A CASE STUDY ON THE CONSOLIDATION OF FINANCIAL STATEMENTS OF ENTITIES AFFILIATED THROUGH DIRECT CONSOLIDATION PROCEDURE

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Abstract
The preparation of annual consolidated financial statements, in the context of the existence of group companies, represents a relatively new problematic issue for accounting practitioners, the world of the academia, as well as for the regulating bodies in the field of accounting. This situation generates intense debates among accounting specialists with the aim of finding practical solutions that facilitate the understanding and correct application of accounting regulations in the area of consolidating accounts. The present article approaches, by means of a case study, the specific aspects related to the consolidation of affiliated entities' accounts by means of using the global integration method and the direct consolidation procedure.

Keywords
consolidation of accounts; consolidation procedures; global integration; direct consolidation

JEL Classification
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The drawing up of consolidated financial statements by means of the global integration method, irrespective of the employed procedure (consolidation on levels or direct consolidation) involves the cumulation of the items from the balance sheets and the profit and loss accounts of affiliated entities with the balance sheet items and the items of the profit and loss accounts of the parent company, as well as the making of the following adjustments:

- the division of the subsidiaries' equity capital elements between the quota the parent company is entitled to and the quotas for "other shareholders" of the subsidiaries as "interests of minority shareholders";
- the accounting recording, as elements of consolidated equity capitals, of the quotas from the equity elements of the subsidiaries that are allocated to the parent company;
- the separate accounting recording of the quota from the equities that are allocated to "other shareholders" of the subsidiaries as "interests of minority shareholders";
- the elimination of the equivalent value of shareholding titles owned by the parent company, directly or indirectly, from the consolidated subsidiaries and the diminishing of the equities of affiliated entities with an equivalent sum.

We will further present a case study regarding the consolidation of financial statements of affiliated entities by means of the direct consolidation procedure, starting from the hypothesis that the group is composed of four companies, as follows: the parent company A and the subsidiaries B, C and D. The parent company A owns 70% of the capital and voting rights of company B. Company B owns 80% of the capital and voting rights of company C, and company C owns 90% of the capital and voting rights of company D.

In this study, we considered that all shareholding titles owned in subsidiaries B, C and D represent ordinary shares and were purchased when the respective companies were established. The study does not present the particularities of accounting treatments corresponding to the reciprocal operations among the companies of the group because they can be the subject of other approaches.
Taking into account that the parent company has exclusive control over the subsidiaries, in order to carry out the consolidation of their financial statements we will employ the global integration method.
We will further present the individual financial statements of the group companies that will be the subject of consolidation, as follows:

a) Balance sheets of the companies that are part of the group:

Items of balance sheets	Company A	Company B	Company C	Company D
A. Fixed assets	**840,000**	**690,000**	**460,000**	**420,000**
- Tangible fixed assets	490,000	450,000	190,000	420,000
- shareholding titles	350,000	240,000	270,000	-
B. Current assets, among which:	**570,000**	**340,000**	**320,000**	**220,000**
- Stocks	150,000	230,000	130,000	80,000
- Clients	250,000	60,000	120,000	120,000
- Cash and bank accounts	170,000	50,000	70,000	20,000
C. Advance expenses	-	-	-	-
D. Debts – sums that should be paid within a year	**190,000**	**150,000**	**160,000**	**130,000**
- Suppliers	65,000	70,000	65,000	50,000
- Various creditors	125,000	80,000	95000	80,000
E. Net current assets/ Net current debts (B-D)	**380,000**	**190,000**	**160.000**	**90,000**
F. Total assets minus current debts	**1,220,000**	**880,000**	**620,000**	**510,000**
G. Debts – sums that should be paid over a period exceeding one year	**50,000**	**60,000**	**50,000**	**40,000**
H. Provisions	-	-	-	-
I. Advance incomes	-	-	-	-
J. Equity capitals	-	-	-	-
- Subscribed capital	850,000	500,000	300,000	300,000
- Capital premium	-	-	-	-
- Reserves from reevaluation	-	-	-	-
- Reserves	130,000	190,000	130,000	80,000
- Profit or loss carried forward	-	-	-	-
- Profit or loss of financial year	190,000	130,000	140,000	90,000
TOTAL equity capitals	**1,170,000**	**820,000**	**570,000**	**470,000**

b) Profit and loss accounts of companies within the group:

Income and expense items	Company A	Company B	Company C	Company D
Operating income	2,800,000	1,300,000	1,600,000	900,000
Financial income	200,000	150,000	230,000	150,000
Operating expenses	2,600,000	1,200.000	1,450,000	850,000
Financial expenses	174,000	95,000	213,000	93,000
Expenses with corporation tax	36,000	25,000	27,000	17,000
Profit or loss of financial year	190,000	130,000	140,000	90,000

In order to draw up the consolidated financial statements by means of the direct consolidation procedure, the following stages will be taken into account:

STAGE 1

The establishment of the shareholders' interest percentage of the parent company (of the group) in each subsidiary, as well as of the interests of minority shareholders:

Indicators	Subsidiary B	Subsidiary C	Subsidiary D
Interest percentage of the parent company	70%	56%	50,40%
Percentage of the interests of minority shareholders	30%	44%	49,60%

STAGE 2.

The cumulation of group companies' balance sheet items and their corresponding accounting recording:

2a. The table regarding the cumulation of the items of the balance sheets of the companies included in the consolidation area is presented below:

Items of balance sheets	Company A	Company B	Company C	Company D	TOTAL A+B+C+D
A. Fixed assets	**840,000**	**690,000**	**460,000**	**420,000**	**2,410,000**
- tangible fixed assets	490,000	450,000	190,000	420, 000	1,550,000
- shareholding titles	350,000	240,000	270,000	-	860,000
B. Current assets, among which:	**570,000**	**340,000**	**320,000**	**220,000**	**1,450,000**
- Stocks	150,000	230,000	130,000	80,000	590,000
- Clients	250,000	60,000	120,000	120,000	550,000
-Cash accounts and bank accounts	170,000	50,000	70,000	20,000	310,000
C. Advance expenses	-	-	-	-	-
D. Debts – sums that must be paid within a year	**190,000**	**150,000**	**160,000**	**130,000**	**630,000**
- Suppliers	65,000	70,000	65,000	50,000	250,000

- Various creditors	125,000	80,000	95,000	80,000	380,000
E. Net current assets/ Net current debts (B-D)	**380,000**	**190,000**	**160,000**	**90,000**	**820,000**
F. Total assets minus current debts	**1,220,000**	**880,000**	**620,000**	**510,000**	**3,230,000**
G. Debts – sums that should be paid over a period exceeding one year	**50,000**	**60,000**	**50,000**	**40,000**	**200,000**
H. Provisions	**-**	**-**	**-**	**-**	**-**
I. Advance incomes	**-**	**-**	**-**	**-**	**-**
J. Equity capitals	**-**	**-**	**-**	**-**	**-**
- Subscribed capital	850,000	500,000	300,000	300,000	1,950,000
- Capital premium	**-**	**-**	**-**	**-**	**-**
- Reserves from reevaluation	**-**	**-**	**-**	**-**	**-**
- Reserves	130,000	190,000	130,000	80,000	530,000
- Profit or loss carried forward	-	-	-	-	**-**
- Profit or loss of financial year	190,000	130,000	140,000	90,000	550,000
TOTAL equity capitals	**1,170,000**	**820,000**	**570,000**	**470,000**	**3,030,000**

2b. Accounting recording regarding the cumulation of group companies' balance sheet items (*recording in the balance sheet*):

3,860,000	%	=	%	3,860,000
1,550,000	Fixed assets		Share capital A	850,000
350,000	Shareholding titles B		Share capital B	500,000
240,000	Shareholding titles C		Share capital C	300,000
270,000	Shareholding titles D		Share capital D	300,000
590,000	Stocks		Reserves A	130,000
550,000	Clients		Reserves B	190,000
310,000	Cash and bank accounts		Reserves C	130,000
			Reserves D	80,000
			Profit or loss A	190,000
			Profit or loss B	130,000
			Profit or loss C	140,000
			Profit or loss D	90,000
			Suppliers	250,000
			Various creditors	380,000
			Long-term bank credits	200,000

STAGE 3

Cumulation of profit and loss accounts of companies within the group and the making of corresponding adjustments:

3a. The cumulation table of profit and loss items of the companies included in the consolidation area is presented below:

Income and expense items	Company A	Company B	Company C	Company D	TOTAL A+B+C+D
Operating incomes	2,800,000	1,300,000	1,600,000	900,000	6,600,000
Financial incomes	200,000	150,000	230,000	150,000	730,000
Operating expenses	2,600,000	1,200,000	1,450,000	850,000	6,100,000
Financial expenses	174,000	95,000	213,000	93,000	575,000
Expenses with corporation tax	36,000	25,000	27,000	17,000	105,000
Profit or loss of financial year	190,000	130,000	140,000	90,000	550,000

3b. Recording of the cumulation of profit and loss items of the companies within the group (*recording in the profit and loss account*)[1]:

7,330,000	%	=	%	7,330,.000
6,100,000	Operating expenses		Operating incomes	6,600,000
575,000	Financial expenses		Financial incomes	730,000
105,000	Expenses with corporation			
190,000	tax Profit or loss A			
130,000	Profit or loss B			
140,000	Profit or loss C			
90,000	Profit or loss D			

<u>STAGE 4.</u>
The division of the subsidiaries' equity capitals between the parent company and the minority interests (that do not have control) and the elimination of the equivalent value of the titles of the consolidated companies as well as their accounting recording

4.a. Table representing the division of equity capitals and the elimination of the equivalent value of the shareholding titles owned by Company A in Subsidiary B as a result of direct consolidation by parent company A

Indicators	Total subsidiary B	Part attributed to group A (70%)	Part attributed to interests of minority shareholders (30%)
1. Share capital B	500,000	350,000	150,000
2. Elimination of shareholding titles (B) owned by company A	-350,000	-350,000	-
3. Divided share capital (1-2)	150,000	-	150,000
4. Reserves B	190,000	133,000	57,000
5. Profit or loss Subsidiary B	130,000	91,000	39,000
TOTAL (3+4+5)	470,000	224,000	246,000

[1] **Note**: The cumulation of the income and expenses items is carried out at the level of the profit and loss account - a component of consolidated financial statements.

4.a1. Accounting recording corresponding to the division of the subsidiaries' equity capitals, the elimination of the shareholding titles owned by Subsidiary B and the different representation of the interests of minority shareholders *(recording at the level of the balance sheet)***:**

820,000	%	=	%	820,000
500,000	Share capital B		Shares owned in affiliated entities (B)	350,000
190,000	Reserves B		Consolidated reserves	133,000
130,000	Profit or loss B		Consolidated profit or loss	91,000
			Interests of minority shareholders	246,000

4.a2. Division of the financial result (profit/loss) in Subsidiary B *(recording in the profit and loss account)*[2]*:*

130,000	%	=	Profit or loss B	130,000
91,000	Profit or loss which is attributed to parent company			
39,000	Profit or loss which is attributed to interests of minority shareholders			

4.b. Table representing the division of equity capitals and the elimination of the equivalent value of the shareholding titles owned by Subsidiary B in Subsidiary C as a result of direct consolidation by parent company A:

Indicators	Total subsidiary C	Part attributed to company A (56%)	Part attributed to interests of minority shareholders (44%)
1. Share capital C	300,000	168,000	132,000
2. . Elimination of shareholding titles (C) owned by company B (70%) *	240,000	-168,000 (240,000x70%)	-72,000 (240,000x30%)
3. Divided share capital (1-2)	60,000	-	60,000
4. Reserves C	130,000	72,800	57,200
5. Profit or loss of Subsidiary C	140,000	78,400	61,600
TOTAL (3+4+5)	330,000	151,200	178,800

* The elimination of shareholding titles in subsidiary C is done on the basis of shareholders' interest percentage owned by the mother company in subsidiary B (70%).

4.b1. Accounting recording corresponding to the division of the subsidiaries' equity capitals, the elimination of the shareholding titles owned by Subsidiary B in Subsidiary C and the different representation of the interests of minority shareholders (*recording at the level of the balance sheet):*

[2] The accounting recording is registered in the profit and loss account - a component of consolidated financial statements.

570,000	%	=	%	570,000
300,000	Share capital C		Shares owned in affiliated entities (B)	240,000
130,000	Reserves C		Consolidated reserves	72,800
140,000	Profit or loss C		Consolidated profit or loss	78,400
			Interests of minority shareholders	178,800

4.b2. Division of the financial result (profit/loss) of Subsidiary C *(recording in the profit and loss account – a component of financial statements):*

140,000	%	=	Profit or loss C	140,000
78,400	Profit or loss which is attributed to parent company			
61,600	Profit or loss which is attributed to interests of minority shareholders			

4.c. Table representing the division of equity capitals and the elimination of the equivalent value of the shareholding titles owned by Subsidiary C in Subsidiary D as a result of direct consolidation by parent company A:

Indicators	Total D	Part attributed to company A (50,40%)	Part attributed to interests of minority shareholders (49,60%)
1. Share capital D	300,000	151,200	148,800
2. Elimination of shareholding titles (D) owned by company C (56%)*	270,000	151,200 (270,000x56%)	118,800 (270,000x56%)
3. Divided share capital (1-2)	30,000	-	30,000
4. Reserves D	80,000	40,320	39,680
5. Profit or loss D	90,000	45,360	44,640
TOTAL (3+4+5)	200,000	85,680	114,320

*The elimination of shareholding titles in subsidiary D is performed on the basis of shareholders' interest percentage owned by the mother company in subsidiary C (56%).

4.c1. Accounting recording corresponding to the division of the subsidiaries' equity capitals, the elimination of the shareholding titles owned by Subsidiary C in Subsidiary D and the different representation of the interests of minority shareholders (*recording at the level of the balance sheet):*

470,000	%	=	%	470,000
300,000	Share capital D		Shares owned at affiliated entities D	270,000
80,000	Reserves D		Consolidated reserves	40,320
90,000	Profit or loss D		Consolidated profit or loss	45,360
			Interests of minority shareholders	114,320

4.c2. Division of the financial result (profit/loss) of Subsidiary D *(recording in the profit and loss account – a component of financial statements):*

90,000	%	=	Profit or loss D	90,000
45,360	Profit or loss which is attributed to parent company			
44,640	Profit or loss which is attributed to interests of minority shareholders			

4.c.3. The transfer of equity capitals' elements *(reserves and profit or loss – in our case)* of the parent company to the reserves and the consolidated financial result of Group A *(recording at the level of the balance sheet)*:

320,000	%	=	%	320,000
130,000	Reserves A		Consolidated reserves	130,000
190,000	Profit or loss A		Consolidated profit or loss	190,000

STAGE 5

5.a. The drawing up of the Register corresponding to the consolidation operations of the balance sheet items carried out in stages 1-4:

Items of balance sheets	Cumulated balance sheet items A+B+C+D	Restatements corresponding to consolidation		Consolidated balance sheet items (Group A)
		Debit	Credit	
1. **Fixed assets**	1,550,000	-	-	1,550,000
2. Shareholding titles B	350,000	-	350,000	-
3. Shareholding titles C	240,000	-	240,000	-
4. Shareholding titles D	270,000	-	270,000	-
5. Stocks	590,000	-	-	590,000
6. Clients	550,000	-	-	550,000
7. Cash and bank accounts	310,000	-	-	310,000
TOTAL ASSETS	**3,860,000**	**-**	**-**	**3,000,000**
8. Share capital A	850,000	-	-	850,000
9. Share capital B	500,000	500,000	-	-
10. Share capital C	300,000	300,000	-	-
11. Share capital D	300,000	300,000	-	-
12. Reserves A	130,000	130,000	-	-
13. Reserves B	190,000	190,000	-	-
14. Reserves C	130,000	130,000	-	-
15. Reserves D	80,000	80,000	-	
16. **Consolidated reserves**	**-**	**-**	133,000 72,800 40,320 130,000	**376,120**
17. Profit or loss A	190,000	190,000	-	-
18. Profit or loss B	130,000	130,000	-	-
19. Profit or loss C	140,000	140,000	-	-
20. Profit or loss D	90,000	90,000	-	-
21. Consolidated profit or loss			91,000 78,400 45,360	**404,760**

			190,000	
22. **Interests of minority shareholders**	-	-	246,000 178,800 114,320	**539,120**
23. Suppliers	250,000	-	-	250,000
24. Various creditors	380,000	-	-	380,000
25. Long-term credit	200,000	-	-	200,000
26. TOTAL LIABILITIES	**3,860,000**			**3,000,000**
27. Total sums D/C		**2,180,000**	**2,180,000**	

5.b. The drawing up of the Register corresponding to the consolidation operations of the profit or loss account carried out in stages 1-4:

Income and expense items	Cumulated incomes and expenses A+B+C+D	Division of results between Group A and interests of minority shareholders		Consolidated incomes and expenses (Group A)
		Debit	Credit	
Operating incomes	6,600,000	-	-	6,600,000
Financial incomes	730,000	-	-	730,000
Operating expenses	6,100,000	-	-	6,100,000
Financial expenses	575,000	-	-	575,000
Expenses with corporation tax	105,000	-	-	105,000
Profit or loss of financial year, among which:	**550,000**	***550,000***	**-**	**-**
Profit or loss A	*190,000*	*190,000*	-	-
Profit or loss B	*130,000*	*130,000*	-	-
Profit or loss C	*140,000*	*140,000*	-	-
Profit or loss D	*90,000*	*90,000*	-	-
Profit or loss corresponding to parent company (Group A)			***91,000*** ***78,400*** ***45,360*** ***190,000***	***404,760***
Profit or loss corresponding to the interests of minority shareholders			***39,000*** ***61,600*** ***44,640***	***145,240***
TOTAL		**550,000**	**550,000**	

<u>STAGE 6</u>

After completing the first 5 stages, the parent company prepares the consolidated financial statements, namely, the consolidated balance sheet and the *consolidated profit and loss account* of group A.

A. Consolidated balance sheet GROUP A

Items of balance sheets	Group of companies
A. Fixed assets	**1,550,000**
B. Current assets	**1,450,000**
-Stocks	590,000
-Clients	550,000

-Cash and bank accounts	310,000
C. Advance expenses	
D. Current debts – sums that must be paid in less than a year	**630,000**
-Suppliers	250,000
-Various creditors	380,000
E. Net current assets/ Net current debts (B-D)	**820,000**
F. Total assets minus current debts (A+B-D)	**2,370,000**
G. Debts – sums that should be paid over a period exceeding one year	**200,000**
H. Provisions	**-**
I. Advance incomes	**-**
J. Equity capitals	**-**
1. Share capital	**850,000**
2. Capital premium	**-**
3. Reserves from reevaluation	-
4. Consolidated reserves (133.000+72.800+40.320+130.000)	376,120
5. Profit or loss carried forward	-
6. Consolidated profit or loss of the financial year (91.000+78.400+45.360+190.000)	404,760
Interests of minority shareholders (246.000+178.800+114.320)	**539,120**
Total equity capitals	**2,170,000**

B. Consolidated profit and loss account GROUP A

Indicators	Group of companies
Operating incomes	6,600,000
Financial incomes	730,000
Operating expenses	6,100,000
Financial expenses	575,000
Expenses on corporation tax	105,000
Profit or loss of the financial year, including *- the part attributed to shareholders in the parent company*	550,000 *404,760*
- part attributed to interests of minority shareholders	*145,240*

Conclusions

The simple consultation of the individual financial statements of the companies that are part of the consolidation area of a group, presented cumulatively, does not allow us to create a real picture of the economic-financial situation of the group, taking into account that the reciprocal operations among the companies that are part of the group are not recorded and nor are their consequences. At the same time, the cumulated individual accounts do not provide a truthful image of equity capitals, including the financial results that belong to the shareholders of the parent company, as distinct from the part that is attributed to other "other shareholders" as "interests of minority shareholders" (shareholders of other companies than the parent company or its affiliated entities).

The necessity of approaching, by means of a case study, the applicative nature regarding the use of the direct consolidation procedure for the individual financial statements of companies that form a group seems all the more imperative given that the accounting theory and practice do not abound in effective solutions for the application of accounting regulations concerning the preparation of consolidated financial

statements. This is why we consider that our study can represent a useful guide for accounting practitioners as well as for students in economics that study accounting.
Confident that the accounting theory and practice can be permanently improved, I am eager to receive proposals or suggestions regarding the problematics approached in the current article.

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