is to refrain, if possible, from allowing minority interest to be increased. Then, too, the stock held by the holding company is just as much available for public sale as the stock of the subsidiary held by the subsidiary. Because of this situation, the stock may be considered as if it were actually canceled (adjust against capital stock account) and kept off the balance sheet entirely. If it is desired to show the total of the securities of the affiliation available for sale, a footnote should suffice.

Treasury bonds:- Treasury bonds present somewhat the same situation as treasury stock except for the fact that the bond account of the holding company is not eliminated like the stock investment account.

Bonds of one company held by another are deducted from the liability as treasury bonds. If the debtor company has some of its own bonds in its possession as treasury bonds, two methods are available for use. Since these bonds are likewise available for sale, they may be considered the same as the bonds held by the other company and be deducted from the liability; or, if an internal financial structure is to be suggested (that is, if the treasury bonds on the consolidated balance sheet are to suggest the bonds as held by another company of the affiliation), the true treasury bonds may be canceled against the liability and kept entirely off the balance sheet.

Premium or discount on inter-company bonds:- When bonds are purchased at a premium or discount from an affiliated company, the premium or discount of the issuing company would be canceled against the same accounts of the purchasing company and the bonds would be valued at par as is shown in the preceding section. If, however, the bonds were purchased at a premium or discount from an outsider, the accounting is likely to be quite different from that of the issuing company. The affiliation may look at such difference as a result of a financial investment with outsiders and record the difference as a deferred item. Visualizing the companies of the affiliation as departments of one organization, however, the transaction appears the same as the retirement of its own bonds with the consequent adjustment of all deferred interest items. This latter view would necessitate clearing all accounts pertaining to premium or discount against the surplus of the holding company. The surplus accounts of the subsidiaries should not be changed, as such a change would alter the minority interest calculation.

Inter-company profits:- One company of an affiliation may sell merchandise to another company of the affiliation and the transaction be recorded in the same manner as those dealing with outsiders. If consolidated statements are to be prepared to present the companies as one operating unit, the purchase and sale transaction is no more than a transfer between departments and must be so considered. The accounts may be adjusted by eliminating the sales credit of the vendor against the purchases debit of the vendee; but, if some of the merchandise is still in the possession of the vendee and included in the current inventory, the normal valuation of cost for the merchandise will include the profit of the vendor. Since this merchandise is still unsold in so far as the affiliation is concerned, no realized profit has taken place, and the merchandise valuation must be decreased to the cost to the affiliation.

Here, again, the necessary adjustment is a simple elimination under ideal conditions, but rather complicated under varied relationships. If the vendor company is 100% a part of the majority interest, the entire amount of the recorded profit may be canceled out of the surplus against the inventory. If the company recording the profit is only partially owned by the holding company, the minority interest should not be deprived of its part of the profit of the merchandise which, to it, was sold to outsiders. This necessitates calculating exactly what portion of the profit included in the inventory is profit of the majority interest and what portion is profit of the minority interest. The profit of the majority interest would be canceled out of the surplus of the majority interest and the remaining profit would be allowed to remain in the surplus of the minority interest. An example will clarify the required adjustment.

Assume Company H to own 80% of Company S. If the inventory of Company H included merchandise purchased from Company S, the profit made by Company S must now be included in the surplus of Company S. Since 80% of the recorded profit is majority interest profit, it must be eliminated from the surplus and taken out of the inventory. This is accomplished by debiting the surplus of the holding company and crediting a valuation reserve for the inventory. If the surplus of the subsidiary were debited, the investment account elimination would be based on the net figure with the consequent miscalculation of the minority interest.

When the stock ownership of the affiliation is complicated, the calculation of the inventory profit of the affiliation often becomes rather involved. For example, assume the following facts:

Company H owns 80% of Company L

Company L owns 70% of Company M

Company H owns 15% of Company M

Inventory data as of adjustment date:

1. Company L has in its inventory $2,000 of merchandise purchased from Company M upon which Company M made a profit of $150
2. Company H has in its inventory $3,000 of merchandise purchased from Company M upon which Company M made a profit of $225
3. Company H has in its inventory $5,000 of merchandise purchased from Company L upon which Company L made a profit of $700, and upon which Company M made a profit of $500

The amount of the inter-company profit of the majority interest to be eliminated would be calculated as follows:

Since L owns 70% of M

and H owns 80% of L

then, H owns through L 56% of M

H owns directly 15% of M

therefore, H has a total of 71% ownership of M, which means that the majority interest has absorbed 71% of the profits of M.

	Profit on books of L	Profit on books of M	Total inter-company profit
Inventory data #1 (above)	--	$ 150	$ 150
Inventory data #2 (above)	--	225	225
Inventory data #3 (above)	$ 700	500	1200
Totals	$ 700	$ 875	$ 1575

Majority interest 71% of M (above)	71% of $875	=	$ 621.25
Majority interest 80% of L (owned by H)	80% of $700	=	560.00
Total majority interest in inter-company profit......................			$1181.25

This inventory valuation reserve would be taken out of the surplus of the holding company, leaving an inter-company profit of $1,575 minus $1,181.25 or $393.75 in the surplus of the minority interest.

Proof of Minority Interests in Inter-company Profit

Minority interest of M	15% of $875	=	$131.25
Minority interest of L	20% of $700	=	140.00
Claim of minority interest			
of L (20%) in M.............	20% of 70% of $875	=	122.50
Minority interest (above) in inter-company profits			$393.75

Merchandise in transit:- In consolidating the balance sheets, the inter-company accounts may reveal the fact that merchandise in transit between two of the companies had not been recorded on the books of the vendee. In such a case, a journal entry must be made in anticipation of the receipt of the merchandise in order to include the cost in the inventories of the affiliation and to bring into agreement the payable of the vendee and the receivable of the vendor.

Declared dividends unrecorded:- When dividends are declared, they immediately become a true liability and should be so recorded on the books of the declaring company. Likewise, the declaration of a dividend by a corporation creates a receivable for the stockholder company. If statements are to be prepared before the payment of the dividends, and the recordings have not been made on the respective books, adjustments for the dividends must be made before the eliminations could be calculated. The declaration of a dividend is merely a debit to surplus and a credit to dividends payable. The recording of the receivable by the stockholder company would depend upon the method used by the company in valuing its investment account. If the investment accout is maintained at cost, the credit for the receivable should go to surplus; if the investment account if maintained by absorbing profits and losses, the credit should decrease the investment account (Section II, page 14).

Miscellaneous receivables and payables:- Any payable account of a debtor company to another company must, of course, be in agreement with the corresponding receivable account of the other company. If such is not true, entries must be recorded to bring them into agreement. If one company, for example, had recorded the accrued interest payable on outstanding bonds, the other companies must, if they own some of the bonds, have the accrued interest receivable recorded. The inter-company obligations, though, are of no interest on a consolidated balance sheet and should be eliminated. The purpose of the consolidated balance sheet is to merge the assets and liabilities of the individual companies, but if such assets and liabilities are not those showing the relationship of the affiliation to outsiders, they are of no significance. Just as both the investment account of the holding company and the net worth section of a subsidiary are dropped from a consolidated balance sheet, so is the payable account of one company and the receivable account of the other company kept from the statement. An elimination of this type merely decreases the current assets and current liabilities to the amounts reflecting relations with outsiders.

V. Working Papers for Consolidating

Form and procedure:- When the adjustments and eliminations are numerous or complicated, working papers are used in determining the consolidated balance sheet. The form of the working papers may vary with the individual accountant; yet, the form must be such as to record first the adjustments and then to divide between eliminated and non-eliminated items. The consolidated balance sheet is prepared directly from the non-eliminated items.

The following work sheet of the simple illustrative problem of Section I will illustrate the consolidating procedure:

Consolidating Work Sheet
Combining Company H With Its Subsidiary
Company S
December 31, 1933

	Co.H	Co.S	Adjustments		Eliminations	C.B.S.
Debits						
Cash	$ 5,000	$ 4,000				$ 9,000
Investment in Co. S	50,000				$50,000	
Furniture and Fixtures	10,000	18,000				28,000
Buildings	20,000	48,000				68,000
	$ 85,000	$ 70,000			$50,000	$105,000
Credits						
Accounts payable	15,000	20,000				35,000
Capital & Surplus: Co. H	70,000					70,000
Co. S		50,000			50,000	
	$ 85,000	$ 70,000	--	--	$50,000	$105,000

The balance sheets of the affiliated companies are placed in columnar form in the first columns of the work sheet. The next two columns are then used for any adjustments that may be necessary before the eliminations. These adjustments may have the debit going to an account of one company with the credit applying against an account of another company. The changes are made only for the purpose of determining on the face of the work sheet the inter-company adjusted balances for elimination or inclusion on the consolidated balance sheet, and, accordingly, are not to be posted actually to any account. If desired or necessary, any one company may record on their particular books the adjusting transation affecting them, but this would be beyond the scope of the procedure in consolidating the balance sheets.

The elimination column is for the purpose of dropping these items that are not to be included in the consolidated statement. Notice in the preceding example that the capital and surplus of Company S was eliminated against the investment account of the holding company, Company H. Since the items of both companies are added together for inclusion on the consolidated balance sheet, the elimination is, in effect, the substitution of the assets and liabilities of Company S in the investment account of Company H.

The consolidated balance sheet presented for the affiliation is prepared from the last column of the work sheet (see page 8).

Illustrative problem:- Company A, a holding company, owns controlling interest in Company B and Company C. The balance sheets of the three companies as of December 31, 1933, were as follows:

Company A

Balance Sheet

December 31, 1933

Assets

Cash	$ 7,000	
Advances to Company B	5,000	
Temporary Investments	15,000	
Investment in Co.B - 90%	71,280	
Investment in Co.C - 80%	45,000	
Bonds of Company B	10,200	
Total assets		$153,480

Liabilities and Capital

Dividends Payable			$ 7,800
Capital Stock	$140,000		
Less: Treasury Stock	10,000	$130,000	
Surplus		15,680	145,680
			$153,480

Company B
Balance Sheet
December 31, 1933

Assets

Current:			
Cash		$ 2,500	
Company C - current account		3,000	
Notes receivable - trade		3,100	
Notes receivable - Co. C	$ 2,000		
Less: Notes discounted	1,500	500	
Inventories:			
Raw materials	$ 2,000		
Work in process	16,000		
Finished goods	4,000	22,000	
Current assets			$31,100
Investment in Company C - 10%			6,250
Capital assets:			
Land		$ 7,000	
Buildings		17,000	
Machinery and Equipment		50,000	74,000
Goodwill			8,000
			$119,350

Liabilities and Capital

Current:			
Accounts payable		$ 3,500	
Notes payable		3,100	
Accrued interest on bonds		870	
Dividends payable		1,200	
Advances from Company A		5,000	
Current liabilities			$ 13,670
Bonds payable		$ 30,000	
Less: Treasury bonds		1,000	29,000
Capital stock	$ 65,000		
Less: Treasury stock	5,000	$ 60,000	
Surplus		16,680	76,680
			$119,350

Company C
Balance Sheet
December 31, 1933

Assets

Current:			
Cash		$ 3,000	
Accounts receivable - trade		2,000	
Notes receivable - trade	$ 2,000		
Less:Notes receivable discounted	1,000	1,000	
Inventories:			
Raw materials	$ 4,500		
Work in process	8,000		
Finished goods	12,000	24,500	
Current assets			$30,500
Capital assets:			
Land		$ 4,000	
Buildings		15,000	
Machinery and Equipment		20,000	39,000
			$69,500

Liabilities and Capital

Current liabilities:		
Accounts payable	$ 700	
Notes payable	1,500	
Company B - current account	1,000	
Notes payable - Company B	2,000	
Dividends payable	1,500	
Current liabilities		$ 6,700
Capital stock	$ 50,000	
Surplus	12,800	62,800
		$69,500

Upon investigation, the following data were disclosed concerning the affiliation:

1. The investment accounts in the stock of Company B and Company C on the books of Company A have been maintained by absorbing the profits and losses of the respective subsidiaries.

2. The investment account on the books of Company B is valued at cost. The net worth of Company C at date the stock was purchased was: Capital stock - $50,000; Surplus - $4,300.

3. Company C frequently purchases partially processed merchandise from Company B which Company B prices at 110% of the accumulated cost so far incurred. On December 31, 1933, Company C has in its work-in-process inventory $3,500 of merchandise so purchased. In addition to the $3,500 worth of merchandise, $2,000 of merchandise is in transit between Company B and Company C and has not been taken up on the books of Company C.

4. $750 worth of the notes receivable shown on the books of Company C as being discounted were in reality transferred to Company B and now appear in the notes receivable account of Company B.

A consolidated balance sheet is required to picture the three companies as one operating unit. The following work sheet was prepared in order to facilitate the preparation of the required statement.

Consolidating Work Sheet

Debit Accounts

Consolidating
Combining with Company
Company B and
December

Debit Accounts	Company A	Company B	
Cash	$ 7,000	$ 2,500	1
Accounts receivable - trade			2
Notes receivable - trade		3,100	3
Inventories:			4
Raw materials		2,000	5
Work in process		16,000	6
Finished goods		4,000	7
Temporary investments	15,000		8
Investment in Company B - 90%	71,280		9
Eliminate present book value:			10
Capital stock - 90% $60,000			11
Surplus - 90% $16,930			12
Consolidated goodwill			13
Investment in Company C - 80%	45,000		14
Eliminate present book value:			15
Capital stock - 80% $50,000			16
Surplus - 80% $12,800			17
Consolidated surplus			18
Investment in Company C - 10%		6,250	19
Eliminate at date of acquisition:			20
Capital stock - 10% $50,000			21
Surplus - 10% $4,300			22
Consolidated goodwill			23
Bonds of Company B	10,200		24
Par			25
Premium			26
Advances to Company B	5,000		27
Notes receivable - Company C		2,000	28
Company C - current account		3,000	29
Land		7,000	30
Buildings		17,000	31
Machinery and Equipment		50,000	32
Goodwill		8,000	33
Treasury bonds		1,000	34
Treasury stock	10,000	5,000	35
	$ 163,480	$ 126,850	36
			37
			38
Accrued interest on bonds of Company B			39
Dividends receivable:			40
Stock of Company B owned by Company A			41
Stock of Company C owned by Company A			42
Stock of Company C owned by Company B			43
Adjustment totals carried forward			44

Work Sheet
"A" Its Subsidiaries
Company C
31, 1933

	Company C	Adjustments Debits	Adjustments Credits	Eliminations	Consolidated Balance Sheet	
1	$ 3,000				$ 12,500	1
2	2,000				2,000	2
3	2,000		I $ 750		4,350	3
4						4
5	4,500				6,500	5
6	8,000	A $ 2,000			26,000	6
7	12,000				16,000	7
8					15,000	8
9			E 1,080			9
10						10
11				a $ 54,000		11
12				a 15,147		12
13					G 1,053	13
14			F 1,200			14
15						15
16				b 40,000		16
17				b 10,240		17
18					NG 6,440	18
19						19
20						20
21				c 5,000		21
22				c 430		22
23					G 820	23
24						24
25			C 10,000			25
26			H 200			26
27				d 5,000		27
28				e 2,000		28
29				i 3,000		29
30	4,000				11,000	30
31	15,000				32,000	31
32	20,000				70,000	32
33					G 8,000	33
34		C 10,000			11,000	34
35			B 5,000		10,000	35
36	$ 70,500					36
37						37
38						38
39		D 300		f 300		39
40						40
41		E 1,080		h 1,080		41
42		F 1,200		g 1,200		42
43		G 150		g 150		43
44		$ 14,730	$18,230	$137,547	$219,783	44

Consolidating Work Sheet

Credit Accounts

Credit Accounts	Company A	Company B	
Adjustment totals brought forward			1
Accounts payable		$ 3,500	2
Notes payable		3,100	3
Company B - current account			4
Notes payable - Company B			5
Accrued interest on bonds		870	6
Notes receivable discounted			7
Notes receivable - Co. C - discounted		1,500	8
Dividends payable:			9
by Company A	$ 7,800		10
by Company B		1,200	11
by Company C			12
Advances from Company A		5,000	13
Bonds payable		30,000	14
Capital stock:			15
Company A	140,000		16
Company B - 650 shares		65,000	17
Eliminate:			18
H. C. 540 shares - 90%			19
Minority - 60 shares - 10%			20
Company C			21
Eliminate:			22
H. C. (owned by Company A) - 80%			23
H. C. (owned by Company B) - 10%			24
Minority - 10%			25
Surplus:			26
Company A	15,680		27
			28
Company B		16,680	29
Eliminate:			30
H. C. 90% of $16,830			31
Minority 10% of $16,830			32
Company C			33
Eliminate:			34
H. C. 80% of $12,800			35
H. C. 10% of surplus at			36
acquisition ($4,300)			37
H. C. 10% of increase since			38
acquisition ($8,500)			39
Minority 10% of $12,800			40
	$ 163,480	$ 126,850	41
			42
Reserve for inter-company profits in inventories			43
			44

	Company C	Adjustments Debits	Adjustments Credits	Eliminations	Consolidated Balance Sheet	
1		$ 14,730	$ 18,230			1
2	$ 700				$ 4,200	2
3	1,500				4,500	3
4	1,000		A 2,000	i $ 3,000		4
5	2,000			e 2,000		5
6				f 300	570	6
7	1,000	I 750			250	7
8					1,500	8
9						9
10					7,800	10
11				h 1,080	120	11
12	1,500			g 1,350	150	12
13				d 5,000		13
14					30,000	14
15						15
16					140,000	16
17		B 5,000				17
18						18
19				a 54,000		19
20					M 6,000	20
21	50,000					21
22						22
23				b 40,000		23
24				c 5,000		24
25					M 5,000	25
26						26
27		(H 200	D 300			27
28		(J 450			S 15,330	28
29			G 150			29
30						30
31				a 15,147		31
32					M 1,683	32
33	12,800					33
34						34
35				b 10,240		35
36						36
37				c 430		37
38						38
39					S 850	39
40					M 1,280	40
41	$ 70,500					41
42						42
43			J 450		R 450	43
44		$ 21,130	$ 21,130	$ 137,547	$ 219,783	44

Company A
and its subsidiaries, Co. B and Co. C
Consolidated Balance Sheet
December 31, 1933

Assets

Current:				
Cash			$ 12,500	
Marketable securities			15,000	
Accounts receivable			2,000	
Notes receivable		$ 4,350		
Less: Notes receivable discounted		250	4,100	
Inventories:				
Raw materials		$ 6,500		
Work in process		26,000		
Finished goods		16,000		
		$48,500		
Less: Reserve for inter-company profits		450	48,050	
Current assets				$ 81,650
Capital assets:				
Land			$ 11,000	
Buildings			32,000	
Machinery and Equipment			70,000	113,000
Goodwill				3,433
				$198,083

Liabilities and Capital

Current:				
Accounts payable			$ 4,200	
Notes payable			6,100	
Accrued interest on bonds			570	
Dividends payable			8,070	$ 18,940
Bonds payable			$ 30,000	
Less: Inter-company holdings			11,000	19,000
Minority interest:				
Capital stock		$ 11,000		
Surplus		2,963	$ 13,963	
Majority interest:				
Capital stock	$140,000			
Less: Treasury stock	10,000	$130,000		
Surplus		16,180	$146,180	
Total net worth				160,143
				$198,083

Comments:- The preceding consolidated balance sheet was prepared from the last column of the work sheet as the required statement for the affiliation. The adjustments and eliminations made on the work sheet will be explained in the following paragraphs with references to the page on which such adjustments or eliminations were discussed.

Adjustment A was made to record the merchandise in transit between Company B and Company C. The work-in-process inventory was debited, since the material had already been partially processed by Company B (see page 30).

Adjustment B was made to cancel the treasury stock on the books of Company B against its capital stock (see page 25).

Adjustment C transfers the par of the bonds of Company B owned by Company A to the treasury bonds account. Both the bonds of Company B owned by Company A and the bonds repurchased by Company B are shown together on the consolidated statement as inter-company holdings (see page 25).

Adjustment D records on the books of Company A the receivable due to the accrued interest on the bonds of Company B (see page 31). The accrued interest on bonds account recorded on the books of Company B show an accrual of 3% on the outstanding bonds (3% of $29,000 = $870). Company A, owning bonds in amount $10,000, has an accrued income of 3% on $10,000 or $300.

Adjustments E, F, and G record on the books of the stockholder companies the portion of the dividends declared that is applicable to the stock they own. The credits for E and F were to the investment accounts, since Company A maintained the investment accounts by absorbing the profits and losses of the subsidiaries (see page 15). Since the investment in Company C account on the books of Company B is valued at cost, the credit in adjustment G is made to the surplus account of Company B (see page 13). The amounts were determined as follows:

	Company B	Company C
Capital stock outstanding	$60,000	$50,000
Dividends payable	$ 1,200	$ 1,500
Dividend percentage	2	3
Par value of stock owned by Co. A	$54,000	$40,000
Dividend receivable	$ 1,080	$ 1,200
Par value of stock owned by Co. B		$ 5,000
Dividend receivable		$ 150

Adjustment H cancels against surplus the premium on the bonds of Company B evidently purchased from outsiders (see page 26).

Adjustment I cancels the contingent liability recorded when Company C transferred to Company B notes receivable in amount $750 (see page 24).

Adjustment J - the total amount in the inventories of Company C (after adjustment A) is $5,500. Since this is 110% of the cost so far incurred, the profit for such merchandise recorded on the books of Company B is $500. The majority interest in Company B, owned entirely by Company A, is 90%. The reserve, therefore, was created for $450 or 90% of $500 (see page 27).

Eliminations a and b are cancelling the portion of the current net worth of the subsidiaries as owned by Company A against the valuation of the investment account with the difference set up as the goodwill and surplus, respectively, acquired with the purchase of the stock (see page 20). The percentage of ownership was applied against the current valuations of the net worth accounts because of the valuation of the investment account by absorbing profits and losses of the subsidiaries.

Elimination c applies the percentage of ownership against the net worth of Company C at acquisition of stock with the difference set up as consolidated goodwill. Since the investment account is valued at cost, the majority interest portion of the increase in surplus since acquisition must be carried to the surplus of the consolidated balance sheet (see page 19).

Eliminations d, e, f, g, h, and i are merely examples of eliminating inter-company receivables and payables (see page 31).

Notes receivable - Company C - discounted, $1,500, was included in the consolidated balance sheet with the notes payable (see page 25).

The consolidated balance sheet valuation of goodwill was calculated as follows:

Goodwill on the books of Company B	$ 8,000
Goodwill arising from the acquisition of Company B by Company A	1,053
Goodwill arising from the acquisition of Company C by Company B	820
	$ 9,873
Less: Application of surplus arising from the acquisition of Co. C by Co. A	6,440
	$ 3,433

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