

# Principles of consolidated financial statement acc to ifrs thesis examples

[Business](#), [Company](#)



## **Principles of Consolidated Financial Statement Acc to IFRS**

### Executive Summary

International Financial Reporting Standards (IFRS) is governed by a set of principles, which came into effect in the year 2005, and determine how consolidated financial statements are prepared by holding companies residing in the EU. Consolidated financial statements are combined financial statements of both a holding company and its subsidiary. This research paper will focus on the principles that govern the creation and presentation of consolidated financial statements by individual company groups residing in the EU. Previous researches have postulated that presentation of financial statements in a consolidated form aids in creating outlook at both company levels i. e. holding and subsidiary company levels as opposed to gauging financial position of individual companies.

This research paper will adapt use secondary sources of data in the collection of information required in attaining its goal of having a common standard for preparation and presentation of consolidated financial statements. This will aid understanding and comparison of state financial statements, therefore, providing reliable information to investors. However, use of secondary sources requires clearly defined topics with selected key words to assist the establishment of reliable sources including but not limited to library catalogues or internet sources.

The first topic to be discussed will be comparability and understandability, which mainly focuses on the basic principle requiring a chosen parent or controlling company amongst those residing in the EU to take the authority to arrange consolidated financial statements. However, consolidated

financial statements prepared by the controlling company must meet certain conditions. The major condition is that other subsidiary entities of the holding company should be well informed on the consolidated financial statements and agree to its content. The research will then discuss the issue on the elimination of intercompany transactions and their results. This will primarily involve the assumption that the consolidated financial statement will offset any intra group shareholding through acquisition cost method. Finally, the research paper will discuss the topic on comprehensive information to investors. This subject will presume that comprehensive income from the subsidiary entities are attributed to the owner of the controlling company during reporting of subsidiary financial statements. This will occur irrespective of the possibility of non controlling interest group to have a deficit in the statements

## **The research will henceforth come up with deductions pertaining consolidated financial statements based on IFRS standards.**

### 1. Introduction

Combined financial statements of both a holding company and its subsidiary are referred to consolidated financial statement. Presenting financial statements in consolidated form helps create a cumulative look at both the holding company and its subsidiaries financial position. As opposed to gauging the financial position of one company, consolidated financial statements would gauge the financial position of the entire group of companies. The subsidiary companies are the companies in which the parent company controls at least fifty percent of its voting rights. This means that

the holding company has power to control almost all the financial policies of subsidiary companies. In addition to the financial policies, the parent company also has power to control operational policies of the subsidiary companies. The main purpose of a company gaining much power over another smaller company lies on the need to gain financial benefit in return.

## 2. 1. Problem Definition

The International Financial Reporting Standards (IFRS) is based on principles that dictate treatments on financial reporting. Since the year 2005, every quoted holding company that resides in the EU, is required to prepare consolidated financial statements. This article focuses mainly on the principles that guide presentation and preparation of consolidated financial statements by company groups residing in the EU

## 2. 2. Objectives

The objectives of having a common standard for preparation and presentation of consolidated financial statements is to provide understandability and comparability of single national financial statements, elimination of intercompany transaction and their results, and comprehensive information to investors. The reason why holding companies are under duress to provide a consolidated financial statement that includes its subsidiaries is because the statements are intended to be used by various regulators. These statements therefore should provide a true picture or reflection of the financial positions of companies including their subsidiaries. Through the statements, companies' business affairs can also be reflected and it's possible to determine financial positions of companies within a

specific period of time.

### 2. 3. Methodology

Secondary data sources are the main instruments used to acquire information to aid this research study. Relying on secondary sources requires that the topic be clearly defined with selected key words to make it easy to identify the sources either online or on library catalogues.

### 3. Consolidation principles

#### **Comparability and understandability**

The first principle is the requirement by the controlling company or the parent company to submit its consolidated financial statement. The parent or the controlling company is mandated to make the consolidated financial statements. In order to this, it has to utilize uniform policies of accounting for preparing such transactions. The consolidated financial statements prepared by the controlling company have to meet certain conditions. The first and most important condition is that every other subsidiary entity of the holding company has got to be well informed of the consolidated financial statement and agreed to its content. The subsidiary entities are not expected to make any objections towards the parent company presenting the consolidated financial statement.

The other condition is that the company's tools of debt or equity must not be traded in a public stock market. The controlling company must have full control of its subsidiaries. When the tools for equity are traded in a public stock exchange market, the holding company may lose full control of its

subsidiaries. The holding company is also not expected to file its statements of finance with any other regulatory body for the sake trying to issue the trading instruments in a public market. Finally, the last condition that controlling companies are given when preparing the consolidated financial statements is that the statements must be able to comply with all the requirements of IFRS.

Another principle for consolidated financial statements, regards foreign currency translations. Every company that engages in acquisition has got to translate transaction currency into a currency that it uses for its daily functions. The exchange rate for translation will be the one used during the time the transactions were conducted. Companies can find themselves involved in gains or losses resulting from exchange rate during transactions. These gains and losses are regarded as adjustment items for sales. When it comes to recording losses and gains resulting from exchange rates as entry items in the financial statements they are regarded as exchange rate differences and are reflected on income and expenses.

The consolidated financial statement requires that all foreign currencies used in the individual statements of finance by the subsidiary companies be converted to Euros. The exchange rate used for the conversion is the one quoted at the time of reporting. Every item in the balance sheet is also converted to Euros. During conversion, there has got to be differences resulting out of it. The differences are entered separately in the consolidated statement as separate items. There are instances when the parent company, can give loans to its foreign subsidiaries. In such cases, differences can occur

resulting from foreign exchange rates. In the consolidated financial statements, this difference is regarded as conversion difference. In the income statements, the differences resulting from conversions and foreign exchange rate is regarded as an expense or an income.

Making the consolidated financial statements also requires a procedure to be followed. The parent company presenting the statements is expected to combine like items in all its subsidiaries companies. These items can include things like liabilities, income, expenditure, the flow of cash, and equity. The like-items are combined with that of the parent company. The statements are not to show any amount indicating the investment that the parent company has made on each of its subsidiaries. It is also not supposed to show the portion of equity that the parent company has in each of its subsidiaries. The process is expected to offset cash flows, expenses, income, equity, liabilities, and assets that are a direct result of inter subsidiary transactions. Any profit or loss from transactions between subsidiaries is to be eliminated.

The entity that reports or presents the statements is to include the expenses and income of all the subsidiary entities in the consolidated financial statement except for the income and expenses from intra group transactions. The dating for the reporting is should be from the time the controlling entity gained full control of the subsidiary entities until the time this control ceased. The information presented in the consolidated financial statements needs to reflect the expenses and income of all the subsidiaries beginning from the moment when acquisition occurred.

The reporting for financial statements by the controlling company and its subsidiaries is expected to fall on the same date. This would facilitate the ease of compiling a consolidated financial statement. The consolidated financial statement therefore can only have additional information from the subsidiary entities if the reporting date is impractical to be the same as the reporting date for its parent company. In such a case where it is not practical to report at the same with all the subsidiary companies, the most recent financial statement or records of the subsidiaries are used to compile the consolidated financial statement. Such records may not be a reflection of an up to date transaction of subsidiaries. However they can be adjusted in such a way that it would show significant transactions and events that occurred between the time of reporting and the time preparing the consolidated financial statement.

### **Elimination of intercompany transactions and their results**

The consolidated financial statement will offset any intra group shareholding through acquisition cost method. When a company acquires a subsidiary company, the assets of the subsidiary company as well as its liabilities have to be measured at a fair value. The measuring is done from the time the parent company made the acquisition up to the time of preparing the consolidated financial statement. If the acquisition cost is in excess over the fair value then this is regarded as good will amount. A parent company that acquired a subsidiary before 2004, when there was the IFRS transition the adjustments for IFRS may not be necessary however certain amounts such



as the good will amount may apply in their consolidated financial statements.

Apart from elimination of intra group shareholding through acquisition cost method, other financial components that are eliminated in the consolidated financial statements include: liabilities, receivables, intra group transactions, intra group dividends, and any unrealized gains between the groups of companies. Whenever impairment occurs, the unrealized losses between the subsidiary companies and the parent company are not eliminated.

The financial statements have to reflect losses and profits of the associate entities. These two financial components are specifically included in the income statement. Losses of group of companies can go beyond the carrying amount. When such a case happens, the shares of the group are reduced to zero and it becomes impractical to make further reflections of the losses. Further reflections of losses can only be made if in case the group intends to or is forced to satisfy the association of companies.

## **Comprehensive information to investors**

Comprehensive income from the subsidiary entities are attributed to the owner of the controlling company during reporting of subsidiary financial statements. This is done irrespective of the possibility of non controlling interest group to have a deficit in the statements. The changes of ownership interest of a parent company in its subsidiaries are considered to be equity transactions as long as the parent company maintains control of its subsidiaries. In case the equity proportion of the non controlling interest

group in a subsidiary changes, then the consolidated financial statement has got to reflect these changes in the carrying amount of both non controlling and controlling interests. If there are differences in this adjusted amount then the considerations made during payment or receiving have to be shown in equity and the owner of the parent company receiving all the attributes for the differences.

There are instances when a parent company can lose its control over one of its subsidiaries. During such a case, the consolidated financial statement that shows the financial position of the company must indicate that the parent company has derecognized every liability or asset of the lost subsidiary. The parent company is also expected make recognition of every investment retained from after the loss of a subsidiary. It is to indicate the fair value of these retained investments providing an account of the amount owed to the lost subsidiary entities as well as the amounts owed by the former subsidiary entities. All these records have got to be based on the standards provided by the IFRS. By indicating the fair value of a lost financial asset, the parent company is making recognition of the gain or loss of its control over one or more of its subsidiary entities. When a company acquires a subsidiary company, the assets of the subsidiary company as well as its liabilities have to be measured at a fair value. The measuring is done from the time the parent company made the acquisition up to the time of preparing the consolidated financial statement.

The allowed difference between the date of presenting the consolidated financial statement and the reporting of the individual subsidiary financial

statement is expected to be three months. The consolidated financial statement needs to reflect that the controlling or holding company does not have a controlling interest in the consolidated financial statement. The subsidiary entities during reporting of their financial statements attempt to attribute components of income and expenses to the parent company. In addition the subsidiaries also attribute financial components to non controlling interest. The present ownership of the subsidiaries is the determining factor that helps clarify what proportion needs to be allocated to the parent company and what proportion needs to be allocated to non controlling interest.

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#### 4. Conclusion

The consolidated financial statements according to IFRS standards are required to meet a certain criteria. The criterion is mainly for the purpose of quality in the statements. The first quality characteristic is understandability. This quality is essential and a reason why the body has to adopt single standards for the statements. Each parent entity that presents its consolidated financial statements has to meet the required standard for the statements in order to make them understandable and easy to interpret. Other qualitative characteristics include reliability, comparability, and relevance. The financial statement account to IFRS when properly prepared, provide understandability and comparability of single national financial statements, elimination of intercompany transaction and their results, and comprehensive information to investors.

## **Integral Total Management**

Complex of topics

The sine qua non of success

Comments / Suggestions

General Economis

Which macroeconomic relevance is inherent in the topics?

Taxation where a group of companies are treated as one entity for the sake of being taxed

Marketing

What advantages and disadvantages arise out of the suggestions for marketing measures, external impact, and the company's general productivity?

Which measures should be taken concerning internal and/or external marketing?

Having comprehensive information to investors helps attract interest in investors and hence creates an effective marketing tool for growth

Financial Management

What criteria have to be considered when choosing appropriate terms of financing?

Which risks are there and what kind of coverage do you suggest? How should the influence of external factors be evaluated?

The main criteria is the ability of a company to show profitability and success.

The risks involved in acquiring foreign companies include foreign exchange

conversion losses and financial risks. Evaluation of influence of external factors is through monitoring operations

## **Human Resources Management**

What personnel consequences (quantitative or qualitative) result from the suggestions?

Acquiring control over companies by a holding affects human resource. The parent company would want to reduce number of employees and retain best performers

## **Business Law**

Which legal fields are affected by the suggestions? What has to be arranged in order to create legal security from the company's point of view?

## **Regulations for merger and acquisitions**

Research Methods /

Management Decision Making

What sources of information should be practised in order to stay up to date in the fields of topics? Which decision criteria should be practised on the choice of alternatives?

## **Secondary data sources are the main instruments used to acquire information. Online sources and financial journals in particular**

Soft Skills / Leadership

What demands does the realisation of the suggestions make on responsible managers? What leadership behaviour is expedient?

Consolidated financial statements are used by financial managers for decision making

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