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PRELIMINARY PROCEDURES AND CHARACTERISTICS UNDERLYING THE APPLICATION OF CONSOLIDATION TECHNIQUES

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***Abstract:** The need to form financial and industrial groups in the Republic of Moldova was determined by the development of market relations, large-scale privatization, structural changes in production, the predominance of international trade over domestic production, etc.*

Consolidation is a technique that allows the presentation of unified information for groups of organizations that are legally independent but financially connected or dependent on a common decision-making center. This procedure allows you to present the financial statements, overall results, economic benefits of these economic units, as for a single entity.

***Key words:** consolidated financial statements, consolidation techniques, set of indicators of controlled companies, investors, economic globalization tool, industrial financial group, intergroup economic transactions.*

JEL Classification: M41

Introduction

Globalisation implies and has been at the root of the means of integration and interdependence, which have led to changes in economic, political, social and technological processes, ensuring a more interconnected society.

Globalisation is a process that has promoted the integration of societies through various activities, which are driving forces behind a significant proportion of human development. Also, the international mobility of factors of production, and especially capital, has led to the need for the existence of globalisation of activities, if we are to speak of the aim of companies to obtain large profits, bearing smaller accounts, compared to the internal growth of entities at national and international level.

The evolution of accounting systems at national and international level are also influenced by the phenomena of interconnected economies and globalisation of financial markets.

The need for the formation of financial-industrial groups in the Republic of Moldova is linked to the development of market relations, structural mutilation in production, predominance of international trade over domestic production, etc.

If we talk about the accounting systems used at the level of groups of companies, which have a physical presence in different countries and are subject to the regulatory basis applied in the countries of residence of the groups of entities, then we can see that there are permanent problematic issues regarding the preparation and preparation of consolidated financial statements.

In the following table we have presented the basic definitions of the accounting of consolidated accounts at the level of groups of companies, found in various normative acts and scientific works on the subject.

Table 1. Addressing basic definitions related to the consolidation of accounts in different legislation / scientific papers

Normative act / Scientific papers	Definitions on the theme
Accounting and Financial Reporting Law No 287 of 15.12.2017, Art. 3 para. (1)	<i>Entity-daughter</i> (Subsidiary entity) - an entity controlled in whole or in part by the parent entity; <i>Parent entity</i> - an entity that controls one or more child entities; <i>Affiliated entities</i> - entities within a group.
National Accounting Standard "Presentation of Consolidated Financial Statements", approved by Order of the Ministry of Finance no. 93 of 07.06.2019, art. 5	The parent entity is required to prepare consolidated financial statements if it has control over subsidiaries that are characterised by: - a majority of the voting rights of shareholders or associates in another entity; - the right to appoint or remove a majority of the members of the board, executive body or supervisory body, as the case may be, of another entity and is simultaneously a shareholder or associate of that other entity; - the right to exercise significant influence over an entity of which it is a shareholder or member by virtue of a contract entered into with that entity or a provision in the instrument of incorporation or statutes of that entity; - being a shareholder or associate of an entity and alone controlling a majority of the voting rights of the shareholders or associates of that entity as a result of an agreement with other shareholders or associates of the entity.
Grigori, L., etc. 2021. <i>Enterprise accounting</i> . Manual, page 194	<i>Equity interests</i> are rights in the form of shares or other interests held by the entity in the share capital of other entities.
National Accounting Standard "Equity and Debts"	<i>Share capital</i> is the total value of the shares of the owners of the entity.
IFRS 10 „Consolidated financial statements”	There is a <i>controlling relationship</i> if an investor has: - power over the entity in which it has invested; - exposure or rights to variable returns from his involvement in the investee; and • - the ability to use its power over the investee to affect the value of those returns.
Săcărin, M., 2014. <i>Account consolidation practices and regulations</i> . Manual, page 16-17	<i>Consolidated financial statements</i> have the basic objective of providing useful information for decision-making and are considered indispensable for both internal and external reporting. The consolidated financial statements provide the parent company's managers with uniform information for assessing the management of subsidiaries, irrespective of their location (domestic or foreign), national regulations or sector of activity.

Source: Adapted by the authors [1, 3, 4, 5, 6, 7]

From the legal provisions analysed above, it follows that the parent entity is obliged to prepare consolidated financial statements if it has control over its subsidiaries.

The *aim of this article* is to research and examine the problematic aspects related to the preliminary procedures underlying the application of consolidation techniques, and the objective is to investigate and elucidate the key moments underlying the resolution of questions related to the subject of consolidated accounts, and directly the preliminary procedures underlying the application of consolidation techniques, proposed for development and analysis by the author.

Therefore, the provisions of national and international accounting regulations, as well as the works, researches and opinions of local and foreign economists and scholars have been studied in order to formulate conclusions and recommendations on the issues addressed.

Methods applied

The research method is based on the analysis of theoretical and practical material on problematic issues related to the preliminary procedures underlying the application of consolidation techniques. The theoretical foundation was based on analysis, synthesis, deduction and the inductive method used for a clear and representative interpretation. The importance of the present article's research lies in achieving the nominated aim and objective by examining the provisions of national and international accounting regulations, as well as the works, researches and opinions of local and non-resident authors, scholars and researchers, in order to solve the concerned issue.

Results and discussion

The participants of the Financial Industrial Group shall be deemed to be the legal entities, which have signed the agreement on the establishment of the Financial Industrial Group and the establishment by them of the parent company and the subsidiaries, which form the Financial Industrial Group.

According to Article 4 of the Law on Financial-Industrial Groups No. 1418 of 14.12.2000 "*Financial-industrial group* means a group of legal entities, registered by the authorized state authority, which, on the basis of the contract, have associated, in whole or in part, their tangible and intangible assets and operate as subjects with equal rights of entrepreneurial activity for the purpose of carrying out investment projects and programs, aimed at increasing the competitiveness of local production and expanding markets for the sale of goods and services". [2]

The members of the financial-industrial group are legal entities - commercial or non-commercial organisations, with the exception of public and religious organisations, which have joined together on the basis of the contract establishing the financial-industrial group.

Transnational financial-industrial group means a financial-industrial group whose members are legal entities under the jurisdiction of other States.

Inter-State financial-industrial group means the existence of a financial-industrial group, which is formed on the initiative of the governments of the participating countries on the basis of an intergovernmental agreement.

The contract of establishment of the financial-industrial group is an agreement between legal entities, which determines the manner and conditions of establishment of the financial-industrial group.

The central company of the financial-industrial group is a legal entity established by all participants in the agreement on the establishment of the financial-industrial group in the legal form of a joint-stock company, which represents the interests of the members of the group and is empowered to manage its affairs.

The draft organization of the financial-industrial group consists of a package of documents, prepared by the members of the financial-industrial group, containing necessary information on the aims and tasks, investment projects and programmes, expected economic and social results of the financial-industrial group's activity;

State register of financial-industrial groups is a single database containing information on established, reorganised and liquidated financial-industrial groups. [2]

The registration of consolidation procedures contributes to the creation of an information circuit that allows the parent entity to:

- set objectives for each group entity;
- assess the performance of group entities and compare them;
- carry out sub-consolidations by business lines, etc.

The requirements for the content of financial reporting have changed fundamentally under the influence of the changing labour and capital market situation: the increase in the number of entities at national and international level has led to the fact that some entities have attracted additional resources from outside to maintain or expand their business, while other entities have been able to provide their own available resources in order to obtain greater economic benefits.

Consolidation of accounts may be carried out by listed or unlisted economic agents, as well as autonomous enterprises, public institutions, carrying out industrial or commercial activities, if they control one or more entities or exercise significant influence over them, and the group established exceeds during two successive accounting periods a certain size of financial result, balance sheet value, or number of employees, etc.

In contemporary economic literature, the role of groups of entities in the internationalisation of economic relations is examined primarily from the point of view of technology transfer.

At the same time, the countries that receive groups of entities on their territory must know in advance their potential and what lies in the combination of fundamental knowledge - generally accessible - with the unencrypted, highly specific technologies that represent the know-how of the given transnational company and that are formed over several years of its evolution.

According to Article 5 of the National Accounting Standard "Presentation of Consolidated Financial Statements", approved according to the Order of the Ministry of Finance No. 93 of 07.06.2019 "The parent entity is obliged to prepare Consolidated Financial Statements if it has control over the subsidiaries", the characteristics of which are exposed to analysis by the matter reflected in Table 1, including preliminary procedures and characteristics underlying the application of consolidation techniques on enterprises can be achieved through different ways, which are determined, including legal circumstances, tax conditions, etc. [3].

That is, in addition to the individual financial statements, the parent entity prepares consolidated financial statements in accordance with the provisions of the Law on Accounting and Financial Reporting and accounting standards, which provision is established according to Article 27 of the Law on Accounting and Financial Reporting No. 287 of 15.12.2017. [1]

In international practice for complex group structures, two consolidation techniques can be used:

- Direct;
- Indirect or tiering.

The direct consolidation technique involves the consolidation by the parent entity of all the companies within the group, regardless of whether the parent entity holds, directly or indirectly, participating interests in their capital. The use of this consolidation technique requires prior determination of the parent entity's share of the equity of the consolidated companies. This technique provides direct financial information at the level of the whole group and makes it possible to determine the contribution of each company to the reserves and results of the group of entities.

The indirect or tier consolidation technique involves the successive consolidation of each company within the group by the entity that owns its securities. This technique involves consolidation at each level of vertical integration. This results in financial information for different segments within the group (sub-groups). Compared to direct consolidation, level consolidation is more labour-intensive and difficult to carry out when the ownership links between group entities are complex.

For each entity that may be included in the scope of consolidation, the process that led to the decision to be consolidated or not and then the applicable consolidation method must be examined. The voting rights held by the parent company should then be determined as the basis for the consolidation process for entities that are neither under common control nor under contractual control.

The percentage of control (percentage of voting rights) held by the consolidating entity in the general meeting of the consolidated entities is the main element on the basis of which control and significant influence is determined. Thus, although control and significant influence can sometimes be determined independently of the percentage of control, in consolidation it is taken into account that:

- a percentage of control greater than 50% allows control to be enforced unless proven otherwise;
- a percentage of control between 20% and 50% allows significant influence to be exercised unless proven otherwise.

Percentage of control should not be confused with financial involvement, which is determined by the percentage of interest.

For each company that may be subject to consolidation, the following steps are considered: first, those entities that are under common or contractual control of the parent entity are identified, then - for other undertakings - it is determined which of them are considered to be under the sole control or significant influence of the parent entity.

To determine whether an entity is considered to be under the sole control of the parent entity (with full integration) or under its significant influence (with equity method), one must:

As a first step, determine the percentage of voting rights held by the parent entity and taking into account indirect holdings determine one of the following:

Voting rights:

- between 100 % and more than 50 % -exclusive control;
- between 50 % and more than 40 % - presumption of sole control;
- between 40 % and 20 % - presumption of significant influence;
- below 20% - exclusion from consolidation.

In the second stage, any justifiable exceptions to the previous situations of establishing links between entities in a group of entities are made.

Finally, the companies under sole control which should be accounted for by the equity method due to the structure of their individual accounts and incompatible with that of the individual accounts of the parent entity are determined.

Determining the parent's links with other entities requires the existence of sole control, significant influence or neither and distinguishing different types of financial links with the parent.

When a break in control occurs, it must be determined whether the next entity in the chain can be regarded as an entity subject to significant influence.

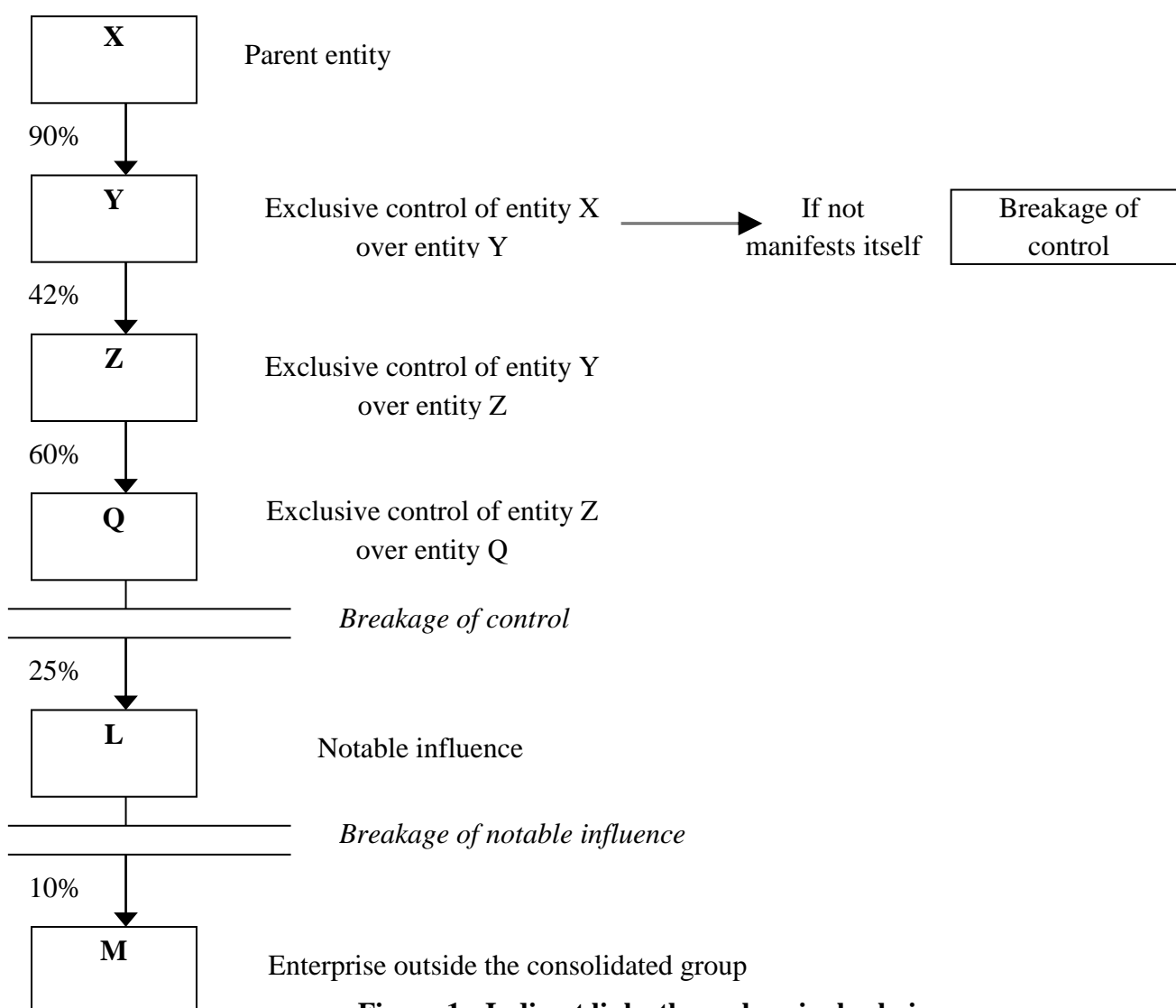


Figure 1 - Indirect links through a single chain

Source: Authors' own study, based on [7]

When the entity causing the breakdown of control is under significant influence and is itself the head of the consolidated group, exercising control or significant influence over other

undertakings, the question arises whether its individual or consolidated accounts should be retained.

For some, the consolidated group is limited to the entities controlled and under significant influence, with all accounts being kept in their individual form.

For others, controlled undertakings and undertakings under significant influence, being part of the consolidated whole, the accounts are kept in their consolidated form.

In the case of direct or indirect links through several chains, the problems arise as follows:

- If an entity is under the sole control of an enterprise at the end of a chain that does not include enterprises under sole control, it is itself under the sole control of the parent enterprise (if it has direct control); it cannot concern itself with other linking chains;

- If an entity is subject to the significant influence of its predecessor at the end of a chain of sole control, it is itself subject to the significant influence of the parent (if the parent directly exercises significant influence).

The following cases can serve as examples of direct and indirect links through several chains:

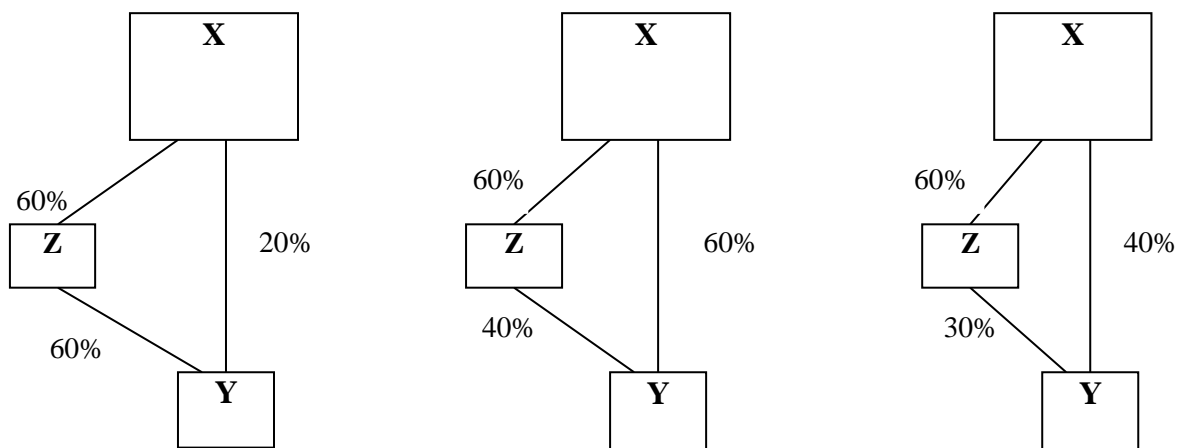


Figure 2 - Exclusive control of entity X over entity Y

Source: Authors' own study

Groups of entities can also be characterised according to the activity carried out. Thus, some groups carry out a single activity, while others, on the contrary, are active in several sectors of activity between which there is no connection. Groups in the latter category are called conglomerate groups.

Parent entities, which hold shares in subsidiaries, are sometimes also called holding companies. These entities whose sole function is to hold equity interests and which do not have an operational activity are referred to as pure holding companies. The contents of the balance sheet (individual accounts) of the pure holding company are, on the assets side, equity securities and loans granted to subsidiaries and, on the liabilities side, equity and long-term and short-term liabilities. The profit and loss statement includes dividend and interest income, interest expense and, possibly, reserves for impairment of investment securities.

Conclusions

After examining the material, the following conclusions can be drawn. As it appears from the above, capital ties between companies are the basis for the existence of groups of entities. But groups of entities can also exist in the absence of capital ties. In this situation, cohesion between companies belonging to the same group is due to the fact that:

- The main shareholder of each entity is the same natural person or the main shareholders are several natural persons belonging to the same family;
- The group entities are placed under common management, even if there is a multiplicity of owners or shareholders;
- Entities have very close contractual relationships that result in the behaviour of integral enterprises;
- Entities are linked by profit-sharing agreements, etc.

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