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United States. Securities and Exchange Commission

Carman G. Blough

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SECURITIES AND EXCHANGE COMMISSION
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ACCOUNTING SERIES
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The Securities and Exchange Commission today published an opinion in its accounting series outlining a procedure which would prevent write-ups arising in the consolidation of accounts by a parent company with those of its subsidiaries through the elimination of only a portion of the investment account.

The opinion, prepared by Carman G. Blough, Chief Accountant, was written with reference to one unnamed company, but the principles enunciated have wider application, in the Commission's belief.

The opinion contends that the purpose of the consolidated balance sheet is to reflect the financial condition of a parent company and its subsidiaries as if they were a single organization. Thus the parent's actual equities in the subsidiaries' net assets should be substituted for its investments in the consolidation of the accounts. In some instances, the Commission has found that only the par or stated value of stocks of subsidiaries are eliminated in the substitution with the result that the surpluses of the subsidiaries are improperly included as surplus in the consolidation. This, the opinion indicates, constitutes, in effect, a write-up in the consolidated accounts, since no new assets have actually been added.

Mr. Blough's letter follows:

"You have requested my opinion concerning the propriety of the practice whereby the subject company, in consolidating its accounts with those of its subsidiaries, eliminated from its investment account only the par or stated value of the stocks of subsidiaries.

"It is my understanding that:

"1. The aggregate cost of these investments to the parent company was in excess of its proportionate interest in the equities in the net assets of the subsidiaries as shown on the books of the latter.

"2. The parent's equities in the surpluses of the subsidiaries at the dates their stocks were acquired by the parent were included as part of consolidated surplus.

"3. The amount of the parent's investment account not eliminated was shown as an asset on the consolidated balance sheet, designated 'Excess of Cost over Par or Stated Value of the Securities of Subsidiaries Eliminated in Consolidation.'

"The acquisition by one company of the controlling stock interest in another constitutes, in effect, the acquisition of the assets of the acquired company subject to its liabilities and the interests of minority stockholders. The values of such assets, after deducting the liabilities and minority interests, constitute the equity of the parent in the subsidiary and the book value of such equity is equal to the par or stated value of the stock(s) owned by the acquiring company plus the portion of the surplus(es) of the subsidiary applicable thereto.

"The purpose of a consolidated balance sheet is to reflect the financial condition of a parent company and its subsidiaries as if they were a single organization. Thus, in such a balance sheet, the parent company's equities in net assets of subsidiaries are substituted for its investments therein. This substitution is effected by eliminating from the parent company's investment account an amount equal to the par or stated value of the subsidiaries' stocks owned by the parent and its proportionate share of their surpluses at acquisition. Any part of the parent's investment account remaining (representing the excess cost thereof over the equities in the net assets represented thereby) may properly be retained among the consolidated assets.

"The foregoing consolidation procedure, which, in my opinion, conforms to sound and generally accepted accounting practice, has not been followed by the subject company. Instead, by eliminating only an amount equal to the par or stated value of the subsidiaries' stocks from the parent company's investment account, consolidated assets and surplus are overstated in an amount equal to the parent's proportionate share of the surpluses of the subsidiaries as at the respective dates of the acquisition of their stocks."

The opinion is the third of a series of interpretations on accounting principles which the Commission is publishing from time to time for the purpose of contributing to the development of uniform standards and practice in major accounting questions.

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