

THE RESTRICTIONS OF CONSOLIDATING ACCOUNTS FROM THE PERSPECTIVE OF CONTROL AND THE FUNDAMENTAL ACCOUNTANCY PRINCIPLES

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Abstract: If we analyze from the point of view of the general accountancy management, the definition of the concept of control and the degree of influence that it exerts the consolidating entity over the dominant ones, constitutes the fundament of rigorous delimitation of the perimeter of consolidation. On the other hand, for the formation of a unitary informational base in consolidation, all the individual accounts of the entities comprised in the perimeter must respect the same accountancy principles. Some of these accountancy principles are valid even in the case of individual accounts, and others, that will be subjected to our analysis, are specific to the consolidation of accounts.

Viewed in its ensemble, the process of consolidation makes its appearance with the establishment of the perimeter of consolidation, with special implications on the future consolidated accounts. The establishment of the perimeter of consolidation presupposes the identification of the companies that, together with the leader entity, will be part of the ensemble for consolidation. Thus, the inclusion or exclusion of some entities from/within the perimeter of consolidation influences its dimension, the general accountancy management, as well as the faithful image of the group supplied by the consolidated accounts by an increase or unreal diminishing of it.

The evolution registered on the line of inclusions or exclusions in, respectively from the perimeter of consolidation, materialized through regulations regarding the consolidated accounts, allows the shaded interpretation of the notion of control.

If we look from the point of view of the general accountancy management, we have to remember that the definition of the concept of control and the degree of influence that it exerts the company that will realize the consolidation (consolidating entity, dominant) on those that will be consolidated (consolidated entities, dominated), it constitutes the fundament of rigorous delimitation of the perimeter of consolidation.

We believe that the approach from the special literature that defines the perimeter of consolidation as being 'the frontier that delimits the sub-ensembles that have between them strong enough links, in such a way that the consolidation of the financial situation shall have sense' (L. Malciu, N. Feleagă, 2004), ensures best the joining of the economic concept of faithful image and of control, to the approach realized in the line of consolidation of accounts.

The notion of control has new valances, thus if we would realize an approach from the perspective of consolidating the accounts, especially from the point of view of financial reports that can be established between the leader company and the consolidated entities. Thus, notions as **exclusive control, conjuncture control or**

notable influence, have become indispensable for the understanding and delimitation of the perimeter of consolidation as well as what it concerns the choosing of new methods of consolidation that shall ensure the materialization of the initial desiderate: the faithful reflection, clear and without distortions of the group reality.

Also from the perspective of the **consolidation-control** relationship, must be stated the fact that the international accountancy norm IAS 27 brings in discussion the possibility of existence of control if the leader of the group possesses, directly or indirectly, more than half of the rights to vote of a company, without being able to demonstrate clearly, in exceptional circumstances, that this possession does not allow control.

Also, control can also exist even if the leader of the group possesses less than half of the rights to vote, in the conditions in which:

- ❖ possesses more than half of the rights to vote, as a consequence of an agreement with the other investors;
- ❖ conducts the financial and operational politics of the company, by virtue of the statutory or contractual provisions;
- ❖ names or revokes the majority of the members of the administration board or of an equivalent organ;
- ❖ disposes of the majority of the rights to vote within the administration board or other equivalent organ.

Continuing our process on the line of emphasizing a parallelism with the American norms, we can observe that, unlike the international accountancy norm IAS 27, that foresees the existence of the control of right, as well as the existence of the control of fact, the USGAAP norms mention not only the control of right, that appears when the leader possesses the majority of the rights to vote of the company.

Trying to comment this situation, we observe that in this way, stirs an informational barrier evident enough, in the conditions in which, let us say, a leader of a group would possess a control of fact over an entity from the space regulated by the USGAAP. For this habitat of regulation, we cannot talk about a true group, while the international norms acknowledge this relation on the basis of control and include it in the sphere of accountancy consolidation.

On the other hand, the optic prefigured by the Directive VII surprises the exclusive control through the result of possessing the majority of the rights to vote within another entity, directly or indirectly. As consequence there is the problem of possessing the majority power and not of exercising effectively this power in the strict sense of the notion of control.

This aspect allows us to remark the fact that, the possess of a fraction inferior to the percentage of 50% from the capital, may allow, by the game of the stocks with right of double vote or of the stocks with right of vote, to exert exclusive control over a society because the rights to vote can be direct or indirect.

The exclusive control can also be the result of a designation during two successive exertion by the majority of the members of the organs of direction and administration. It is about an exclusive control of fact and is due to the direct or indirect possession of a bigger fraction of 40% from the rights to vote, in the conditions in which no other entity or shareholder does not possess, directly or indirectly, a superior fraction of this percentage.

There is yet the possibility of existence of an exclusive control as a result of the right to exert a dominant influence over a company, by virtue of a contract or a statutory

provision, a control difficult to appreciate (the contract of location of administration, of exclusive cession or unilateral collaboration), in the case in which the consolidating leader is the shareholder or associate of this company.

The norms regarding the consolidation of accounts from our country, inspired by the Directive VII and the international accountancy norms, mention, timely in our opinion, that the leader entity exerts control over another entity (subsidiary) when this fulfills a series of conditions (Săcărin M., 2001), from which there are mentioned:

- ❖ possesses the majority of the rights to vote of the shareholders or associates of the subsidiary; or

- ❖ is a shareholder or associate and has the right to name or revoke the majority of the members of the administration organs, of direction or control; or

- ❖ is a shareholder or associate and has the right to exert a dominant influence over the entity by virtue of a contract or a statutory provision, in the case in which the law permits such contracts or provisions; or

- ❖ is a shareholder or associate, and the majority of the members of the organs of administration, direction or control of the entity were named only as a result of an exert of the rights to vote of the leading group. Also, these members must have had this functions during the current financial exertion, of the previous financial exertion; or

- ❖ is a shareholder or associate and possesses on his/her own the control of the majority of the rights to vote of the shareholders or the associates of the entity, as consequence of a contract with other shareholders or associates; or

- ❖ has the right to exert a dominant influence over the entity by virtue of a contract or a statutory provision, in the case in which the law permits such contracts or provisions.

Also from the perspective of ensuring a new efficient general accountancy management that will allow an organization and full informational usage of the consolidated accounts, we must mention also another type of control emphasized in the special conditions of a limited number of associates or shareholders, and that is **conjectural control**. This presupposes the partition of the control of a company exploited in common (join-ventures) after finalizing a contractual agreement, in such a way that the decisions cannot be taken only after the unanimity of the co-shareholders, being funded on three essential conditions:

- the exploitation in common or equally, that presupposes that the vided entity should realize a significant part of its activity through the conjectural company.

- limited number of associates, element of fact that claims that the partition of control shall not allow none of its partners to exert alone the exclusive control.

- the partition of control between them.

The international accountancy norm IAS 31 'The financial information relative to the participations within the entities of joint-ventures type' defines the common control as 'the division of the control of an economic activity, by virtue of a contractual agreement' (International Accounting Standards Board - IAS 31), focusing over the necessity of a contract (of a convention) by which the common control must be proved. This contract can be separated or incorporated within the status of the entity. Usually, the contractual agreement must comprise dispositions regarding the activity, duration, the accounts of the joint-venture entity that is under common control, the denomination of the members of the administration board, the participations to the capital, the division by the associates of the production, expenses, incomes and results of the joint-venture entity.

We think that, in the conditions in which the sphere that comprises this type of control is relatively restrained and poorly regulated in Romania, the common control cannot be viewed only as a contractual agreement of division of the power of decision between a limited number of shareholders or associates, by virtue of an agreement between them, aspects that we recommend to be re-dimensioned and re-evaluated in such a way to be able to surprise the realities of joint-venture type, specific to a market economy fully operational.

Another possibility of manifestation and exertion of a type of control, with an area much more restrained, is **the notable** influence or significant over the financial administration and politics of a company. This appears in the case in which an entity disposes, directly or indirectly, of a fraction at least equal with the fifth part from the rights to vote of another entity. We find within this category the companies associated to the group.

The notable influence (significant) is defined by the IAS 28 'The accounting of the participations within the associated entities' as: 'the power to participate to the operational decisions and financial of an entity, but without, although, exerting control over them'.

We can thus reach to a **conclusion after this analysis**, embodied in that the appreciation of the capacity of an entity to exert a notable influence, is not a notion defined by law and, moreover, is not always clear and requires a professional reasoning. It is about a simple participation on long term to the making of decisions without the possibility to control these decisions.

This simple participation has a special impact upon the general accountancy management, this if we take into account that it can be realized through an exchange of information, personnel of direction, the representation within the structure of the direction organs.

Thus, in order to reach a satisfactory degree of uniformity in the appreciation of the **notable influence**, it is presupposed that there is an exertion of a notable influence, if the possessor of titles has at least 20% from the rights to vote of a society, excepting the situation when it is proved, clearly, that this influence does not exist. In the vice-versa situation, if the possessor of titles has, directly or indirectly, less than 20% from the rights to vote of a society, it is presupposed that there is not an exertion of a notable influence, excepting the situation when it is proved, clearly, that this influence exists, being able to be manifested by:

- ✓ important transactions with the respective entity;
- ✓ the change of the directing personnel;
- ✓ the presence within the administration board or another leading organ equivalent;
- ✓ the participation to the process of making political decisions;
- ✓ the supply of essential technical information.

The interpretation that we find in the FASB (Financial Accounting Standards Board) norms orientate us to the identification of the presumption according to which a shareholder that has at least 20% from the rights to vote does not exert a notable influence over the issuing entity, only if he/she has at the basis an ensemble of facts and circumstances regarding this participation. The presumption of notable influence remains valid for as long it exists a contrary proof.

Unlike the international accountancy norm IAS 28, **the norms from our country** do not state the minimum percentage of the rights to vote according to which shall be

established the presumption of exertion of the notable influence, mentioning in a way, in our opinion, restrictive enough, only ‘the right to participate directly or indirectly at the financial politics and operational of an entity, but without exerting exclusive or common control over it’.

The establishment of the exerted control, creates the basis of stabilization of the force reports that can be established between the entities of the group, as well as the way in which it can be structured a general accountancy management capable to satisfy the more and more diverse and numerous informational needs regarding the accounts that require to be consolidated.

In what regards the basic accountancy principles applicable to the consolidated accounts, there must always be taken into consideration the scope of their creation and that is the obtain of a faithful image of the position, financial situation and the performances of the entities subjected to control or notable influence, perceived in consolidation in an unitarian manner, homogenous, like one entity.

For the formation of a unitarian base to start into consolidation, all individual accounts of the entities comprised in the perimeter must respect the same accountancy principles. **Some of these accountancy principles are valid even in the case of individual accounts, and others are specific to the consolidation of accounts.**

If we orientate our attention to the **accountancy** principles found in the level of group entities, we can observe that these are similar, mostly to those afferent to the individual entities, with the differentiation that for some of these the perspective of approach presupposes new valences. Thus, beside the recognized fundamental principles such as prudence, permanence of methods, activity continuity, independence of the exercise, intangibility of the opening balance, non-compensation, within the category of fundamental principles there are included also the relative importance, the prevalence of the economic reality over the juridical form, the principle of entity, the principle of well information.

In the special literature (A. Tiron Tudor, 1998), we can observe that some rules, like the **homogeneity of the individual accounts of the consolidating entities**, are raised to the level of principle, determined also in the Directive VII, and other fundamental principles, valid in the case of individual accounts, are taken also at the level of consolidated accounts, what it is observed from what are forward presented.

➤ **The principle of prudence**, with the same significance as in the case of individual accounts, according to which does not admit the over-evaluation of the elements of active and of the incomes, respectively the under-evaluation of the elements of passive and of the expenses.

We consider that, the non-application or incorrect application of this principle generates a distortion in what regards the financial-accountancy information at the level of the group, irrespective if it is identified at the level of group leading entities or at the level of subsidiaries. An example to this, in our opinion, could be represented by the interest of the minorities, that, to the extent in which it is presented in a under-evaluated manner within the consolidated passive, could lead to a ‘poverty’ of the shareholding with a participation that does not give right of control within the corporation.

➤ **The principle of methods’ permanence** aims to the insurance of continuity in the application of norms regarding the evaluation, registration and presentation of the patrimonial structures and of the results within the consolidated financial situations, insuring one of the fundamental characteristics of the accountancy information and that is the **comparability**. In this way the duration of the periods and the data of closure of

the accounts must be identical from one exercise to another. If we would do the crossing strictly towards the sphere of consolidated accounts, we can observe that this principle aims, first of all, to the methods of evaluation. The exception is constituted by the case when the significant change in the nature of the group's activity or the analysis of the presentation of the financial situations, demonstrates that the change will have as a result a more adequate presentation of the events and transactions. When the presentation or classification of the elements changes, the afferent information to the previous periods must be, also, in conformity with the new presentation. Supplementary, there must be presented in the annex the nature, values and motives of the amendments. Also in the annex there must be exposed the implications of the changes over the consolidated result or of the own capitals.

➤ **The principle of intangibility of the opening balance** of an exercise must correspond to the closure balance of the previous exercise.

Within the process of realization of the consolidation of accounts, we must mention that the application of this principle presents some aspects more 'sensitive' and, in our opinion, insufficiently regulated by the Romanian accountancy referential connected to the consolidation of accounts. Thus, a big impediment of this principle for the group entity is determined by the fact that, in the case of existence of subsidiaries implemented abroad, there can be manifested a high degree of variability in what concerns the perimeter of consolidation. The restrictions are given by the complexity of the structure of group, by the successive acquisitions within the group, as well as by the intra-group operations.

➤ **The principle of activity continuity**, according to which there is supposed that the group continues its activity normally within a foreseeable future, without entering in state of liquidation or sensitive reduction of the activity.

We join the opinion of specialists in the field who consider in unanimity that a consequence of incorrect application of this principle at the level of group entities, may constitute the unfavorable influence of the ensemble of fundamental evaluation rules.

Thus, **the consolidated financial** situations are elaborated regularly, starting from the presumption that group entities will continue their activity also in the predictable future and that they do not have the intention to liquidate or reduce significantly their activities. When the general management of the group appreciates the presumption of activity continuity there are taken into account all available information for the predictable future, that must be for at least 12 months from the date of the balance, although without being limited, to this period.

We consider that the level of detail of this appreciation depends on the specific situation of the group. When an entity from the group has had a profitable activity and easy access to the financial resources, it is considered that the presumption of activity continuity is manifested and there is not necessary a detailed analysis. In other cases, the management could be obliged to take into consideration a wide range of factors that affect the current and anticipated profitability, the graphics of reimbursement of debts and the potential sources of refinancing and hardly after that it can be pronounced if the presumption of activity continuity is adequate.

A major effect of non-application or incorrect application of this principle to the level of the group, is that it is generated a severe disinformation, when the financial consolidated situations are not fundamental on a provisional solid process. This fact must be mentioned by the general management of the group together with the base on

which there are established the financial consolidated situations and with the motif for which this will not be able to continue its activity within the limits previously prefigured.

If the group or certain entities within the group are in the impossibility to develop all or one of its activities, the evaluation in historical costs will be replaced with the evaluation in values of liquidation, taking into consideration the ensemble of costs that results from the closure of the activity.

➤ **The principle of independence of exercise** at the level of the group does not presuppose differentiations towards the individual accounts and presupposes the delimitation in time of the incomes and costs afferent to the activity while employing them and using them in order to determine the result of the period to which it is referred.

➤ **The principle on non-compensation**, according to which the elements of active and passive must be evaluated and registered in the accountancy separately, being inadmissible the compensation between the posts of active and passive of the balance, as well as between the incomes and costs from the account of results.

Yet, we think that the referential Romanian accountant is deficit in what concerns this principle, in the conditions in which, at the level of the international referential is used a compensation between the incomes and costs of the group, when it is realized the consolidation of the profit and loss account, considering, according to the chosen method of consolidation, these elements and at the level of integrated subsidiaries. This is the reason why we recommend the implementation of a derogation from this principle in the accountancy referential regarding the consolidation of the accounts of groups from Romania.

➤ **The principle of relative importance** or of the significance sill, refers to the obtain and supply of information, more relevant financial situations, credible and homogenous, with minimum costs.

By virtue of this principle, we recommend for the consolidated accounts to avoid the excessive synthesizing of information, and also the abundance of information, of detailing that, we assume, it won't do anything else but to contravene to the desiderate of insurance of a new faithful image of the group. The principle aims to the regroupings that are realized in the synthesis documents, the elimination of reciprocal operations, the incidence of some operations over the results, over the patrimonial situation.

➤ **The principle of good information** presupposes that the general management should issue consolidated financial situations based upon the principle of the faithful image, to ensure the users of financial situations a satisfactory information, otherwise said, an information sufficient and significant for the intelligibility of accounts, taking into consideration that the synthesis documents represent an official means of communication, structured, and for supplementary details considered necessary it is used the annex.

It is important, in our opinion, that the users can distinguish the information that represents the components of the consolidated financial situations, considering the fact that these have a higher degree of complexity in comparison with that of the individual financial situations. That is why, each component of the financial situation must be clearly identified, in this sense it must contain:

- ✚ the protractor group denomination or other means of identification;
- ✚ the fact that the financial situations refer to the group and not to the individual entities within its component;

- ✚ the period to which the financial situations refer to;
- ✚ the currency of report and the degree of exactness used in the presentation of information from the consolidated financial situations.

The individual financial situations of the banking situations and the consolidated accounts realized by these must be published in each member state of the European Union, in which those institutions have representations. These member states can solicit that those documents be published in their official language.

The consolidated financial situations, as well as the consolidated report of administration and the report of auditors, regarding the consolidated financial situations, will be published by the entity that elaborates the respective consolidated accounts.

For example, in the case of the group from Romania on which we focused our analysis, UTI Group, we observe that this must also publish together with the individual financial situations the consolidated financial situations, in the conditions in which, countries like USA or Great Britain, there are published only the consolidated financial situations.

If we analyze this situation through the insurance of a good information, we consider that is opportune the recommendation to institute a system of annual financial report well consolidated, in the conditions in which the individual reports do nothing but uselessly loading a report, we say, complex and difficult enough to be perceive. The eventual supplementary clearances meant to enlighten the possible informational impediments of the consolidated reports, we believe that could be included within an annex whose structure be expressly regulated.

➤ **The principle of prevalence of the economic reality over the juridical form**, specific to the Anglo-Saxon system is not thoroughly accepted within the continental system. The IAS 1 standard defines the principle like this: ‘the operations and other events of the entity’ s life must be registered and presented according their nature and financial reality, without taking into consideration unitarily their juridical pertinance’.

We consider that this principle encounters its applicability on the whole to the level of the group of entities, within which the consolidation of accounts, as exclusive economic aspect, aims to the heterogeneous ensemble within which the independence of each entity is proved juridical.

And yet, the accountancy consolidation exceeds this barrier and demonstrates that, irrespective of the perspective of juridical positioning of the entities, either leader, subsidiary, associated entities etc, the economic is the only one that can offer all interested a clear image, real and intelligible about what today represents the heterogeneous entity of the group.

➤ **The principle of entity** ensures the delimitation in space of the entity. Appeared from the necessity to delimitate the patrimony of the entity of personal patrimony of the owners, it considers the entity as an autonomous entity, distinct from its owners, irrespective its juridical form and of the developed activity. **At the level of group entity, the economic entity is circumscribed to the juridical entity.** The limits of the economic entity exceed the limits of the juridical entity, in the sense that even they exist from the juridical point of view there are more entities, due to the connections that exist between them, forming one economic entity – the group, from which the necessity to determine the patrimony, the financial situation and the results of this entity with the help of the consolidated accounts.

➤ **The principle of homogeneity, specific to the consolidated accounts**, aims to

the methods of evaluation and the information comprised within the consolidated financial situations.

The desiderate of obtaining a faithful image of the patrimony, the financial situations and the results of the group through the consolidated accounts, presupposes the use of individual accounts of the entities to be consolidated that must be homogenized. The homogenization consists in re-treatments, reclassifications and adjustments meant to ensure a 'fluidization' regarding the presentation of the accounts, the methods of evaluation, the elimination of fiscal and juridical incidents for certain operations.

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