**Nataliia Svichkar**
*Department of Real Estate Development, Accounting and Marketing,*
*Prydniprovska State Academy of Civil Engineering and Architecture, Dnipro, Ukraine*
*E-mail: svichkar.nataliia@pdaba.edu.ua*
*ORCID: https://orcid.org/0000-0001-8609-5837*
*ResearcherID: https://publons.com/wos-op/researcher/4788398/nataliia-svichkar/*

**Hanna Kusnetsova**
*Department of Real Estate Development, Accounting and Marketing,*
*Prydniprovska State Academy of Civil Engineering and Architecture, Dnipro, Ukraine (corresponding author)*
*E-mail: makarova.hanna@pdaba.edu.ua*
*ORCID: https://orcid.org/0000-0002-0015-7476*
*ResearcherID: https://publons.com/wos-op/researcher/4788638/hanna-makarova/*

**Kostiantyn Zhyzhko**
*Director of SKODA TRANSPORTATION UKRAINE LLC, Dnipro, Ukraine*
*E-mail: kostiantyn.zhyzhko@skodagroup.com*

# Development of the Enterprise Management System Through the Implementation of International Financial Reporting Standards

***Abstract***

Explain the concept of consolidated financial statements, parent company, subsidiary company according to international and national standards. To study the composition of consolidated reports, the consolidation process, the principles of consolidation. Study the types of controlled entities, taking into account the proportion of voting rights held by the investor and the standards that govern them. Define the concept of control according to international standards and identify the factors that influence the determination of whether the investor controls the investee. The *purpose* of the paper is to develop methodological and practical recommendations for preparing group management reporting in accordance with international standards. Consolidated reporting should be prepared to identify the results of the analysis of the state and activities of the holding, there is a need to transform consolidated reporting in accordance with IFRS for entering the international market and attracting foreign investment. *Methodology*. The research is based on the application of general scientific techniques and methods. The methods of detailing, analysis and synthesis, deductive and inductive approach have been used to clarify the concept of "IFRS". The methods of selective observation and historical argumentation of the researched problems are applied – to generalise the unsolved problems of IFRS. *Results*. Consolidated financial statements undoubtedly contain important information for making financial and management decisions. Intra-group transactions can give an unrealistic picture of the activities of a group of companies, their sales, calculations, stocks and financial results; therefore, consolidated reporting gives a more objective picture of the operations and financial status of a single economic unit and does not replace the individual financial reports of group companies, since transactions between group members are not taken into account during consolidation. *Practical implications*. The concepts of consolidated financial statements, parent company, subsidiary company according to international and national standards are revealed. The composition of the forms of consolidated reporting, the consolidation procedure, the principles of consolidation are considered. The types of controlled entities, taking into account the investor's share of voting rights, and the standards governing them are presented. The concept of control in accordance with international standards is defined and the factors influencing the determination of whether the investor controls the investee are presented. *Value/originality*. Methodological and practical recommendations have been developed for the preparation of group management reporting in accordance with international standards.

***Keywords***

group of companies, consolidation, parent and subsidiaries, international accounting standards, financial statements

**JEL:** G34, M14, M20, M41, M40



**DOI:** https://doi.org/10.30525/2500-946X/2023-2-3

## 1 Introduction

The preparation of consolidated financial statements in accordance with international standards is governed by:

– IAS 1 "Presentation of Financial Statements";
– IAS 27 "Consolidated and Separate Financial Statements";
– IAS 28 "Investments in Associated Enterprises";
– IFRS 3 "Business Combination";
– IFRS 10 "Consolidated Financial Reporting";
– IFRS 12 " Disclosure of Information on Parts of Participation in Other Business Entities".

The specific features of the preparation of consolidated financial statements in accordance with national standards are set out below:

NR(S)A (National Regulation (Standard) of Accounting) 1 "General Requirements for Financial Reporting";

– NR(S)A 2 "Consolidated Financial Reporting";
– Ukrainian Commercial Code;
– Ukrainian Tax Code.

According to IFRS 10, consolidated financial statements are the financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity (2012).

Consolidated financial statements under NR(S)A 1 are financial statements that present the financial position, results of operations and cash flows of a legal entity and its subsidiaries as a single economic entity (2013).

Thus, the definition of "consolidated financial statements" is identical under international and national standards.

## 2 The Consolidation Process

The consolidation process consists of two stages:

1) initial consolidation (during the preparation of consolidated financial statements for previously independent entities);

2) on-going consolidation (during the preparation of consolidated financial statements for a group that was previously formed and has already engaged in inter-company transactions).

On initial consolidation, the results of the consolidated financial statements and accounting procedures depend on the method of business combination.

International practice distinguishes between the following consolidation methods:

– full consolidation method;
– equity method;
– proportionate consolidation method;
– acquisition method;
– new parent company method;
– equity consolidation method;
– extended equity method;
– full goodwill method;
– partial goodwill method.

However, the most common methods of consolidation in international practice are the acquisition method, the equity method, the proportionate consolidation method and the equity method.

In domestic practice, depending on the nature of the investment transaction and the establishment of control, there are two methods of preparing the initial consolidated financial statements: the acquisition method and the merger method. These methods differ procedurally and have a significant impact on the overall financial results reported in the consolidated financial statements.

The acquisition method involves a business combination that results in the acquirer obtaining control of the net assets and operations of another entity in exchange for the transfer of assets, the assumption of liabilities or the issuance of shares. As a result, the acquiree may cease to operate as a separate legal entity. In such a case, only first consolidation occurs at the date of full acquisition by the acquirer. The companies become one legal entity, and no subsequent consolidation is required during the period of mutual operations.

The acquisition method also allows the legal status of the acquiree to be preserved and a parent-subsidiary relationship to be established between the acquirer and the acquiree.

The acquisition gives rise to goodwill, which is the excess of the cost of the business combination over the acquirer's interest in the fair value of the identifiable assets and liabilities at the date of acquisition. When applying this method, certain steps have to be taken: identifying the buyer, determining the fair value of the business combination and allocating (at the acquisition date) the value of the combination to the assets and liabilities acquired, as well as recognising any non-controlling interests (Gurska, 2012).

Domestic practice distinguishes between two methods of preparing initial consolidated financial statements based on the nature of the investment agreement and the establishment of control: the acquisition method and the pooling of interests method.

The merger method is characterised by a situation where a parent company enters into an agreement with another company resulting in the combination of their interests, but the parent company is not the buyer of the other company. Typically, mergers involve companies of similar size combining their interests and neither party is recognised as the acquirer. The combined entity reflects the assets, liabilities and equity of the combined entity at their carrying amounts, taking into account changes in accounting policies.

The result of such a merger can be either an economic union or a legal merger. In an economic union, the enterprises remain separate legal entities after the merger. An example of this would be where an enterprise acquires a controlling interest in another enterprise, making the acquired enterprise a subsidiary of the acquirer. In a legal merger, the assets and liabilities of one company are transferred to another and the first company is dissolved, or the assets and liabilities of both companies are transferred to a new entity and both former companies are dissolved.

The main criterion that distinguishes the merger (pooling of interests) method from the acquisition method is that, in a merger, the parties cannot determine who is the seller and who is the buyer. In other words, a merger results in equal control of the combination and no party can dominate. A merger is considered to be the final stage between two companies, and the question of their merger is only a matter of time (Luchko, Benko, 2016).

The advantages and disadvantages of using M&A methods are presented in Table 1.

A comparison of the two consolidation methods shows that the acquisition method has more advantages than the merger method and is therefore the most efficient method for domestic companies. Consolidated financial statements are prepared and presented by an entity acting as a parent.

## 3 Definition of the Term "Control" According to International Standards

Under IFRS 10, a parent is an entity that controls one or more other entities, and a subsidiary is an entity, including an unincorporated entity, such as a partnership, that is controlled by another entity (known as a parent) (2013).

In turn, national standards provide the following definitions of parent and subsidiary enterprises: the parent (holding) enterprise (Regulations (Standards) of Accounting (R(S)A) 19 "Unification of Enterprises") is an enterprise that exercises control over subsidiary enterprises, and the subsidiary enterprise is an enterprise that is under the control of the parent (holding) enterprise (2012).

International standards, unlike national standards which do not define the term "control", give the following interpretation of control of an investment "An investor controls an investment object if the investor has the right to variable results of the investment object's activities or is exposed to related risks and is able to influence these results through its own authority over the investment object." (2012) That is, an investor controls an investee when it has all of the following:

- authority over the investee, i.e., if the investor has existing rights that give it the current ability to direct the relevant activities;
- is exposed to, or has rights to, variable returns from its involvement with the investee;
- the ability to use its power over an investee to influence the investor's performance.

If it is not clear that control is achieved through voting rights alone, the following factors should be considered to conclude whether an investor has control over an investee:

1. Whether the activity is significant. Significant activities are those that have a significant impact on the return on investment.

An activity can be called significant if it gives the right to:

- determination of operational policy;
- investment decision-making;
- management of significant investments.

2. Whether the investor has management powers. This factor can be analysed by looking at the powers arising from the definition of rights, which may include:

- voting rights;
- the right to appoint and dismiss senior management personnel;
- the right to make decisions within the management contract.

3. Return on investment. ROI can be negative, positive or both positive and negative. Examples of ROI considered include:

- dividends and other distributions of economic benefits (e.g., interest on debt securities) and changes in the value of the investment in the investment object;

TABLE 1 Advantages and disadvantages of using acquisition and merger (M&A) methods (Gurska, 2012)

| Methods | Advantages | Disadvantages |
|---|---|---|
| Acquisition method | 1. It is almost always possible to identify the buyer company.<br>2. The creation of an additional asset – goodwill.<br>3. All costs directly related to the purchase are fully included in the purchase price.<br>4. Reduction of competition. | 1. The need for the investor to have free cash.<br>2. The possibility of negative goodwill.<br>3. The seller loses control of its property. |
| Merging method | 1. Tax avoidance.<br>2. Reduction of competition<br>3. Increasing international competitiveness. | 1. High level of risk in case of incorrect assessment of the company.<br>2. Instability of the domestic securities market.<br>3. Unfavourable innovation and investment climate.<br>4. Lack of significant cash resources to conclude profitable acquisitions. |

– remuneration for servicing assets or liabilities of the investment object, commissions and the risk of incurring losses due to the provision of credit support or sources of liquidity, residual interests in the assets and liabilities of the investment object in the event of its liquidation, tax benefits;
– benefits that are not available to other participants in the enterprise (for example, economies of scale, cost reductions, access to scarce products, proprietary knowledge).

The return on investment is often an indicator of control. The reason for this is that the greater the willingness of an investor to take on the risks associated with variable returns on an investment in an entity, the stronger the incentive for the investor to acquire rights that give it the power to control the entity.

However, the amount of the return on investment is not a determining factor in whether an investor has control. An investor may have control over an investee but not receive benefits from those rights and, therefore, not exercise control over the investee. Conversely, an investor that receives returns on its investment from an investee may not be able to use its management powers and therefore does not control the investee.

According to R(S)A and IFRS, the following types of controlled entities are distinguished (Table 2):
– a joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control;
– associate – an entity in which an investor has significant influence;
– subsidiary – an entity controlled by an investor.

## 4 Procedure for Consolidation of Financial Statements

The consolidated financial statements prepared in accordance with international standards do not have a strictly prescribed format, and IAS 1 "Presentation of Financial Statements" provides a list of minimum items to be included in the reports (2012).

Consolidated financial statements prepared according to national standards have prescribed formats that do not differ from the traditional financial statements prepared for individual companies. The composition of consolidated reporting formats is shown in Table 3.

Consider the procedure for consolidating financial statements. Consolidation is based on certain principles set out in IFRS 10:

1. The consolidated financial statements are prepared and presented by the parent company.
2. The period for which the financial statements of the parent and subsidiary are prepared should be the same.

Consolidated financial statements comprise the financial statements of a group of entities that use the same accounting policies for similar transactions. If this is not the case, then, in accordance with national standards, a note is made in the notes to the financial statements that different accounting policies have been used. Under international standards, corrective actions are taken.

Financial statements are consolidated in several stages.

*Stage 1.* Prepare the individual financial statements of the group entities for the consolidation process. To do this, the following steps are required:

TABLE 2 Types of associates in relation to investor voting rights

| Level of control | Shared control | Significant impact | CONTROL |
|---|---|---|---|
| Control object status | Joint venture | Associated enterprise | Subsidiary company |
| Percentage of investor voting rights | Less than 20% | 20% – 50% | Over 50% |
| Regulatory standard | National Regulations (Standards) of Accounting (NR(S)A) 12 "Financial Investments", IFRS 11 "Joint Activities" | NR(S)A 12 "Financial Investments", IAS 28 "Investments in Associated Enterprises" | NR(S)A 2 "Consolidated Financial Statements", IAS 27 "Consolidated and Separate Financial Reporting", IFRS 10 "Consolidated Financial Reporting" |

TABLE 3 Composition of consolidated reporting forms

| According to International Standards | According to National Standards |
|---|---|
| Consolidated Statement of Financial Position | Consolidated Balance Sheet (Statement of Financial Position) |
| Consolidated Statement of Comprehensive Income | Consolidated Statement of Financial Performance (Statement of Comprehensive Income) |
| Consolidated Statement of Cash Flows | Consolidated Statement of Cash Flows (using the direct or indirect method) |
| Consolidated Statement of Changes in Equity | Consolidated Statement of Equity |
| Notes comprising a summary of significant accounting policies and other explanatory notes | Notes |

1. Identify and eliminate all intra-group transactions that give rise to unrealised gains and losses due to the absence of resale of current and non-current assets to other entities outside the group.

Determine the amount of unrealised gains and losses from intra-group transactions, namely from:

a) intra-group sale of inventories;

b) intragroup sale of non-current assets.

When recognising a gain or loss on the intra-group sale of non-current assets, depreciation of the sold non-current assets should be adjusted.

2. Define the concept of goodwill. Goodwill, according to IFRS 3 "Business Combinations", is future economic benefits arising from assets that cannot be individually identified and recognised separately (2012). Goodwill is defined as the difference between the market (stock exchange) valuation of an enterprise and the value of its tangible assets recognised in the balance sheet.

3. Calculate and charge goodwill amortization.

4. Estimate income from participation in the capital of a subsidiary.

5. Analyse the carrying amount of an investment in a subsidiary.

6. Determine income tax.

Stages 2-6 are related to the preparation of the transformation table.

*Stage 2.* Entering line items of the parent company's separate financial statements in the corresponding “Parent company” column of the transformation table.

*Stage 3.* Entering line items of individual financial statements of a subsidiary in the “Subsidiary” column of the transformation table.

*Stage 4.* Calculating and entering the amounts of adjustments made in the course of consolidation in the appropriate “Debit” or “Credit” column of “Adjusting transactions”.

*Stage 5.* Calculating and entering the amounts of minority interest in net profit (loss) and net assets of a subsidiary in the line “Minority share” in the transformation table.

*Stage 6.* Calculate the consolidated amounts of the respective financial statements in the “Consolidated statements after adjustments” column of the transformation table.

## 5 Conclusions

Consolidated financial statements undoubtedly contain important information for financial and management decisions. Intra-group transactions can give an unrealistic picture of the activities of a group of companies, its sales, accounts, stocks and financial results; therefore, consolidated reporting gives a more objective picture of the operations and financial status of a single economic unit, but does not replace the individual financial reports of group companies, since transactions between group members are not taken into account in consolidation.

When analysing the requirements of national and international standards in relation to the process of financial reporting consolidation, it was found that in Ukraine there is a process of harmonising national regulatory acts with international ones. During the research it was found that the main content of national standards meets the requirements of international standards, however, national standards consider a much narrower range of issues than international ones. Having analysed the regulatory framework governing the process of consolidation of financial statements, it can be concluded that international practice provides a broader scope for the assessment of control and a description of the consolidation process.

## References

[1] Gurska, O. M. (2012). Consolidated and combined financial reporting of groups of enterprises. *Bulletin of Lviv Polytechnic National University: Management in Ukraine: stages of formation and problems of development*, 721, 82–86. (in Ukrainian)

[2] Luchko, M. R., & Benko, I. D. (2016). Accounting and financial reporting according to international standards. Ternopil: “Econ. opinion of TNEU”. (in Ukrainian)

[3] International Accounting Standard 1 “Presentation of Financial Statements” (2012, January 01). zakon.rada.gov.ua. E-source: http://zakon2.rada.gov.ua/laws/show/929_013 (in Ukrainian)

[4] International Financial Reporting Standard 3 “Business Combination” (2012, January 01). zakon.rada.gov.ua. E-source: http://zakon3.rada.gov.ua/laws/show/929_006 (in Ukrainian)

[5] International Financial Reporting Standard 10 “Consolidated Financial Reporting” (2013, January 01). zakon.rada.gov.ua. E-source: http://zakon2.rada.gov.ua/laws/show/929_065 (in Ukrainian)

[6] International Financial Reporting Standard 12 “Disclosure of Information on Parts of Participation in Other Business Entities” (2013, January 01). zakon.rada.gov.ua. E-source: http://zakon5.rada.gov.ua/laws/show/929_067 (in Ukrainian)

[7] International Financial Reporting Standard 27 “Consolidated and Separate Financial Statements” (2012, January 01). zakon.rada.gov.ua. E-source: http://zakon0.rada.gov.ua/laws/show/929_045 (in Ukrainian)

[8] International Accounting Standard 28 “Investments in Associated Enterprises” (2012, January 01). zakon.rada.gov.ua. E-source: http://zakon3.rada.gov.ua/laws/show/929_046 (in Ukrainian)

[9] National Regulation (Standard) of Accounting No. 1 "General Requirements for Financial Reporting" (2013, February 07). zakon.rada.gov.ua. E-source: https://zakon.rada.gov.ua/laws/show/z0336-13#Text (in Ukrainian)
[10] National Regulation (Standard) of Accounting No. 2 "Consolidated Financial Reporting" (2013, June 27). zakon.rada.gov.ua. E-source: http://zakon5.rada.gov.ua/laws/show/z1223-13 (in Ukrainian)
[11] Regulation (Standard) of Accounting 19 "Unification of Enterprises" (1999, July 07). zakon.rada.gov.ua. E-source: http://zakon2.rada.gov.ua/laws/show/z0499-99 (in Ukrainian)

Received on: 14th of June, 2023
Accepted on: 30th of July, 2023
Published on: 31th of August, 2023