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INFLUENCES OF NEW IFRS ON CONSOLIDATED FINANCIAL REPORTING

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Abstract:

The main aim of this study is to make a brief incursion into national and international legislation, correlated with the specialized literature on the advantages, disadvantages and obstacles faced by the process of elaboration of the consolidated financial statements. At the same time, through the specialty literature we want to investigate whether the reporting practices and accounting policies of the companies changed in response to IFRS 10. The topic is of importance and usefulness not only for the companies obliged to elaborate consolidated financial statements, but for all the parties involved in the process of communication with such a company.

Key words: IFRS; consolidated financial situations, control, consolidation perimeter

JEL Classification: M41

1. INTRODUCTION

According to international standards, a group is "represented by a parent company together with all its subsidiaries " (IAS 27, 2008) over which it exercises control, and within the meaning of national rules, the group is a "formation of companies made up of the consolidating company - Romanian legal entity (consolidator) - and its subsidiaries - Romanian and foreign companies" (OMFP 1802/2014, art. 493). Each company has its own legal personality, but the decision center is unique, namely, the group as an economic entity, but without legal personality.

Any information user seeks to find an image of the group, but its nature is not always the same, sometimes being of economic, financial or patrimonial interest (Ţurcanu et al., 2008). Therefore, a simple publication of the balance sheet and of the profit and loss account is not enough to inform third parties, as it is necessary to form an image of the group due to the diversity of the observers, each having a specific hypothesis regarding the related companies (Mihaila & Jieri, 2017).

The consolidated financial statements of the group do not consist of summing up the individual annual financial statements of the entities in the group, as internal transactions can be found between them, which would artificially increase the values of the individual accounts. By consolidating the financial statements, external users can appreciate the situation as a whole and not on each component of the group. Thus, it facilitates the determination of the real financing needs and the possibilities of repayment or the assessment of the related risk, respectively the result as a whole, the capacity of self-financing, the rates of profitability and the capacity of investment. In order to present the consolidated financial statements, the ensemble of companies that make up the group must be delimited. Therefore, the consolidation perimeter must first be determined.

So that the consolidation of the situations makes sense, the subassemblies of the group, which have some fairly close links, are delimited by a border called the consolidation perimeter. Thus, "consolidated companies over which the company exercises exclusive control (subsidiaries), conjunctive or concurrent control (joint ventures also called as Joint Stock Company) or significant influence (associated companies)" add up to the consolidation perimeter (Sacarin, 2002).

The consolidation perimeter consists of the parent company and the companies over which it exercises its exclusive, conjunctive control or notable influence. In order to be part of the consolidation perimeter, the percentage of control held by the parent company in the subsidiary company must be greater than 20%.

The inclusion of an entity in the consolidation perimeter is effective on the date of the acquisition of the securities by the consolidating company, on the date of the acquisition of the control or significant influence, if the acquisition was made by several tranches, or on the date provided by the contract, if the control transfer is specified at a different time from the one of transfer of securities. The exit from the consolidation perimeter is realized when the securities are sold, when the control or significant influence held in the company is lost.

The purpose of this paper is to make a brief incursion into national and international legislation, correlated with the specialized literature on the advantages, disadvantages and obstacles faced by the process of elaboration of the consolidated financial statements.

The theme is of permanent importance and usefulness not only for the companies obliged to elaborate consolidated financial statements, but for all the parties involved in the process of communication with such a company.

2. INTERNATIONAL AND NATIONAL REGULATIONS REGARDING CONSOLIDATED ACCOUNTS

Starting with World War II, first in the Western world and later in the emerging economies, we have witnessed an unprecedented technological progress, thanks to the speed with which new discoveries have taken place, on the one hand, and the increase in the social welfare level of the people, on the other hand. As a result, consumers have changed their habits but also their needs and desires.

Due to the propulsive force induced by the technological development, the economies have begun to develop new business systems, with the main purpose of obtaining a greater efficiency in production and the expansion of the sale markets. This is in fact the beginning of the first collaborations, cooperations, aggregations between different companies, which try to exploit technical and managerial knowledge and skills, presence on the market, integration of productive activities (Antonelli, 2001)

In this context, the structure of the corporate group has been developed. In studies, in doctrine and in legislation, there is no unique and always valid definition describing the corporate group, for this reason it can be said that large companies have been organized over time as a group, assuming every day a role of increasing importance in the development and growth of economic and social systems. Small and medium-sized enterprises, determined by the need for growth and improvement of their own efficiency, are organized in such a way as to carry out the management activities under governance, and the cooperation and coordination are subordinated to a single decision-making center. The essence of the groups is practically expressed by the specific economic-legal relationship existing between the parent company and the subsidiary companies. The notion of group itself is based on two distinctive elements considered essential for the configuration of its structure: the plurality of autonomous legal entities and their subordination to a unique economic entity identifiable in the subject exercising control of the parent company. This last aspect is generally recognized by the doctrinal orientation as a determinant for the end of the recognition of the phenomenon in question: the corporate group. (Fellegara, Tibiletti and Marchini, 2011). This means that the individual companies in the pursuit of their productive activities do not act alone, but in collaboration with other stakeholders, which means that, on the one hand, they give up their decision-making autonomy, but on the other hand, they become part of a group trying to improve the efficiency of operations, aiming at the development and growth of the entire business complex, delegating the choice and implementation of corporate strategies to a single control entity. So, on the one hand, all the companies belonging to a corporate group retain their legal autonomy regarding the outside world, a fundamental feature to distinguish a corporate group from a single large company, divided into sections spread over its territory, because, in the latter case, several sections of the company do not have full legal autonomy (Terzani, 1993). If the groups differ according to the type of economic-operational integration, it is possible to identify groups with vertical, horizontal and conglomerate integration (Antonelli, 2001; Paolone, 2007).

The relationships that put the mother company and the subsidiary in contact allow the identification of an additional distinction of the groups, characterized in this case by two factors: managerial behavior that can be unitary or fractional, and the operational interrelation or the degree of economic-technical integration, which in turn can be high or moderate. Therefore, this taxonomy makes it possible to identify a group based on its management structure (Brunetti, 1987).

Based on those presented, four types of groups can be identified: strategic, financial, patrimonial and formal.

The strategic group, characterized by a high degree of operational interrelation and guided by a directional and strategic unitary behavior, represents the maximum expression of the group concept. In this context, the individual economic entities function as if they were branches or sectors belonging to a single company that implements the business strategies of the top management. Generally, the strategic groups are formed by companies that operate in adjacent segments of the same business and, due to these particularities it is possible to assert that these companies are often vertically integrated, forming due to the strong bonds that bind the individual companies into a real network managed in a unified way. In these groups, the consolidated balance sheet can be useful to all stakeholders and shows its maximum information capacity.

The financial groups are made up of companies that do not operate in the same sector and therefore have a rare operational interrelation, if they do not exist. Despite this, the parent company is able to target the group's companies in a unified manner, due to the targeted allocation of available resources (especially financial resources). In this particular type of group, the consolidated financial statements should inform about the distribution of the resources available to the group.

The patrimonial groups present a situation completely opposite to the strategic groups. In fact, in this type of group there is no unitary strategic orientation of the group and no contiguity of the activities carried out by the different companies, because they belong to different sectors, thus seeking a heterogeneous group. The intrinsic motivation of this type of group is the simple diversification of the activities carried out by the different companies, benefiting from such general compensatory effects. In this case, the consolidated balance sheet cannot effectively communicate the reality of the group, because inside it there are completely different components between them, which makes their reporting univocal.

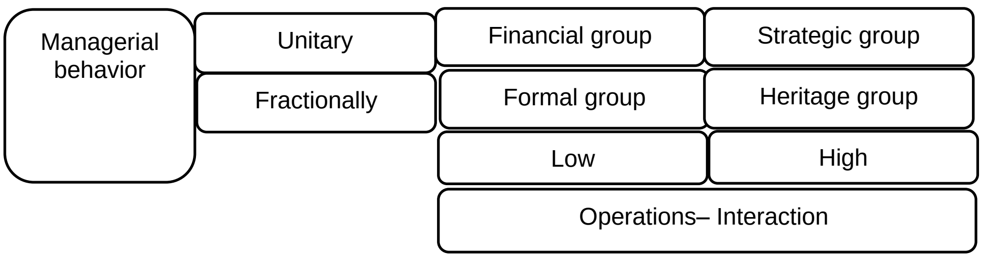

Figure 1. The typology of the groups according to the managerial configuration
Source: Author's own elaboration

One type of atypical group is the one represented by the formal groups. In fact, they have a high economic-technical integration, but they are not addressed through a common strategy. In fact, the parent company does not influence the direction of the economic activity and, therefore, does not offer a common objective to all the entities of the group. For these reasons, the consolidated financial statements represent only a combination, a summary of the profitability and economic results of the individual units, without being able to enjoy all the benefits arising from belonging to a group of companies (Lai, 2005).

Based on these distinctions, it is possible to specify that the consolidated financial statements are the main information tool regarding the interpretation of the group as a single company, providing more precise information about the development, the economic situation, the technical-operational integration and the management of a group of companies regarding to the one provided by the financial statements of the individual units (Bostan, Grosu & Socoliuc, 2009).

In these contexts, the desire to harmonize at European level the accounting regulations with regard to the consolidated accounts was created by the publication by the Council of the European Communities of the VII Directive in 1983, and currently in the 34/EEC Directive, the provisions being subsequently harmonized with the International Financial Reporting Standards (IFRS). The standards that directly concern the consolidation of the accounts are [1]:

- IAS 27 - Consolidated and individual financial statements;
- IAS 28 - Investments in associates;
- IAS 31 - Interests in joint ventures;
- IFRS 3 - Business combinations.

At national level, the first standard on consolidation was OMFP no. 772/2000 approving the Norms regarding the consolidation of the accounts. In order to transition to an accounting system in accordance with the European directives, OMFP 1752/2005 was published regarding the approval of the accounting regulations with the European directives. Currently, the regulations regarding the consolidated accounts are transposed in OMFP no. 1802/2014, within chapter 8 - Consolidated annual financial statements and consolidated reports.

There are differences between the two accounting standards:

- the entities obliged to present the consolidated financial statements;
- exemptions and sparings from the preparation of the consolidated financial statements (Issakova et al., 2017);
- exclusion from consolidation and application of consolidation methods;
- assessment of interests that do not control.

The identification of the group area and the scope of consolidation are regulated by IFRS 10, which provides that each control entity prepares the consolidated financial statements. In order to define the concept of control, first it is necessary to identify the stakeholders: the investor or controlling entity is the parent company; the object of the investment, i.e. the controlled entity is the subsidiary company. An investor is identified as a parent company, if it is found that it controls or not the invested entity (IAS/IFRS, IFRS 10, paragr. 10.5). The control exists if the investor is exposed or has rights to the variable profits arising from the investment and if he has the possibility to modify these returns due to the influence on the investments.

Earlier, we specified that the consolidated financial statements are the instrument by which the public is informed about the reality of the group. We also specify that, from the accumulation of the elements of the financial statements of the parent company and its subsidiaries, a second level balance results.

In order to properly prepare the consolidated financial statements, it is therefore necessary to follow certain operations that can be divided into two categories: organizational operations and accounting operations. The purpose of an appropriate group organizational system is to assist the parent company in the correct and timely preparation of the consolidated financial statements, in accordance with the reference legislation. In fact, a precise definition of the organizational aspects is a necessary condition for the subsequent processing of the accounting operations, out of all the organizational aspects, those considered the most relevant belong to three distinct categories namely (Gardini, 2010).

- The use of means and information tools;
- Defining the degree of centralization of the consolidation process;
- Preparation of documents for the elaboration of the consolidated financial statements.

The first aspect refers to the adoption of an adequate information system that allows all group companies to make homogeneous accounting records. The use of certain accounting software helps the various entities of the group to ensure the clarity, completeness, correctness and accuracy of the accounting records. This accounting homogeneity is a fundamental aspect for the preparation of the consolidated financial statements, because the accounting elements derived from all the consolidated entities must be presented in the report.

Organizational operations and accounting operations aimed at preparing consolidated financial statements require particular interpretations with significant differences in accordance with the legislation and accounting principles followed.

3. MODALITIES OF CONSOLIDATION

In practice we find two ways to consolidate financial statements:

a. Consolidation on the basis of the flows, which consists of closing the accounts at the end of the financial year, taking over the balances at the beginning of the following financial year, followed by the recording of the operations performed by the consolidated entities to be carried out as they are performed. The flows of values related to the assets, liabilities, expenses and revenues from the financial statements of the consolidating companies are recorded. Finally, the information obtained will be subject to adjustments, deletions, withdrawals, taking into account only the specific elements of the current exercise (with an impact on the result). "the main advantage of this consolidation method is that it allows a better consideration of the elements related to the previous exercises, while the disadvantage consists of a larger workload and a more laborious way of organizing the consolidation works " (Lenoci and Rocca, 2012 p. 34).

b. Consolidation by adding up the balances is based on the use of the information obtained from the individual financial statements drawn up at the end of each financial year by the consolidated entities. This information is aggregated and subject to adjustments, restatements and deletions, both in respect of the current exercise and previous exercises. Finally, through the centralization of information, a consolidated verification balance is obtained. Here we find the disadvantage of risking omitting certain records from previous years with effects on the consolidated financial statements.

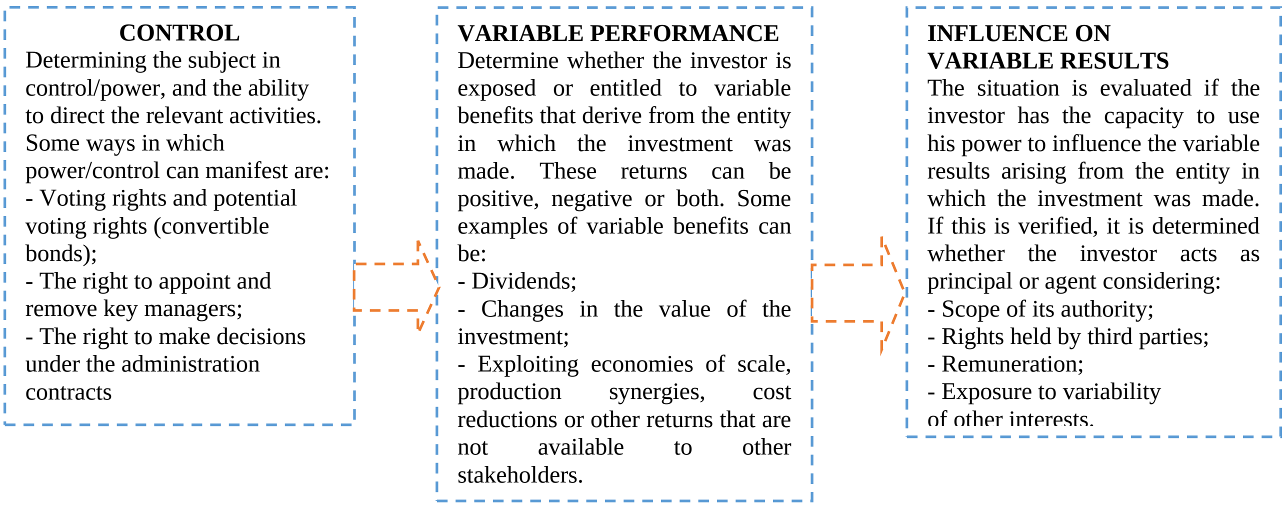

Figure 2. The correlation between investor control and purpose

For a company to be considered a parent, it must present and display all the features in relation to a subsidiary (GAAP, 2015):

- Control over the activity of the entity that is the object of the investment;
- Exposure or the right to obtain variable benefits arising from the investor's activity;
- The ability to harness its own power/control and to influence the performance of the entity that is the object of the investment.

The first condition refers to control, that is, the investor's ability to direct the relevant activities of the subsidiary. In order to evaluate whether the investor holds this control, it is therefore necessary to pay attention to two critical factors, namely: relevant activities and validated rights. The relevant activities are the activities of the company that significantly affect the variable results of the company, and the decisions regarding these activities are, in general, operational in nature, investment decisions, appointment and remuneration of the management. In order to be able to approach these relevant activities, the investor must have substantial rights, that is, he must have the opportunity to exercise them [2]. The existence of these substantive rights is often confirmed by the holding of voting rights (due to the holding of shares), but this is not sufficient to identify the influence control over the relevant activities.

4. CONCLUSIONS

In any company, and especially within a group of companies, it has become a necessity to base on real economic and financial basis the managerial and investment decisions, as a result of the eminent risks that can cause the failure of the business activity, but also because of the significant costs involved in adopting and implementing an inopportune decision.

By consolidating the financial statements - engineering technique of financial accounting, the information necessary to the external users is obtained, clarifying the relations between the subsidiaries and the parent company, and comparing the results obtained with the objectives set.

The topic seems to be of great relevance in the national and international economic-social context, due to the increasing importance and influence of the corporate groups, which are navigating with the phenomenon of globalization.

The information communicated by the group of companies to the market is numerous and can refer to any aspect of it, such as: business organization, economic, financial and asset structure, commitment to the local community, the desire to pursue sustainable development; information through which stakeholders develop and build specific analyzes to support their decisions (Socoliuc & Grosu, 2015).

Therefore, we can conclude that in this informational context, the consolidated financial statements are the main tool used to communicate the group of companies.

ENDNOTES

[1] International reference accounting standards for the preparation of consolidated financial statements are:
• IFRS 3 regulating the accounting of aggregation processes and accounting treatment differences in consolidation;
• IFRS 8 that governs the operating segments, qualifying the results formation and the related economic and financial risks in relation to the business sectors;
• IFRS 10 which establishes the principles for the preparation and presentation of the consolidated financial statements;
• IFRS 11 concerning joint control agreements;
• IFRS 12 regarding the information to be disclosed in order to allow interested parties in the financial statements to evaluate investments in other entities;
• IAS 28, which regulates investments in associates and joint ventures
[2] IFRS 10 in order to identify the control provides that the investor owns these substantial rights, but it is not necessary for them to put them into practice.

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