PARTICULAR ASPECTS REGARDING THE USE OF CONSOLIDATED STATEMENTS AGAINST THE BACKGROUND OF THE EUROPEAN ACCESSION

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Abstract: The decision of an investor to place capitals in a business is conditioned by obtaining intelligible cost-effective information. To this purpose, quoted multinational companies that make consolidated accounts had to use one only accounting referential, that are the IAS/IFRS regulations. In other words, an equivalence was established between accounting practices at an international level that create the premises for the understanding and the comparability of the financial statements of companies from various countries, the international accounting harmonization being conceived as means of economic integration and also as means of the large international financial markets transparency and efficiency. This study focuses on highlighting the particular aspects (advantages and limits) with regard to the use of the information contained in consolidated financial statements.

Key words: consolidated financial statements, use of information, group of companies etc.

General considerations

Consolidated accounts represent the informational product given to the users that are interested in business groups. By group of companies we understand a parent company and its subsidiaries. It goes without saying that the business scope of the business groups surpasses national borders. They are the consequence of the economy going global and implicitly of external development and financial markets going global. To characterize it briefly[288], the globalization of the financial markets is the consequence of the following directions and measures: the un-regulation and the liberalization of the capital circulation world-wide; the adoption by developed countries of external capital-related convergent policies; the increase of the power of institutional investors; the increase of population's savings as financial placement; the internationalization of banking activities.

With regard to the use of the consolidated financial statements, we see that if from the very beginning the consolidated accounts were made to meet own management needs or upon the request of the parent company, afterwards, as a natural consequence of the *enhanced importance of the consolidated accounts in internal and external reporting*, it became necessary to make and issue financial statements for business groups. Attention can be drawn to some shortcomings of the individual accounts of the parent company that are *advantages*[289] of the consolidated accounts in the area of the financial information, that is: the turnover recognized in the profit and loss account of the parent company shows both the external sales and the sales within the group; the profit of the parent company may be affected by the loss of a subsidiary; the financial structure of the parent company may be compromised by the high debt ratio of another company within the group; the performance of the subsidiaries are noticeable only when dividends are shared and specified in the profit and loss account of the parent company, but their results may be different etc.

Making financial statements enables the supply of full information about the entire economic status of the group, which will lay at the basis of the decision-making by the users of financial and accounting information. For instance, in the *consolidated balance sheet*, the interest titles held by branches are replaced with their debts and assets, like the parent company would be the owner. In the same manner, *the consolidated profit and loss account* presents the results of all the entities within the group, after the necessary eliminations. All these aspects show the true position of the consolidated accounts in the hierarchy of financial statements.

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[288] **Săcărin, M.,** *Business groups and landmarks of consolidated account interpretation*, Economic Publishing House, Bucharest, 2002, p.34.

[289] **Guedj, N.**, *Finance d'entreprise. Les règles du jeu*, Editions d'Organisation, Paris, 2001, pp. 242-245.

Of course, besides the advantages that the consolidated financial statements bring to their users, they also present a series of *limits*. First, the variance of the consolidation perimeter impairs the comparability of the information from one exercise to another. Then, the contribution of each entity within the group is less shown by the consolidated financial statements, as the global debt ratio may conceal significant individual debt ratios. As some authors say[290], "one of the challenges of the consolidated accounts is the fact that every user searches to find in them an image of the group , but the nature of the image is not always the same: economic for some, financial for a few, patrimonial for others and sometimes the three altogether". Consequently, a solid use of the financial statements of a group of companies should refer both to consolidated account and to the relevance of individual accounts within them.

Characteristics of particular structures of consolidated financial statements

It is known that the *goodwill* regularly appears in consolidated financial statements and accounts for the difference between the purchase price of the interest (titles purchased) and the corresponding fraction of the re-valuated net asset at the purchasing time. In time, several accounting treatments of the goodwill were approached, from its recognition as asset within incorporeal fixed assets (depreciable or not) up to the deduction from equity capital at the purchasing time (the British treatment). And the international accounting regulations retained until 2003 the idea of activating the goodwill and its systematic depreciation during its use. But, as the regulation IAS 22 "Business combinations" was revised and it was changed into IFRS 3 "Business combinations[291], the goodwill acquired further to a business combination should be recognized as asset starting with the purchase time. Moreover, the new regulation forbids the depreciation of the goodwill acquired in a business combination, but requests its annual depreciation or even more frequently, if certain circumstances show there is any depreciation. It seems just logical to give up the depreciation of the goodwill, if we consider that neither participation titles are depreciated, nor there is a direct connection between these (goodwill and interest title). Moreover, expenses might double as a series of expenses are made to maintain or increase the purchased economic advantages. Then, another explanation of the failure to depreciate the goodwill and to replace it with the depreciation test may be also the consequence of the introduction of the fair value in accounting, some authors'[292] state, and we agree to them.

Another element that occurs only in consolidated financial statements is represented by the *emphasized titles*, as structure of financial fixed assets. The last national accounting regulations regarding the consolidation are true to the European directives[293] and contain various precisions to this respect. We synthesize as follows some of the most significant aspects. The titles that are in equivalence are specified in the consolidated balance sheet when an entity included in the consolidation has a significant influence over the operational and financial policy of an associated company in which it holds an interest title. The part of profit or loss of the associated companies that is assignable to such interests is presented in the consolidated profit and loss account at the elements "Profit or loss of the financial year afferent to the associated companies". The investment in an associated company is accounted using the *method of equivalence* since the day it becomes an associated company. If in the countries of continental Europe the equivalence is considered a method of consolidation, in Anglo-Saxon countries it is seen rather as a method of valutation.

Another particular feature of the structure is that only the consolidated accounts refer to the *differences of conversion* as a result of the foreign enterprises' conversion of financial statements in the consolidation currency. IAS 21 "The fluctuating effects of the exchange rate", revised, keeps a single method of conversion, as compared to the previous standard, i.e. the closing price method which means that the assets and debts for each presented balance sheet must be conversed at the closing price of the balance sheet date, the revenues and the expenses must be conversed at the exchange rates of the transaction dates (or at a medium course) and all the resulting exchange rate differences must be acknowledged as a separate

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[290] **Raffegeau, J.,** ş.a., *Comptes consolidés, Solutions françaises et internationales*, Editions Francis Lefebvre, Paris, 1999, p. 71 (according to Săcărin, M., *Op. cit.*, p. 91).

[291] *** **IFRS 3** "*Business combinations*", par. IN7, lett. f and g.

[292] **Săcărin, M.,** *Fair value: history, adoption, valences and critiques*, in the Journal: "*Business Accountancy, Expertise and Audit*" issue 3/2007, p.16.

[293] *** OMFP nr. 1752/2005 *for the approval of accounting regulations in keeping with European directives*, M. Of., Part I, issue 1080bis of 30/11/2005.

constituent of the personal capitals (exchange rate differences). In other words, when a group includes individual entities with different functional currencies, the results and the financial position of each entity are expressed by means of a currency they have in common, so as the consolidated financial statements could be presented.

Minority interests are the amounts attributed to subsidiary companies belonging to other persons than the entities included in the consolidation. The national regulations mention that they must be presented in the consolidated balance sheet in the form of personal capitals and distinguished by the capitals of the company owning the subsidiary companies as separated by two constituents: the profit or the lost financial year corresponding to the minority interests and other personal capitals. In the literature of the field[7], there are two theories with respect to the treatment of minority interests that is the theory of economic entity and financial theory. According to the former (mentioned by national references), the minority interests are included *in the personal capitals*, the quota to the net assets of the subsidiary company being genuinely determined for both categories of owners (the owning society and the minority ones). With respect to financial theory, the minority interests are mentioned in the balance sheet at *debts*, determined either by right book values or the subsidiary company assets and liabilities, the differences of purchase being presented only for the corresponding share of the parent company, as compared to the theory of economic entities, according to which the difference of purchase is applied to the whole value.

Problems encountered in the analysis of financial position and performances at the level of business groups

The analysis of financial position and performance at the level of business groups mainly involves the same techniques as in the case of individual enterprises but particular problems with difficulties of interpretation may also arise. In this sense, we could mention the following difficulties: problems created by the evolution of the consolidation perimeter, the incapacity of the group's financial statements to give full information on the transactions between the subsidiary companies of the group and difficulties encountered in the analysis of activity department results.

If, at the level of an individual enterprise, its size and structure are known at any time, at the level of company groups, there can be changes in size from a period to another, according to the purchases and cessions of subsidiary companies that took place. Certainly, the analysis of group performances is directly linked to the *evolution of the consolidation perimeter*, as a purchase or cession of a subsidiary company brings important changes and affects both assets and financial flow. Such significant changes should be eliminated so as to ensure a proper comparison and the right interpretation of the performance registered by a group from a period to another. In most cases, modifying the integration rate of the subsidiary companies is determined by reasons of financial improvement, as an entity with favorable results that aims at global integration, while the equivalence method is chosen for a society with negative results. In order to come to apply the aforementioned methods, the group acts as directed.

The transactions between group companies have in view the fund transfer between them, sometimes, with the purpose of manipulating the results of financial improvement. We are aware that a group of enterprises is also a fiscal entity because each company of the group brings profit and pays taxes for it. In this case, there can be transfers of benefits from the entities of highly fiscal areas towards the companies of low or null fiscal countries. Besides the fiscal objectives, a group of enterprises definitely aims at improving its value. The policy for establishing the internal cession prices influences all performance indicators. For instance, in the case of a sale transaction between the parent company and a daughter one, if the cession price is lowered, the the parent company result will also be diminished, while the daughter's one will be raised. Thus, when the price of sale is raised, the situation changes the other way round, the result of the parent company being raised as opposed to minority interests. At a group level, the result will be the same after the carried out eliminations, also if the revenue tax quota is the same for both entities. If the revenue tax quota is different, for example, higher for the parent company and lower for the subsidiary one, in this case, the result will be higher for a price of sale and lower if the the price of sale is increased. Consequently, an increase of the group result is performed when the internal cession prices are lower, in the aforementioned tax conditions.

[7] **Săcărin, M.,** *Business groups and landmarks of consolidated account interpretation*, Economic Publishing House, Bucharest, 2002, p. 117.

Another aspect usually encountered at the level of business groups is *department information.* In groups with diversified activities on various geographical areas, segment reporting is necessary and unavoidable, as long as accountancy, by its products, must give new and useful information to the interested parties in their decisions. In IFRS 8 "Operational segments"[8], it is mentioned that segment information is always necessary to satisfy the needs of financial statement users. More precisely, the international norm regulates the principles of financial reporting on operational segments to help the users of financial statements understand better the entity's prior results, evaluate better the risks and benefits and give more pertinent opinions on the entity as a whole. The IFRS 8 approach is called "management approach" and it ensures the conformity of external financial reporting to the internal one which allows the external users to see the entity segments as same as the managers. With respect to segment reporting, the initial accountancy standard, before the revision, asked for the information to be reported on segments of activity departments and on geographical segments. On the contrary, the revised standard asks for the information to be reported on activity segments **or** geographical ones. Although the department information has a strong informative content for the users of financial statements, there are also cases in which the company management is reluctant to the publishing of department information because it might cause prejudice to their own interests, as the competition might use it. However, one thing is clear, i.e. publishing department information allows a better management of risks and benefits of the group activities as they can be observed for each department or geographical areas.

Another issue that is noted only at the level of groups and enterprises refers to the date of drafting the consolidated financial statement. The accountancy regulations see to the established date for the drafting of consolidated financial statements to be the same with the date for drafting the financial statement of the parent company. If the reporting dates are different (i.e. that of the parent company and of the subsidiary ones), some completions must be carried out due to the effects of transactions or significant events that have taken place between these reporting periods. It is important for the difference between the reporting date of a subsidiary company and the one of the parent society not to be longer than 3 months.

We know that the performances of the enterprise can be appreciated, firstly, from the perspective of the *result,* as main indicator of financial statements, both individual and consolidated (included in the balance sheet, the profit and loss account, the situation of personal capitals and of treasury flows, when drafted according to the indirect method). Yet, another performance indicator of the entity, even more objective than the previous one is the cash-flow determined and included in the treasury flow statements. Even if the framework of the consolidated treasury flow abides to the same drafting regulations as the one for individual enterprises, a series of peculiarities might arise, as we would like to point below. *Firstly*, the treasury flows between the parent company and the entities comprised by the consolidation must be eliminated and, according to the consolidation method applied (global integration, proportional or equivalent), they will be included in the framework of treasury flows, the cash flows of consolidated entities. *Secondly*, the cash-flows correspondent to the purchase and cession of subsidiary companies must be presented separately in the category of flows generated by investments[9]. *Thirdly*, in the framework of consolidated treasury flows, exchange rate variations may appear, as a result of financial statement conversion of foreign subsidiary companies. The latter ones, even though presented separately in the category: "Effects of currency exchange rate variation", do not appear as classified according to the three operational categories: exploitation, investment and financing, so as to quantify the influence of exchange rates to the level of each flow category.

A few aspects of gainfulness and risk at the level of society groups

Gainfulness can be viewed as a homogeneous indicator for the performance of an entity because it takes into consideration the results and capitals invested to obtain these entities. However, at the level of entity groups, a series of features may appear, firstly linked to the type of result had in view, if we take into account the fact that several results are found here: the result of the group, of the parent company, the global result (both of majorities and minorities), etc. Secondly, both gainfulness (especially the economic one) and the result per share are influenced by the purchases and cession performed by the group. In most

[8] **Feleagă, L., Feleagă, N.**, *A new dimension of the convergence process between the international accountancy references and the American one: IFRS 8 Operational segments publishing*), in the Magazine "Contabilitatea, expertiza şi auditul în afaceri" (Business Accountancy, Survey and Audit) no. 1/2007, p. 38-42.

[9] *** see the annexes to IAS 7 "*Cash flow statements*".

cases, a diminution of economic gainfulness (caused by the growth of assets) and a result reduction per share (due to the increase in the number of shares) mark the group's purchase of other enterprises.

In the following part, we will focus on highlighting some particular aspects in the analysis of *financial gainfulness* at the level of company groups. The features are a result of the fact that, as opposed to individual financial statements, the consolidated ones are defined by a lower homogeneity, generated by the existence of majority and minority share holders, on the one hand, and the heterogeneity of group companies, together with the consolidation methods used (global, proportional and equivalent integration), on the other hand.

We know that financial gainfulness means result reporting, that is net result as a general rule, to capitals invested by the share holders. In the case of company groups, the following variables can be taken into account: the global result and the personal global capitals (both of majorities and minorities), the result of parent company, its own capitals or group result (which returns to the majorities) and its own capitals. We could ask ourselves which would be the most objective choice from all possible alternatives? We believe that it is the following example: the parent society owns 80% of the actions of a subsidiary company. The former sells products to the latter at a cession price: a) lower; b) higher. After calculations and consolidation, the results, the personal capitals and the financial gainfulness are the ones presented in the table below.

Table no. 1. Establishing financial gainfulness for a company group

Indicators (Ron and %)	**a) Lower price of sale**	**b) Higher price of sale**
Global profit	555,000	555,000
Group profile	457,800	465,000
Parent society profile	69,000	105,000
Minority profile	97,200	90,000
Personal capitals – Total	3,155,000	3,155,000
Personal group capitals	2,617,800	2,625,000
Personal capitals of the parent company	2,069,000	2,105,000
Minority personal capitals	537,200	530,000
Global financial gainfulness	17.59%	17.59%
Group financial gainfulness	17.49%	17.71%
Financial gainfulness of the parent company	3.33%	4.99%
Minority financial gainfulness	18.09%	16.98%

From the data above, we notice that global financial gainfulness (both of majorities and minorities) is the same, regardless of the changing value applied to the price of sale. This is because the mutual transactions are eliminated. However, group financial gainfulness is greater, if the price is higher (17.71%, as opposed to 17.49%). Financial gainfulness of the parent company shows growth, but from the group's perspective, this is not a relevant indicator as it is incomplete. The decreasing financial gainfulness, with respect to minority interests, leads to the fact that changing cession prices damages them, as opposed to majority and minority financial gainfulness, as result of the fund transfer from the subsidiary company to the mother one. Thus, we conclude that in the case of a company group, its financial gainfulness is more relevant than its global financial gainfulness or other partial gainfulness. Moreover, it was proved each time that any fund transfer from subsidiary companies to the parent ones (which own a higher percentage) makes the majorities' result grow as opposed to the minorities' one.

The risks that an entity can be exposed to are in direct ratio with the entity, being directly related to its gainfulness and because all options regarding gainfulness determination at the level of group companies also influence the risk degree. Furthermore, in the case of a company group, the operational space is much

larger than in an individual enterprise so, the risk can also be diminished. In the literature of the field[10], we can find various cases of analysis and interpretation. For instance, a group's indebted degree is established on the basis of individual capacities belonging to the group and not according to the consolidated balance sheet, if the latter is in its advantage. As a conclusion, the interpretation of the pieces of information must be performed cautiously.

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