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Consolidated financial statements. Practical problems in preparation and presentation of consolidated financial statements

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Abstract

Consolidation of financial statements is combining of financial statements (balance sheet, income statement, cash flow, change in equity) of parent and its subsidiaries, as a collected look at the financial position of a parent and its subsidiaries is displayed in consolidated financial statements. These consolidated financial statements let you measure the general condition an entire group of companies in lieu of self-contained status. This research subject covers a lot of researchers' opinions, and different literatures. While reading dissertation reader will learn how financial statements of parents and its subsidiaries are consolidated. The aim of research is to present which problems arise during the consolidation process in practice, and how these problems are solved.

Contents

1 Introduction

A business combination is determined by IASB ("Board") as a 'transaction or other event where an acquirer gets control of one or more businesses'.

Through the years, business combinations have been specified in various methods. It doesn't matter which definition has been used, it contains situations where an entity acquires governance of integrated set of activities and assets which compose a business also transactions as a consequence of which an entity becomes a subsidiary of a parent.

According to accounting terms two separately different methods of the reporting the impacts of a business combination have traditionally been existed.

1) the purchase method of accounting (or acquisition method of accounting)
2) the pooling of interest method (or merger accounting).

Before separately explanation, it should be stated that these accounting methods are completely different in business combination. Main difference is that in pooling of interest method of business combination, the assets, liabilities and reserves are combined and recognized at their historical values, however, in purchase method business combination, assets and liabilities of the transferor (subsidiary) company are combined and shown at their market value in the books of the transferee (parent) company.

The pooling of interest method is based on hypothesis that made of deal is not important but interchange of equity securities. As a result, the capital account of the business acquired is eliminated and substituted with the new stock by the acquiring company (parent). Finally, total assets of the combined business are equal to the whole of the assets of the individual firm. The method is no longer permitted, the assets and liabilities of the acquire are transferred only with their FV.

According to the acquisition method of business combination, acquired company should be reported at fair value. Accounting records of acquire company will carry on to keep the carrying values applying the accounting basis which was used before the acquisition. The adjustments of fair value consolidation are prepared on a worksheet to impact the business combination, and they are not to be placed to both the acquirer (parent) or acquiree (subsidiary) accounting records. In short, goodwill is calculated and recorded as the consideration transferred (at fair value) plus any of the noncontrolling(at fair value) (it will be explained at next chapters) interest in the acquire minus the fair value of net assets acquired.

Exemption from preparing consolidated financial statements by an intermediate parent

A parent that prepares financial statements in accordance with IFRS is exempt from presenting (i.e. need not present) consolidated financial statements if it meets all of the following conditions:

(a) it is a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;

(b) its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);

(c) it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and

(d) its ultimate or any intermediate parent produces financial statements that are available for public use and comply with IFRSs, in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with IFRS 10 *Consolidated Financial Statements*

2 Chapter 1.

2.1.1 Control and, Acquisition method of accounting

An entity may conduct its business not only directly, but also through strategic investments in other entities. IFRS broadly distinguishes between three types of such strategic investments:

- entities controlled by the reporting entity (subsidiaries);
- entities or activities jointly controlled by the reporting entity and one or more third parties (joint arrangements); and
- entities that, while not controlled or jointly controlled by the reporting entity, are subject to significant influence by it (associates).

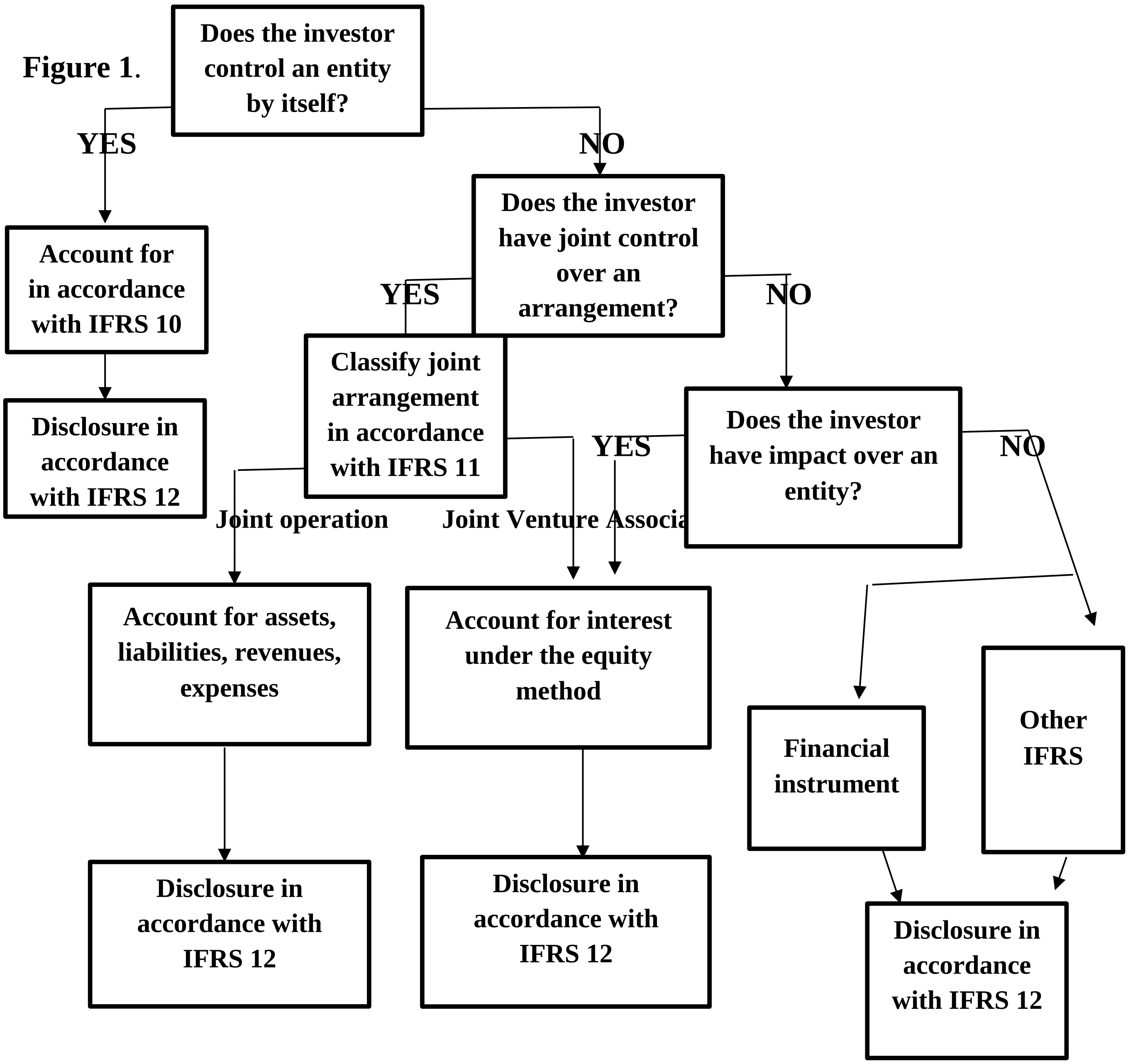
The first type of investment is accounted for in accordance with IFRS 10 – Consolidated Financial Statements.

IFRS 10 establishes a single control model that applies to all entities, including ‘structured entities’ (‘special purpose entities’ and ‘variable interest entities’ under the previous IFRS standards and US GAAP, respectively). In addition, IFRS 10 deals with accounting for subsidiaries by investment entities. FRS 10 contains no disclosure requirements. Instead, all disclosures required in respect of an entity’s interests in subsidiaries or its interests in structured entities (whether consolidated or unconsolidated) are contained within IFRS 12 – Disclosure of Interests in Other Entities.

When management concludes that an entity does not have control of an investee, the requirements of IFRS 11 – Joint Arrangements – and IAS 28 – Investments in Associates and Joint Ventures – must be considered to determine whether it has joint control or significant influence, respectively, over the investee.

Figure 1: Interaction between IFRS 10, IFRS 11, IFRS 12 and IAS 28

Figure 1.



When an investor determines that it controls an investee, the investor (the parent) consolidates the investee (the subsidiary). A parent consolidates a subsidiary from the date on which the parent first obtains control, and continues consolidating that subsidiary until the date on which control is lost. IFRS 3 – Business Combinations – defines the date of acquisition, that is, the date on which control is first obtained. The term ‘date of acquisition’ is used even if a parent gains control without acquiring an interest, or taking any action, as discussed below. When a parent gains control of a group of assets or an entity that is not a business, such transactions are excluded from the scope of IFRS 3. This is often the case when a parent gains control of a structured entity. Business combinations under common control are also excluded from the scope of IFRS 3, which means that if a parent gains control of a subsidiary (as defined in IFRS 10) that was previously controlled by an entity under common control, IFRS 3 also does not apply. A parent consolidates all subsidiaries and recognises non-controlling interests for any interests held by investors outside of the group.

The objective of IFRS 10 is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. To meet this objective, the standard:

(a) requires an entity (the parent) that controls one or more other entities (subsidiaries) to present consolidated financial statements;

(b) defines the principle of control, and establishes control as the basis for consolidation;

(c) sets out how to apply the principle of control to identify whether an investor controls an investee and therefore must consolidate the investee;

(d) establishes the accounting requirements for the preparation of consolidated financial statements; and

(e) defines an investment entity and the criteria that must be satisfied for the investment entity exception to be applied. IFRS 10 requires that a parent (unless exempt or an investment entity as discussed below) shall present consolidated financial statements. This means that the financial statements of the group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are included, should be presented as those of a single economic entity. A group consists of a parent and its subsidiaries. It is not clear whether IFRS 10 requires an entity to prepare consolidated financial statements only if it is a parent at the end of the reporting period or also if it was a parent at any time during the reporting period. In our view, consolidated financial statements must be prepared by an entity that was a parent during the reporting period, even if that entity is no longer a parent at the end of the reporting period (e.g. because it disposed of all its subsidiaries). IFRS 10 requires a parent to consolidate a subsidiary until the date on which the parent ceases to control the subsidiary. This means that if a parent does not prepare consolidated financial statements pursuant to a concession in local law the parent may not present separate financial statements in compliance with IFRS.

Combined financial statements must include all normal consolidation entries (such as elimination of group transactions, unrealised profit elimination, etc. discussed below). In our view, the combined financial statements should disclose:

• the fact that the financial statements are combined financial statements;

• the reason why combined financial statements are prepared;

• the basis for determining which ‘units’ are included in the combined financial statements; • the basis of preparation of the combined financial statements; and

• the related party disclosures required by IAS 24 – Related Party Disclosures.

An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Thus, an investor controls an investee if and only if the investor has all of the following: (a) power over the investee; (b) exposure, or rights, to variable returns from its involvement with the investee; and (c) the ability to use its power over the investee to affect the amount of the investor’s returns.

Applying the acquisition method is required for business combination by IFRS 3. This method includes the following steps:

1) identifying an acquirer

2) determining the acquisition date

3) recognising and measuring the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquire

4) recognising and measuring goodwill

In the first step the acquirer is identified. It is required one of the combining entities to be stated as the acquirer IFRS 3. According to IFRS 10, the acquirer is the entity that gets control of the acquire. In a business combination, the acquirer is usually the entity that transfers the cash or other assets or incurs the liabilities.

Other circumstances should also be considered according to IFRS 3, including:

- the related voting rights in the combined entity. In this case, the combining entity (acquirer) obtains the largest part of the voting rights over the combined entity (acquire), after getting special voting arrangements and options, warrants or convertible securities;
- if there is not a significant voting right with another owner or an organized group of shares, the being of a few voting rights in the combined entity. Hence the acquirer keeps the largest minority voting interests in the combined;
- the combination of the governing body of the combined entity. The acquirer is usually a united entity that can choose or appoint the governing body of the united entity;
- the combination of the senior management of the combined entity. Management of the acquirer govern the management of the combined entity;

The purchaser is generally the combining entity whose own size is considerably greater than that of the other combining entity or entities, whether this be gauged by assets, revenues or profit.

Determining the acquisition date is the second step in applying the acquisition method, 'the date when the acquirer gets control of the acquire'. This is also called the 'closing date'. the date on which the parent legally transfers the cash (consideration), purchases the assets and assumes the liabilities of the acquire. However, 'closing date' does not vitally mean that the transaction has to be completed at law before the purchaser gets control over the acquire. The buyer may control the date before or after the closing date. If a written settlement presents that the purchaser gets manipulation of the acquire on a date before the closing date, the acquisition date may precede the closing date. This does not mean that the date of acquisition is artificially transposed or otherwise changed, for instance, if the settlement indicates that the acquisition is to be effective as of an earlier date, then the parent being entitled to profits arising after that date, even the buying price is based on the net asset position of the acquire at that date. The date control will depend on some factors, they are whether the acquisition arises from a public offer or a private deal, is issue to approval by other parties, or is impacted by the issue of shares.

By way of a public offer for an acquisition, acquisition date can be:

- when the offer become unconditional as sufficient acceptances have been received;
- when the offer closes. In a specific agreement, the date becomes clear when the unconditional offer by sellers is made.

Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquire are the next step of the acquisition method.

To be eligible for recognition, an item acquired or assumed must be:

1) an asset or liability at the acquisition date;

2) portion of the entity acquired (the acquire).

The identifiable assets and liabilities assumed shall comply with the definition of the assets and liabilities set out in the IASB Conceptual Framework. For instance, liabilities are not the business's plans to reorganise the activities of acquire (plans to exit from an activity, or cease the employment of or transfer employees) at the acquisition date. The acquirer will identify these costs in its post-combination financial statements in accordance with other IFRSs. If labilities for restructuring meet the definition of a liability at the acquisition date they can only be identified. The Basis for Conclusions clearly shows that the requirements for recognising liabilities associated with restructuring remain the same, even though the standard no longer includes the clear requirements relating to restructuring plans. Basic principle is that acquirer gauge the liabilities assumed and identifiable assets acquired at their acquisition-date fair values. In this chapter, fair value is measured reference to IFRS 13. Guidance on how to gauge fair value is provided by IFRS 13, however it does not alter when fair value is required or approved according to IFRS.

'Fair value' is identified as the price according to IFRS 13 that would be paid to transfer a liability or obtained to sell an asset in an orderly agreement (transaction) between market participants at the measurement date according to current market conditions. It ("fair value" is definitely an exit price. Where measurement of liability assumed or an identifiable asset acquired at its fair value at the date of acquisition are required under IFRS, it does not need to disclose information about those acquisition-date fair value measurements under IFRS 13, despite a business uses the IFRS 13 measurement requirements. However, the IFRS 13 disclosure requirements will be used or applied to any fair value measurement after initial recognition, for instance the fair value measurement of contingent consideration obligation is categorized as a financial liability.

The acquirer must categorize or appoint the liabilities assumed and identifiable assets under the terms of its contract, economic conditions, operating and accounting policies and other appropriate conditions as at the acquisition date.

Two exceptions are provided under the standard:

1) categorization of leases in line with IAS 17 (but, according to IFRS 16, this exception applies only to categorization of leases where the acquire is the lessor, this is discussed below); and

2) categorization of a contract, insurance contracts should be classified in accordance with IFRS 4 Insurance Contracts (but, this classification exemption is eliminated by FRS 17 - Insurance contracts for business that apply this standard）.

The measuring and recognising goodwill is the last stage in applying the acquisition method. 'Goodwill' is not determined in respect of its measurement, however it is defined in terms of its nature according to IFRS 3. IFRS 3 determines goodwill as 'an asset representing the future economic benefits emerging from other assets acquired in a business combination that are not exclusively distinguished and independently perceived.'

Nevertheless, the direct gauge of goodwill is not conceivable, the basic requirement of the standard is that goodwill should be gauged as a residual.

Goodwill at the acquisition date is calculated as (1) minus (2) below:

1) The sum of: the consideration transferred (usually gauged at acquisition-date fair value) and the total of any non-controlling interest in the acquire and the fair value of the acquirer's beforehand held equity interest in the acquire at acquisition-date.

2) The net of the acquisition-date fair of the liabilities assumed and the identifiable assets acquired.

To draw the conclusion that goodwill has to be gauged as a residual, the IASB considered the following two components to include 'core goodwill':

- The fair value of the going concern component of the acquiree's current business. This illustrates the capacity of the set up business to win a higher rate of profit for an amassed accumulation of net assets than would be anticipated if those net assets must be acquired independently. The value originates from the collaborations of the net assets of the business, and also from different advantages, for example, factors identified with market defects, including the capacity to gain monopoly benefits and barriers to market entry (by potential opponents, regardless of whether through lawful limitations or expenses of entry);

- The fair value of the estimated synergies and other advantages from combining the acquirer's and acquire's businesses and net assets.

Nevertheless, practically the amount of goodwill perceived in a business combination would probably not be restricted to 'core goodwill'. Some items which do not qualify for separate recognition and items that are not gauged at fair value, e.g. deferred tax liabilities and assets, will also have impact on the amount of goodwill perceived.

Subsequent accounting for goodwill.

How goodwill should be subsequently accounted in a business combination is the basic matter relating to the goodwill acquired. The requirements of IFRS 3 in this case are direct; goodwill acquired in a business combination is gauged at the amount perceived at the acquisition date minus any accumulated impairment losses. Acquirer should not amortize goodwill. Rather, if changes or events in circumstances show that it may be impaired impairment test has to be done by the acquirer annually, or more regularly, according to IAS 36.

Consideration transferred

In a business combination process the consideration transferred comprise the total of liabilities (incurred by the acquirer to the former owners of the acquire), equity interests (issued by the acquirer) and assets which is measured at fair value at acquisition date (conveyed by the acquirer). There is a great deal of forms of the consideration, containing subsidiary of the acquirer, cash, other assets, and securities of the acquirer (for instance, preferred shares, ordinary shares, warrants, options and debt instruments). The consideration transferred likewise incorporates the reasonable estimation of any unforeseen thought and may likewise incorporate a few or the greater part of any acquirer's share based instalment grants exchanged for grants held by the acquiree's workers estimated as per IFRS 2 as opposed to at fair value.

Moreover, liabilities and assets that their fair values are different from their carrying amount also could be comprised. At the acquisition date these liabilities and assets are measured again to fair value and any resulting gains or gains are perceived in profit or loss. The acquirer holds control of assets and liabilities, if after the acquisition date the exchanged liabilities or assets stay inside the joined entity after the acquisition date since they were conveyed to the acquire instead of to its previous proprietors,. They are held at their current carrying sums and no loss or gain is perceived.

3 Chapter 2

3.1.1 Main issues in identifying the assets acquired, the liabilities assumed

3.1.2 Contingent consideration

In business combinations, there are payments that are contingent upon future results. When there is a contingent consideration arrangement in a deal between parties, there are conditions when those payments don't represent purchase price, they represents compensation expense in the post-combination period.

When the difference occurred in price during negotiations, contingent consideration settlements bridge the gap between acquirer and acquire. For instance, if an acquirer believes the value of acquired company is worth AZN 5 million, however the acquiree states its value is AZN 8 million, the deal could not be settled. At that moment the contingent consideration can play main role. The acquirer might say that I will pay you AZN 5 million right now, and I'll repay you the additional AZN 3 million in the future, if the acquired company performs like you promise it will, At first view, it is understood that that AZN 3 million payment would be extra purchase price.. However, some or all of this AZN 3 million might really be compensation expense, in the case of an ongoing employment situation.

When going into a business combination, the gatherings to the course of action might not generally concur on the correct value of the business, especially if there are vulnerabilities with regards to the achievement or worth of specific resources or the result of dubious occasions. For this reason, they usually decide on a temporary value for the purpose of completing negotiations with future extra payments in order to complete the agreement. Namely, economic dangers relating to the uncertainties about the fate of the business distributed by them. Samples of these future payments might be in shares or cash or other assets and may be contingent upon the achievement of specified events, as well as might be connected to future financial performance over a specified period of time. Cases of such extra payments contingent upon future occasions are:

- earnings over concurred focus over a concurred period;
- cash flows emerging from specified assets over an concurred period;
- endorsement of a patent/permit;
- parts of earnings (e.g. income) over a concurred focus over a concurred period;
- remaining an employee of the entity for an concurred period of time;
- successful finish of specified contract transactions.

Although these payments might be negotiated as part of getting control of another entity, this might not necessarily always reflected by the accounting, especially if these payments are paid to those who stay as workers of the business after business is acquired. In the latter case, depending on the exact terms of the arrangement, the payment made may be accounted for as remuneration for services provided subsequent to the acquisition, rather than as part of the consideration paid for the business.

Contingent consideration is recognised at its fair value as part of the consideration transferred in exchange for the acquiree. IFRS 13 has specific requirements with respect to measuring fair value for liabilities. An entity has to determine the price it would need to pay to transfer the liability to a market participant at the measurement date The initial measurement of the fair value of contingent consideration is based on an assessment of the facts and circumstances that exist at the acquisition date. Although the fair value of some contingent payments may be difficult to measure, it is argued that ‘to delay recognition of, or otherwise ignore, assets or liabilities that are difficult to measure would cause financial reporting to be incomplete and thus diminish its usefulness in making economic decisions’. Information used in negotiations between buyer and seller will often be helpful in estimating the fair value of the contingent consideration.

An estimate of zero for the fair value of contingent consideration would not be reliable. Equally, it would be inappropriate to assume an estimate of 100% for the acquisition-date fair value of the obligation to make the payments under the contingent consideration arrangement. The fair value of contingent consideration will be measured in accordance with IFRS 13 which does not limit the valuation techniques an entity might use.

IFRS 3 also recognises that, in some situations, the agreement may give the acquirer the right to the return of previously transferred consideration if specified future events occur or conditions are met. Such a right falls within the definition of 'contingent consideration', and is to be accounted for as such by recognising an asset at its acquisition-date fair value.

3.1.3 Business combinations achieved without the transfer of consideration

Control of an acquiree sometimes obtained by an acquirer without transferring consideration. The standard emphasises that the acquisition method applies to a business combination acquired without the transfer of consideration. IFRS 3 indicates that such circumstances include:

1) the acquiree repurchases a sufficient number of its own shares for an existing investor (the acquirer) to obtain control;

2) minority veto rights lapse that previously kept the acquirer from controlling an acquiree in which the acquirer held the majority voting rights; and

3) the acquirer and the acquiree agree to combine their businesses by contract alone. In that case, the acquirer transfers no consideration in exchange for control of an acquiree and holds no equity interests in the acquiree, either on the acquisition date or previously. Examples of business combinations achieved by contract alone include bringing two businesses together in a stapling arrangement or forming a dual listed corporation.

In computing the amount of goodwill in a business combination, IFRS 3 normally requires the acquirer to aggregate: (i) the consideration transferred; (ii) the amount of any non-controlling interest in the acquiree; and (iii) the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree. However, where the consideration transferred is zero, IFRS 3 requires the entity to use the acquisition-date fair value of the acquirer's interest in the acquiree instead.

3.1.4 Recognising and measuring non-controlling interests

Noncontrolling interest (NCI) is the portion of equity ownership in a subsidiary not attributable to the parent company, who has a controlling interest and consolidates the subsidiary's financial results with its own.

For instance, suppose Company ZO acquires 80% of the outstanding stock of Company SA. Because Alpha owns more than 50% of Sierra, Company ZO consolidates financial results of Company SA with its own. The 20% of Company SA's equity that Company ZO does not own is recorded on balance sheet of Company ZO as NCI. Consolidated net income is allocated to the parent and noncontrolling interests (minority shareholders) in proportion to their percentages ownership; 80% to Company ZO and 20% to the noncontrolling interests, in this case.

NCI is recorded in the shareholders' equity section of the parent's balance sheet, separate from the parent's equity, rather than in the mezzanine between liabilities and equity. The amounts of consolidated net income attributable to the parent and to the noncontrolling interest must be clearly identified and presented on the consolidated income statement. Previously, net income attributable to the noncontrolling interest was generally recorded as an expense or other deduction in calculating consolidated net income.

IFRS 3 requires any non-controlling interest in an acquiree to be recognised, but provides a choice of two measurement methods. These apply to those components of noncontrolling interests that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of a liquidation ('qualifying noncontrolling interests').

- Option 1, to measure such components of non-controlling interests at acquisition-date fair value (consistent with the measurement principle for other components of the business combination).

- Option 2, to measure such components of non-controlling interests at their proportionate share of the value of net identifiable assets acquired

Measuring qualifying non-controlling interests at acquisition-date fair value - An acquirer will sometimes be able to measure the fair value of a non-controlling interest on the basis of a quoted price in an active market for the equity shares it does not hold. If a quoted price in an active market is unavailable, the acquirer will need to measure the fair value of the non-controlling interest by using other valuation techniques.

Measuring qualifying non-controlling interests at the proportionate share of the value of net identifiable assets acquired- Under this option, the non-controlling interest is measured at the share of the value of the net assets acquired and liabilities assumed of the acquiree (see 5 above). The result is that the amount recognised for goodwill is only the acquirer's share. However, if any part of the outstanding non-controlling interest is subsequently acquired, no additional goodwill is recorded as under IFRS 10 this is an equity transaction.

The following example illustrates the impact of the two measurement options on measuring those components of qualifying non-controlling interests.

Entity B has 40% of its shares publicly traded on an exchange. Entity A purchases the 60% non-publicly traded shares in one transaction, paying AZN630. Based on the trading price of the shares of Entity B at the date of gaining control a value of AZN400 is assigned to the 40% non-controlling interest, indicating that Entity A has paid a control premium of AZN30. The fair value of Entity B's identifiable net assets is AZN700. For the purposes of the illustration, Entity B has no other instruments that would be regarded as non-controlling interests.

Option 1 – Non-controlling interest at fair value

Entity A accounts for the acquisition as follows:

	DR	CR
Fair value of identifiable net assets acquired	***700***	
Goodwill	***330***	
Cash		***630***
Non-controlling interest in entity B		***400***

Option 2 – Certain non-controlling interests are measured at proportionate share of identifiable net assets

Entity A accounts for the acquisition as follows:

	DR	CR
Fair value of identifiable net assets acquired	***700***	
Goodwill	***210***	
Cash		***630***
Non-controlling interest in entity B (700*40%)		***280***

In Example above, the acquiree had no other instruments that would be regarded as noncontrolling interests. This will not always be the case. The impact of the measurement of such non-controlling interests on goodwill is illustrated in Example below

Parent acquires 80% of the ordinary shares of Target, a private entity, for AZN950 in cash. The total fair value of the equity instruments issued by Target is AZN1,165 and the fair value of its identifiable net assets is AZN850. The fair value of the 20% of the ordinary shares owned by non-controlling shareholders is AZN190. In addition, the subsidiary has also written gross settled call options over its own shares with a fair value of AZN25, which are considered equity instruments under IAS 32

Option 1 – Non-controlling interest at fair value

The impact of the business combination, and the measurement of non-controlling interests, are as follows:

	DR	CR
Fair value of identifiable net assets acquired	***850***	
Goodwill l (AZN1,165 – AZN850)	***315***	
Cash		***950***
Non-controlling interest (AZN190 + AZN25)		***215***

Under this method, goodwill represents the difference between the fair value of Target and the fair value of its identifiable net assets. The non-controlling interests are measured as the fair value of all equity instruments issued by Target that are not owned by the parent (i.e. ordinary shares and gross settled call options)

Option 2 – Certain non-controlling interests are measured at proportionate share of identifiable net assets

The impact of the business combination, and the measurement of non-controlling interests, are as follows:

	DR	CR
Fair value of identifiable net assets acquired	***850***	
Goodwill ((AZN950 + AZN195) – AZN850)	***295***	
Cash		***950***
Non-controlling interest (20% × AZN850 + AZN25)		***195***

Under this method, goodwill represents the difference between the total of the consideration transferred and the amount of the non-controlling interests less the fair value of the net assets acquired and liabilities assumed. The non-controlling interests that are present ownership interests and entitle their holders to a proportionate share of the Target's net assets in the event of liquidation (i.e. the ordinary shares) are measured at the non-controlling interest's proportionate share of the identifiable net assets of Target. The non-controlling interests that are not present ownership interests or do not entitle their holders to a proportionate share of the Target's net assets in the event of liquidation (i.e. the gross settled call options) are measured at their fair value.

Reconciliation of goodwill

Goodwill as determined under the two methods can be reconciled as follows:

Option 2:

Goodwill (AZN950 – 80% × AZN850 + AZN25) 295

Goodwill related to the non-controlling interest in ordinary shares (AZN190 – 20% × AZN850) 20

Option 1:

Goodwill (AZN1,165 – AZN850) 315

This makes clear that Option 2 effectively ignores the goodwill related to ordinary shares that are held by non-controlling shareholders.

3.1.5 Intragroup eliminations

When preparing consolidated financial statements, an entity first combines the financial statements of the parent and its consolidated subsidiaries on a 'line-by-line' basis by adding together like items of assets, liabilities, equity, income, expenses and cash flows. IFRS 10 requires a parent to prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances. Consolidation of an investee begins from the date the investor obtains control of the investee and ceases when the investor loses control of the investee.

In order to present financial information about the group as that of a single economic entity, the entity must make adjustments to:

(a) combine like items of assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries;

(b) offset (eliminate) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary (IFRS 3 – Business Combinations – explains how to account for any related goodwill; and

(c) eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group (profits or losses resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full). Intragroup losses may indicate an impairment that requires recognition in the consolidated financial statements. IAS 12 – Income Taxes – applies to temporary differences that arise from the elimination of profits and losses resulting from intragroup transactions.

Income and expenses of a subsidiary are based on the amounts of the assets and liabilities recognised in the consolidated financial statements at the acquisition date. IFRS 10's example is depreciation expense, which will be based on the fair values of the related depreciable assets recognised in the consolidated financial statements at the acquisition date, but many items will have a fair value on acquisition that will affect subsequent recognition of income and expense. Point (b) above refers to the elimination of the parent's investment and the parent's portion of equity. The equity in a subsidiary not attributable, directly or indirectly, to the parent represents a non-controlling interest. The profit or loss and each component of other comprehensive income of a subsidiary are attributed to the owners of the parent and to the noncontrolling interests. Non-controlling interests in subsidiaries are presented within equity, separately from the equity of the owners of the parent, and changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions. The basic procedures described above effectively mean that 100% of the assets, liabilities, income, expenses and cash flows of a subsidiary are consolidated with those of the parent, irrespective of the parent's ownership interest in the subsidiary. However, the profit or loss and each component of other comprehensive income of the subsidiary, and the equity of the subsidiary, are attributed to the parent and the non-controlling interest.

IFRS 10 requires intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group to be eliminated. Profits or losses resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full as shown in Example below.

Entity A holds a 75% interest in its subsidiary, Entity B. Entity A sold inventory costing AZN100,000 to Entity B for AZN200,000 giving rise to a profit in Entity A of AZN100,000. Entity B still held the inventory at the end of the reporting period. Tax effects are ignored in this example. Under IFRS 10, as well as the intragroup sale between Entity A and Entity B, the unrealised profit is eliminated from the group's point of view in consolidation as follows:

	DR	**CR**
Revenue in Entity A	**200**	
Cost of sales in Entity A		**100**
Inventory in Entity B		**100**

The profit from the sale of inventory of AZN100,000 is reversed against group profit or loss. As the parent made the sale, no amount of the eliminated profit is attributed to the non-controlling interest. If the fact pattern was reversed, such that Entity B sold inventory to Entity A, and Entity A still held the inventory at the end of the reporting period, the AZN100,000 of profit would still be reversed in the consolidated financial statements. However, in this instance, as the subsidiary made the sale, AZN25,000 of the eliminated profit (i.e. the non-controlling interest's 25% share of the AZN100,000 profit) would be allocated to the non-controlling interest. If the inventory held by Entity B had been sold to a third party for AZN300,000 before *the end of the reporting period (resulting in a profit in Entity A of AZN100,000 for the sale to Entity B at AZN200,000 and a profit in Entity B of AZN100,000 for the sale to a third party at AZN300,000), no intragroup elimination of profit is required. The group has sold an asset with a cost of AZN100,000 for AZN300,000 creating a profit to the group of AZN200,000. In this case, the intragroup elimination is limited to the sale between Entities A and B as follows:*

	DR	CR
Revenue in Entity A	**200**	
Cost of sales in Entity B		**200**

Even though losses on intragroup transactions are eliminated in full, they may still indicate an impairment that requires recognition in the consolidated financial statements. For example, if a parent sells a property to a subsidiary at fair value and this is lower than the carrying amount of the asset, the transfer may indicate that the property (or the cash-generating unit to which that property belongs) is impaired in the consolidated financial statements. This will not always be the case as the asset's value-in-use may be sufficient to support the higher carrying value. Intragroup transactions may give rise to a current and/or deferred tax expense or benefit in the consolidated financial statements. IAS 12 applies to temporary differences that arise from the elimination of profits and losses resulting from intragroup transactions.

3.1.6 <u>Consolidating foreign operations</u>

IFRS 10 does not specifically address how to consolidate subsidiaries that are foreign operations. As explained in IAS 21 – The Effects of Changes in Foreign Exchange Rates, an entity may present its financial statements in any currency (or currencies). If the presentation currency differs from the entity's functional currency, it needs to translate its results and financial position into the presentation currency. Therefore, when a group contains individual entities with different functional currencies, the results and financial position of each entity are translated into the presentation currency of the consolidated financial statements. A reporting entity comprising a group with intermediate holding companies may adopt either the direct method or the step-by-step method of consolidation. IFRIC 16 – Hedges of a Net Investment in a Foreign Operation – refers to these methods as follows:

• direct method – The financial statements of the foreign operation are translated directly into the functional currency of the ultimate parent.

• step-by-step method – The financial statements of the foreign operation are first translated into the functional currency of any intermediate parent(s) and then translated into the functional currency of the ultimate parent (or the presentation currency, if different).

IFRIC 16 explains:

'The difference becomes apparent in the determination of the amount of the foreign currency translation reserve that is subsequently reclassified to profit or loss. An ultimate parent entity using the direct method of consolidation would reclassify the cumulative foreign currency translation reserve that arose between its functional currency and that of the foreign operation. An ultimate parent entity using the step-by-step method of consolidation might reclassify the cumulative foreign currency translation reserve reflected in the financial statements of the intermediate parent, i.e. the amount that arose between the functional currency of the foreign operation and that of the intermediate parent, translated into the functional currency of the ultimate parent.'

3.1.7 <u>Operating leases</u>

If the acquired entity is classified as an operating lease in accordance with IAS 17 under a lease arrangement agreement, the acquirer will carry on to lease its operating lease as long as there are no changes to the terms of the contract. Only if, before or as at the acquisition date, the terms of the lease were changed in such a way which it will be reclassified as a finance lease according to IAS 17 would the acquirer entity recognise the related finance lease liability and the asset. A single accounting model for lessees is introduced by IFRS 16, most leases are required to be recognized in the balance sheet.

The categorization of leases between finance and operating is not altered in accordance with IAS 17, despite the current leases of the acquire are new leases from the perspective of the acquirer. If the acquire is the lessee to an operating lease and the terms of the lease are unfavourable (liability) or favourable (asset) concerning prices and market terms, the acquirer is required to recognise either an intangible asset or a liability.

3.1.8 Intangible assets

Although identifiable intangible assets have not previously been recognised by the acquire, identifiable intangible assets may have to be recognised by an acquirer.

Intangible assets created by contract or other legal rights

Marketing-related

- Newspaper mastheads
- Trade dress (unique colour, shape or package design)
- Internet domain names
- Trademarks, trade names, service marks, collective marks and certification marks
- Non-competition agreements

Customer-related

- Order or production backlog

- Customer contracts and
- the related customer relationships
- Customer lists
- Customer contracts and the related customer relationships

Contract-based

- Operating and broadcast rights
- Licensing, royalty and standstill agreements
- Franchise agreements
- Construction permits
- Use rights such as drilling, water, air, mineral, timber
- Servicing contracts such as mortgage servicing contracts
- Employment contracts
- Advertising, construction, management, service or supply contracts – Lease agreements

We have considered above a lot of different types of identifiable intangible assets like depositor relationships, subscriber and customer lists, registered trademarks, unpatented technical expertise, favourable operating leases according to IAS 17, technology patents and licences that are recognised apart from goodwill.

3.1.9 Assets with uncertain cash flows

According to IFRS 3, a separate provision or valuation allowance for assets that are initially recognised at fair value may not be recognized by the acquirer, since at the acquisition date, receivables including loans, are to be gauged and recognised at fair value, at the fair value measure any uncertainty about future cash flows and collections are included. Moreover, although an acquire might has assets (typically financial assets like receivables), against that it has recognised valuation allowance or a provision for uncollectible amounts or impairment, any such valuation allowances cannot be continued by an acquirer and in respect of those financial assets, its own allowances cannot be created

Assets that the acquirer does not plan to utilize or intends to utilize in a way that is various from other market participants

There may be some acquired assets that an acquirer might intend not to utilize, for instance, research or a brand name and development intangible asset or it might plan to utilize the asset in a way that is different from the way where other market participants would utilize it. Recognising of all such identifiable assets by acquirer are required under IFRS 3, and gauge them at their fair value identified in accordance with their best and highest use by market participants.

Example: ***Acquirer's plan not to utilize an intangible asset***

Entity X purchases its competitor (Entity Y). The trade name of one of Entity Y's branded products is one of the identifiable intangible assets of Entity Y (acquire). Because Entity X has a similar product, it does not plan to utilize that trade name post-acquisition date. Sales of Entity Y's product will not be continued by Entity X, as a result it means upgrading the value of its own branded product and eradicating competition. Therefore, the cash flows that related to the acquired trade name are considered to be nil. Could Entity X assign a fair value of nil to that trade name?

In this case, in accordance with its use by other market participant the fair value of the asset has to be determined. Future objectives of the Entity about the asset should only be reflected in determining the fair value if that is what other market participants would do

- There are other market participants who would carry on to sell the product;

- Entity X has chosen not to sell the trade name, however it could probably have sold the trade name after acquisition date
- Although all other market participants would like not sell that product in order to increase the value of their own products, the trade name has still likely some value.

That's why the fair value applies to that trade name. Although the entity does not intend to utilize the trade name in order to generate cash flows in future, to utilize it protectively by protecting others from utilizing it, the entity has to amortize trade name over the period it is predicted to contribute indirectly or directly to future cash flows of the entity's . That period is the period that the trade name provides significant value to Entity X, however will not stretch beyond the date the Entity effectively relinquish its rights to the trade name.

3.1.10 ***Deferred revenue***

Deferred revenue at the date of acquisition may have been recorded an acquire for some reasons. For instance, it might represent upfront payments for services or products that have yet to be delivered, or payments for delivered goods or services sold as a part of a multiple-element arrangement that could not be accounted for separately from undelivered items included in the same arrangement. In accounting for a business combination, a liability for deferred revenue of the acquire should be recognized by an acquirer if it is concerned with an extraordinary performance obligation undertaken by the acquirer. Like performance obligations will include obligations to provide services or goods or the right to utilize an asset. The measurement of the deferred revenue liability should be recognized according to the fair value of the obligation at the acquisition date, that will not consequently be the same as the amount of deferred revenue recognised by the acquire. Generally, amount of deferred income recognised by the acquire will be high than fair value of that, because the amount of revenue that a market participant would expect to receive for meeting that responsibility will not comprise any profit element relating to the selling or other endeavours already accomplished by the acquire.

Example

Company Zo is an electronics company that sells contracts to service all kinds of electronics equipment for an annual fee of AZN110,000. Company Zo is purchased by acquirer in a business combination. At the acquisition date, Company Zo has one service contract outstanding with 5 months remaining and for which AZN50,000 of deferred revenue is recorded in Company Zo t's pre-acquisition financial statements.

To carry out the contract over its remaining 5-month term, acquirer expects that a market participant would expect to receive AZN44,000 for carrying out that responsibility. It has estimated that a market participant would incur direct and incremental costs of AZN35,000, and expect a profit margin for that fulfilment effort of 20%, i.e. AZN7,000, and would, thus, expect to receive AZN42,000.

Consequently, a liability of AZN42,000 will be recognized by parent in respect of the deferred revenue obligation

However, if the deferred revenue of acquire does not relate to an outstanding performance obligation but to services or goods that have already been transferred, the acquirer don't have to recognize liability for deferred revenue of acquire.

3.1.11 <u>Contingent liabilities</u>

Contingent liabilities are not recognised as a liability according to IAS 37, rather they are disclosed in financial statements. But, the recognition rules of IAS 37 are not applied by IFRS 3, rather if there is a present obligation arising from a past event which can be faithfully gauged, the acquirer is required to recognise a liability by IFRS 3 at its fair value, even if it is possible (not probable) that an outflow of resources are not likely to be required to establish the responsibility. If a contingent liability only represents a possible obligation arising from a past event, whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly under the control of the entity, a liability is not to be recognised according to IFRS 3. If the fair value of contingent liability at acquisition-date cannot be

According to IFRS 3 it is required that after introductory recognition and until the point when the liability is settled, cancelled or terminates, the acquirer gauges a contingent liability that is perceived in a business combination at the higher of:

1) the sum that would be perceived in accordance with IAS 37; and

2) the sum at first perceived less, if proper, aggregate amortization perceived in accordance with IAS 18 – Revenue (for entities applying IFRS 15, the sum at first perceived less, if fitting, the combined measure of income perceived in accordance with standards of IFRS 15).

The implications of section (1) of the necessity are clear. If the acquire needs to perceive an provision in regard of the previous contingent liability, and the best gauge of this liability is higher than the first original fair value ascribed by the acquirer, at that point the more liability should now be perceived by the acquirer with the distinction taken to the income statement. In accordance with IAS 37 It would now be a provision to be estimated and perceived. What is less clear is section (2) of the prerequisite. The reference to 'amortization perceived as per IAS 18' may identify with the recognition of income in regard of those advance duties that are contingent liabilities of the acquire, however have been perceived at fair value at date of acquisition. The prerequisite would seem to imply that, unless amortization under IAS 18 is suitable, the measure of the liability can't be lessened underneath its initially attributed fair value until the point when the liability is settled, wiped out or lapses.

3.1.12 ***Income taxes***

Under IFRS 3 it is required that the acquirer to perceive and gauge deferred tax liability or asset, as per IAS 12, emerging from the liabilities expected and the assets acquired in a business combination. As per IAS 12 it is required that the acquirer also to represent the potential tax impacts of brief differences and convey advances of an acquire that exist at the acquisition date or emerge because of the acquisition.

Under IAS 12 it is required that:

1) Acquired deferred tax benefits perceived within the estimation time frame lessen the goodwill identified with that acquisition in the event that they result from new data got about certainties and conditions existing at the acquisition date. Any outstanding deferred tax benefits is to be recognised in profit or loss statement, if the carrying amount of goodwill is zero; and.

2) Acquirer recognize all other acquired tax benefits realized in profit or loss statement, unless under IAS 12 it is required recognition outside profit or loss statement.

It will in this manner be important to evaluate painstakingly the purposes behind changes in the appraisal of deferred tax made during the estimation time frame to decide whether it identifies with realities and conditions at the acquisition date or if it is an adjustment in certainties and conditions since acquisition date.

3.1.13 ***Business combination vs Asset purchase.***

Numerous organizations would preferably the exchange be delegated an advantage securing than a business combination on the grounds that, to be perfectly honest, the bookkeeping is simpler. At that point, they able to capitalize exchange costs; they don't need to fair value every one of the assets procured; and they don't need to decide the fair value of contingent consideration. The best part is that they don't need to mess with recording (and in this manner playing out a yearly impairment test on) goodwill.

4 CHAPTER 3

4.1.1 Data Analysis

As an example, the consolidated financial statements of Socar is analysed below

State Oil Company of the Azerbaijan Republic — Consolidated financial statements

Consolidated statement of financial position

(Amounts presented are in millions of Azerbaijani Manats)

	31 December 2016	31 December 2015
Assets		
Current assets		
Cash and cash equivalents	4,163	4,881
Restricted cash	121	203
Deposits	1,039	143
Available-for-sale investments	82	77
Trade and other receivables	8,618	6,146
Inventories	4,968	1,903
Other current financial assets	1,564	611
Total current assets	**20,555**	**13,964**
Non-current assets		
Property, plant and equipment	20,116	17,236
Goodwill	342	275
Intangible assets other than goodwill	689	716
Investments in joint ventures	4,555	3,171

Investments in associates	4,442	2,838
Deferred tax assets	841	712
Other non-current financial assets	578	502
Other non-current assets	889	540
Total non-current assets	**32,452**	**25,990**
Total assets	**53,007**	**39,954**
Equity		
Charter capital	1,802	1,617
Additional paid-in-capital	2,159	1,423
Retained earnings	6,265	6,191
Other capital reserves	(46)	(12)
Put option on company's shares	(1,305)	(1,305)
Gain on sale of subsidiary share	1,280	1,234
Cumulative translation differences	6,292	4,427
Equity attributable to equity holders of the Group	**16,447**	**13,575**
Non-controlling interests	1,257	1,073
Total equity	**17,704**	**14,648**

Liabilities			
Current liabilities			
Trade and other payables	19	9,662	6,253
Short-term and current portion of long-term borrowings	20	6,717	3,085
Taxes payable	21	616	532
Other provisions for liabilities and charges	23	74	70
Deferred acquisition consideration payable	26	153	133
Deferred income	24	98	–
Other current liabilities	25	1,052	174
Total current liabilities		**18,372**	**10,247**
Non-current liabilities			
Long-term borrowings	20	8,210	7,826
Asset retirement obligations	22	968	748
Other provisions for liabilities and charges	23	149	142
Deferred income	24	74	79
Deferred tax liabilities	33	1,272	1,037
Advances received for the sale of shares	34	2,897	2,097
Put option liabilities	35	2,832	2,492
Other non-current liabilities	25	529	638
Total non-current liabilities		**16,931**	**15,059**
Total liabilities		**35,303**	**25,306**
Total liabilities and equity		**53,007**	**39,954**

State Oil Company of the Azerbaijan Republic — Consolidated financial statements

Consolidated statement of profit or loss and other comprehensive income

(Amounts presented are in millions of Azerbaijani Manats)

	2016	**2015**
Revenue	51,905	33,103
Cost of sales	(47,387)	(29,849)
Gross profit	**4,518**	**3,254**
Distribution expenses	(814)	(653)
General and administrative expenses	(1,092)	(855)
Loss on disposal of property, plant and equipment and intangible assets	(34)	(19)

Social expenses	(148)	(143)
Exploration and evaluation expenses	(35)	(31)
Other operating expenses	(1,196)	(427)
Other operating income	697	161
Operating profit	**1,896**	**1,287**
Finance income	189	65
Finance costs	(841)	(476)
Foreign exchange gains and losses, net	(1,284)	(2,934)
Share of result of joint ventures	767	273
Share of result of associates	209	201
Profit/(loss) before income tax	**936**	**(1,584)**
Income tax expense	(586)	(201)
Profit/(loss) for the year	**350**	**(1,785)**
Other comprehensive income		
Other comprehensive income to be reclassified to profit or loss		
in subsequent periods − currency translation differences, net		
of tax	1,818	5,024
Other comprehensive (loss)/income not to be reclassified to		
profit or loss in subsequent periods − loss on cash flow		
hedge, net of tax	(34)	6

Other comprehensive income for the year, net of tax	**1,784**	**5,030**
Total comprehensive income for the year	**2,134**	**3,245**
Profit/(loss) is attributable to:		
Equity holders of the Group	147	(1,818)
Non-controlling interests	203	33
	350	**(1,785)**
Total comprehensive income attributable to:		
Equity holders of the Group	1,978	2,815
Non-controlling interests	156	430
	2,134	**3,245**

(Consolidated Financial Statments of SOCAR, 2016)

Information about subsidiaries

The consolidated financial statements of the Group include the following material subsidiaries:

		Country of	% equity interest	
Name	**Principal activities**	**incorporation**	**2016**	**2015**
SOCAR Turkey Enerji A.Ş.	Refinery	Turkey	86.99%	86.99%

Azerbaijan (ACG) Ltd	Oil production	Cayman Islands	100%	100%
Azerbaijan (Shah Deniz) Ltd	Gas production	Cayman Islands	100%	100%
Caspian Drilling Company (CDC)	Drilling operations	Azerbaijan	92.44%	92.44%
SOCAR Energy Georgia LLC	Sales and Distribution	Georgia	51%	51%
SOCAR Overseas LLC	Sales and Distribution	UAE	100%	100%
SOCAR Trading Holding	Sales and Distribution	Malta	100%	100%
Azerbaijan (BTC) Ltd	Sales and Distribution	Cayman Islands	100%	100%
Cooperative Menkent U.A.	Sales and Distribution	Netherlands	100%	100%
SOCAR Energy Holdings AG	Sales and Distribution	Switzerland	100%	100%
SOCAR Energy Ukraine	Sales and Distribution	Ukraine	100%	100%
Azerbaijan (SCP) LTD	Sales and Distribution	Cayman Islands	100%	100%
SOCAR Petroleum CJSC	Sales and Distribution	Azerbaijan	100%	100%
Baku Shipyard Company	Construction	Azerbaijan	65%	65%
Socar Polymer LLC	Chemicals production	Azerbaijan	71%	71%
BOS Shelf LLC	Construction	Azerbaijan	90%	90%

Subsidiaries are all entities (including special-purpose entities) over which the Group has control. Control is achieved when the Group is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Specifically, the Group controls an investee if and only if the Group has:

► Power over the investee (i.e., existing rights that give it the current ability to direct the relevant activities of the investee);

► Exposure, or rights, to variable returns from its involvement with the investee; and

► The ability to use its power over the investee to affect its returns.

When the Group has less than a majority of the voting or similar rights of an investee, the Group considers all relevant facts and circumstances in assessing whether it has power over an investee, including:

► The contractual arrangement(s) with the other vote holders of the investee;

► Rights arising from other contractual arrangements;

► The Group's voting rights and potential voting rights.

The Group re-assesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control. Consolidation of a subsidiary begins when the Group obtains control over the subsidiary and ceases when the Group loses control of the subsidiary. Inter-company transactions, balances and unrealized gains on transactions between group companies are eliminated. Unrealized losses are also eliminated but considered an impairment indicator of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group. Total comprehensive income within a subsidiary is attributed to the non-controlling interests even if that results in a deficit balance.

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, which is measured at acquisition date fair value, and the amount of any non-controlling interests in the acquiree. For each business combination, the acquirer measures the non-controlling interests in the acquiree at the proportionate share of the acquiree's identifiable net assets. Acquisition costs incurred are expensed and included in administrative expenses. When the Group acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date.

Foreign currency translation

All amounts in these consolidated statements are presented in millions of Azerbaijani Manats ("AZN"), unless otherwise stated. The functional currencies of the Group's consolidated entities are the currencies of the primary economic environments in which the entities operate. The functional currency of SOCAR and its 23 business units and the Group's presentation currency is the national currency of the Azerbaijan Republic, AZN. However, US Dollar ("USD"), Swiss Franc ("CHF"), Georgian Lari ("GEL"), Ukrainian Hryvnia ("UAH"), Japanese Yen ("JPY") and Turkish Lira ("TRY") are considered the functional currency of the Group's certain subsidiaries, associates and joint ventures as majority of these investments' receivables, revenues, costs and debt liabilities are either priced, incurred, payable or otherwise measured in these currencies.

The transactions executed in foreign currencies are initially recorded in the functional currencies of respective Group entities by applying the appropriate rates of exchanges prevailing at the date of transaction. Monetary assets and liabilities denominated in foreign currencies other than functional currency of respective Group entity are translated into the functional currency of that entity at the appropriate exchange rates prevailing at the reporting date. Foreign exchange gains and losses resulting from the re-measurement into the functional currencies of respective Group's entities are recognized in profit or loss. The results and financial position of the Group entities which functional currency differ from the presentation currency of the Group and not already measured in the Group's presentation currency (functional currency of none of these entities is a currency of a hyperinflationary economy) are translated into the presentation currency of the Group as follows:

(i) assets and liabilities for each statement of financial position are translated at the closing rate at the date of that statement of financial position;

(ii) income and expenses for each statement of profit or loss and other comprehensive income are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and

(iii) all resulting exchange differences are recognized as a separate component of equity − currency translation difference.

5 Chapter 4

5.1.1 Suggestions and consequences for AZERBAIJAN

When we view Azerbaijan big companies, some of them carry out consolidation whit its parents such as SOCAR, Pasha holding and so on, because there are some problems. Azerbaijan's local GAAP doesn't some with IFRS/IAS even comparison of local standards with international accounting policies can be meaningless ad impracticable, because in IAS/IFRS some standards is absent in local GAAP and doesn't have any equivalent (discussion of it is very complex issue, so that in this, illustration only simple version defined). Thereby, changing, adoption and implementation new accounting standards the causing convergences, which these misunderstandings, completely and their explanation steps given below:

-The process of a period of changing local policy to the international standard is cost-based. The included that relates with changes clarified following line:

- Software costs –application of new ERP system must be required;
- Professional staff with knowledge of IFRS

It is the most important substance among the given explanations, first of all training of the staff highly cost based, on the other hand shortage of both resources trainers and staff are extremely vital for feature performance of entity. Nevertheless, senior management should be plan budget for training staff is a side of professional sceptism.

The acquaintance of IAS/IFRS is very significant for organizations particularly small – size entities in Azerbaijan. However, it is not quite straightforward issue the acceptance and implementation of it on the local accounting system, on the other hand it advantageous for external operation purposes. In most cases implementation problems of IAS/IFRS more focus area than its benefits. As a consequence of survey which gathered from worldwide administrations of countries which accepts IAS/IFRS commented that highly costs of adoption and implementation take attention more than its advantages.

First and furthermore entity adopt and implement IAS/IFRS within the assistance of international auditing companies, such as Big Four companies in our country KPMG, Ernst & Young, Deloitte, PWC, McKinsey, Grant Thornton other most popular auditing forms which operated grate organizations transition process. Due their international reputation cost of transition process quite expensive than small-sized auditing consulting firms. As given before previous illustrations, the most important matter relates with the personal who has IAS/IFRS knowledge. Organizations in involve training personnel groups for staff for IFRS knowledge purposes. Nevertheless if hardware and software plays and impressive role on the adoption IAS/IFRS, it also demands involving IT personnel group for developing IAS/IFRS bases software systems which out of system error and control efficiently operational process of transactions. And this training personnel provides with the relevant accounting and information system, expertise for operations, their auditing and other relating issue. This transition procedure is not simplistic, however, depends on firstly from staff, there efforts and demands more time for changings all the transactions and other process to the IAS/IFRS based. Most countries among the worldwide apply this method on the transition procedure. Staff of international auditing firms are the compulsory of this procedure. For that reason employment of these firms carrying proper manner. As the consequence of questionnaire entities reported that more companies involve international audit experienced staff for transitioning local accounting system to the IFRS/IAS based accounting system they must be compliance with legislative norm also this should not be considered entities which still operates they accounting transition process with their former accounting system. Introduction of the financial statements must be regulate with governance, broadly explain systematic and strategic manners and changes on the financial statements.

6 Conclusion

The main purpose of thesis was to give broad information about practical problems of implementing consolidated financial statements.

In the first chapter information refers in which circumnutates control occurred over the subsidiary by parent and when an investor (parent) consolidates the investee (the subsidiary) and the term 'date of acquisition' is used, what the combined financial statements should disclose, the steps of applying the acquisition method (identifying an acquirer, identifying an acquirer, recognising and measuring the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquire, recognising and measuring goodwill), and how goodwill is calculated, what consideration transferred comprises.

Second chapter illustrates the main issues in identifying the assets acquired, the liabilities assumed in a business combination, (When there is a contingent consideration arrangement in a deal between parties,how this contingent consideration is treated, control of an acquiree sometimes obtained by an acquirer without transferring consideration, recognizing and measuring non-controlling interests and how they are calculated, how intragroup transaction affect consolidated financial statements, how foreign operations affect consolidated financial statements.

The third chapter was given to information about data analyses consolidated financial statements of SOCAR, which standards are applied during this process.

IAS/IFRS ensure certain benefits to organizations. As consequence it is directly for developing country's economy fully.

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