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Consolidated Financial Statements - Elements of the Management Decision to Invest

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Abstract

The objective of the consolidated financial statements is to present the financial position, performance and evolution of the financial position in relation to the units included in the group of companies, as if it were a single company. The subject of consolidation is the companies within the group, and the object of consolidation is their annual financial statements. Consolidation of financial statements is a technique of engineering financial accounting, which aims to produce information necessary for external users. It is also a management tool, as it allows to clarify the complex relations between subsidiaries and the parent company and to compare the results obtained with the set objectives.

Keywords: consolidated, financial, statements, management, decision, investment.

1 Introduction

In the economic life of different countries there are both economic agents who carry out their activity as independent legal entities and groups of companies linked to each other from an economic and financial point of view, under the control or influence of one of them. Groups of societies are an increasingly important reality in the contemporary world. The group of companies represents the ensemble made up of two or more companies, each with its own legal personality, but which are subject to a unitary economic direction assumed by one or more of them. The companies within the group, having legal personality, each prepare consolidated financial statements according to the specific regulations established by each country.

The information provided by the individual annual financial statements of the component companies of the group is insufficient and irrelevant, as they do not allow a correct assessment of the economic-financial situation of the group. The individual financial statements do not reflect the joint activity of the various group companies.

The consolidated financial statements of the group are not equal to the sum of the annual financial statements of the group companies, as there may be internal transactions between the group companies. These operations artificially increase the values of individual accounts. The elimination of these operations is not limited to the simple addition of individual accounts.

The need for consolidated financial statements is obvious, they give a more comprehensive picture of the real situation of a group, an image that can not give all the balance sheets of the component companies, they allow the global expression of the financial situation and the result of the group. The consolidated financial statements ensure the aggregation of assets, liabilities and equity, as well as income and expenses to provide a global and accurate picture of the group of companies. For a group of companies, whether operating at national, regional or global level, benefiting from the information provided through the consolidated financial statements is a real and solid basis for substantiating investment decisions, strategic decisions and, last but not least, executive management decisions. An investment decision based on viable, comparable, consolidated and real accounting information is subject to a high degree of success.

2 The purpose and content of the consolidated financial statements

In a modern accounting framework, the purpose of the consolidated financial statements is to provide a structured financial representation of the financial position and transactions of the group. Consolidated financial statements must provide information about the financial position, performance and cash flows of an enterprise, information that must be useful to a wide range of users in making their economic decisions [1].

To achieve this goal, the consolidated financial statements must provide information to enable users to make forecasts of future cash flows, in particular regarding their maturity and probability.

In this regard, the information aims to:

- Group-controlled assets, ie resources generating future cash flows;
- Group debts, ie external liabilities that must be at the origin of payments;
- Equity, as residual interest of the owners in the assets controlled by the group;
- The result of the group and, in a broader sense, its economic performance, rendered by reflecting the evolution of equity, evolution from which are excluded the effects of operations performed directly with the owners;
- Past cash flows, which can be the basis for determining future cash flows.

This information must enable account users to specify the ability of the undertaking concerned to pay dividends, interest and, in general, to pay its debts on time. In accordance with IAS 1 Presentation of Financial Statements, a complete set of financial statements includes the following components:

1. Balance sheet
2. Income statement
3. A situation showing:

a. Either all changes in equity (all changes in equity);

b. Either changes in equity, except for those arising from capital transactions with owners and distributions in their favor (changes in equity than those arising from capital transactions with owners and distributions to owners);

c. Cash flow statement;

d. Accounting policies and explanatory notes.

According to OMFP 3055/2009, the consolidated financial statements include the consolidated balance sheet, the consolidated profit and loss account and the explanatory notes to the consolidated financial statements. These documents constitute a unitary whole [2].

The consolidated financial statements provide a true and fair view of the assets, liabilities, financial position and profit or loss of the companies included in these financial statements as a whole.

Beyond these financial statements, companies are encouraged to provide critical management views, by describing and explaining the main features of financial performance and financial position, as well as the main uncertainties they face.

Such a report must include:

- the main factors and influences that determine performance, including the environmental changes in which the entity operates, its response to such changes and effects, its investment policy to maintain and increase the performance from which, distinctly, the dividend policy should be presented;
- the sources of financing used by the entity, its borrowing rate policy and its risk management policies;

- the solidity of the entity and its resources, elements whose value expression is not reflected in the balance sheet, in accordance with the international accounting reference.

2.1 *The consolidated balance sheet*

In accordance with the international standard IAS 1, the structure and content of the balance sheet must distinguish between current and non-current items.
When such a distinction is not made, assets and liabilities are, in principle, classified according to their liquidity and their exigibility.
Regardless of the presentation, the group mentions, in the consolidated financial statements, the under-one-year portion of assets and liabilities for all items that are likely to contain both short-term and long-term items.
Overall, this standard (IAS 1) refers to the items that must be disclosed in the balance sheet: property, plant and equipment; intangible assets; financial assets (excluding equity investments, customer and operating receivables, cash and cash equivalents; equity investments; inventories; customers and other operating receivables; cash and cash equivalents; suppliers and other operating liabilities; tax liabilities and assets, provisions, non-current interest-bearing liabilities, minority interests, issued capital and reserves.
According to OMFP 1802/2014, the assets and liabilities of the entities included in the consolidation are fully incorporated in the consolidated balance sheet, by summing up similar elements [2].

2.1.1 Current and non-current assets

Current balance sheet assets include:
- Items intended to be made or held for sale or consumption within the normal operating cycle of the enterprise; or
- Items intended mainly for trading on different markets; or
- Items held in a short-term perspective, the entity (group) expecting to achieve them within a maximum of one year from the end of the year; or
- Liquidity or liquidity equivalents, if their use is not restricted.

The other assets are considered non-current items. They include both tangible and intangible assets, as well as long-term operating and financial assets.
Current assets refer, in particular, to inventories and receivables, which are sold, consumed or realized in the normal operating cycle, even when they are not expected to be realized in the next 12 months after the end of the year.
Both OMFP 3055/2009 for the approval of the Accounting Regulations compliant with European directives and Order 2239/2011 which were subsequently repealed by Order 1802/2014 (the latter coming into force on January 2015) [2] show that stocks can be presented as a single item in the consolidated annual financial statements, if there are special circumstances that could lead to unjustified expenses.
Securities traded on the markets are current assets, if they are expected to be realized in the next 12 months following the end of the year, otherwise they are considered non-current assets.
Order 1802/2014 specifies that the book values of the shares in the capital of the entities included in the consolidation are offset by the proportion they represent in the capital and reserves of these entities, as follows:
a) offsets are made on the basis of the book values of the identifiable assets and liabilities at the acquisition date of the shares or, if the acquisition takes place in two or more stages, at the date when the entity became a subsidiary. The acquisition date is the date on which control over the net assets or operations of the acquired entity is effectively transferred to the acquirer.

b) in the conditions in which the values provided in letter a) cannot be established, the compensation is made on the basis of the accounting values existing on the date when the entities concerned are included in the consolidation for the first time.
The differences resulting from such offsets are presented as a separate item in the consolidated balance sheet, as follows:
- the positive difference is presented under the item "Positive goodwill";
- the negative difference is presented in the item "Negative goodwill".
These elements, the methods used and any significant changes from the previous financial year must be explained in the explanatory notes to the consolidated annual financial statements. The amount attributable to the shares in the subsidiaries included in the consolidation, held by persons other than the entities included in the consolidation, is presented separately in the consolidated balance sheet, under the item "Minority interests". Minority interests must be presented in the consolidated balance sheet in equity, separately from the parent company's equity.

2.1.2 Current and non-current debts

A debt is a current element of the external liability when it is to be repaid:
- Either within the normal operating cycle;
- Either at a maturity within the next 12 months following the end of the financial year.
Some current liabilities, such as trade payables, those related to employee relations or other operating costs, are part of the working capital requirement used in the normal operating cycle. Such items, as in the case of assets, are classified in the current category, even if they must be repaid over a period of more than one year.
There are also cases where some current debts are not repaid within the normal operating cycle, but must be settled within the next 12 months, following the year-end date. For example, the short-term part of medium- and long-term loans, dividends paid, taxes on benefits payable, other non-commercial creditors.
Interest-bearing debts, which generate a long-term financing of working capital requirements, are non-current elements of debts, for their part due at a date of more than one year. An enterprise must classify its long-term interest-bearing liabilities as non-current liabilities, even if they must be settled within the next 12 months following the end of the financial year, if [3]:
- these are debts that, at the time of their contracting, were long-term debts;
- the entity in question intends to refinance these debts through a long-term debt;
- this intention is confirmed by the existence of a refinancing or rescheduling contract, concluded before the financial statements were approved.
An analysis of the consolidated balance sheet allows us to make the following assessments:
- within the balance sheet items of assets, respectively equity and debts, the following items specific to the consolidated accounts are presented: goodwill (positive acquisition difference), equity investments, minority interests;
- the consolidated equity consists of: the share capital of the parent company, the consolidated reserves (the reserves of the parent company to which is added its share of the reserves obtained by the consolidated companies after the acquisition of the securities) and the accumulated accumulated profits or losses (the accumulated profits or losses of the parent company to which is added its share of the profits or losses accumulated by the consolidated companies after the acquisition of the securities);
- the differences generated by the conversion of the accounts of the foreign subsidiaries based on the closing rate method must be included in the category of consolidated equity;
- the balance sheet is presented after the distribution of the result.

2.2 *The consolidated profit and loss account*

In accordance with IAS 1, the income statement must disclose at least the following items: income; financial expenses; the share in the result of the affiliated entities and of the joint ventures put in equivalence; the pre - tax gain or loss recognized on the sale of assets or the settlement of obligations relating to discontinued operations; income tax; gain or loss after tax, found on discontinued operations; the result of the exercise.

Also, some items will be presented in the profit and loss account as profit or loss allocations. These are the profit or loss attributable to minority interests and the profit or loss attributable to the capital holders of the parent company.

A group must present in its profit and loss account or in the explanatory notes a classification of expenses by nature or by function. However, IAS1 encourages entities to use such an analysis directly in the income statement.

The analysis by function of expenses, called the sales cost method, requires the allocation of expenses on three functions, as part of the cost of sales, distribution or administration activities. This classification may be of more interest to the recipients of the accounts than the classification by nature, giving them more relevant information, but sometimes involves arbitrary choices in the distribution of expenditure. In its application, professional judgment has an important role.

The analysis by nature is simpler than the analysis by function, because it does not require an allocation of expenses according to the nature of the different functions of the enterprise.

2.3 *The consolidated statement of changes in equity*

The statement of changes in consolidated equity explains the changes in consolidated equity from one year to the next. Consolidated equity may change due to:

- Increasing the capital of the consolidating enterprise;
- Distributions made by the consolidating enterprise during the year;
- The incidence of the exchange rate variation, in case of consolidation of foreign enterprises;
- Incidence of revaluations;
- The incidence of restructurings and certain internal disposals of assets;
- Changes in the percentage of interest in consolidated enterprises, following the change of its capital;
- Changes in accounting methods.

2.4 *Incidences of the conversion of foreign companies' accounts on equity*

In order to consolidate foreign companies, their financial statements may be converted based on the use of the historical cost method or the closing rate method. The use of the historical exchange rate method does not cause a change in equity, because they are converted based on historical cost and the incidence of exchange rate changes is recorded in the income statement.

In the case of the closing exchange rate method, equity is also converted on the basis of the historical exchange rate. But, due to the conversion of the other balance sheet items based on the closing rate, in the balance sheet of the foreign company is presented the balance sheet item of capital "Conversion differences". When the securities of the consolidated company are eliminated, the translation differences are divided between the group and the minority. In this situation, the conversion difference that belongs to the group changes from one year to another depending on the evolution of the exchange rate.

2.5 *Consolidated cash flow statement*

The cash flow statement is an essential component of the financial statements presented by large enterprises. The format of the cash flow statement in the international accounting framework is based on the IAS 7 standard “Cash flow statement”.

The current success of the cash flow statement is closely linked to the development of the valuation of economic activities through financial markets. As it provides investors with useful information for making decisions, the picture of cash flows contributes to the efficiency of markets. Also, the success of value-based management can only increase the importance of the cash flow statement.

The table of cash flows shows such flows, known as receipts and payments, during the period. In other words, it shows where the liquidity came from and how it was spent, thus explaining the causes of their variation.

In the vision of the accounting norm IAS 7 “Statement of cash flows”, cash is assimilated with cash and cash equivalents. Liquidity includes cash and demand deposits. Liquidity equivalents are short-term investments that are highly liquid, easily convertible into a predetermined amount of liquidity and whose value is not likely to change significantly.

The purpose of holding cash equivalents is to meet short-term treasury commitments. It follows that their maturity is usually less than 3 months. The securities representing the participations are excluded from the cash equivalents, except for the preferred shares acquired shortly before their maturity and which have a fixed redemption date. The expression cash flows refers to the set of cash inflows and outflows and cash equivalents. Cash flows do not include movements between items that constitute liquidity or cash equivalents, because they are part of the management of the company's treasury. The statement of cash flows must show the cash flows for the year, broken down into operating, investing and financing activities.

2.5.1 Cash flows generated by operating activity

These refer to:

- Proceeds from the sale of goods and services;
- Receipts from royalties, fees, commissions and other income;
- Payments on debts to suppliers of goods and services;
- Payments in favor of employees;
- Payments and refunds of income taxes, provided that they cannot be specifically associated with financing and investment activities, etc.

2.5.2 Cash flows generated by investment activity

These refer to:

- Payments made for the acquisition of tangible and intangible assets, as well as other long-term assets;
- Proceeds from the sale of tangible and intangible assets and other long-term assets;
- Payments made for the acquisition of equity securities and debt securities issued by or from other undertakings, as well as payments made for the acquisition of securities in joint ventures; - Receipts relating to the sale of equity securities and debt securities issued by or from other undertakings, as well as receipts relating to the sale of securities held in joint ventures;
- Cash advances and loans to third parties;
- Receipts from the repayment of cash advances and loans to third parties.

2.5.3 Cash flows generated by financing activity

These refer to:

- Receipts from the issue of shares and other equity instruments;
- Payments made to shareholders for the acquisition or redemption of the company's shares;

- Proceeds from the issuance of bonds, bank loans, treasury bills, mortgages and other short-term or long-term loans;
- Liquidity repayment of borrowed amounts;
- Payments made by the lessee to reduce the debt balance related to a lease-financing contract.

3 Conclusions

The need for consolidated financial statements is obvious, they give a more comprehensive picture of the real situation of a group, an image that can not give all the balance sheets of the component companies, they allow the global expression of the financial situation and the result of the group. The main factor in generating this need is presented by the existence on foreign capital markets of multinational companies and groups. In order to be able to manifest themselves as actors of the international capital markets, the groups of companies must first of all have comparable information, but also sufficient, or relevant, regarding the existing investment opportunities.

The existence of consolidated information at the level of a group of companies, especially in the conditions in which it operates beyond the borders of the national economy, represents a mandatory condition for the success and economic performance of the group [4]. The objective of the consolidated financial statements is to present the financial position, performance and evolution of the financial position in relation to the units included in the group of companies, as if it were a single company. The existence of consolidated financial statements at the level of the group of companies has quickly covered the distance between necessity and reality, due to the needs manifested by economic reality, but also due to significant efforts to increase the competitive advantages of different economic entities [5].

Within any company, but especially within a group of companies, the foundation of managerial decisions and, in particular, of investment decisions on real economic and financial bases has become a necessity, as a result of the risks that may arise and cause a failure of actions taken, but also due to the significant costs involved in adopting and implementing an inappropriate decision.

Benefiting from the information provided through the consolidated financial statements is a real and solid basis for substantiating investment decisions, strategic decisions and, last but not least, executive management decisions. An investment decision based on viable, comparable, consolidated and real accounting information is subject to a high degree of success.

Consolidation of accounts is an important condition for rendering a true and fair view of the balance sheet, performance and financial position of an enterprise in accordance with the normative framework of International Accounting Standards. The harmonization of the accounting regulations in our country with the international ones will bring to the forefront this issue, in the not too distant future. Consolidation of accounts, especially using a regulatory framework, leads to clarification of the financial position and performance of a group of enterprises. It is thus eliminated that the public is misled by multiplying turnover as a result of reciprocal transactions, or by confining all risks and indebtedness to a single enterprise in the group for a more favorable presentation of the others.

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