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Practical methodologies in the field of Consolidated Financial Statements

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Abstract

In today's our modern world, companies are growing day by day and open their branches often more than one country because extending their businesses throughout the world enables them to operate more efficiently and profitable. However, in terms of accounting, things are getting complex in such a way that, companies are compulsory required consolidated financials if they own subsidiary companies at the same time. So, in this study the practical methodologies in the field of consolidated financial statements are analyzed, by using mainly secondary data sources.

The objective of the study is to analyze principal consolidation procedures from the point of view of IFRS and US GAAP approach, and then investigate to what extent these procedures are implemented in Azerbaijan. Research questions are identified and designed in order to accomplish that objective, they are include firstly, determining main consolidation methods used by accountants; next, examining consolidation under two sets of standards, IFRS and US GAAP; and finally investigating the degree of application of those standards by Azerbaijani companies. Along the study, answers for the research questions have been sought, for this purpose, a number of books, articles, and specialized works investigated, state regulations and laws have been taken into consideration.

According to the results of the thesis, it is revealed that Azerbaijani accounting system is gradually adapted for international accounting, that many steps have been taken in this direction, introducing the Accounting Law in 2004 was the most important of them. Based on the classification of entities, Law has given companies a choice between NAS and IFRS, however made applying IFRS mandatory for "Public Interest Entities". As regards to consolidation, companies operate in Azerbaijan, are obliged to report their consolidated financial statements in addition to individual financials, in accordance with Azerbaijan Republic Accounting Law and IFRS or NAS depending on the type of the entity, if they have controlling interests in other entities. This is a case when the term of control is precisely defined.

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1. Introduction

1.1. Research background and motivation

In general, the financial statements are considered the most vital accountability tool and vehicle of information for all different users even it is talking about individual or consolidated financial statements.

For many years, consolidated financial statements have been acknowledged as a best way to express a group of companies' financial performance and position as it is a single entity. Like individual financial statements, the role of them is to report users of financial statements including shareholders, investors, creditors, government and others about the financial condition of an entity by providing users with related information for the purpose of enabling them to evaluate the activities of a group and make decisions in this direction.

In our modern world, companies tend to grow day by day because of strong competition. By expanding their businesses and spread activities all over the world, they grab a chance of being most efficiently and effectively operated company. So, this growth often involves purchasing new companies which in turn, result in acquiring new customers, new product lines. This new acquiring companies are called subsidiaries. Although they are purchased by the parent company, they still continue to operate as usual, keep accounting records, prepare and present their own financial statements. Afterwards, subsidiary's accounting records are aggregated with parent accounting records in order to prepare consolidated financial statements.

Besides all these, choosing this thesis is determined by the author because of a personal interest in the topic. In addition, eagerness to learn significant consolidation procedures under international accounting standards, including International Financial Reporting Standards and Generally Accepted Accounting Principles, their application in Azerbaijan oblige the author doing this type of research. Also the topic is essential enough for today's growing world, for accountancy profession, if we take into account companies tend to develop and spread their businesses all over the world, causes reporting consolidated financials to be unavoidable.

1.2. Purpose of research and research questions

The aim of the research is to clarify main procedures used when preparing consolidated financial statements under IFRS and US GAAP, and application methods of these procedures in Azerbaijan in the case of Azerbaijani companies.

The study is designed in order to find answers to research questions. They are followings:

1. What practical methodologies are used by accountants to prepare consolidated financial statements?
2. How is the international approach of Consolidation under IFRS and US GAAP?
3. How do consolidation procedures implement Azerbaijani accounting system?

1.3. Research methodology

It is clear that before you go anywhere, you are probably aware of your route, otherwise, you will lose one's way. Similarly, each thesis has its own methodology which includes research approach and strategy and also research methods. In simple terms, they describe the route of a thesis, direction which it goes in. So our study is based on its own research methodology in order to achieve our objectives.

As mentioned above, the general area of research for this thesis is practical methodologies used for preparation and presentation of consolidated financial statements. The research approach is done by theoretical and practical perspective. On the one hand, in the theoretical approach, existing standards and regulations are analyzed, while in the other hand, the empirical approach is done by analyzing and investigating a group of companies which are selected from Azerbaijani capital markets. Thus, these approaches formulate our strategy to accomplish overall objectives of the thesis.

Several research methods were used for investigation purposes, such as document analysis. Data collection was especially based on secondary sources. In document analysis, relevant standards and accounting regulations in this field were analyzed, in addition, most relevant articles and specialized works were considered as a tool.

1.4. Research structure

The thesis is organized as follows:

Firstly, some background information about the topic is described in the first chapter. The second chapter presents the basis for consolidation, essential terms are discussed separately. Next, we look at the international approach to consolidation in this field, in the third chapter. Then, application and impact of consolidation to Azerbaijan accounting system is taken into account, by looking at Azerbaijani companies' financial statements. Finally, thesis ends up with the conclusion and findings are presented in a good way.

2. Basis of Consolidation

When companies grow, this growth induces them to make sound investments by buying new subsidiary companies, because through this expansion they can maximize their profits, their market share, brand name and also customers. As a result of expanding, big companies spread their businesses across the world, making sound investments and open new branches abroad. Being large company with its subsidiaries make the reporting much more complex. Briefly, international accounting requires that company with subsidiaries must present combined financial statements of parent and subsidiaries, in addition to individual financial statements.

In other words, each subsidiary prepares its own financial statements, as usual, however holding company not only prepare its own financial statements but also is obliged to prepare consolidated ones.

Consolidated financial statements are the financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent company and its subsidiaries are presented as those of a single economic entity, according to International Accounting Standard 27 "Separate financial statements"[1], and International Financial Reporting Standard 10 "Consolidated financial statements"[2].

Benefits and limitations of consolidated financial statements Preparing consolidated financials is not an easy process however it has benefits from the advantages being offered.

First of all, it gives shareholders, investors, analysts, creditors, vendors and anyone else who is interested in financial statements of the company and its subsidiaries, an opportunity to look at these companies as a single entity by using consolidated financial statements and measure its financial condition. Users of consolidated financial statements always use them to evaluate group's financial health, its ability to meet its long-term debts, also how the company is profitable and how long it will continue to operate profitably.

Another benefit for parent company which is considered sinister benefit (it is a main limitation of consolidation on the behalf of users of financial statements) is that significant financial problems can be hidden and users of CFS can be manipulated in this way. It is really a complicated issue for investors and other users to determine hidden problems and define where they are. For example, the company with its tens of subsidiaries, on the one hand, some of these subsidiaries may have debts with significant amounts, as a result, they have made losses and on the other hand, the others have made a profit for the end of the financial year. So when these companies' financial statements are combined in order to prepare CFS, consequently profits of those companies compensate losses of others. For this reason, consolidated financial statements sometimes can be deceptive.

[1] Accounting standard-IAS 27 "Separate financial statements" specifies the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements.

[2] Accounting standard-IFRS 10 "Consolidated financial statements" specifies principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.

Having said that, as being advantages there are also some limitations of consolidation. One of them is mentioned above- manipulating readers of financial statements by hiding some financial problems of subsidiaries. Another is that it is obvious readers who are closely interested in the company utilize financial ratios to evaluate its overall financial condition and performance. They can assess company's profitability, solvency, efficiency, and liquidity. All of them are examined by using relevant financial ratios. However, in the case of consolidated financials, combined numbers are used to calculate ratios and they do not present each company's ratios separately. These ratios just show the performance of a group as a whole. So, even ratios may not helpful for readers in some matters when they look at consolidated financial statements of the company.

Exemptions from preparing and presenting consolidated financials As we have written above, companies are subject to prepare and present consolidated financial statements, if the term of control is identified. However, IFRS 10 defines some situations where parent company is not required to prepare and report consolidated financials as individual financials. These situations are summarized below.

Firstly, if the parent company meets all the following conditions, then there is no need for consolidation, this exemption is called as "Parent company on an interim level". If all those conditions are met, companies can exempt from produce the consolidated financials:

1. If the parent company itself is a subsidiary of another company (wholly-owned or partially-owned);
2. Debt and equity instruments that belong to the parent, is not traded in a public market, in addition financial statements is not filed with a regulatory organization in order to issue financial instruments in the public market;
3. Ultimate parent of the parent company prepare consolidated financial statements under IFRS, and these statements are available and appropriate for public use.

The next exemption involves if the employee benefit plans is under the control of investee, consolidated financial statements is not required. (IAS 19 Employee benefits)

The third exemption is the investment entities. IFRS 10 excludes this type of entities from preparing consolidated financials. The logic here is that because of the investment entities primary purpose is to earn an investment income, to make an investment is a core of those businesses, like producing a product or providing services, examples include mutual funds, private equity funds and so on.

According to the IFRS 10, if the parent has following characteristics, in this case it can benefit from not producing consolidated financials:

- Funds is received from investors, in return they are provided specific investment management services by an entity;
- The aim of a business is to invest only for returns as a consequence of increase of capital and investment income;
- The performance of investments is evaluated based on a fair value basis.

The other essential features of investment entities include, they own more than one investment, more than one investor, the entity owns ownership interests in other entities, and some of the investors are not related parties of an entity.

Preparing consolidated financials is not more straightforward. Nonetheless, there are three main procedures used and describe consolidation process in a perceivable way: first is *combine*- add together the assets, liabilities, equities, revenues, expenses and any other items of both parent company and all its subsidiaries; Secondly, *eliminate* transactions which are intragroup- if there are buying and selling or any other transactions between subsidiaries, or parent company and its subsidiaries they must be eliminated. The logic here is that transactions would not appear in the consolidated financial statements until they happen to third parties. Thirdly, show the extent of ownership which parent company does not own, it is considered *non-controlling interest.* The acquisition method is used in order to account investment in subsidiaries.

2.1. Parent-subsidiary relation identification

The parent-subsidiary relationship is such a relationship which means that one company owns, directly or indirectly, 50 percent of the voting power of another company, in this case holding company is a parent company and the other one is a subsidiary. In short, holding company exercises “control” over its all subsidiaries, which gives it main power over subsidiary companies’ business activities. According to IFRS 10, the term of *control* means that a parent company has the rights to variable returns from the investee’s activities and ability to impact them with its power. IAS 27 defines the essential terms as follows:

A parent is an entity that controls one or more entities.

A subsidiary is an entity that is controlled by another entity.

A group is a parent and all its subsidiaries.

A parent company is a holding company which owns and controls its subsidiaries. All subsidiaries, no matter they are wholly or partially owned are supervised by the parent company.

As we stated above, there exist parent-subsidiary relationship, if parent company hold more than 50 percent of the voting stocks of the subsidiary, which it means parent have control over that subsidiary. However, the parent company may own less than 50 percent voting stock but still has control (IAS 27). It is possible in the following situations, when parent company:

- ✓ has the agreement with other investors, through this way it still owns more than half of the voting right;
- ✓ has a power to manage operating and financing policies of the subsidiary;
- ✓ has such a strength which pertains to appoint or remove majority of members in the subsidiary companies’ board of directors;
- ✓ cast majority of votes at the board of directors’ meetings, thus gives it control by that board

In spite of the fact that, subsidiary companies is controlled by the holding company, they are still separate legal entities, have obligations to prepare and present its own financial statements.

Investment in associates and joint ventures It is worth noting that, in addition to subsidiaries, there also are other types of investments including investment in associates, joint ventures and simple trade investments which all of them require different accounting treatments in turn. Most of the listed companies make investments in subsidiaries, associates and joint ventures as a result these investments substantially contribute to their businesses, assist companies to spread their products all over the world and gain more market share through expanding.

The accounting treatment for investment in associates is regulated by IAS 28 "Investments in Associates and Joint Ventures"[3]. According to standard, associate is an entity in which investor exercise significant influence. As the term of control is considered to be a key factor for consolidation, significant influence plays an important role for accounting for associates in a similar manner. Significant influence implies the power of an investor to participate (but not control or jointly control) in decisions about operating and financing policies of an investee. It will be achieved by owning more than 20% but less than 50% of the voting shares of the investee. Other indicators of significant influence include taking part in policy making decision, represent in board of directors, material transactions occurred between investee and investor, change of management personnel, supply of technical information.

The treatment of investment in joint ventures is also regulated by the IAS 28 and accounting for them is the same as associates, equity method is applied. Joint venture is just an arrangement between people by contributing their resources, in order to achieve business objectives such as new business projects or any other activities.

Equity method Investment in associates is accounted for by an investor under the equity method, while acquisition method is used for investment in subsidiaries. Under the equity method, company which exerts significant influence, initially record

[3] IAS 28 *"Investments in Associates and Joint Ventures"* outlines how to apply, with certain limited exceptions, the equity method to investments in associates and joint ventures.

the value of an investment in associates in the balance sheet, non-current assets section, at cost. Subsequently, adjustments are made -company's share on profit (loss) of an investee is added (deducted) to that investment in balance sheet, increase (decrease) the value of investment in associates, the value of earnings is also reported on the income statement. This share on earnings is obviously based on the percentage of common stock which the investor company owns. Furthermore, if the investor company receives dividends from the investee, the value of an investment in associates in the balance sheet have to be reduced by the amount of dividends. In other words, receiving dividends result in an increase in cash balance and decrease in investment. Let us consider an example.

Assume that Company A has 25% of the voting stock in Company Bit means Company B is an associate of Company A. Company B net income for the end of the year is reported as $10,000. Then $2500 of that net income is reported as earnings on investment by Company A in the income statement, meanwhile, the value of investments in balance sheet will also increase by the same amount.

As noted above, subsidiaries may be wholly owned or partially owned. It is wholly owned subsidiary if 100 percent of common shares are owned by parent company. When parent company owns more the 50 percent but less than 100 percent of the common shares, in this case it is considered partly owned. It is quite obvious that certain portion of subsidiary's shares belong to parent company but what about the rest?

2.2. The non-controlling interest

Subsidiary company's outstanding shares that do not belong to parent company are always owned by other shareholders, which are known as Non-controlling interest (NCI), also referred to as minority interest. They can own less than 50 percent of common shares and can solely influence the management of the company, not control it. Their degree of influence depends on the percentage of common shares they own.

The significance of the accounting for NCI is that because of the equity and profit of the subsidiary does not fully belong to the parent company, so in the consolidated financial statements, the percentage of non-controlling interests has to be shown. In other words, the parent company cannot claim all profits earned by subsidiary until it owns 100% of the subsidiary company. Profit and equity attributable to both the parent company and non-controlling interest have to be shown in the consolidated financial statements. Thus, NCI share will appear in the combined statement of financial position, statement of profit or loss and other comprehensive income, and also the statement of changes in equity. Its accounting treatment can be defined by using an example.

Let us assume that Company A owns 75% of the outstanding common shares in Company B, which in this case Company B is a subsidiary of Company A. The rest of the shares (25%) represent non-controlling interests (Figure 1.1)

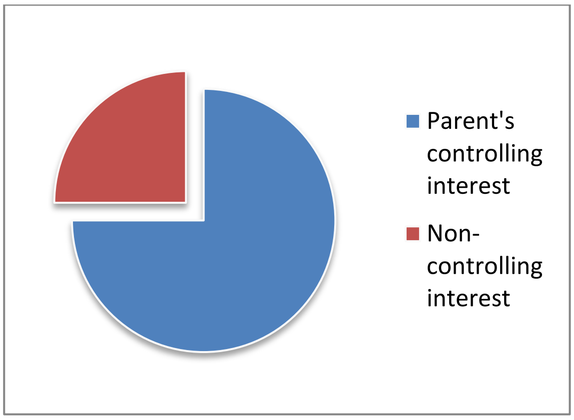

Figure 1 Equity ownership in a subsidiary

Company A and Company B has the reported revenues of $960,000 and $450,000, expenses of $360,000 and $210,000 respectively.

	Company A	Company B
Revenues	960000	450000
Expenses	360000	210000
Profit	600000	240000
Equity ownership	75%	25%
Controlling interest	180000	
Non-controlling interest		60000

Table 1 Profit attributable to the equity owners and NCI

Based on the degree of their equity ownership (75% and 25% here), Company A's controlling interest is calculated as $240,000*75%=$180,000; hereby NCI share will be $240,000*25%=$60,000 or $240,000-$180,000=$60,000.

Consolidated profit is 840,000 by taking into account profit of both companies. Profit to controlling interest is calculated as deducting non-controlling interest from the consolidated profit: $840,000-$60,000=$780,000.

From the above-mentioned example, it seems that NCI decreases consolidated profit, so related double entry will be DR- Non-controlling interest (Statement of Profit or Loss) and CR- Non-controlling interest (Statement of Financial Position). If there are losses, opposite effect will be observed.

There are several reasons for why parent company may not want to obtain 100% of the shares in a subsidiary. One of them is that if the investor owns at least 51% of the share of stock in a subsidiary, in this case, it has already get control over the investee which is essential term conditions parent-subsidiary relationship. So instead of owning more shares which mean more risk, the investor may prefer owning only the needed number of shares to give it control and leave the rest for minority interest. Another reason is that there may be some difficulties buying all the shares in a subsidiary, therefore shares that do not belong to the parent company will be in possession of other investors whose considered non-controlling interest.

Accounting treatment for NCI under IFRS and US GAAP rules is a bit different from each other. Under IFRS, requires the value of non-controlling interests must be shown in the equity section in the statement of profit or loss. However, according to US GAAP rules, the value of non-controlling interest can be shown either in the non-current liabilities section or equity section in the statement of financial position. The calculation of minority interest under IFRS is shown below step by step:

1. Calculate the fair value of NCI: for example, let us say Company A acquired 80 % of Company B, 20% is owned by other investors who are known as NCI. If value of subsidiary is $500,000, thus minority interest would be based on its ownership percentage, 500,000*20% = $100,000.
2. Any fair value adjustments should be made.
3. Add income attributable to non-controlling interest to the fair value of NCI: it is known that all income earned by the group does not belong to the parent company, the value of NCI must be taken into account. For instance, if a purchased company has $250,000 net income for the end of the year, income attributable to non-controlling interest would be $250,000*20%= $50,000. The rest ($200,000) would be attributed to parent company earnings.
4. Deduct prorate share of dividends from the value of NCI. For example, prorate share of dividends is $5,000, this amount would be deducted from NCI in order to find ending figure for minority interest.
5. Finally, record the fair value of NCI in the equity section of the parent company's consolidated statement of financial position.

In simple terms, calculation of NCI can be described as a formula as follows:

$$NCI\ equity = NCI\ fair\ value + income\ attributable\ to\ NCI - NCI'share\ of\ dividends$$

2.3. Goodwill and its valuation

Goodwill is simply an intangible asset like patents, trademarks, copyrights and etc. which arises when one company acquire another for a premium. Goodwill includes brand name, customer loyalty, product reputation, good customer, employee relations and so on, they make company more valuable.

When the parent company acquires subsidiary it has to pay the specific amount of money for that subsidiary, it is called cost of acquisition. If the cost of acquisition is more than the fair value of net assets of the purchased company, the excess amount would be considered goodwill and recorded in the parent company's balance sheet as an intangible non-current asset. International Financial Reporting Standard IFRS 3 "Business Combinations"[4] looks at accounting treatment of goodwill.

As noted above, goodwill is excess difference between the amount paid by company to buy another one and acquired company's fair value of net assets. To compute net identifiable assets, liabilities of acquired company have to be deducted from all its identifiable assets they include both tangible and intangible assets. In simple terms, fair value of net assets of acquired company means just its equity.

Simply, goodwill calculation can be described in this way: Let us suppose that Company A acquired Company B by paying \$3 million for it. Company B's fair value of net identifiable assets is \$2.2 million, or it has identifiable assets of \$1.8 million, and liabilities of \$400,000. So, Company A paid \$23,000 premium for buying that company. In this case, that \$800,000 is called goodwill and recorded in the Company A's statement of financial position in the intangible non-current assets section.

According to IFRS 3, goodwill is calculated as the difference between:

- "the aggregate of (i) the value of the consideration transferred (generally at fair value), (ii) the amount of any non-controlling interest and (iii) in a business combination achieved in stages the acquisition-date fair value of the acquirer's

[4] Accounting standard- IFRS 3 *"Business Combinations"* outlines the accounting when an acquirer obtains control of a business (e.g. an acquisition or merger).

previously-held equity interest in the acquiree, and

- the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed (measured in accordance with IFRS 3)"

Above example showed only logic of what is goodwill. To be more precise, goodwill can be computed as follows:

$$Goodwill = consideration\ transferred + NCI\ fair\ value\ at\ acquisiton\ date - fair\ value\ of\ identifiable\ net\ assets$$

Consideration transferred is something which is paid by the acquirer to buy a business. Consideration transferred can consist of the following forms:

- ✓ Cash
- ✓ Share exchange
- ✓ Contingent consideration
- ✓ Cost of issuing debt and equity instruments
- ✓ Undertaken liabilities

Let us look at simple example which describes goodwill valuation: Company P acquired 80% of the equity shares in Company S by paying \$750 in cash and the amount of non-controlling interests was \$150. The fair value of identifiable net assets of Company S at the acquisition date was \$600. The determination of goodwill in a is described in an easy way in **Table 2.2**:

Consideration transferred	\$750
Non-controlling interests	\$150
	\$900
Fair value of net assets	\$(600)
Goodwill	\$300

Table 2 Determination of goodwill

IFRS requires acquirer companies must include acquired subsidiary's identifiable net assets in the consolidated financials at their fair values at the acquisition date. The need for fair value adjustments arises from the fact that, statement of financial position reflects the carrying value of assets which can be different from their fair value or market value. This is a case that carrying value of net assets (historical cost minus accumulated depreciation), especially long-term assets such as property, plant and equipment is most of the time less than those assets' fair value. This issue must be taken into account for goodwill calculation. Therefore, any fair value adjustments must be made by companies for the purpose of fair presentation and correctly identify the value of goodwill.

The fair value adjustments are simply added to the identifiable net assets of the subsidiary in order to calculate goodwill. For example, let us assume it is known that fair value of property, plant and equipment exceeds their carrying value at the date of acquisition and any adjustments to the individual financial statements have not made by subsidiary itself. The effect of fair value adjustment on goodwill calculation is illustrated below:

	$	$
Consideration transferred		X
Less the fair value of identifiable net assets at the date of acquisition:		
Ordinary share capital	X	
Share premium	X	
Revaluation suplus	X	
Retained earnings	X	
Other capital reserves	X	
Fair value adjustments at acquisition date	X	
		(X)
Goodwill		X

Table 3 Fair value adjustment in goodwill calculation

Goodwill impairment It is the essential point that only on the acquisition date goodwill can be determined. In contrast to the other intangible assets, goodwill can never be amortized, instead, it will subject to annual impairment review. The purpose of impairment is to ensure that assets are not overvalued on the balance sheet or their carrying amount is not more than their recoverable amount. So goodwill impairment occurs when the value of goodwill goes into a decline and book value is greater than its purchase price. In order to identify goodwill impairment, firstly management team compares the fair value of goodwill with its carrying value. If the fair value is greater than carrying value it means there is no need for impairment, in contrast, if the fair value is less than carrying value, it is signal for management that value of the asset is decreased, impairment has to be charged against that asset.

Impairment expense like depreciation and amortization expense has to be written off as an expense in the statement of profit or loss as a result, it will reduce earnings by that amount. Impairment loss has also effects on the statement of financial position and statement of cash flows. On the balance sheet, it will reduce the value of goodwill by the amount of impairment expense. For example, if the value of goodwill is $1million and an impairment loss is $200,000, after impairment the value of goodwill in the balance sheet will change to $0.8 million ($1 million – $0.2 million). However, in the statement of cash flows, as it is a noncash expense like depreciation and amortization will be added to the cash flow from operating activities.

Furthermore, if the fair value of assets, as well as goodwill, exceeds its recoverable amount, in this case there is nothing required to account, any accounting policy does not exist for such cases.

Negative goodwill Most of the time, company is purchased for a premium, a price that is more than its net assets, in that case term of goodwill arises. However, sometimes company can be purchased for less than its value of net assets, which is referred to as a negative goodwill. Negative goodwill can rarely come across. In terms of its accounting treatment on consolidated financials, according to International Accounting Standards Board, negative goodwill does not appear on the balance sheet instead, it is recorded on the acquirer company's income statement as an extraordinary gain. In the simple terms, it is a bargain purchase.

3. International Approach of Consolidation

In the modern changing world, countries are developing day by day and companies are getting bigger, thus most of the companies have obligation to publish their own financial statements for public use to facilitate their decision-making process. In order to make that process easier and make comparisons between companies from the four corners of the world without any difficulties, international approach to accounting exists.

Naturally, each country has the national regulations in the all fields as well as accounting, however international accounting standards are applied in the most of the countries to assist them developing and harmonizing with the world. In the next section international regulatory bodies will be discussed, and then two sets of standards, US GAAP and IFRSs and their application within the consolidation will be analyzed.

3.1. International Regulatory Bodies

International accountancy bodies and organizations play the role of beating in the accounting sector. The most well-knowns of them are followings:

International Federation of Accountants (IFAC) is known as a representative organizational body in the accounting sector for accountancy profession which is engaged in promoting the best accountancy practice for all over the world. As a global organization, IFAC has more than 175 members from the four corners of the earth (approximately in 130 countries)

Financial Accounting Standards Board (FASB) is such a standard setter organization which issues standards in the field of accounting and financial reporting, and to improve them in order to provide investors, shareholders and other users of financial statements with useful financial information in the United States. Those standards are known as generally accepted accounting principles (GAAP). Its activity is confirmed by Securities Exchange Commission (SEC).

International Accounting Standards Board (IASB) is an independent body of the IFRS Foundation which engaged in standard setting process, issuing and developing international financial reporting standards (IFRSs), encouraging the application of those standards in different countries. International financial reporting standards are required by the most of the countries compared with US GAAP. Besides IASB, IFRS Interpretation Committee and IFRS Advisory Council also operate under the oversight of IFRS Foundation. Interpretation Committee as its name suggests, is responsible for interpretation of those standards which are issued by IASB, at the same time Advisory Council is a forum provides an advice for users of IFRSs.

The Association of Chartered Certified Accountants (ACCA) is a global professional body for accountants. Its qualifications are recognized and respected in more than 180 countries in the world.

The Chartered Institute of Management Accountants (CIMA) is one of the biggest professional bodies for management accountants. It offers high-quality training and qualifications for management accountancy profession. In addition, CIMA is a member of IFAC.

American Institute of Certified Public Accountants (AICPA) is United States based professional organization for public accountants, with more than 400,000 members.

3.2. Consolidation under US Accounting standards (US GAAP)

Generally accepted accounting principles, also known as US GAAP is standards which issued by Financial Accounting Standards Board. As its name suggests, these standards are applied in the United States. Unlike IFRS, US GAAP standards is a rules-based.

In US GAAP standards, ASC topic 810, Consolidation standard represents consolidation rules and procedures for preparing consolidated financials. It is a bit different from IFRSs. According to ASC 810, a company has to prepare consolidated financial statements only if it has a “control” over the acquired company. However, unlike IFRS, according to this standard two consolidation models- Voting Interest Entities model and Variable Interest Entities model have to be taken into account.

The main logic under the Voting Interest Entities (VOEs) model is that voting rights is considered as the essential keyword for the determination of control. In other words, if one company owns more than 50% of voting shares of another company, in this case that purchaser company has obligation to prepare and present consolidated financial statements in addition to its own separate financial statements.

However, under the Variable Interest Entities (VIEs) model, the control over subsidiary activities is not looking at the perspective of owning majority of voting shares, instead here power over the decision-making process play an important role.

In general, companies which work under US GAAP standards, firstly have to determine whether to consolidate or not, and then which one of these two models applied should be identified. If the entity is considered as a voting interest entity, that circumstances relatively simple, companies are required to consolidate if they hold more than 50% voting shares of that entity. However, in the case of VIEs, process is getting more complicated. According to the VIE consolidation model, economic influence is an essential factor for exercising control, thus consolidation is also inevitable. Economic influence means the power of participating decision making process and influencing financial results of the entity through contractual agreements. So, under US GAAP consolidation rules, exercising economic power have to be taken into account as a primary factor, and then ownership percentage will be looked as a secondary one.

Let us look at identification of the process which describes requirements for consolidation under variable interest entities consolidation model. All conditions should be met, they are followings:

1. Variable interest model exceptions should be analyzed, more clearly, there are some cases when entities cannot consolidated under VIE model, examples include non-for-profit organizations, government organizations, entities having

employee benefit plan, registered investment companies. If one of these exemptions exist, VIE model cannot be applied, VOE model will be applicable.

2. Does the company have variable interests in that VIE? Because holding variable interests of the entity is one of the main conditions that must be met according to the VIE consolidation model.
3. Determination of whether the entity is a variable interest entity. The definition of the VIE can be expressed as a legal entity with specific features a) equity is insufficient to finance company's activities, often additional financial support is needed; b) equity holders do not enough power to operate the most important activities of an entity, in addition they do not receive returns or absorb losses.
4. Finally, is the company primary beneficiary of VIE? In other words, does company in itself or with other parties have power to operate and direct activities of VIE? Essentially, this means more than half of the losses are absorbed and more than half of the returns are received by company.

So, companies that preparing their financial statements in accordance with US GAAP and meet above certain criterions are obliged to prepare consolidated financial statements under variable interest model, otherwise, voting interest model must be applied.

3.3. Consolidation under IFRS

International Financial Reporting Standard (IFRS) is such a framework consist of international accounting standards which issued by International Accounting Standards Board are used by majority of the world countries, approximately more than 110 countries, except United States. Most businesses work under IFRS, prepare their financial statements and present them to the public under those standards. Unlike GAAP, IFRS is a principle-based, for that reason IFRS is considered more perceivable, clear and easy to understand than GAAP.

Thesis is written down exactly based on IFRS accounting standards.

First of all, it is worth to note related accounting standards issued by IASB that prescribe the accounting treatment of individual types of investments, including subsidiaries, associates, joint ventures and financial assets or trade investments. First three standards mainly specify accounting treatment of investments in subsidiaries, the situation when there is acquisition and control. They are followings:

- IAS 27 Separate Financial Statements
- IFRS 10 Consolidated Financial Statements
- IFRS 3 Business Combinations
- IAS 28 Investments in Associates
- IFRS 11 Joint Arrangements
- IFRS 12 Disclosure of Interests in Other Entities

Consolidation procedures under IFRS have been discussed more broadly in the second chapter. New terms such as parent, subsidiary, goodwill, non-controlling interests and others have been clarified, for this reason, in this chapter we will not touch them again. Instead, we will demonstrate their treatments in the consolidated statement of financial position and consolidated statement of profit or loss by using examples from practice.

As it is mentioned above chapters, subsidiaries' assets, liabilities, equity, income and expenses is added to parent company such numbers, it does not matter whether the subsidiary is wholly owned or partially owned. Key point here is that, if company is partially owned then the amount of non-controlling interests must be shown in the equity section of consolidated balance sheet. The NCI share also must be illustrated in the Statement of Changes in Equity under the heading of equity attributable to non-controlling interests as distinguished from the equity attributable to owners. In the case of wholly owned subsidiaries, 100% of the equity and net profit belong to the parent company.

The consolidated statement of financial position is illustrated in the following table. It is a case for partially owned subsidiary, when NCI is a matter.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION FOR THE YEAR ENDED 2017	2017	2016
	'000	'000
ASSETS		
Non-current assets		
Property, plant and equipment	40500	32000
Goodwill in a business combination	5500	
Other intangible assets	4000	2400
Deferred tax asset	250	378
Other non-current financial assets	4660	1580
	54910	36358
Current assets		
Inventories	27800	29433
Trade and other receivables	26355	21040
Prepayments	500	378
Cash and cash equivalents	18965	16683
	73620	67534
TOTAL ASSETS	**128530**	**103892**
EQUITY & LIABILITIES		
Equity		
Ordinary share capital	25000	15000
Share premium	10000	5000
Revaluation surplus	3200	1300
Retained earnings	38357	31345
Other capital reserves	578	978
Equity attributable to the owners of the parent	77135	53623
Non-controlling interests	5800	2400
Total equity	**82935**	**56023**
Non-current liabilities		
Interest-bearing loans and borrowings	16862	18900
Government grants	2800	1500
Provisions	610	335
Other non-current financial liabilities	3200	2750
	23472	23485
Current liabilities		
Trade and other payables	17350	15452
Interest-bearing loans and borrowings	1200	2600
Provisions	463	956
Other current financial liabilties	3110	5376
	22123	24384
Total liabilities	**45595**	**47869**
TOTAL LIABILITIES AND EQUITY	**128530**	**103892**

Table 4 Structure of Consolidated Statement of Financial Position

Accounting for intragroup transactions under IFRS Another key issue that must be taken into account is the accounting for intragroup transactions. Intragroup transactions means business transactions between parent company and subsidiary, two subsidiaries, and even departments. They have to be eliminated in full when preparing consolidated financials in order to prevent double counting. These transactions may be followings:

- Receivables and payables – one of the company’s receivable is the payable of another on the grounds of intragroup transactions, therefore these transactions are exposed to cancellation;
- Sales and purchase transactions between companies- the combined sales is reduced by the amount of intragroup sales, cost of sales also is reduced by the amount of intragroup sales and unrealized profit is added to adjust it;
- Subsidiary dividends received by parent- as they are inter-company transactions, dividends only can be recognized if and only if they are received from the third parties, outside of the group;
- During inventory sales between parent and subsidiary, unrealized profit have also to be eliminated because as transaction have occurred in the group there is actually no profit to be recognized. The profit will be realized only when the inventory sold to the third parties.

Consolidated Statement of Profit or loss Like statement of financial position (the same principles are pursued) consolidated statement of profit or loss is also prepared and reported by the companies to show financial performance of the group of companies as a single entity.

Consolidated income statement only shows revenues generated and expenses incurred as a result of transactions between group and third parties. Because there may be buying& selling transactions within the group that will lead to overstating revenues and expenses, so any intergroup transactions are eliminated in order to achieve transparency and fair presentation. The IFRS stipulates that if the transaction occurs between parent and subsidiary or two subsidiaries, effect of them is zero for group. Therefore, only business deals occurred with outside of the group can be recognized in the consolidated statement of profit or loss.

First step to be followed is adding together. Revenues and expenses of parent and subsidiaries are combined. Secondly, if there intragroup transactions exist, they are eliminated accordingly. Then, unrealized profits must be eliminated in full, by adjusting for closing inventory (current assets section in the balance sheet), retained earnings (in the equity section of balance sheet) and non-controlling interests is necessarily needed. In other words, in the one hand, the value of closing inventory will be reduced by the amount of unrealized profits. In the other hand, unrealized profits will reduce equity attributable to the owners through retained earnings and equity attributable to non-controlling interests based on their ownership interest. For instance, parent company and NCI share is 80% and 20% respectively, the value of unrealized profit is $5000, it will decrease retained earnings by$\$5000 \times 80\% = \$4000$, NCI by$\$5000 \times 20\% = \$1000$ and closing inventory will also be reduced by $\$5000.$ However, a key point to be taken into account is that NCI share will decrease if and only if the subsidiary is a seller, briefly stated, inventory is sold by subsidiary to the parent. This is because unrealized profits belong to both sides- equity owners and non-controlling interests. If it is reverse, parent company sold inventory to the subsidiary, NCI share cannot be reduced by certain amount because all unrealized profits belong to the parent itself, it only affects closing inventory and retained earnings. The reason behind why unrealized profit necessarily results in decreasing closing inventory is to avoid overstated balances in consolidated financial statements.

Finally after ending with profit figure, it is necessary to split it between equity owners and non-controlling interests. The profit attributable to non-controlling interests is added to NCI share in the statement of financial position, at the same time profit attributable to the owners of equity is added properly to the retained earnings.
NCI share will be seen in the equity section of statement of financial position and under the heading of equity attributable to NCI in the statement of changes in equity.

General structure for consolidated statement of profit or loss and other comprehensive income is illustrated below:

Consolidated Statement of Profit or Loss and Other Comprehensive Income for the year ended 2017	2017	2016
	0	0
Revenue	230077	198456
Cost of sales	160860	145870
Gross Profit	69217	52586
Other operating income	3500	3200
Selling and distribution expenses	17600	13800
Administrative expenses	20000	11000
Other operating expenses	2850	1200
Operating profit	32267	29786
Finance income	1500	1000
Finance expenses	7780	6300
Profit before tax	22987	22486
Income tax expense	6896,1	6745,8
Profit for the financial year	16090,9	15740,2
Gains and losses that not to be reclassified back to profit or loss:		
Gains and (losses) on defined benefit plans	520	310
Gain and (losses) on revaluation surplus	40	21
Total comprehensive income for the year	16650,9	16071,2
Profit attributable to the equity owners	13320,72	12856,96
Profit attributable to non-controlling interests	3330,18	3214,24

Table 5 Structure of Consolidated Statement of Profit or Loss and Other Comprehensive Income

Consolidated Statement of Cash Flows Generally, Cash flow statement is one of the fours statements indicates company's liquidity position in more detail, it is like a liquidity report which investors, creditors and others use to be aware of the ability of the company to fund its operations, to meet its short-term and long-term obligations. The purpose and logic of consolidated cash flow statement is the same, the only difference is that consolidated statement of cash flows indicates movement of cash within the group in full, as a single economic unit. It consists of three activities that referred to as operating, financing and investing activities. Operating activities are just the company's routine activities that are related to day to day receipts and payments, such as interest expense, interest received, dividends paid, taxes paid, payments to suppliers, wages to employees and so on. Investing activities are those activities which demonstrate the company's investment strategy, this section include sale and purchase of long lived assets, investments and loans made to other companies. Financing activities include loans payable, dividend payments, bond redemptions and others.

Consolidated statement of cash flows can be prepared like ordinary individual cash flow statements by taking items on the statement of financial position and statement of profit or loss and making an adjustment to them, but this method is considered right and perfectly appropriate when the same functional currency is applied both in the subsidiaries and the parent. When it comes to using the different functional currencies, this method can produce incorrect results. Therefore the correct method for preparing consolidated cash flow statement pursues the following steps:

- First step involves preparing individual cash flow statements for the parent company and its subsidiaries. It will not so complex preparing consolidated cash flow statement because parent and subsidiaries are obliged to prepare and present their own cash flow statements as well as other financial statements anyway, regardless of consolidated financials, so taking these individual statements will not time-consuming, they will already exist, they will already be within arm's reach;
- If the parent and its subsidiaries financial statements are in different currencies, translating them into parent's presentation currency cover the next step;
- Then, put together the parent's cash flow statement and subsidiaries' cash flow statements;
- After aggregating these statements, the next step involves eliminating any intragroup transactions that exist. There may be several intragroup transactions such as dividends received and paid, receivables and payables, unrealized profits;
- The final step is putting together these statements after all adjustments being made.

The following table summarizes all we have written above and illustrate the simple structure of the consolidated statement of cash flows:

Consolidated Statement of Cash Flows for the year ended 2017	**2017**	**2016**
	'000	'000
OPERATING ACTIVITIES		
Profit before tax	28987	26486
Depreciation and of property, plant and equipment	8500	7200
Amortization and impairment of intangible assets	673	564
Finance income and expenses, net	1500	1000
Cash from operations before working capital changes	39660	35250
Increase in trade and other receivables	7045	4420
Decrease in inventories	6345	5867
Increase in trade and other payables	2300	3560
Cash generated from operations:	41260	21403
Interest paid	2500	1900
Income taxes paid	6500	3200
Net cash from operating activities	32260	16303
INVESTING ACTIVITIES		
Proceeds from sale of property, plant and equipment	4000	5200
Purchase of property, plant and equipment	18090	9700
Purchase of financial instruments	3100	2680
Net cash from investing activities	-17190	-7180
FINANCING ACTIVITIES		
Proceeds from borrowings	8700	10200
Repayment of borrowings	3460	3170
Dividends paid	2900	3100
Net cash from financing activities	2340	3930
Increase in cash and cash equivalents	17410	13053
Cash and cash equivalents at the beginning of the year	20122	17432
Cash and cash equivalents at the end of the year	37532	30485

Table 6 Structure of Consolidated Statement of Cash Flows

Consolidated Statement of Changes in Equity is combined form of the parent and subsidiaries' individual statements of changes in equity as a single statement. It is a statement that demonstrates the equity section of the balance sheet in more detail, in simple terms just a movement of the equity. Investors often keep close eye on the statement of changes in equity, in order to be aware of how the company holds its equity. The structure of consolidated statement of changes in equity can be describes as follows:

	Share capital	Share premium	Other capital reserves	Retained earnings	Asset revaluation reserve	Total	Non-controlling interests	Total Equity
	‘000	‘000	‘000	‘000	‘000	‘000	‘000	‘000
As at 1 January 2017	15000	5000	978	31345	1300	53623	2400	56023
Issue of share capital	10000	5000	-	-	-	15000	-	15000
Total comprehensive income for the year	-	-	-	13320	-	13320	3330	16650
Transfer to capital reserve	-	-	500	-500	-	0	-	0
Share-based payment transactions	-	-	200	-	-	200	-	200
Dividends	-	-	-	-1920	-	-1920	-480	-2400
Non-controlling interests arising on a business combination	-	-	-	-	-	-	240	240
At 31 December 2017	25000	10000	1678	42245	1300	80223	5490	85713

Table 7 Structure of Consolidated Statement of Changes in Equity

The preparation of consolidated statement of changes in equity differs from other set of statements, it means unlike such statements, combine line-by-line basis does not works here, in other words, you cannot add together subsidiary share capital and parent share capital for the purpose of consolidation. Instead, the value of equity that does not belong to the parent has to be shown as non-controlling interests.

It can seem from above pro forma that consolidated statement of changes in equity consists of two headings: equity attributable to the owners of equity, including share capital, share premium, other capital reserves, retained earnings, assets revaluation reserve, and non-controlling interests. As it is shown, profit attributable to non-controlling interests based on their ownership percentage increases NCI, on the contrary, dividends reduce it.

It is worth to touch one of the key issues about consolidation that how to consolidate with foreign currencies. It is quite obvious that companies are growing day by day, opening their new headquarters in foreign countries or expanding their business by acquiring new companies around the world. As a result large companies' subsidiaries carrying on a business and operate in several foreign countries with foreign functional currencies. The purpose of consolidated financials is just to combine these several subsidiaries which belong to the group and parent company financial statements and report it as a single entity for the use of investors, analysts and others who are interested in them.

However, consolidation process and its relevant procedures in the case of same currencies are not different from those with different currencies. Consolidation process is still the same- adding together, eliminating the intragroup transactions, and showing the value of non-controlling interests is still necessarily needed. The key issue here is that if consolidated financial statements mean combine, the currencies cannot be different predictably. So subsidiaries currencies (it does not matter which currency they use) that their own financial statements are prepared based on, have to be translated into parent company's presentation currency.

The IFRS defines a specific standard that guides for companies how to translate subsidiary financial statements into parent's currency. The accounting standard IAS 21"The Effects of Changes in Foreign Exchange Rates"[5] specifies rules and procedures for translating different currencies to presentation currency. There are functional and presentation currency should not be confused, presentation currency is just an option for companies. For example, for Azerbaijani company functional currency is manat AZN, however, it can select to present their financial statements in other currencies, such as USD. Companies cannot choose functional currency, so that

[5] Accounting Standard IAS 21 "The Effects of Changes in Foreign Exchange Rates" IAS 21 outlines how to account for foreign currency transactions and operations in financial statements, and also how to translate financial statements into a presentation currency.

it depends on economic environment they operate. However selection of presentation currency is just a choice.

All we write above is about when the subsidiary acquired at the end of the year, and for the next beginning of the year subsidiary will operate under the control of the parent, as a result consolidation done by taking into account subsidiary's activity for the whole year, for example all profit earned by subsidiary will split between the equity owners and non-controlling interest according to their ownership percentage. But in reality, sometimes subsidiary can be purchased part way through the year, in such circumstances profits earned by subsidiary for the last financial year have to be split into pre-acquisition and post-acquisition profits. This is because if the parent exercises control over its subsidiary, it does not matter when the subsidiary is purchased, parent company is obliged to prepare consolidated financial despite of the acquisition date can even be close to the end of the year.

The consolidation procedures under the acquisition part way through the year is not different, the only thing should be considered is a profit figure. First of all we need to determine pre-acquisition profits for the purpose of calculating goodwill, and then post-acquisition profits in order to compute group retained earnings and non-controlling interests. All other items treat in the consolidated financial statements as always elements of the statement of financial position, profit or loss and cash flows are added together by eliminating any intragroup transactions.

To give an example, assume that for the parent company beginning and ending of the financial year is 1 January 20X7 and 31 December 20X7 respectively (subsidiary company's financial year cover the same period from January to December). This parent company acquires new subsidiary at 1 April 20X7. At the end of the year profit of the subsidiary company is computed to be as \$8500. According to IFRS, this profit is accrued year during the year, so pre- and post-acquisition profits can be calculated as $\$8500 \times \frac{3}{12} = \$2125$ (first 3 month until April), $\$8500 \times \frac{9}{12} = \$6375$ or simply $\$8500 - \$2125 = \$6375$. Pre-acquisition profits will be added to the value of identifiable net assets at the acquisition date, while post-acquisition profits will be split between equity attributable to parent company in order to shape the retained earnings figure, and non-controlling interests, for the purpose of shaping NCI figure in the equity section of the statement of financial position.

4. Implementation of consolidation under IFRS to Azerbaijani accounting system

Generally, implementation of IFRS and adoption process is a challenge which most of the countries meet today. IFRS is the abbreviation for International Financial Reporting Standards which issued by the International Accounting Standards Board for the purpose of bringing transparency, accountability to financial markets all over the world. In fact, using the same accounting standards across the world will significantly assist the users of financial data to make comparisons between companies and make decisions. So, the purpose of issuing IFRSs is to make it internationally used and implemented standard around the world, including United States. However, although IFRS is applied by the most of the countries, and the others are in a process of transition to international standards, even so it is still not easy to make comparisons between companies which operate in different countries. This is because in fact, each country has its own laws, rules and regulations that affect all fields in the country, as well as accounting.

The transition to IFRS in Azerbaijan has already happened to a certain degree.
The main step towards the international accounting had happened in 2004, by enacting the new law-Accounting Law of Azerbaijan Republic. This law introduces the new approach to accounting in Azerbaijan, involves the development of accounting standards on the basis of international standards and plays the role of a bridge between national and international accounting. It is worth noting that there are no substantial differences between Azerbaijan National Accounting Standards and IFRS, because NAS is prepared on the basis of IFRS.

Implications of this new approach can be already seemed in Azerbaijan, in such a way that, some entities is required by law to prepare and publish the financial statements in accordance with IFRS, and the others can choose between the IFRS and NAS. It is stated in law as "International Financial Reporting Standards are hereby adopted in their entirety for use by the subjects of accounting mentioned in article 8.1.of this law; Modifications to these standards can only be made by the International Accounting Standards Board and such modifications shall be effective when they are officially adopted by the International Accounting Standards Board." (Accounting Law of Azerbaijan Republic, Article 6.0.1.)

4.1. Accounting system of Azerbaijan

Azerbaijani accounting system is regulated and governed by Ministry of Finance of the Republic of Azerbaijan which in turn is responsible for standard-setting process in the field of accounting. Briefly stated, the responsibilities of the Ministry of Finance are the followings:

- ✓ translating of International Financial reporting Standards and International Accounting Standards into Azerbaijani language;
- ✓ setting the National Accounting Standards based of IFRS and IAS;
- ✓ providing the interpretations and recommendations for both the accountants and users of those standards;
- ✓ establishing the simplified accounting rules for the purpose of application by small entrepreneurships

Other professional accountancy bodies including the Chamber of Auditors of Azerbaijan Republic (member of IFAC) and Association of Accountants of the Republic of Azerbaijan operate in Azerbaijan for the purpose of advising to the Ministry of Finance, harmonizing with international accounting and transition to IFRS.

Accounting system in Azerbaijan is adjusted with the Accounting Law, 2004 that is consist of the setting rules for preparing financial statements by the legal entities who engaged in business activity in Azerbaijan territories. In addition, state substantially pay attention to the regulation of accounting in the country for the purpose of ensuring transparency over financial statements is provided and they are available and useful for public use.

The next step in the direction of international accounting was the establishment of Advisory Council in the field of accounting. The primary purpose of Advisory Council is to stimulate the development of accounting in Azerbaijan by advising executive authorities regarding the essential accounting and financial reporting issues including decisions taken on the point of the NAS, IFRS and International Public Sector Accounting Standards.

Generally, two sets of standards apply in the country depending on the type of the entity including International Financial Reporting Standards (IFRS) and National Accounting Standards (NAS). The four types of entities are distinguished according to the new law.

Public Interest Entities According to the law (Accounting Law of Azerbaijan Republic, Article 8.1.), for “Public Interest Entities” IFRS is strictly required. These types of entities include:

- Credit organizations
- Insurance companies
- Non-state private social funds
- Investment funds
- Entities with securities traded on the stock exchange
- Commercial organizations that on the date to which the financial statements are prepared, exceed two of the thresholds (for annual revenue, average number of employees during the financial year and total balance sheet) in an amount determined by the relevant executive authority. (Accounting Law of Azerbaijan Republic, Article 2.1.9.)

The law also states that, companies (public interest entities) with one or more subsidiaries must prepare consolidated financial statements in addition to their individual financial statements in compliance with IFRS. Companies that have one or more subsidiaries do not need to prepare consolidated financials if and only if all of the certain following conditions are met:

- company itself is a subsidiary of another company;
- debt and equity instruments belonging to the company is not traded in a public market;
- the company is not in the process of issuing securities;
- the ultimate parent of the company prepare and present consolidated financials in accordance with IFRS and the Article 10 of the Accounting Law

Commercial organizations Based on the Azerbaijani accounting system and the Law of Accounting, commercial organizations prepare their financial statements under the National Accounting Standards for Commercial Organizations meanwhile depending on their choices they also can prepare their financial statements in compliance with International Financial Reporting Standards.

Small Entrepreneurships They are obliged to prepare their financial statements under "Simplified Accounting Rules", at the same time depending on their choices, application of National Accounting Standards for Commercial organizations is also permitted.

Non-commercial organizations these organizations including municipal organs, budget organizations and non-government organizations are subject to prepare their financial statements under National Accounting Standards for Budget organizations and National Accounting Standard for Non-government organizations respectively.

4.2. Comparative analysis of consolidation under IFRS and NAS

As we mentioned before, relevant accounting standards- IFRS 10 "Consolidated Financial Statements" and IAS 27 "Separate Financial Statements" outlines essential consolidation procedures under International Financial Reporting Standards. We have already discussed consolidation under IFRS in detail in the above chapters, so we will not touch them again, only comparisons between IFRS and NAS will be made.

Consolidation procedures are specified through the following standards under the NAS:

- ✓ National Accounting Standard for Commercial Organizations 19- “Consolidated Financial Statements” (NASCO 19)
- ✓ National Accounting Standard for Budget Organizations 6- “Consolidated and Separate Financial Statements” (NASBO 6)

First of all, both of the standards are prepared by the executive authority in conformity with IAS 27. The consolidation procedures under NASCO 19 are approximately the same in such a way that, elements of the financial statements are aggregated line by line basis, by eliminating any intragroup transactions such as income, expenses, and dividends within the group and showing the value of minority interests in the consolidated financials. In addition, according to the standard the reporting dates of the financial statements of the parent and subsidiaries have to be the same. Otherwise, subsidiary is obliged to prepare its financial statements to the same date as parent for the consolidation purposes.

The situations where the commercial organizations are entitled not to prepare consolidated financial statements is specified in the standard, this is a case firstly, when the entity itself is a wholly-owned subsidiary of another entity, or partially-owned by another entity and its owners are aware of, do not object to not preparing consolidated financials. Secondly, ultimate parent of the entity prepare and present consolidated financial statements and make it available for public use. In such circumstances companies are subject to prepare separate financial statements. In this case, companies must account its investments in subsidiaries, joint ventures and associates at cost, in compliance with NASCO 20 “Accounting for Associates” and NASCO 21 “Interest in Joint Ventures”.

In terms of comparisons with IAS 27, it is stated that there are no substantial differences between the two standards. Only few differences include several paragraphs are added to the standard referring to the Accounting Law. Standard has its own application framework that it is appropriate for solely commercial organizations, not all companies. In addition, examples and interpretations are not covered by the standard, while IAS 27 shows how to apply relevant standards through illustrative examples. Separate explanation document exits for the purpose of making explanations through examples. Finally, some issues are specified easily in terms of language than IAS 27.

As stated above, consolidation procedures for budget organizations are adjusted under the NASBO 6 and based on International Public Sector Accounting Standards (IPSAS) 6 “Consolidated and Separate Financial Statements”. The standard firstly introduces the essential definitions then, exemptions from consolidation are determined. The conditions that make consolidation unnecessary are the same as NASCO 19 the only difference is that conditions which equity instruments belonging to parent are not traded in a public market and parent is not in a process of filing are included as exemptions from consolidation. Otherwise, budget organizations are obliged to prepare consolidated financial statements. When preparing consolidated financials for budget organizations, all controlling entities must be taken into account. The controlled entity is excluded from consolidation if it is held primarily for the purpose of disposal within the twelve month and the buyer is actively being searched by the organization. Other consolidation procedures are the same as IAS 27.

Subjects of NASBO 6, have to account their investments in associates and joint ventures at cost, with equity method or as financial instruments by using the same accounting for all of them when preparing the separate financial statements.

4.3. Outstanding challenges companies face during the merge

First of all, it is worth to note that the term of merger is different from the consolidation. A merger means the combination of two (or more) corporations, however after the process only one of them will be alive. It can simply be illustrated like this: $X + Y = X$ However, consolidation involves two (or more) corporations joined, as a result an entirely new corporation come into existence like $X + Y = Z$

As mergers offer companies some benefits, consequently they operate more efficiently by owning majority of market share and customers, there are also several challenges that companies meet during mergers and acquisitions. Only if these challenges are successfully taken up by the organization, the merger can be prosperous.

Cultural challenges Generally, corporate culture defines the way that organization follows in its existence, it consist of the attitudes, beliefs, assumptions and values which influence the behaviors of the people in an organization. Even numerous studies show that, "culture issues cause 30 percent of failed M&A integration".[6] As each organization has its own culture, in the case of merge and acquisition the integration of the two different cultures creates a problem for companies. This is because people in an organization, say employees, get used to work under the previous corporate culture and when the merge occurs they lose one's way and get confused. It is not a coincidence that, a successful merger takes at least one or two years by demanding the perseverance. So, in order to overcome this type of challenges companies need to review both corporate structures after acquisition and reorganize its corporate culture by eliminating any discrepancies between the two, it will help the company operate effectively and efficiently, without any uneasiness.

Communicating challenges This is the other challenge that sometimes can be a reason for failures of synergies. Communication with people in an organization is the most essential factor that influences company to keep on doing business. Informing employees about what is going on in an organization and provide them information needed about decisions made by management, such as organization merging decision, will eliminate uncertainties in their minds, increase employees' morale and their

[6] Addressing Culture Differences in M&A
http://deloitte.wsj.com/cio/2015/06/18/addressing-culture-differences-in-ma/

productivity. The reason of merging, its effects on employee's working condition, and any other issues must be answered by the management in order to achieve a successful merger.

Employee retention issues Employees' reactions to the management decision about merger and acquisition is normally not positive. They can regard M&A as a threat to their career in an organization. Maintaining trust with employees and keep employee turnover in its normal level is an essential point. Because merge process obviously results in downsizing, which can pose a challenge for both company's management and employees. The logic here is that, if two corporations come together, their staff will combine also, however, there cannot be two Chief Executive Officers or Chief Financial Officers. So, after the merger and acquisition HR must determine who should go and who stay in. If the decisions are made more quickly, valuable employees can be dismissed which afterwards recruiting new employees can cost a company a lot. Another factor to be taken into consideration is that sometimes employees themselves can leave the job intentionally. Uncertainties about their future career in an organization, job security and other related issues force them to take that step. Loss of valuable employees will result in loss of customers, brand loyalty, and market share, therefore HR has to be so cautious when making substantial decisions about company's staff and try keeping employee turnover low.

M&A and consolidation in the case of Azerbaijani companies Business environment in Azerbaijan after independence is changing rapidly and conform to the international business environment. This shows oneself in the field of accounting as well. For instance, reporting consolidated financial statements as individual ones is now mandatory for the group in Azerbaijan and moreover, reporting under IFRS is the most required by investors for decision-making. Although some companies do not apply IFRS in their accounting, they convert the financial statements into the IFRS by using special services for the purpose of making them available for the all users from different countries.

In 2015, Azerbaijan has entered strict economic crisis, decrease in oil prices on the world market resulted in the twice devaluation of national currency- Manat and strongly affected financial and bank sector of the country, even economy as a whole. Although the devaluation occurred in April and December 2015, its negative effects still last. Bank sector, households and businesses were the most injured and damaged parties respectively. On the one hand, the loans of households to commercial banks increased twofold in its size, and most of them were not able to pay their debts, led to large quantities of non-performing loans. On the other hand, a drop in national currency also jeopardized the savings belonging to the households. The same scenario also repeated for the subjects of businesses.

Especially bank sector get substantially harmed and bigger problems in bank sector arose, in such a way that, the size of banks' foreign debts and debts to the households double increased, as a result of the process, Central Bank made decisions towards revoking the licenses of several banks. The two banks stopped their activity after the first devaluation, the other tens closed after the second one. In order to overcome such problems and alleviate the effects of crisis, experts recommended two remedies as a way out, one of them was the consolidation of several banks and the other was revoking the licenses. It was thought that, consolidation is more convenient than closing of the banks, because when two or more banks merge, they combine their capital and become more powerful, this is a case if those banks have not enormous problems. If they have, consolidation can lead to greater problems, which will cause disaster.

Although, after the devaluation some banks entered into negotiations towards merging with another bank, the results were not heartwarming. Only two banks- Atabank and Caspian Development Bank sign an agreement for merging in 2017, CDB bank stopped its activity and transferred all its assets to Atabank which led to substantially increase in financial indicators of a merger. In addition, it is worthy of note that, previously, Atabank and Caspian Development Bank are owned and controlled by Ata Holding and Synergy Group respectively. However after the consolidation, Synergy obtained control over the merge. Atabank operates for now under the control of Synergy Group.

Synergy Group Limited Liability Company is one of the biggest investment companies was created in 2000, operates on the non-oil sector in Azerbaijan territories. It owns large investments in the field of production, construction, healthcare, education, agriculture, hospitality and banking.

SYNERGY GROUP			
	Ownership interest	**Type of the entity**	**Main avtivity area**
Synergy Group OSJC	100%	*parent*	Investment company
Bestpack LLC	100%	*subsidiary*	Packing
Khazar-Tourism LLC	100%	*subsidiary*	Hospitality
Ecolime LLC	100%	*subsidiary*	Manufacturing materials
Exclusive Dining LLC	100%	*subsidiary*	Restaurant
B.N.M. LLC	100%	*subsidiary*	Hospitality
Shamkir City Hotels and SPA LLC	100%	*subsidiary*	Hospitality
Synergy Construction LLC	100%	*subsidiary*	Construction
Azagro LLC	100%	*subsidiary*	Agriculture
Synergy Foundation	100%	*subsidiary*	Non-for-profit organization
Azerbaijan Fibro Cement LLC	100%	*subsidiary*	Manufacturing materials
Synergy Trading LLC	100%	*subsidiary*	Trading
Synergy Jet LLC	100%	*subsidiary*	Jet operating
Synergy Technics LLC	100%	*subsidiary*	Investment company
Synergy Sport	100%	*subsidiary*	Non-for-profit organization
Synac LLC	100%	*subsidiary*	Education
Synergy Development LLC	100%	*subsidiary*	Management of property
Cybernet LLC	100%	*subsidiary*	Information technologies
Atabank	100%	*subsidiary*	Banking
Azerbaijan University LLC	90%	*subsidiary*	Education
Azorchid Hotels LLC	70%	*subsidiary*	Hospitality
Caspian Agro LLC	50%	*subsidiary*	Agriculture
Caspian Coast Winery and Vineyards LLC	50%	*subsidiary*	Winery
AAC LLC	39%	*subsidiary*	Manufacturing materials
Azerbaijan Global Investments	32%	*associate*	Investment company

Table 8 Composition of SYNERGY GROUP

Group prepares and presents its consolidated financial statements in addition to its individual financial statements, in accordance with International Financial Reporting Standards and Azerbaijan Republic Accounting Law. According to the annual financial report 2015 of Synergy, group is represented by a parent company, twenty three subsidiary companies and single associate with different ownership interests. Synergy Group's annual financial reports including consolidated financials and individual ones (Statement of Financial Position, Statement of Profit or Loss, Statement of cash Flows, Statement of Changes in Equity) are placed in its website under the heading of Annual Reports[7] (link below). All of them are compliance with International Financial Reporting Standards.

[7] "Synergy Group" LLC - Consolidated Financial Statements for the year ended 31 December 2015 http://www.synergygroup.az/docs/Synergy%20Group_2015.pdf

Conclusion

This study has examined and focused the issues such as which practical methodologies used by accountants in the field of consolidated financial statements, consolidation procedures under IFRS and US GAAP standards, and to what extent application of these standards implemented to Azerbaijani accounting system. So, as a result of the theoretical analysis, main terms related to consolidation have been clarified, their importance disclosed. Then, consolidation process and procedures under IFRS have been investigated in contrast with US GAAP, main differences between them elucidated.

According to the results of the study, it is revealed that accounting in Azerbaijan is progressively adapted to the international accounting in that, companies have an option for choosing between International Financial Reporting Standards or National Accounting Standards. Introducing the Accounting Law of Azerbaijan Republic was one of the most vital steps toward transition to IFRS and European accounting system. This law classifies four types of entities depending on their activities and distinguishes the Public Interest Entities from the others. So that, only public interest entities are obliged to prepare its financial statements including both the individual and consolidated ones in accordance with IFRS. However, for commercial organizations preparing financial statements under IFRS is not mandatory, state gives them opportunity for selecting NAS or IFRS, for non-commercial organizations NAS is applicable, in addition, small entrepreneurships produce their financials under “Simplified Accounting Rules” or NAS.

The thesis also found out the fact that, consolidation and merge is needed in Azerbaijan, the necessity of merging have been analyzed especially in the case of commercial banks and it is understood that, consolidation is crucial for several banks for now after the twice devaluation. Despite this fact, since 2015 only a merge of two banks successfully realized. Therefore, there are actions to be taken by the state toward consolidation. At the same time, companies must be able to overcome difficulties arising as a result of merging otherwise, consolidation will not be lucky.

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