Constraints in preparing consolidated financial statements between the Algerian FAS and IFRS

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Abstract:

The main objective of this article is to focus on the problem of the application of the Financial Accounting System (FAS), largely inspired by the "International Accounting Standards" IAS-IFRS in terms of accounting consolidation. Expecting a documentary analytical approach, the study concluded that Algerian groups of companies find a lot of difficulties when drawing up their financial statements, not only with regard to accounting principles, but also with regard to tax laws. These constraints are due to the lack of updates of the SCF by the National Accounting Council, which is supposed to be the national standard setter, as well as to the accounting culture of financial statement preparers who are called upon to communicate reliable and comparable information to their users, in particular, the shareholders in order to protect their interests.

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1. Introduction:

The world has witnessed an evolution in financial reporting since the emergence and expansion of the business of multinational companies and the associated technological developments resulting from globalisation. Several factors have led to this new trend of harmonising accounting systems, as each country had its own system and consequently a difficulty in exchanging financial information.

Also, the need to standardise and regulate practices in different countries through the development of standards by competent bodies, notably the "International Accounting Standards Committee" (IASC) was founded in June 1973 in London, after the reform of accounting over time; the IASB became the best body to regulate the accounting profession from 2001.

The International Accounting Standards (IAS) encompass a collection of a collection of specific regulations and rules relating to the requirements for the preparation, presentation and disclosure of individual and consolidated financial statements, specifically intended for users for decision-making purposes.

For several years, Algeria has tried to adapt to the external environment by reforming its accounting system through the promulgation of Law 07-11, which included the Financial Accounting System, which deals for the first time with accounting consolidation.

The process of consolidation encompasses the compilation of financial statements for both the parent company and its subsidiary entities, whether they are situated within the country or abroad. In the form of a unified financial statement, this report conveys the financial standing of the entity as if it were a singular corporation.

The IASB has focused on determining the type of control, after determining the scope of consolidation based on the financial relationship between the parent and its subsidiaries. In order to determine the accounting consolidation methods, exclusive control necessitates the utilization of the global integration method. Joint control necessitates the application of the proportional integration method, whereas significant influence, is recognized through the equity method.

The latter method requires the preparation of a consolidated balance sheet, a consolidated income statement, and a consolidated appendix. Moreover, there have been explaination of the methods used and explanations of the financial and operational policy adopted, as well as accounting methods for the determination of operations that are part+ of the consolidation operation and those that are not, and finally to proceed with the allocation of equity capital.

The tax legislation imposes a number of tax requirements, while adding that the joint stock company is the only company that has the right to collect accounts as it has legal personality. It also guarantees the taxation rules, granting tax benefits and exemptions for all types of taxes on transactions and exchanges between affiliated companies in the same group.

The purpose behind the creation of a group of companies is to dominate the market, both locally and internationally, due to the integration of group companies through the emergence of several factors such as globalisation, expansion of world markets, exchange of information, increased competition, etc., These factors have led to the need for consolidated financial statements prepared in accordance with international accounting standards for the quality of financial information provided to users of 'financial statements'.

The process of corporate consolidation is the association between the parent company and its affiliated members of the complex through quality control which determines the methods of consolidation of the 'financial statements' in accordance with the conditions and steps based on which it is done.

Considering all the elements we have developed, this study will make a valuable contribution to the literature by investigating the following research question: **What are the primary legislative requirements governing consolidated financial statements, as delineated by FAS and IFRS?**

2. Literature review

Camfferman & Zeff (2018: 289) call for research into the ramifications of jurisdictional constituency diversity, as well as the changing perceptions of 'standard' setting within jurisdictions, for all aspects of the IASB's operation. Such research should make greater use of the variety of sources available to researchers today.

The results of Diem Hong et al (2018: 44) show that the knowledge of accounting staff is the main obstacle and that legislation is a key motivation for the preparation of CFS in Vietnam. Sukyoon Jung and Mihye Ha (2021) ascertain a heightened degree of informational significance in earnings following the implementation of IFRS.

They discern a robust correlation between the presence of 'consolidated financial statements' and the amplified informational value. Their examination enriches comprehension of the origins of the impact of IFRS, as it furnishes fresh evidence regarding the pivotal influence of policy modifications in the disclosure of consolidated statements.

Luehlfing (1995) posits that the process of consolidation fluctuates depending on how the parent company records its substantial long-term investments (via various recording methods) throughout the accounting cycle. It's worth noting that all these diverse recording methods necessitate the preparation of consolidated financial statements.

3. Theoretical background

We will present a short overview of the evolution of accounting consolidation

3.1. Historical overview of accounting consolidation:

We will present the history of consolidation from which we have chosen in three countries, namely: the USA with the oldest consolidation operation in history, France from which Algerian law is largely inspired and Algeria which is the case of the present study.

- **The main phases of consolidation in the "United States of America":**
  - 1882 "First publication of special consolidated accounts",
  - 1905 "Organization of a world forum on consolidated accounts",
  - 1910 "Consideration of consolidated accounts in annual reports",
  - 1934 "Obligations to prepare accounts in annual reports",
  - 1955 "Publication of accounting standards on consolidated financial statements"
- **The main phases of consolidation in France:**
  - 1966 "Publication of the first consolidated accounts",
  - 1968 "The initial recommendation put forth by the National Accounting Board concerning consolidated accounts"
  - 1978 "Draft report of the National Accounting Board on consolidated accounts"
  - 1985 "Publication of the law on the establishment and mandatory publication of aggregated accounts of listed companies"
  - 17 September, "notice 10-98 on consolidated accounts"
- **The main consolidation phases in Algeria:**
  - 1996 Decree 96-27 of 9/12/1996 is published for the first time under Article 732 bis of the Commercial Code, which requires listed companies to prepare consolidated accounts.
  - 1997 - Decree 96-31 of 9/10/1999 establishing the adoption of the national accounting plan for the activities of holding companies to establish consolidated financial statements.
  - 2007: Law 07-11 of 25/11/2007 If the parent company is located in Algeria and falls within the scope of the Financial Accounting System, it is a mandatory requirement to compile and publicly disclose consolidated annual financial statements for the conglomerate.
  - 2008: Executive Decree No. 08-156 of 26/05/2008 incorporating the application of the provisions of Law 07-11 (Articles 39 to 41).

- 2009: Order of 26/07/2008 setting the rules of valuation and accounting, the content and presentation of financial statements as well as the nomenclature of accounts and their operating rules.
- 2016: It should also be noted that the CNC published on 14 August 2016 a notice on the accounting of tax on consolidated taxable income (Algerian National Accounting Board, 2016).

3.3. Disadvantages of the composition of business groups

The present phase displays a plethora of statuses. They are presented as follows:

- The status of the claimants: the principle of autonomy of the legal personality of each company of the complex can be prejudicial to the claimants because of their ignorance of the real financial size of their debtors and this, by allowing companies belonging to the same group to carry out the transfer of claims, in this case they are in front of a company unable to pay their rights.
- Staff status: workers within the group may lose certain provisions and measures that preserve their rights, as they may be employed in a subsidiary that is less advantageous than the company in which they worked due to their transfer, and their working life becomes more difficult due to changes and instability in one place.
- The status of tax administration: Group management focuses on tax management at the level of the parent company, which allows it to achieve tax savings, as well as the complex uses the advantages provided by various tax laws, which allows groups to transfer profits to other countries less causing a violation of international laws (tax evasion).

It is also added that consolidation is even applied by the public sector with the adoption of IPSAS "International Public Sector Accounting Standards" and developing countries are finding difficulties or even obstacles in preparing them (Grossi, G. and Bisogno, M., 2018: 236).

4. Consolidation methods

The consolidation methods are determined according to the type of control. There are three types of consolidation methods: the full consolidation method, the proportional consolidation method and the equity method.

4.1. Full consolidation method

The technique for preparing consolidated financial statements in the form of full consolidation in accordance with IFRS10 is as follows:

- "Merge the financial records of the parent company and its subsidiary entities with regard to assets, liabilities, equity, income, expenditures, and cash flows".
- "Eliminate the carrying amount of the parent's contribution to each branch and the parent's share of each subsidiary's capital".

The consequent outcomes lead to a a complete elimination of assets and liabilities, private equity, income, expenses and cash flows between groups related to transactions between group entities (excluding gains and losses from intra-group transactions, which are included in assets, such as inventories and fixed assets);

According to paragraph 1100 of CRC 99-02 (Accounting Standards Authority, 2017), the full consolidation method contains:

- "Incorporate into the parent company's financial statements the components of the consolidated branch accounts, following appropriate adjustments as required".
- "Allocating the private capital of the subsidiaries on the basis of the percentage of interest and the result of the subsidiary is made on the basis of the percentage of minority interests (minority rights) of the parent company. Exclude intra-group transactions and accounts".

4.2. Proportional integration method

The proportional integration method is employed when there is joint control over a company, as defined by IAS 31. It is worth mentioning that the Financial Accounting System has not incorporated this method. Consequently, proportionate consolidation is an accounting approach where the proportionate share of assets, liabilities, income, and expenses of the jointly controlled entity is consolidated into corresponding items within the shareholder's financial statements and can be reported as distinct entries.

The shareholder's balance sheet includes its share of the assets of the jointly controlled entity and its share of the liabilities in which it is a participant. The elements of the joint venture are presented in the shareholder's consolidated financial statements in two ways:

- It either amalgamates the shareholder's portion of each asset, liability, revenue, and expense, treating similar items within its financial statements.
- Or takes into account its share separately.

The application of this method involves three steps: They are stated as follows:

- Includes in the consolidated accounts of the company the proportionate share of the interests expressed in the accounts of the joint venture company, after the necessary adjustments and corrections, and do not recognise any minority rights;
- Excludes all transactions between the group;
- Presents the rights of the group in the reserves and results.

It is worth mentioning that the Financial Accounting System has not addressed this method in its conceptual framework (Official Journal No. 19 of 25 March, 2009).

4.3. Equity method

This method supplants the carrying value of equity securities retained by the parent company and corresponds to the net position of the consolidated entity. The method encompasses:

- Replacing Substituting the “book value” of equity securities in the “consolidated balance sheet” with equity shares, and incorporating the annual results.
- Excluding transactions and accounts between equity accounted subsidiaries and other consolidated companies

5. Consolidation of financial statements in Algerian law

We will deal with the Algerian laws relating to the establishment of financial statements in different instances or institutions. These are known as: tax law, commercial law, and the Financial Accounting System.

5.1. The group in Algerian tax law

A distinction must be made between the theory of the group of companies and its point of view on the part of taxation. The group of companies legally means the grouping of several companies whatever their type and legal form.

This is the case even for indirect control. In contrast to this, the group from a tax point of view according to the code of direct taxes and assimilated taxes proposes that an economic entity is composed of two or more companies with legally independent shares, each called "parent company".

“The latter controls the other "subsidiary" company which is subordinated to the direct ownership of 90% or more of the share capital, and which is not wholly or partially owned by other companies”.

The above-mentioned concept explains the following conditions where the Algerian legislator considers joint stock companies as the only ones that can be subject to the group tax regime. Thus, such a notion excludes the rest of the other forms of commercial companies known in commercial law, whether private companies or capital companies. The aforementioned conditions are listed below as follows:

- The company must have an independent legal personality (parent company with subsidiaries).
- Requires that the parent company directly holds at least 90% of the share capital of the subsidiary.
- The capital of the parent company must not be wholly or partly owned by the subsidiaries.
- No other company having the character of a parent company may hold 90% or more of the parent company's capital.
- There are also a number of exceptions related to the subject of the enterprise group system, notably, oil companies, which regulate their relations with other laws in addition to commercial law.

5.2. “Consolidated financial statements” in the FAS “Financial Accounting System”

The Law 07-11, enacted on November 25, 2007, introduced the Financial Accounting System in Algeria, replacing the National Accounting Plan of 1975, as part of accounting reform in the country. This new accounting framework, aligned with International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS), brought about significant changes, both in terms of definitions and concepts, as well as accounting valuation and recording principle.

Furthermore, it addressed the nature and content of financial statements to be prepared by business enterprises. It introduced a multitude of new concepts and definitions, establishing a structured framework for organizing financial information.

This framework enables the systematic storage of fundamental data pertaining to the financial position and assets of the entity. Ultimately, it facilitates the assessment of the entity's performance, status, and cash position at the end of each fiscal year.

For the first time, it addressed the subject of consolidation through:

- **Consolidated accounts according to articles:**
  - The The primary goal of consolidated accounts is to portray the assets, financial standing, and performance of the group of companies in a manner that simulates their association with a single entity (the parent company). Consolidated financial statements are not mandatory when the parent company holds less than 90% of the voting rights.
  - Control is defined as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.
- **Control is assumed in the following cases:**
  - “Direct or indirect acquisition by the branch broker of a majority of the voting rights in another company”.
  - Authority over more than 50% of the voting rights is obtained in agreement with other partners or shareholders.
  - Power to appoint or terminate a majority of the directors of another company.
  - Power to determine the company's operational financial policies by law or contract.
  - The power to cast the majority of votes at meetings of the company's governing bodies

6. Requirements for the preparation of consolidated financial statements

After analysing the Algerian accounting and tax laws on consolidated accounts and presenting the role and importance of the preparer of financial statements, we will focus on the requirements that must be made available to these preparers due to accounting consolidation. We will furthermore, present the main objectives

pursued by the IASB in terms of international standardisation through the respect of the qualitative characteristics of financial information.

The current quality of consolidated accounts is still not convincing for users. However, it is difficult to find a suitable solution because of the lack of an organisation or control office (Diem Hong et al, 2018).

6.1. Criteria for achieving the objective of IFRS 10

The main criteria should include the following points. They are shown in the following list as follows:

- Require the parent company, which is considered to have control over the decisions of one or more subsidiaries, to prepare and present consolidated financial statements.
- Provide a foundation for ascertaining control, which is regarded as the cornerstone for creating consolidated financial statements. Additionally, elucidate the application of the control principle to the investor.
- Establish the accounting bases and requirements for the preparation of consolidated financial statements.

However, there are exceptions to the presentation of consolidated financial statements in accordance with IFRS 10:

- **Cases that meet all the following conditions:**
  - If the parent company is itself a wholly or partly owned subsidiary of another company and all other owners have been informed that the parent company has not presented consolidated financial statements.
  - If the financial instruments of the parent (holding) company are not traded on a stock exchange, whether the market is local or foreign.
  - In cases where the financial statements are not formally submitted to the Securities Commission or any other regulatory authority for the purpose of issuing a class of securities in a public market.
  - If the parent company (the holding company) discloses consolidated financial statements to the public in compliance with international standards.
  - Post-employment benefit plans and long-term employee benefit plans under IAS19.

The investment company does not need to present its consolidated financial statements if it is required to measure all of its subsidiaries at fair value through profit or loss under IFRS9, but if the investment company owns a subsidiary and provides services related to investment activities, it must consolidate those subsidiaries in accordance with IFRS 9. This standard applies the IFRS3 requirements to the acquisition of one of these subsidiaries.

6.2. Consolidated disclosure requirements

Consolidation procedures and disclosures are the accounting requirements for the preparation of financial statements, based on IFRS 10 and IFRS 12; Disclosure is defined as the procedure of presenting financial information, whether it is quantitative or descriptive, within the financial statements, reports, notes, and supplementary schedules, in a punctual manner, rendering the financial statements pertinent to authorized external stakeholders.

Disclosure methods and general information requirements that may guide the effectiveness of information contained in financial reports.

Disclosure is also regarded as a mechanism through which a company engages in communication with the external environment, leading to the inclusion of transparent and reliable information in the financial reports. The company commits to delivering this information on a regular basis

In accordance with IFRS12, the disclosure requirements in the consolidated financial statements can be summarised as follows:

- The company shall disclose information about significant assumptions and judgements when it has, for example, control of another subsidiary or when, for example, the parent company determines that it is an investment company, it shall also disclose information about the significant judgements and assumptions made Investment company ...
- In situations where the financial statements of the parent company period differs from that of its subsidiaries, the company shall disclose the year-end date of the subsidiaries and the reasons why a different date was used in preparing the consolidated financial statements.
- The parent company must disclose to the parent company all its subsidiaries with non-controlling interests of substantial value, e.g. the subsidiary's shares and principal place of business, and the percentage of voting rights held by the non-controlling interests.
- An investment company that is required to apply the exception to consolidation and exercise its investment in the subsidiary at fair value through profit or loss should disclose this.
- Disclose the nature and extent of any material restrictions on the subsidiary's ability to transfer funds to the parent in the form of cash dividends or to repay borrowings or debt.

7. Results and suggestions

The present section exhibits the main results attained from the undertaken research. In addition to that, it provides some suggestions that may help gaining the ultimate objectives so awaited.

- ✓ The need for scientific and practical training to bring the financial accounting system in line with international accounting standards.
- ✓ The need to review legal texts to ensure compatibility and consistency between the financial accounting system, commercial law and tax law.
- ✓ The need to make Algerian companies aware of the culture of disclosure of financial information and to provide it explicitly to its users.
- ✓ The need to clarify to Algerian companies how to prepare consolidated financial statements in accordance with the presentation and disclosure requirements of international accounting standards.
- ✓ The need to activate the tax system of Algerian companies in order to meet the needs of the national economy.
- ✓ The modification of the conceptual framework of the CFS has become paramount while building on the work of the IASB in order to follow and maintain the requirements of the period.
- ✓ Increasing the efforts of the National Accounting Board in upgrading the FAS so that it can respond to and meet the changing specificities of corporate transactions.
- ✓ Homogenisation between accounting principles and tax requirements through the will of all economic actors in Algeria.
- ✓ The contribution of academics remains necessary insofar as they are required to improve the work of the CNC based on the results of their research.

8. Conclusion

The adoption of a universal practice is a necessity imposed by the economic environment which is in full of mutation these last years. As far as Algeria is concerned, the application of the FAS constitutes a revolution in the accounting culture of companies in general and corporate groups in particular.

According to international accounting standards, the objective of the preparers of financial statements is to communicate relevant and reliable information in order to allow investors to estimate the value and the exact financial situation of the firm. This will only happen if certain criteria are met, which were considered to be the major challenges facing these preparers of consolidated financial statements.

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