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## **Group Accounts: A UK Perspective**

This article discusses some UK Generally Accepted Accounting Principles (UK GAAP) associated with UK Japanese companies which are specifically required to prepare group accounts.

As a general principle, where one company (or undertaking) controls another company (or undertaking) it is required to prepare group accounts to show the combined results and position of both companies. The original UK standard on group accounts, Statement of Standard Accounting Practice No. 14 (SSAP 14) 'Group Accounts' was issued in September 1978 and was drafted to accord with the relevant provisions of the Companies Act then in force. At that time the Companies Act did not include detailed rules regarding the preparation of group accounts.

The issue of International Accounting Standard No. 3 (IAS 3) 'Consolidated Financial Statements' prompted the UK standard setting board to act. IAS 3 was later replaced by IAS No. 27 'Consolidated financial statements and accounting for investments in subsidiaries' which was recently amended in January 2008. The need to revise SSAP 14 for changes in the law provided an opportunity to conduct a thorough review of the standard. Consequently the Accounting Standards Board issued Financial Reporting Standard 2 (FRS 2) 'Accounting for Subsidiary Undertakings' in July 1992. FRS 2 was later amended in December 2004 to reflect further changes in the law, exemptions from the preparation of consolidated accounts for intermediate parent undertakings whose immediate parents are not governed by the law of a European Economic Area State and remove the requirement for exclusion from consolidation of subsidiaries with dissimilar operations to the parent undertaking.

FRS 2 and IAS 27 are very similar standards in many respects. Therefore the situation is now even clearer than when SSAP 14 was first introduced. It is normal for group accounts to be in the form of consolidated financial statements, with the terms more or less having the same meaning. The group is effectively treated as though it were a separate single company with only one group of shareholders. The balances and profits shown are only those resulting from transactions with third parties and all balances and transactions within the group are eliminated. Some common adjustments are discussed later.



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An undertaking is the parent undertaking in relation to another undertaking, the subsidiary, if the subsidiary undertaking is controlled by the parent undertaking. This implies that a group will consist of all undertakings under the control or ownership of the parent.

## Consolidated Adjustments

### Intra-Group Transactions

The objective of consolidated financial statements is to present the results of the parent and all the entities over which it has control (i.e. a group) as if they were a single entity. It follows from this that an entity cannot trade with itself nor make a profit from any transactions within the group. Thus any intra-group transactions need to be eliminated i.e. cancelled as part of the consolidation process. Such transactions include sales, transfers of assets and loans.

*Sales* - If one member of a group sells goods to another, these sales are recorded by the seller in turnover, and by the purchaser in cost of sales at the same amount (the transfer price). Provided the purchaser has sold on the goods to an entity that is not a member of the group, it is a simple matter to eliminate the intra-group sale from turnover and cost of sales (at the same amount) when consolidating the profit and loss accounts. This elimination does not have an effect on the balance sheet. A problem arises when some of the goods from the intra-group sale are still in the inventory (or stocks) of the purchasing company at the year end. As these goods have not left the group, any profit added by the supplying company has not been realised and must therefore be eliminated. Once the amount of the unrealised profit has been determined, it is deducted from gross profit (by increasing cost of sales) and also deducted from the carrying amount of the consolidated inventory on the balance sheet. This deduction reduces the balance sheet value of the inventory to the cost of the group.



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*Non-current asset transfers* - Occasionally, a non-current asset is transferred within the group. The parent may have manufactured the asset as part of its normal production (and therefore included the sale in turnover or revenue, or it may have transferred an asset previously used as part of its own non-current assets. If the transfer is done at cost the required elimination would therefore be to remove the cost of the asset from turnover or revenue and cost of sales. The situation is also complicated if the transfer contains a profit element. At the date of sale /transfer, the profit is unrealised so in the financial statements prepared at this date the profit would be eliminated and also deducted from the carrying amount of the asset.

*Loans* - It is quite common for a parent to provide a loan to a subsidiary on which interest will usually be paid and received. The parent will normally show the loan as an investment with any interest received included in its profit and loss account. Conversely, the subsidiary will show the loan as a non-current liability (assuming repayment is due in more than one year's time) and will show any interest paid as a financing cost in its profit and loss account. It is a relatively simple matter to eliminate the asset (investment) against the liability (loan) in the consolidated balance sheet and the interest received against the interest paid in the consolidated profit and loss account.

### **Accounting policies**

Uniform accounting policies should be used for determining the amounts to be included in the consolidated financial statements, if necessary by adjusting for consolidation the amounts which have been reported by subsidiary undertakings in their individual financial statements. In exceptional cases, different accounting policies may be used but any departures require disclosure of the particulars.

### **Accounting period and dates**

The financial statements of subsidiary undertakings to be used in preparing consolidated financial statements should, wherever practicable, be prepared to the same financial year and for the same accounting period as those of the parent undertaking of the group. Where the financial year of the subsidiary undertaking differs from that of the parent, interim financial statements should be prepared to assist in the consolidation. If it is not practicable the subsidiary's last financial statements, providing that the year ended not more than three months before the relevant year end of the parent of the group, should be used for consolidation purposes.



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In summary, FRS 2 sets out the conditions under which an entity qualifies as a parent undertaking which should prepare consolidated financial statements for its group - the parent and its subsidiaries. The FRS also sets out the manner in which consolidated financial statements are to be prepared.