T.C.
UNIVERSITY OF GAZİANTEP
GRADUATE SCHOOL OF SOCIAL SCIENCES
DEPARTMENT OF BUSINESS ADMINISTRATION

CONSOLIDATED FINANCIAL STATEMENTS AND AUDITING: PREPARATION AND FINANCIAL ANALYSIS

MASTER OF SCIENCE THESIS

SHAYMAA FARSAT NAJEM

GAZİANTEP
FEBRUARY 2018

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GAZİANTEP ÜNİVERSİTESİ
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Konsolide Finansal Tablolar Ve Denetim: Hazırlık Ve Finansal Analiz

Shaymaa Farsat NAJEM

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Bu tez tarafımızca okunmuş, kapsamı ve niteliği açısından bir Yüksek Lisans tezi olarak kabul edilmiştir.

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Bu tez tarafımızca okunmuş, kapsam ve niteliği açısından bir Yüksek Lisans tezi olarak kabul edilmiştir.

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ETHICAL DECLARATION

I the following the statements to be correct for the thesis study that I prepared according to University of Gaziantep, Graduate School of Social Sciences, Department of Business Administration Thesis Guidelines;

- I have obtained the data, information and documents I have given in the thesis under the academic and ethical rules,
- I have presented all information, documents, evaluations and results in accordance with scientific ethics,
- I have cited the resources that I have used for this study,
- I haven’t changed the data used in this study,
- The study presented in this thesis is unique.

I hereby declare that I accept all consequences which may arise in case otherwise.

Shaymaa Farsat NAJEM

26.02.2018

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ABSTRACT

CONSOLIDATED FINANCIAL STATEMENTS AND AUDITING: PREPARATION AND FINANCIAL ANALYSIS

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This century is characterized by the liberation of economies from the political, social and economic restrictions. The rapid advent of the economic complexes throughout the world necessitated on accounting, just like most other fields, to cope with the swift shifts. The existence of large complexes and their subsidiaries throughout the world and the needs for close monitoring leads makes resorting to consolidation a necessity. Consolidated financial statements (CFS) and auditing, preparation in addition to financial analysis for (CFC) are investigated in this study. CFS are the financial statements of a 'group' presented as those of a single enterprise, where a 'group' refers to a parent structure and all its subsidiaries. A group of companies that are legally independent but economically interconnected and is under the supervision of the parent company. Consolidation is an accounting and technical procedure that aims to provide a more comprehensive view of the financial status of the complex that expresses economic transactions? taxation, financial and social processes. Consolidation is based on a set of techniques controlled by international accounting standards. CFS is also based on domestic regulations in addition to the fundamental accounting conceptions of consolidation. Auditing the consolidated financial statements is not different from that of the individual statements, however it possesses some peculiarities in order to cope with the nature of the consolidated financial statements. As a conclusion, the major strengths of the financial analysis of CFS for Coca-Cola Company (C.C.C.), can be observed as; favorable economic and industry outlook; geographically well-positioned firm to allow for benefitting from the anticipated economic and industrial growth; aggressive marketing and expansion strategies; successful use of financial leverage and solid coverage of debt service requirements; effective control of operating costs ; increased profitability, and positive generation of cash flow from operations. Nevertheless, the weaknesses of C.C.C. were identified as: recent deterioration in management of receivable accounts and inventories, highly sensitive to economic fluctuations and weather conditions.

Key words: Consolidated Financial Statements, Auditing, Financial Analysis

ÖZET

KONSOLİDE FİNANSAL TABLOLAR VE DENETİM: HAZIRLIK VE FİNANSAL ANALİZ

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Yeni yüzyıl, ekonomilerin politik, sosyal ve ekonomik kısıtlamalardan kurtuluşu ile karakterize edilmektedir. Ekonomik komplekslerin dünyaya hızlı bir şekilde girişi, diğer birçok alanda olduğu gibi muhasebe işlemlerini de hızlı değişimlerle başa çıkmaya yöneltmiştir. Büyük çaplı komplekslerin ve bunların yan kuruluşlarının dünyadaki varlığı ve bunu izlemeye yönelik ihtiyaç konsolidasyon için büyük önem arz etmektedir. Bu çalışmada, konsolide finansal tablolar (CFS) ve finansal analiz (CFC) için hazırlanan denetimler incelenmiştir. CFS, bir "grup" un bir ana şirketin finansal tablolarından oluştuğu ve bu "grup" un bir ana ortaklığa ve tüm bağlı ortaklıklarına atıfta bulunduğu anlamına gelmektedir. Söz konusu grup şirketler, ana şirketin gözetiminde, yasal olarak ayrı olmalarına ragmen ekonomik anlamda birbirlerine bağlıdırlar. Konsolidasyon, ekonomik, vergi, mali ve sosyal süreçleri ifade eden kompleksin mali durumu hakkında daha kapsamlı bir imaj vermeyi amaçlayan muhasebe ile ilgili teknik olgudur. Konsolidasyon, uluslararası muhasebe standartları tarafından kontrol edilen bir dizi tekniğe dayanmaktadır. Ayrıca, konsolidasyon temel muhasebe kavramlarına ek olarak iç düzenlemelere de dayanmaktadır. Konsolide finansal tabloların denetimi, bireysel finansal tablolardan farklı değildir, konsolide finansal tabloların niteliğine göre bazı özel niteliklere sahiptir. Coca-Cola Company (C.C.C.) için CFS'nin mali analizinden elde edilen en önemli sonuçlar; olumlu ekonomik ve sanayi görünümü; beklenen ekonomik ve endüstriyel büyümeden yararlanmak için coğrafi olarak iyi konumlandırılmış firma; agresif pazarlama ve genişleme stratejileri; finansal kaldıraçın başarılı bir şekilde kullanılması ve borç ödeme gereksinimlerinin sağlam bir şekilde kapsanması; işletme maliyetlerinin etkin kontrolü; karlılığın artırılması ve operasyonlardan olumlu bir nakit akışı sağlanması. Olarak sıralanabilir. Ancak son zamanlarda C.C.C'nin zayıflığı ile ilgili olarak, bozulan alacak hesapları ve stok yönetimi, ekonomik dalgalanmalara ve hava koşullarına karşı oldukça hassaslaşmış yapısı ile az da olsa bozulan envanter ve alacakların yönetimi konuları ön plana çıkmaktadır.

Anahtar Kelimeler: Konsolide Finansal Tablolar, Denetim, Finansal Analiz

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LIST OF ABBREVIATIONS

CFSs: Consolidated Financial Statements

IAS: International Accounting Standards

IFRS: International Financial Reporting Standards

ISA: International Standards of Auditing

IASC: International Accounting Standards Committee

IFAC: International Federation of Accountants

IASB: International Accounting Standards Board

IASCF: International Accounting Standards Committee Foundation

IFRIC: International Financial Reporting Interpretations Committee

SIC: Standing Interpretations Committee

KGK: Kamu Gözetimi, Muhasebe ve Denetim Standartları Kurumu

TFRS: The Turkish Financial Reporting Standards

GAAP: Generally Accepted Accounting Principles

AICPA: American Institute of Certified Public Accountants

SAC: Standards Advisory Council

FAF: Financial Accounting Foundation

GASB: Governmental Accounting Standards Board

FASAC: Financial Accounting Standards Advisory Council.

GASB: Governmental Accounting Standards Board.

GASAC: Governmental Accounting Standards Advisory Council.

IAASB: The International Auditing and Assurance Standards Board

GAAS: Generally Accepted Auditing Standards

ACPA: American Society of Certified Public Accountants

SQCS: Statement on Quality Control Standards

IESBA: International Ethics Standards Board for Accountants

IAPN: International Auditing Practice Notes

ISRE: International Standards on Review Engagements

ISAE: International Standards on Assurance Engagements

ISRS: International Standard on Related Services

IESBA: International Ethics Standards Board for Accountants

NPM: Net profit margin

TAT: Total asset turnover

ROI: Return on investment

FL: Financial leverage

ROE: Return on equity

CHAPTER ONE
INTRODUCTION

1.1. INTRODUCTION

This new century is characterized by the liberation of economies from the political, social and economic restrictions. Such developments encouraged the emergence and grouping of economic institutions in multiple forms in order to gain more competitive advantage crossing over territorial borders. The existence of these complexes or their subsidiaries all over the globe is seen as a realization of globalization with all its diverse dimensions.

The rapid advent of such economic complexes throughout the world pushed accounting, like most other fields, to cope with the swift shifts. Therefore, accounting exceeded traditional simple mechanisms and it is now based on an integrated philosophy and profound logic. So, accounting has regained its lost legitimacy and maintained its traditional function regarding the daily recording of economic transactions which evolved gradually to become an active indispensable communication tool.

International auditing standards aim at establishing a unified language for all firms without taking into account their geographical locations. Thus, accounting is not confined to recording transactions, and monetary flows; it regularly assesses the overall performance of the firm.

Such considerable developments in the concepts of institutions and their conglomeration and development in accounting concepts encouraged establishing proficient auditing tools since economic life nowadays require more controlling entities that are highly effective and credible which ensure the formulation of high-quality and credible FSs for these firms.

The FSs, whether consolidated or individual, should go through assessment for their performance to identify the strengths and weaknesses. The performance assessment is done through certain techniques of financial analysis. These techniques can be used for both individual and CFSs because they are treated as one single entity after consolidation.

In this respect, Iraq like most other nations tried to make a balance between attracting and encouraging investments and protecting its establishments and economy. The same thing is true for Turkey which strives to join the European Union.

The existence of a large complexes and their subsidiaries throughout the world and the needs for monitoring it leads for the following problem:

Helps several FSs are consolidated for different firms to form one financial statement? How it is audited? How it is assessed and financially analyzed?

To approach this problem, the following secondary questions may be raised:

- What is capital consolidation? Its types and benefits?
- What are complexes? What is consolidation? What is its importance? What are its techniques of financial analysis?
- Do CFSs express the reality about the fortune of all firms that are subject to consolidation?
- How FSs are analyzed, and what is the importance of the techniques utilized in the analysis?
- What is auditing? What is its significance? What are its objectives and types?
- Was is the international perspective of auditing? What are the international standards of auditing and the institutions that issue them?
- How CFSs are audited?
- How the financial analysis is done for consolidates FSs? What are the characteristics of the validity of invalidity of the CFSs that optimize their shares for purchasing or for investment by investors and businessmen?

To answer the above questions, the following hypotheses are put forward:

- There are complex techniques for consolidating FSs.

- There are economic, legal and admin strata of the relationship between different subsidiaries of the complexes on the one hand, and between the parent institution and the subsidiaries on the other hand.
- CFSs aims at accurately expressing their real fortune and the real financial status for all subsidiary firms that constitute the complex.
- The sound financial analysis for the CFSs aims at highlighting clear image about the financial status for the company from all aspects and providing it to owners and investors.
- The techniques of financial analysis attempt to highlight of the strengths.

The current topic has been selected for the following reasons:

- Scarce literature in Iraq and the foreign libraries on this topic.
- Growing need for this research due to the increased complexes on the national and international levels.
- Declined in the control over the techniques and mechanisms of consolidation.
- The complicity of consolidation techniques.
- Inadequate to knowledge about auditing complexes.
- Personal motivation for the researcher to better understand this topic.
- Lack of research that combines the three concepts of consolidation, auditing and techniques of financial analysis.

The current research has the following objectives:

- Highlighting all transactions relevant to auditing, consolidation, and financial analysis.
- Explaining general procedure is adopted to in consolidation and financial analysis.
- Setting a group of rules to control auditing, consolidation, and analysis.
- Defining the old techniques used in consolidation.
- Giving an idea about all institution relevant to the research.
- Highlighting some techniques of the financial analysis used in consolidated the FSs.

- Explaining the proper way to identify the validity/ invalidity of offered shares in the international stock markets of investment path for any holding (parent) company.
- Urging the conducting of research about complexes and consolidation as accounting concepts with economic dimensions.

The significance of the research lies basically in highlighting all aspects relevant to complexes whether theoretical or technical and presenting the three concepts of CFSs, their auditing and financial analysis together which enables the investor the techniques that determine the financial status for any company and its performance with through the financial analysis of the FSs whether individual or consolidated. Readers can also use this research as a reference.

Spatial limitations: this research is focused on the financial analysis for a specimen from the holding company of Coca-Cola. This study will investigate the adopted international standards in auditing and accounting concerning consolidation procedures on the international level. Then, in theoretical study of the financial analysis is implemented on real conditions.

Time limitations: in the theoretical part of the study, the history and development of the auditing and consolidation have been thoroughly presented.

The descriptive method has been adopted in some parts of the research that deal with the background of auditing and consolidation. Whereas the analytical descriptive method was used to in some other parts to give accurate descriptions for some phenomena under investigation without interfering or influencing them. While the historic method was utilized when talking about the development of consolidation and auditing as well as the history of establishing the company of Coca-Cola which served as the specimen of the financial analysis of the research

The study comprises three chapters and conclusions. **Chapter One** mentioned the general introduction. **Chapter Two** presented some previous studies about the notion of consolidated of FSs in addition to institutional framework. The institutional framework is focused on the paths, types, systems and stages of consolidation, also referred to procedures adopted in the auditing process under international auditing standards for the financial statements. Approached the audit of consolidation FSs from an auditing perspective is investigated in chapter two. The final part in this chapter is treated shared-size financial data and the main financial ratios as techniques used by the analysts of financial data whether these data were individual or consolidated. **Chapter Three** was devoted to presenting the specimen of the study that went through financial analysis and ended up with discussing its outcomes. Finally, **Conclusions** put forward the main findings and conclusions concerning the consolidation of FSs and auditing in addition to financial analysis.

CHAPTER TWO

LITERATURE REVIEW AND INSTITUTIONAL FRAMEWORK

2.1. LITERATURE REVIEW

The motivations of a group, seen as single complex economic unit, are to achieve more efficient operating procedures and to improve management information systems, through exploiting specialization, diversification and integration of production processes. A group structure also permits the reduction of business risks.

By reviewing the literature on this thesis topic, it can be found research's related to the origin of thesis topic, namely the consolidation of the FSs.

Stolowy et *al*., for instance, tried to explain key parts of the IASB standards for consolidating FSs. The relation between the parent company and the other companies in the group is the key issue of the way the individual FSs is taken into account in the consolidation process to create the group FSs. There are three types of relations between parent company and others companies in the group: control, joint control and significant influence. Depending of the type of relation, the group companies will be classified as subsidiaries (control), joint ventures or associates (Stolowy, 2013).

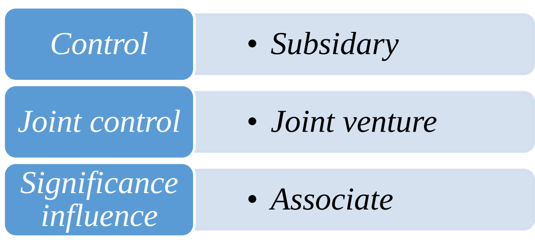


Figure 2.1 Types of control and group companies (Stolowy, 2013)

To improve accounting treatment for group's structures and to integrate all companies of a group that are subject to consolidation into CFSs, the IASB has issued a collection of standards for group accounting for subsidiaries, joint ventures and

associates. These standards are IFRS 10, IFRS 11, IFRS 12, IAS 27 (rev. 2011) and IAS 28 (rev. 2011) which are mandatory and applicable to January 2013 onwards. All these standards supersede the old group accounting standards IAS 27, 28 and 31 (Krimpmann, 2015).

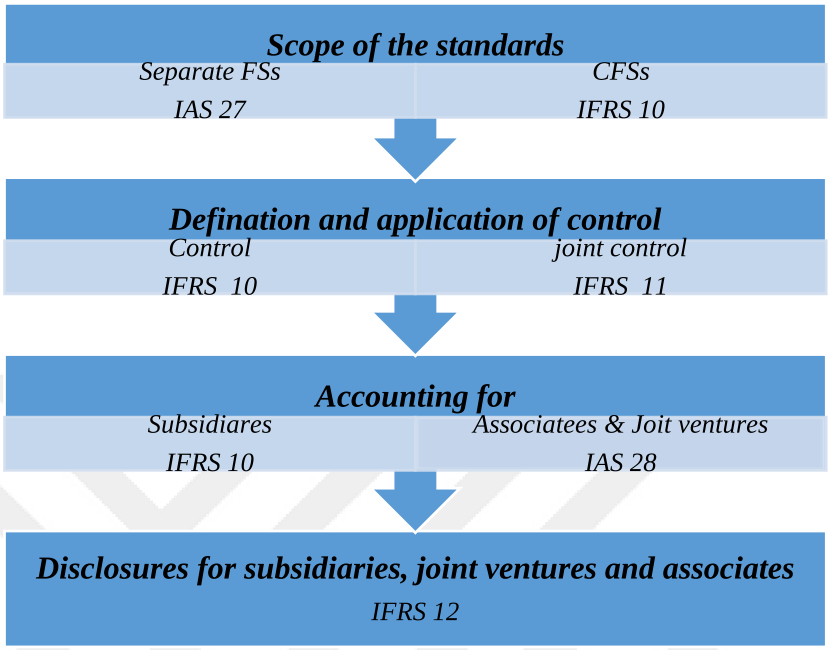


Figure 2.2. The group accounting standards (Krimpmann, 2015)

It is clear that after the explanation of IFRS 10 the new standard IAS 27 “Separate FSs” deals with the accounting to be invested in subsidiaries, jointly the entities that are controlled , and associates when an entity is decided or even required by regulations that are local, to present separate (non-consolidated) FSs (Mihai, 2015)

Until 1980s, it was largely analytical instead of empirical, namely, research in the accounting field. In the middle of various topics that adopted by the experts that it was the history of ideas focusing on preparing consolidated statements. Walker approaches consolidation accounting from a point that is global of view, connecting to the emerge of statements that are consolidated with the development that is industrial in different countries like UK ,us , Australia, Canada and several of European ones . It was noticed about the circumstances that indicates to the first use of statements that are consolidated which were from various countries. For example, they started to consolidate the accounts the reason is attracting funds that are modern, namely, American companies (e.g. United States Steel Corporation, 1902). The

Focus on the experience of American and British, Walker displays that accountants had opinions that are different according to the purpose of statements consolidated. The aim of CFSs, in the United Kingdom, was reflecting the position and earnings of a holding company group, viewed not as a series of separate entities but as a unit that describes as economic , Robson (Robson, 1936)**.** Meanwhile, using statements that are consolidated at the first of 1900s in US shows that they were substituting the reports of parent company, studied not important to introduce group's performance and position (Walker, 1978).

Concerning the purpose of consolidated statements, several theories were developed and taken into consideration by academics and practitioners of the field. The rationale behind using these theories was discussed by several researchers and different points of view were stated.

When the literature related to CFSs is deeply examined, certain aspects regarding the theories of CFSs may be noticed. Nistor used the descriptive approach and he suggests a theory of each ones has aspects that are certain which are different from others in terms of recognition of subsidiary income and reporting net assets of the subsidiary. Anyway, the theory that is entity takes into account many significant guidelines when preparing CFSs: "You can't own yourself!", "You can't owe yourself money!", and "You can't make money selling to yourself" (Nistor, 2015). Mihai & Radu investigated accounting treatment for individual and CFSs. They explained the key components of the IASB standards for consolidation of FSs. They found the presence of agency relationships, silos and investment companies could change the inspection reports and, therefore, the composition of the Group compared to the previous years the entry into force IFRS standards 10. Consistent with this possible change, must also be modified preparation of consolidated accounts, to make it up to date with the group dynamics. IFRS 10 makes no changes to the entire IAS 27: its provisions remain unchanged in respect of the exemption and obligations of presentation of the consolidated financial statement and the consolidation procedures (Mihai & Radu, 2015). Kucher & Кучер deal with the preparation and submission of the CFSs of countries that have different systems of accounting standardization in order to identify the areas of accounting improvement for the process of consolidating financial reporting indicators. The main problems of CFSs preparation by business entities were found in Ukraine. Also determines the theoretical and practical problems of consolidation of FSs of organizational and methodical character. The comparative analysis of the features of standardization process of FSs consolidation is carried out worldwide. The main differences in the requirements for the formation of CFSs indicators of such countries like France, Germany, Belarus and China are outlined. The main directions of research on improving the accounting and analytical support for the preparation of CFSs are formed (Kucher, 2016).

Some contributions that are relevant to the literature on the CFSs in the sector that is public were by some authors brought like Grossi & Pepe who to underline the reasons behind the emergence of consolidated reports in the public sector, they tried, the traits of consolidation, and making between principles and standards that are accounting a comparison that used for the preparation of CFSs in the sector that is public in countries about seven (Grossi, 2008). Walker dealt with the advantages of implementing the CFSs in the sector that is public from a theoretical perspective and highlighted the practices of CFSs in the sector that is public (especially in Australia), (Walker R. , 2009). By identifying the obstacles that took place in Australia before, he tackled these problems when he indicates to the decisions that can be applied in circumstances that are routine by the users of these reports (Walker R. G., 2011). It was examined by Wise the modern literature that has a relation with the antecedents to sector that is public accountability performance by introducing a new variable, namely preparer-commanders' opinions about the usefulness of whole of government consolidated reporting that is financial and finding a solution for problems if the information of consolidated financial is beneficial for government resource allocation decisions, not only for purposes of decision-making (Wise, 2010).

Christiaens & Cauwenberge tested the full government accounting framework as improved by IPSAS, by finding a solution to the following questions: What are the results of applying IPSAS as a framework that is conceptual for full government accounts? What type of information that are accounting will give from the application of IPSAS concept? (Christiaens, 2008)**.** Grossi made many tests for the impact on the consolidated financial reporting accounting and reporting system of government that is Italian and studied CFR that is a stimulus that is possible for the full implementation of accrual accounting and reporting (Grossi G. , 2008) &

(Grossi, G., 2009). Grossi identified the most problems, obstacles that are common to CFSs implementation at the level that is local:

- lack of homogeneity of the accounting of local administrations and municipal companies;
- lack of expertise and know-how (insufficient knowledge about the consolidated reports);
- lack of staff;
- no obligation to completion;
- difficulties in obtaining necessary data and documents over time;
- limited transparency of annual reports of the local government; and
- lack of appropriate software.

It was studied by Bergmann & Bietenhader the situation that is modern in Switzerland according to the consolidated financial reporting in sector that is public (the differences in practice and views on the consolidation introduction). For not presenting, among the reasons such these cases, they said: the lack pressure that is interest or political; the high costs of implementation; the lack of legal obligations; and technical problems (Bergmann, 2008). Tagesson make an argument about consolidated reporting that is a want in the sector that is public as a whole, but also for administrations that are local, and at the same time, he holds the opinion for consolidation that is proportionate according to the method of acquisition (Tagesson, 2008)**.** Cîrstea tested the need for sector that is public of CFSs in paper that is theoretical. He strongly holds the opinion of significant of the introduction and presentation of CFSs by sector that is public entities and reveals the link in the middle of those types of reports that prepared by entities from sector that is private and public. The essential conclusion of the paper that is conceptual, is sector that is public entities that should prepare these reports that are consolidated and the regulators and governments play a significant role by introducing and taking these practices into the sector that is public. So, there can be no excellence in accounting without excellence in reporting or vice versa as he thought (Cîrstea, 2014).It is presented in the literature, accounting convergence process, that observes the issue of convergence that is particular between United States GAAP and international accounting referentials represented by IAS/IFRS, specifically, the issue of assimilation of the two systems that are accounting through a stepwise process, that aims at establishing a set of accounting and reporting that is financial accepted standards and utilized by all markets of existing capital participants globally. The interaction between the international accounting referential that concentrated, issued by the IASB (IAS/IFRS) as well as U.S accounting referential and improved by FASB (U.S GAAP) that can be illustrated throughout a lot of papers (Choi, 2002) & (Zeff, 2007).

Besides, there are various studies that want to measure the harmonization that is accounting and some of them were conducted on two pillars that are different: the first one is studies on material (de facto) harmonization that concentrated on practice that is accounting and the second one is studies on formal (de jure) that concentrated on standards harmonization that is accounting (Van der Tas, 1988) & (Tay, 1990). They concluded after using these methods that the studies are arranged a cording to two categories, one of them is studies presenting research methods depends on statistics that are descriptive, in terms of the analysis shares to determine the percentage in the sample analyzed for criteria of certain selection that were studied ; and the second one contains tests that having analysis that is developed depends on correlation and/or association of the elements considered. In this category, the research studies were found by them by using various methods based on the distant concept, namely: Mahalanobis the Method of Distance in 1996 they used. The study of Rahman et al. (Rahman, 1994)and by Garrido et al., Euclidean Distances was used (Garrido, 2002) and by Fontes et al. (Fontes, 2005) and tests them by using coefficients (indicators) of correlation: Spearman Rank correlation coefficient Fontes et al. (Fontes, 2005) and Pearson Correlation coefficient Ding et al. (Ding, 2007), and the respective coefficients (indicators) of the association: Jaccard's Coefficients Fontes et al. (Fontes, 2005). Cîrstea & Baltariu (Cîrstea A. &., 2014) made many tests to concentrate on a issue that is specific, namely the formal accounting harmonization between IFRS and the regulations of U.S GAAP regarding CFSs. The research methodology which they utilized to attain their objective was based on some statistical tools, like association coefficients or correlation. It was revealed in the result that IFRS includes substantially converged with the U.S GAAP, at least in the area of consolidated reporting that is financial, but it exist some of the differences between them ,namely , the referentials.

2.2. INSTITUTIONAL FRAMEWORK

2.2.1. Consolidated Financial Statements (CFSs)

Financial reporting aims principally at providing data needed for investment and lending judgments. Similarly, the reason behind developing and submitting FSs is to offer data concerning the organization's financial condition, financial functioning and cash flows.

CFSs share the same reason; however, they are developed so that they can offer thorough financial information about a BC alongside its subsidiaries as a whole. Meanwhile FSs are developed only for one organization. Moreover, disclosure of FSs is a legal commitment, but arranging CFS for a BC is only an economic necessity.

BCs are made up of at least two entities with each entity has its individual FSs. However, their individual FSs cannot offer financial information needed by a BC and all its subsidiaries as one economic organization. Nevertheless, CFSs can offer such information through uniting individual FSs of each firm on a line-by-line basis.

CFSs are defined in IFRS 10 as "the FSs of a set in which the, equity ,liabilities, assets ,income, expenses as well as cash flows of the parent and its subsidiaries were given like these of an entity of the single economic" (iasplus, 2017).

Yet, so that the concept can be understood obviously, the following questions should be answered; what are the criteria of developing CFSs? What is shared between FSs and CFSs? Why CFSs are an economic requirement? Are there any drawbacks of CFSs? What are the rules adopted for developing CFSs?

The principle that is basic of preparing CFSs is in direct manner having a relation with the power of control of a subsidiary by a company that is parent. The participation towards an entity is impossible to be entire reason to prepare CFSs. It has to be continuous in addition has to cease with the relationship of parent-subsidiary. The relationship of Parent-subsidiary shortly stands for parent that has the power to control the policies that are financial and operating of the subsidiary**.**

“As amended in 2011 “IAS 27 *Separate FSs* put outlines about the requirements of accounting and disclosure for what so called the 'separate FSs', that can be FSs that prepared by an investor in a venture that is joint, where these investments are responsible to either in accordance with IAS 39 Instruments Financial or at cost: Measurement and Recognition or IFRS 9 Instruments that are Financial. It was outlined by the standard the requirements that are accounting for dividends and contains the requirements of numerous disclosure. It was outlined by IFRS 10 *CFSs* the requirements for presentation and the preparation of CFSs, needing entities the reason is by consolidating entities it controls. In this case, the Control needs exposure to many returns and the capacity to affect the returns throughout the power over an investee (iasplus, 2017).

In the consolidation process we need to consider both IAS 27 *Separate FSs* & IFRS 10 *CFSs* together in the CFS preparation.

CFSs include a consolidated balance sheet; a consolidated income statement; a consolidated retained earnings statement, or consolidated statement of changes in stockholders’ equity; and a consolidated statement of cash flows (Beams, . Advanced accounting. , 2012).

Anyway, the CFS has various manner, too. The solution to these questions should be as the following; the question is what are the tools for creating CFS and to whom we can give? What are the similarities as well as differences between them, namely, CFS and FSs? Why are CFS necessity that is economic? Do we have traits of CFSs? What are the manners for preparing CFS and do we have any arrangements has a relation to them?

The meaning of Parent is that, an entity which direct the entities that are one or more, and Power is rights that are existing and present the capacity that is modern to direct the activities that are relevant.

The terms of “Control of an investee”: It is an investor that organizes an investee when the investor can be without covering, towards a lot of or various returns from its involvement with the investee and it contains the capacity to affect these returns throughout its power above it.

CFSs should be developed and submitted on a line-by-line basis. Meanwhile consolidating the balance sheets, income statements and cash flow statements of the parent company as well as majority of owned subsidiaries, the assets, liabilities, revenues and expenses of all subsidiaries are placed on the parent’s account. For example, cash balance of the subsidiary is placed under the cash balance of the parent and the total sum is transferred to the parent’s balance sheet (Horngren, 2005).

CFSs share certain points with separate FSs since they both aim at offering a thorough financial data to concerned sides. While separate FSs are developed only for one organization but CFSs for at least two organizations.

FSs only reveal the financial condition of each combined organization and they do not reveal the overall financial condition of the combination. Accordingly, once FSs of all combined companies are consolidated, financial information regarding the BC and all its subsidiaries as a whole is offered; that is why CFSs are seen as an economic requirement.

CFSs are an economic requirement for both shareholders and creditors of the parent company. Shareholders need to know their profits or losses, while suppliers, banks, and other lenders need to recognize whether a business is creditworthy or if they can retake their capitals on time. Managers too want CFSs as a base for total control and evaluation of functioning. Similarly, FSs are needed to know the functioning of firm managers and to assess their success. Finally, financial investors or disposal owners may need to know about the firm’s financial condition and functioning outcomes (Bovee, Business Today, 2001).

2.2.1.1 A background about the organizations that issue IAS and IFRS

IASs have been issued because organized, uniform arrangements are needed in accounting and to reveal the FSs. Such standards are enacted to demonstrate how given activities should be echoed in FSs (http://www.ifrs.org/, 2017).

The Committee of International Accounting Standards that stands for (IASC) was created in 1973 throughout a conset hold by bodies of professional accountancy in , Mexico, Canada, Germany, France, , Japan, , the Netherlands, u.s and , UK and Ireland. In subsequent years, the members of additional sponsoring were added, and in 1982 the sponsoring "members" of the IASC creating the whole bodies of professional accountancy that were members of the Federation that is

International of Accountants (IFAC). In 1973 until a comprehensive reorganization in 2000, from its formation, the building to set Standards of International Accounting was famous for the Committee of International Accounting Standards that stands for (IASC) (iasplus, 2017).

Next of 25 years of achievement, the foundation that stands for IASC sum up in 1997 that to go ahead to carry out in effective manner its role, it is essential to find out a manner to cause a convergence in the middle of standards of national accounting and practices and standards of high-quality global accounting. By doing that, it has seen a need to change its building. It was formed by IASC in late 1997 a Strategy Working Party to examine again its strategy and structure. The following names were from this group (Deloitte Touche Tohmatsu Global Managing Partner-Strategic Clients, Jacques Manardo (iasplus, 2017).

It was approved by IASC Board that the suggestions by agreeing the all in December 1999, and the bodies of IASC member made similar in May 2000. A new Constitution of IASB made influence begin from 1 July 2000. The body of standards-setting was given another name: (IASB) that stands for the International Accounting Standards Board. It can be operated under a modern IASCF that stands for International Accounting Standards Committee Foundation but to keep in our minds that it becomes the IFRS Foundation) (iasplus, 2017).

Accordingly, from 1 April 2001, the work of standards-setting of the Foundation of IFRS has been carried out by the Board of International Accounting Standards (IASB). The Committee of IFRS Interpretations improves and solicits comment on guidance that is interpretive for applying Standards declared by it, but the IASB has to acknowledge the explanations that improved by IFRIC (iasplus, 2017).

With the restructuring, together, the strategy of the standards had to be renovated as well as IFRSs were made.

The standards, which IASB set out, stands for IFRSs. The reason is that IAS 1 Presentation of FSs IFRSs contain; IASs; IFRSs and Interpretations created by the Committee of International Financial Reporting Interpretations that stands for (IFRIC) in other words, (SIC). That stands for the former Standing Interpretations Committee

The abbreviation “(IFRSs) “that stands for 'International Financial Reporting Standards' has abroad as well as narrow meaning.

IFRSs stands for new series that are numbered of pronouncements that the IASB is issuing, as recognize according to the International Accounting Standards (IASs) series that issued by predecessor of it.

IFRSs, more broadly, stands for full body of IASB pronouncements, having interpretations and standards agreed by IASs and the IASB and SIC interpretations agreed by the Committee of predecessor International Accounting Standards (iasplus, 2017).

In Turkey, Turkish Accounting Standards Board issues Turkish Accounting Standards (TAS) according to ISs. TASs which gained a legal tender with a notice issued by Ministry of Finance, came into effect after December 31, 2005 and standards.

The “Muhasebe , Kamu Gözetimi ve Denetim Standartları Kurumu (KGK)” are putting the standards of accounting in Turkey. The (TFRSs) that stands for “Turkish Financial Reporting Standards” has entire compliance with IFRS.The standards that are new and amended are permanent and accepted by publishing in the O.F that stands for Official Gazette. They are regarded as "public interest companies" namely, all companies, and they are needed by utilizing TFRSs in their FSs. Their number, I mean the companies, is increased since 2005 (iasplus, 2017).

2.2.2. Arrangements concerned with CFSs

IAS 27 “Consolidated and Separate FSs” were again issued in 2008 in January in addition it is applied to periods that are annual starting after the first of July 2009, in addition to that it is replaced by IAS 27 Separate FSs and IFRS 10 CFSs with effect from periods that are annual starting after the first of January 2013. IFRS 10 CFSs and IFRS 3 BCs are currently the main standards, which directly organize CFSs.

2.2.2.1. Summary of IFRS 10 CFSs

Reporting of consolidated accounts is the main subject of IFRS 10 “CFSs” which was issued in May 2011 and applies to annual periods beginning on or after 1 January 2013 (iasplus, 2017).

IFRS 10 aim at establishing principles for presenting and developing CFSs when organization controls one or more other organizations. [IFRS 10:1].

The Standard: [IFRS 10:1];

- The parent organization should reveal CFSs,
- determines controlling principles, and sets control as a basis for consolidation,
- determines how to apply such principle to know whether an investor controls an investee and therefore must consolidate the investee,
- sets accounting conditions for developing CFSs,
- defines an investment entity and regulates an exception to consolidating certain subsidiaries of an investment organization (iasplus, 2017).

2.2.2.1.1. Presentation of CFSs

Referring to IFRS 10:19, the parent company develops CFSs through consistent accounting guidelines for transactions and other events. Nevertheless, the parent company need not to reveal CFSs once all these requirements are met: [IFRS 10:4(a)]

- if the subsidiary is totally or partially-owned of another organization and its other owners, including those who do not the right of voting, have been told about, and do not object to, the parent company not revealing CFSs,
- its debt or equity tools are not dealt in an open market (an internal or external stock exchange or an over-the-counter market),
- it did not file, nor is filing, its FSs with a securities commission or other regulatory organizations in order to issue any class of tools in an open market, and
- its eventual or any transitional parent of the parent produces FSs available for public use according to IFRSs, in which subsidiaries are consolidated or

are measured at fair value via profit or loss according to IFRS 10 (iasplus, 2017).

In order to clarify such a case it would be better to give an example. Assume that the structure of entities X, Y, Z, K and L is illustrated as follows:

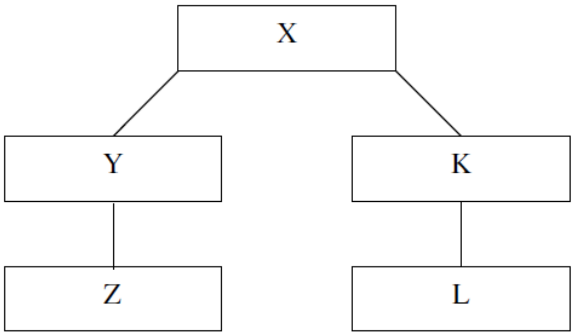


Figure 2.3 Structure of a wholly owned and partially owned subsidiary

The X entity has about a 100% of the interest in K entity in addition to It has a 60% of interest in L entity. X entity has a 95% of the interest in Y entity and it has a 60% of the interest in Z entity.

To prepare CFSs, none of them is required, namely, the entity Y and K, X entity can make the statements. To prepare CFSs, Y is not required, the reason is a full subsidiary that is owned itself. Because K is a partially owned subsidiary, it is not required as well. It is sometimes interpreted by meaning 90% or more than that in IFRS 10 ,namely , Partially wholly owned subsidiary , and here X has 95% of the K that prepares it to be partially subsidiary that is owned.

IFRS 10 comprises particular accounting conditions for investment organization. If an organization fulfills the requirements of an 'investment entity', it does not consolidate its subsidiaries, or apply IFRS 3 BCs when it controls another organization. [IFRS 10:31]

An organization needs to study all facts and circumstances in order to evaluate whether it is an investment entity, including its objectives and structure. IFRS 10 necessitates that an investment entity must possess the following properties [IFRS 10:28]:

- more than an investment is included,
- more than an investor is included,

- The investors do not have a relation to the parties of the entity,
- In the form of equity , the ownership interests is included

Not having any of these properties does not automatically prohibit an organization from being ragged as an investment entity.

Investment entities need to measure an investment in a subsidiary at fair value through profits or losses according to IFRS 9 Financial Instruments or IAS 39 Financial Instruments: Recognition and Measurement. [IFRS 10:31]

Though, it needs to consolidate a subsidiary, namely, an investment entity where this subsidiary can give many helps which has a relation to the activities of investment entity. [IFRS 10:32]

To consolidate its subsidiaries, the investment entity is not required, so we cannot eliminate outstanding balances and the intragroup related party transactions [IAS 24.4, IAS 39.80].

The requirements that are Special will apply where an entity ceases being an investment entity. [IFRS 10:B100-B101] (iasplus, 2017).

From consolidation, the exemption is just to apply it to the same the investment entity. It is required to consolidate all entities that it controls, namely, a parent of an investment entity, containing these controlled throughout the subsidiary of investment entity, unless the same parent can be what so called “an investment entity”. [IFRS 10:33] (iasplus, 2017).

2.2.2.1.2. Consolidation Procedures According to IFRS 10

On a line-by-line basis, CFSs must be prepared to use accounting policies that are uniform for other events in similar circumstances as well as transactions.

CFSs: [IFRS 10:B86]

- With those of its subsidiaries , gathering the items of, expenses , liabilities, assets , equity, income, and cash flows of the parent .
- Eliminating the amount that is carrying of the parent's investment to every subsidiary in addition to the parent's portion of equity to every subsidiary (IFRS 3 BCs explains how to account for any related goodwill)

- Eliminating it in intragroup assets that are full and, equity, liabilities , expenses, income and cash flows that has a relation to transactions in the middle of entities of the group (losses or profits that producing from intragroup transactions that are seen in assets, such as fixed assets and inventory are left out as all) .

An organization incorporates that is reporting the expenses and income of a subsidiary in the CFSs from the date can be the controller so far to stop controlling the subsidiary. Expenses and income of the subsidiary depends on the amounts of the liabilities in addition to assets that reshuffled in the CFSs at the date that is acquisition [IFRS 10:B88].

They, parent and subsidiaries, require sharing the same reporting dates, or we can say the consolidation that depends on additional information that is financial arranged by subsidiary, if it is not practicable. They utilized recent FSs of the subsidiary, adjusted for the effects of transactions or events that are significant among the dates that are reporting of CFSs as well as the subsidiary. It can be found a difference among the CFSs exceed three months as well as the date of the subsidiary's FSs [IFRS 10:B92, IFRS 10:B93] (iasplus, 2017).

2.2.2.2. Summary of IFRS 3 BCs

22nd the Standard of International Accounting, BCs has went into force on 1 January 1995. That issue has been passed by 3rd the Standard of International Financial Reporting, it became effective, namely, BCs on 1 January 2005. IAS 22 has been passed by IFRS 3 BCs (2004), effectively, BCs for it the consent date is about after March, 31, 2004 (iasplus, 2017).

A version of IFRS 3 that is revised was given in 2008 in January in addition putting in applying to BCs occurring in an entity's first period that is annual that begun after 1 July 2009.

IFRS 3 (2008) has been sought to make the relevance enhanced, the information that is reliability and comparability supply about BCs (e.g. acquisitions and mergers) in addition to the influences. The principles have been set out on the measurement and recognition of assets and liabilities acquired, it is the determination of the necessary disclosures (iasplus, 2017).

Key definitions [IFRS 3, Appendix A]

Business combination: Other events on which obtains control that are acquirer of more businesses. It referred to as 'true mergers', namely, 'mergers of equals' that can be BCs they used the term [IFRS 3].

Business: A set of activities and assets that are integrated has the capacity to conduct and manage the purpose of supplying a return as the shape of dividends, costs that are lower or economic benefits that are different and to other owners, investors and even participants.

Acquisition date: On which, the date, obtains control that are acquirer for acquiree.

Acquirer: That obtains control of the acquiree is the entity.
Acquiree: The acquirer who obtains control of in a business combination is the businesses or even business (iasplus, 2017).

Method of accounting for BCs
Acquisition method

The method that is acquisition “it can be called the method that described as 'purchase ' version of IFRS 3 in the 2004) has been utilized for all BCs. [IFRS 3.4].

Steps in applying the acquisition method are: [IFRS 3.5]

1. The 'acquirer' has been Identified
2. The 'acquisition date' has been Determined
3. The identifiable assets acquired have been recognized measured towards the assumed liabilities and any interest that are non-controlling (NCI, formerly called minority interest) in the acquire
4. Measurement as well as recognition of goodwill or a gain from a bargain purchase.

More details on above steps can be seen in this reference (iasplus, 2017)

2.2.2.3. Foreign Currency Translation

A subsidiary or another unit within a consolidated group of companies (or within a company or an affiliated group of companies), such as a joint venture, a division, or a branch, may be a foreign operation, an operating unit that prepares foreign currency FSs. Before such statements can be included in domestic currency CFSs, they ordinarily have to be translated into the domestic currency used in the

CFSs, the currency of the parent company's country (Carmichael, D. R., Whittington, O. R., & Graham, L., 2007). IAS 21 explain how to account and translate FSs into a presentation currency (iasplus, 2017).

In Foreign Exchange Rates, IAS 21 *The Effects of Changes,* outlines the way of accounting for foreign transactions and operations in FSs that are currency, and the way of translating FSs into a currency presentation. They required an entity to decide a currency that is functional (for each of its operations if necessary) depends on the environment of primary economic in which it operates and generally records currency that is foreign by utilizing the spot conversion rate to that currency that is functional on the date of the transaction (iasplus, 2017).

It is clear about the objective of IAS 21 and to prescribe the way of including the transactions of foreign currency and operations that are foreign in the FSs of an entity and the way of translating FSs into a currency that is presentation. [IAS 21.1] The issues that describe as principal which exchange the rate(s) is by using and to know the way of reporting the effects of changes in exchanging the rates in what so called the FSs. [IAS 21.2] (iasplus, 2017).

Presentation currency: Presenting the currency of FSs.

Exchange difference: the results that are different from the translation in a given number of units of a currency inside different currency at exchange rates that are different.

Foreign operation: joint venture, associate, a subsidiary or branch that have activities that depend on currency or a country rather than the reporting entity (iasplus, 2017).

2.2.2.4. Consolidation Techniques and Procedures

CFSs include a consolidated balance sheet; a consolidated income statement; a consolidated retained earnings statement, or consolidated statement of changes in stockholders' equity; and a consolidated statement of cash flows (Beams, Advanced accounting, 2012).

2.2.2.4.1. Consolidation Policy

CFSs provide much information that is not included in the separate statements of the parent, and are usually required for fair presentation of the financial position and results of operations for a group of affiliated companies. The condition that is usual for consolidation is ownership of more than 50 percent of the voting stock of another company. Under current GAAP, a subsidiary can be excluded from consolidation in some situations:

- When the control is impossible to stay or relax with the majority of the owner.
- Formation of ventures that are joint.
- The acquisition of a group or an asset of assets that impossible form a business.
- A combination among entities under control that is common.
- A combination among the entities of not-for-profit or the business of the acquisition of a for-profit by an entity of not-for-profit. Control is impossible to relax by the main owner as if the subsidiary is in reorganization that is legal or bankruptcy that does under the restrictions of the severe foreign-exchange, controls, or even the of different governmentally-imposed (Beams, Advanced accounting., 2012).

2.2.2.4.2. The purpose of CFSs

Primarily, it was presented to clarify the benefit of creditors as well as the owners of the parent company, its results of operations in addition to the position that is financial of a parent and all of them ,namely , its subsidiaries , as if the group of consolidated were an entity of single economic. A suggestion was introduced to CFSs that has meaningful more than FSs that is separate and they are necessary for a presentation that is fair when one of the entities in the group that is consolidated in a direct manner or in an indirect manner has an interest of controlling financial in the entities that are different (Beams, Advanced accounting, 2012).

2.2.2.4.3. Consolidated Balance Sheet

2.2.2.4.3.1. Consolidated Balance Sheet at Date of Acquisition

An entity that is consolidated is a fictitious (conceptual) reporting entity. It depends on the suggestion of separating the entities of legal and accounting of a parent and its subsidiaries could be together into a set of single meaningful of FSs for reporting purposes that are external. Note that the consolidated entity does not have transactions and does not maintain a consolidated ledger of accounts (Beams, Advanced accounting, 2012).

2.2.2.4.3.1.1. Parent Acquires 100 Percent of Subsidiary at Book Value

Table 2.1 shows the basic differences between separate-company and consolidated balance sheets. Pen Corporation acquires 100 percent of Sel Corporation at its book value and fair value of $40,000 in an acquisition on January 1, 2011. Table 2.1 shows the balance sheets prepared immediately after the investment. Pen's "Investment in Sel" appears in the separate balance sheet of Pen, but not in the consolidated balance sheet for Pen and Subsidiary. When preparing the balance sheet, we eliminate the Investment in Sel account (Pen's books) and the stockholders' equity accounts (Sel's books) because they are reciprocal—both representing the net assets of Sel at January 1, 2011. We combine the nonreciprocal accounts of Pen and Sel and include them in the consolidated balance sheet of Pen Corporation and Subsidiary. Note that the consolidated balance sheet is not merely a summation of account balances of the affiliates. We eliminate reciprocal accounts in the process of consolidation and combine only nonreciprocal accounts. The capital stock that appears in a consolidated balance sheet is the capital stock of the parent, and the consolidated retained earnings are the retained earnings of the parent company (Beams, Advanced accounting, 2012) .

Table 2.1 100 Percent Ownership acquired at Book Value (Equal to Fair Value) (Beams, Advanced accounting, 2012)

(in thousands)	*Separate Balance Sheets* Pen	Sel	*Consolidated Balance Sheet:* Pen & subsidiary
Assets			
Current assets			
Cash	$ 20	$ 10	$ 30
Other current assets	45	15	60
Total current assets	65	25	90
Plant assets	75	45	120
Less: Accumulated depreciation	(15)	(5)	(20)

Total plant assets	60	40	100
Investment in Sel—100%	40	—	—
Total assets	**$ 165**	**$ 65**	**$ 190**
Liabilities and Stockholders' Equity			
Current liabilities Accounts payable	$20	$ 15	$35
Other current liabilities	25	10	35
Total current liabilities	45	25	70
Stockholders' equity			
Capital stock	100	30	100
Retained earnings	20	10	20
Total stockholders' equity	120	40	120
Total liabilities and stockholders' equity	**$ 165**	**$ 65**	**$ 190**

2.2.2.4.3.1.2. Parent Acquires 100 Percent of Subsidiary—With Goodwill

Table 2.1 presented the consolidated balance sheet prepared for a parent company that acquired all the stock of Sel Corporation at book value. If, instead, Pen acquires all of Sel's stock for $50,000, there will be a $10,000 excess of investment cost over book value acquired ($50,000 investment cost less $40,000 stockholders' equity of Sel). The $10,000 appears in the consolidated balance sheet at acquisition as an asset of $10,000. In the absence of evidence that identifiable net assets are undervalued, this asset is assumed to be goodwill. Table 2.2 illustrates procedures for preparing a consolidated balance sheet for Pen Corporation, assuming that Pen pays $50,000 for the outstanding stock of Sel (Beams, Advanced accounting, 2012).

We need only one workpaper entry to consolidate the balance sheets of Pen and Sel at acquisition. Take a few minutes to review the format of the workpaper in Table 2-2. The first two columns provide information from the separate balance sheets of Pen and Sel. The third column records adjustments and eliminations, subdivided into debits and credits. The last column presents the totals that will appear in the consolidated balance sheet. We calculate amounts in the Consolidated Balance Sheet column by adding together amounts from the first two columns and then adding or subtracting the adjustments and eliminations, as appropriate. This basic workpaper format is used throughout the discussions of acquisitions and preparation of CFSs in this book. The elimination entry is reproduced in general journal form for convenient reference:

a	Capital stock - Sel (-SE)	30	
	Retained earnings – Sel (-SE)	10	
	Goodwill (+A)	10	
	Investment in Sel (-A)	50	

To eliminate reciprocal investment and equity accounts and assign the excess of investment cost (fair value) over book value to goodwill.

Entries such as those shown in Table 2.2 are only workpaper adjustments and eliminations and *are not recorded in the accounts of the parent or subsidiary corporations*. The entries will never be journalized or posted. Their only purpose is to facilitate completion of the workpapers to consolidate a parent and subsidiary at and for the period ended on a particular date. In this book, workpaper entries are shaded in blue to avoid confusing them with actual journal entries that are recorded in the accounts of the parent and subsidiary companies.

2.2.2.4.3.1.3. Parent Acquires 90 Percent of Subsidiary—With Goodwill

Assume that instead of acquiring all of Sel's outstanding stock, Pen acquires 90 percent of it for $45,000. GAAP requires the acquisition method to record BCs and subsequent issuance of CFSs. Essentially, the acquisition method uses the entity theory of consolidations. Under the acquisition method, all assets and liabilities of the subsidiary are reported using 100 percent of fair values at the combination date, based on the price paid by the parent for its controlling interest, even when the parent acquires less than a 100 percent interest. Thus, both the controlling and noncontrolling interests will be reported based on fair values at the acquisition date.

Table 2.2 100 Percent Ownership, Cost (Fair Value) $10,000 Greater Than Book Value, PEN Corporation and subsidiary consolidated balance sheet workpapers January 1, 2011 (in thaousands) (Beams, Advanced accounting, 2012)

	Pen	100% Sel	*Adjustments and Eliminations* Debits	Credits	Consolidated Balance Sheet
Assets					
Cash	$ 10	$10			$ 20
Other current assets	45	15			60
Plant assets	75	45			120
Accumulated depreciation	(15)	(5)			(20)
Investment in Sel	50			a 50	

Goodwill			a 10	10
Total assets	$165	$65		$190
Liabilities and Equity				
Accounts payable	$ 20	$15		$ 35
Other current liabilities	25	10		35
Capital stock—Pen	100			100
Retained earnings—Pen	20			20
Capital stock—Sel		30	a 30	
Retained earnings—Sel		10	a 10	
Total liabilities and stockholders' equity	$165	$65		$190

a. To eliminate reciprocal investment and equity accounts and to assign the excess of investment cost (fair value) over book value to goodwill.

We can assume that the acquisition is an "arm's-length" transaction. Pen paid $45,000 for a 90 percent interest. This implies that the total fair value of Sel is $50,000 ($45,000 / 90 percent). In this case, the excess of total fair value over book value of Sel's net identifiable assets and liabilities is $10,000, and there is a noncontrolling interest of $5,000 (10 percent of the $50,000 fair value of Sel's equity). The $10,000 excess of fair value over book value is goodwill. The workpapers in Table 2.3 illustrate procedures for preparing the consolidated balance sheet for Pen and Sel under the 90 percent ownership assumption (Beams, Advanced accounting, 2012).

Workpaper entry (a) eliminates the reciprocal accounts of Pen and Sel and recognizes goodwill and the noncontrolling interest in Sel at the date of acquisition:

a	Capital stock - Sel (-SE)	30
	Retained earnings – Sel (-SE)	10
	Goodwill (+A)	10
	Investment in Sel (-A)	45
	Noncontrolling interest	5

To eliminate reciprocal investment and equity balances, to assign the $10,000 excess of investment fair value ($50,000) over book value ($40,000) to goodwill, and to recognize a $5,000 noncontrolling interest in the net assets of Sel ($50,000 equity × 10% noncontrolling interest)..

2.2.2.4.3.1.4. Noncontrolling Interest

We include all assets and liabilities of the subsidiary in the consolidated balance sheet and record the noncontrolling interest's share of subsidiary net assets based on fair values separately in stockholders' equity (Beams, Advanced accounting, 2012).

Table 2.3 90 Percent Ownership, Fair Value Greater than Book Value, PEN Corporation and Subsidiary Consolidated Balance Sheet Workpapers January 1, 2011 (In Thousands) (Beams, Advanced accounting, 2012)

			Adjustments and Eliminations		
	Pen	100% Sel	Debits	Credits	Consolidated Balance Sheet
Assets					
Cash	$ 15	$10			$ 25
Other current assets	45	15			60
Plant assets	75	45			120
Accumulated depreciation	(15)	(5)			(20)
Investment in Sel	45			a 45	

Goodwill			a 10		10
Total assets	$165	$65			$190
Liabilities and Equity					
Accounts payable	$ 20	$15			$ 35
Other current liabilities	25	10			35
Capital stock—Pen	100				100
Retained earnings—Pen	20				20
Capital stock—Sel		30	a 30		
Retained earnings—Sel		10	a 10		
	$165	$65			
Noncontrolling interest				a 5	5
Total liabilities and stockholders' equity					$195

a. To eliminate reciprocal investment and equity balances, assign the $10,000 excess of investment fair value ($50,000) over book value ($40,000) to goodwill, and recognize a $5,000 noncontrolling interest in the fair value of net assets of Sel ($50,000 equity × 10% noncontrolling interest).

Workpapers provide the basis of preparing formal FSs, and the question arises about how the $5,000 noncontrolling interest that appears in Exhibit 2-3 would be reported in a formal balance sheet (Beams, Advanced accounting, 2012).

2.2.2.4.3.2. Consolidated balance sheets after acquisition

The account balances of both parent and subsidiary change to reflect their separate operations after the parent–subsidiary relationship has been established. Subsequently, we make additional adjustments to eliminate other reciprocal balances. If a consolidated balance sheet is prepared between the date a subsidiary declares and the date it pays dividends, the parent's books will show a dividend receivable account that is the reciprocal of a dividends payable account on the books of the subsidiary. Such balances do not represent amounts receivable or payable outside the affiliated group; therefore, they must be reciprocals that we eliminate in preparing consolidated statements. We also eliminate other intercompany receivables and payables, such as accounts receivable and accounts payable, in preparing consolidated statements (Beams, Advanced accounting, 2012).

2.2.2.4.3.2.1 Assigning excess to identifiable net assets and goodwill

We assigned the excess of fair value over the book value in the Pen–Sel illustration to goodwill in the previous exhibits. An underlying assumption of that assignment of the excess is that the book values and fair values of identifiable assets and liabilities are equal. When the evidence indicates that fair values exceed book values or book values exceed fair values, however, we assign the excess accordingly (Beams, Advanced accounting, 2012).

2.2.2.4.3.2.2. Effect of Assignment on Consolidated Balance Sheet at Acquisition

The separate books of the affiliated companies do not record fair value/book value differentials in acquisitions that create parent–subsidiary relationships. We use workpaper procedures to adjust subsidiary book values to reflect the fair value/book value differentials. The adjusted amounts appear in the consolidated balance sheet (Beams, Advanced accounting, 2012).

2.2.2.4.4. Consolidated Income Statement

Table 2.4 presents comparative separate-company and consolidated income and retained earnings statements for Pil Corporation and Subsidiary. These statements reflect the previous assumptions and amounts that were used in preparing the consolidated balance sheet workpapers for Pil and Sad. The difference between a consolidated income statement and an unconsolidated income statement of the parent company lies in the detail presented. Table 2.4 by comparing the separate income statement of Pil with the consolidated income statement of Pil and Subsidiary. It can be seen (90 percent Ownership, consolidation one year after acquisition) in reference (Beams, Advanced accounting, 2012).

Table 2.4 Separate Company and Consolidated Income and Retained Earnings Statements, PIL and SAD Corporations Separate Company and Consolidated Statements of Income and Retained Earnings for the year Ended December 31, 2012 (In Thaousands) (Beams, Advanced accounting, 2012).

	Separate Company		
	Pil	Sad	Consolidated
Sales	$9,523.5	$2,200	$11,723.5
Investment income from Sad	571.5		
Total revenue	10,095	2,200	11,723.5
Less: Operating expenses			
Cost of sales	4,000	700	4,800
Depreciation expense—buildings	200	80	305
Depreciation expense—equipment	700	360	1,000
Other expenses	1,800	120	1,920

Total operating expense	6,700	1,260	8,025
Operating income	3,395	940	3,698.5
Nonoperating item: Interest expense	300	140	540
Net income	**$3,095**	**$ 800**	
Consolidated net income			3,158.5
Less: Noncontrolling interest share			63.5
Controlling interest share			**$ 3,095**
Retained earnings December 31, 2011	4,300	900	4,300
	7,395	1,700	7,395
Deduct: Dividends	1,500	300	1,500
Retained earnings December 31, 2012	$5,895	$1,400	$ 5,895

2.2.2.4.4.1. Push-down accounting

In the Pil and Sad illustration, we recorded the investment on the books of Pil at cost and assign the purchase price to identifiable assets and liabilities and goodwill through workpaper adjusting entries. In some instances, the assignment of the purchase price may be recorded in the subsidiary accounts—in other words, pushed down to the subsidiary records. **Push-down accounting** is the process of recording the effects of the purchase price assignment directly on the books of the subsidiary. Push-down accounting affects the books of the subsidiary and separate subsidiary FSs. It does not alter CFSs and, in fact, simplifies the consolidation process (Beams, Advanced accounting, 2012)

Table 2.5 Worksheet for Consolidated Balance Sheet (Beams, Advanced accounting, 2012)

			Adjustments and Eliminations		
(in thousands)	Parent	Subsidiary	Debits	Credits	Consolidated Balance Sheet
Cash	420	200			= B7+C7+D7-E7
Receivables—net	500	1300			= B8+C8+D8-E8
Inventories	3500	500			= B9+C9+D9-E9
Land	1500	200			= B10+C10+D10-E10
Equipment—net	6000	1000			= B11+C11+D11-E11
Investment in Subsidiary	4590				=B12+C12+D12-E12
					=B13+C13+D13-E13
Total assets	=SUM(B7:B13)	=SUM(C7:C13)			=SUM(F7:F13)
Accounts payable	4,100	800			= B15+C15-D15+E15
Dividends payable	600	100			= B16+C16-D16+E16
Capital stock	10000	3000			= B17+C17-D17+E17
Retained earnings	1810	1100			=B18+C18-D18+E18
Total equities	=SUM(B15:B18)	=SUM(C15:C18)			
					=SUM(F15:F21)
			=SUM(D7:D22)	=SUM(E7:E22)	

2.2.2.4.5. Preparing a Consolidated Balance Sheet Worksheet

In this section you will explain how set up a worksheet to prepare a consolidated balance sheet. Refer to Table 2.5. We have two columns to record the balance sheet information for a parent company and (in our example) a 90 percent-owned subsidiary company. The numbers in these two columns are simply copied from the individual-company balance sheets. We include two columns to record the debits and credits for consolidation adjustments and eliminations. The final column provides calculations of the correct consolidated balance sheet totals (Beams, Advanced accounting, 2012).

Table 2.5 shows spreadsheet formulae used in preparing the worksheet. Notice that most of these can be input using the COPY command *available in the spreadsheet software.* In the first two columns, total assets and total equities are simple summations of the relevant balances. The adjustments and eliminations columns each contain a single summation formula for the column totals. This is useful in verifying the equality of debits and credits—that in other words, you have not made any errors in posting your consolidation entries

There are lots of formulae in the consolidated balance sheet column, but again most of these can be entered with the COPY command. Let’s look at the formula for Cash (=B7+C7+D7−E7). We simply sum parent-company cash plus subsidiary-company cash and then make any needed adjustments and eliminations. Notice that cash has a normal debit balance, so we add the debit adjustments (+D7) and subtract credits (−E7) to arrive at the consolidated total. We can copy our formula for all accounts having normal debit balances (i.e., all assets).

Now let’s review the formula for Accounts payable (=B15+C15−D15+E15). We sum parent company accounts payable plus subsidiary-company accounts payable and then make adjustments and eliminations. Notice that accounts payable has a normal credit balance, so we subtract debit adjustments (−D15) and add credits (+E15) to arrive at the consolidated total. We can copy our formula for all accounts having normal credit balances (i.e., all liabilities and equities).

We will discuss the completion of the worksheet by working through a sample problem. Separate company balance sheets for Parent Corporation and

Subsidiary Company at December 31, 2011, are summarized as follows (in thousands):

	Parent Corporation	Subsidiary Company
Cash	$ 420	$ 200
Receivables—net	500	1,300
Inventories	3,500	500
Land	1,500	2,000
Equipment—net	6,000	1,000
Investment in Subsidiary	4,500	
Total assets	$16,510	$5,000
Accounts payable	$4,100	$800
Dividends payable	600	100
Capital stock	10,000	3,000
Retained earnings	1,800	1,100
Total equities	$16,510	5,000

Parent Corporation acquired 90 percent of the outstanding voting shares of Subsidiary Company for $4,500,000 on January 1, 2011, when Subsidiary's stockholders' equity was $4,000,000. All of the assets and liabilities of Subsidiary were recorded at their fair values (equal to book values) when Parent acquired its 90 percent interest. During 2011, Subsidiary reported net income of $200,000 and declared a dividend of $100,000. The dividend remained unpaid on December 31. Because the fair value of Parent's 90 percent interest is $4,500,000, the implied total fair value of the subsidiary is $5,000,000 on the acquisition date. Because subsidiary book value equals $4,000,000, goodwill must be $1,000,000 (Beams, Advanced accounting, 2012).

We enter the data into our worksheet in Table 2.5. We record balance sheet amounts picked up from the parent and the subsidiary. Total assets and total equities are simple summation functions. Next, we will review the required consolidation adjustments and eliminations. We provide a separate Table 2.6 to show the final worksheet, after posting the adjustments and eliminations. This is simply Table 2.5

updated to reflect the entries that follow. Notice too, that we have added some new accounts. We create noncontrolling interest and goodwill and copy the relevant formulae. The first workpaper entry in Table 2.2 is the following:

a	Capital stock (– SE)	3,000	
	Retained earnings (– SE)	1,100	
	Goodwill (+A)	1,000	
	Investment in Subsidiary (– A)		4,590
	Noncontrolling interest (+SE)		510

To enter goodwill and the noncontrolling interest and to eliminate subsidiary capital accounts and the parent-company investment account.

Here is a journal entry for workpaper entry b for Table 2.6:

b	Dividends payable (– L)	90	
	Receivables—net (– A)		90
	To eliminate the intercompany receivable and payable for dividends.		

Our spreadsheet formulae compute the consolidated totals for us in the final column, completing the worksheet. Practice creating the spreadsheet for a few problems to be certain you understand the mechanics. However, you will not need to create your own spreadsheet for all problem assignments.

For consolidation under the equity method of a parent that uses the complete equity method of accounting for its subsidiary explains basic procedures used to consolidate the FSs of Subsidiary look (Beams, Advanced accounting, 2012).

The following example of a parent that uses the complete equity method of accounting for its subsidiary explains basic procedures used to consolidate the FSs of Subsidiary.

Table 2.6 Final Worksheet

Parent Corporation and subsidiary consolidated balance sheet workpaper December 31, 2011 (Beams, Advanced accounting, 2012)

			Adjustments and Eliminations		
(in thousands)	Parent	Subsidiary	Debits	Credits	Consolidated Balance Sheet
Cash	420	200			620
Receivables—net	500	1300		b 90	1,710
Inventories	3500	500			4,000
Land	1500	200			3,500
Equipment—net	6000	1000			7,000
Investment in Subsidiary	4590			a 4,590	0
Goodwill			a 1,000		1,000
Total assets	16,510	5,000			17,830
Accounts payable	4,100	800			4,900
Dividends payable	600	100	b 90		610
Capital stock	10000	3000	a 3,000		10,000
Retained earnings	1810	1100	a 1,100		1,810
Total equities	16,510	5,000			
Noncontrolling interest				a 510	510
					17,830
			5,190	5,190	

2.2.2.4.6. Consolidated Statement of Cash Flows

We prepare the consolidated statement of cash flows (SCF) from consolidated income statements and consolidated balance sheets, rather than from the separate parent and subsidiary statements. With minor exceptions, the preparation of a consolidated SCF involves the same analysis and procedures that are used in preparing the SCF for separate entities (Beams, Advanced accounting, 2012).

2.2.2.4.6.1 Preparing a Consolidation Worksheet

We set up a three-part worksheet to prepare a consolidated income statement, retained earnings statement, and balance sheet. This worksheet follows the same basic pattern as that described to prepare a consolidated balance sheet at acquisition (Beams, Advanced accounting, 2012).

To complete preparing a consolidation worksheet, we need passing through three main steps:

- Preparing a Complete Consolidation Worksheet
- Building the Worksheet
- Completing the Worksheet

Example.

Parent's \$105,000 income from Subsidiary for 2011 consists of 70 percent of Subsidiary's \$150,000 net income for 2011. Its \$490,000 Investment in Subsidiary account balance at December 31, 2011, consists of the \$455,000 investment cost plus \$105,000 income from Subsidiary, less \$70,000 dividends received from Subsidiary during 2011 (Beams, Advanced accounting, 2012).

The first workpaper entry in Table 2.7 is the following:

a	Income from Subsidiary (− R , − SE)	105,000
	Dividends (+ SE)	70,000
	Investment in Subsidiary (− A)	35,000

To eliminate income and dividends from subsidiary and return the investment account to its beginning-of-the-period balance.

The difference between income from a subsidiary recognized on the books of the parent and the dividends received represents the change in the investment account for the period. The $35,000 credit to the Investment in Subsidiary account reduces that account to its $455,000 beginning-of the- period balance and thereby establishes reciprocity between the Investment in Subsidiary and Subsidiary's stockholders' equity at January 1, 2011.

Here is a journal entry for workpaper entry b for Table 2.7:

b	Noncontrolling interest share (− SE)	45,000	
	Dividends (+ SE)		30,000
	Noncontrolling interest (+ SE)		15,000
	To enter noncontrolling interest share of Subsidiary income and dividends.		

Entry b incorporates the noncontrolling interest in a Subsidiary's net income and the noncontrolling interest's share of dividends declared by Subsidiary directly into the consolidation workpapers.

Workpaper entry c in journal entry form is as follows:

c	Retained earnings—Sub. (beginning) (− SE)	110,000	
	Capital stock—Subsidiary (− SE)	500,000	
	Other paid in capital—Subsidiary (− SE)	40,000	
	Investment in Subsidiary (− A)		455,000
	Noncontrolling interest (+ SE)		195,000
	To eliminate reciprocal equity and investment balances, and establish beginning noncontrolling interest.		

This entry eliminates reciprocal investment and equity balances, enters the unamortized excess of investment fair value over book value acquired as of the beginning of the year (zero in this example), and constructs beginning noncontrolling interest ($650,000 × 30 percent) as a separate item. Observe that entry c eliminates reciprocal investment and equity balances as of the beginning of the period and enters noncontrolling interest as of the same date.

Parent retained earnings under the complete equity method of accounting are equal to consolidated retained earnings. Because Parent correctly applies the equity method, its net income of $435,000 equals the controlling share of consolidated net income. Its beginning and ending retained earnings balances equal the $650,000 and $785,000 consolidated retained earnings amounts, respectively.

Our spreadsheet formulae compute the final consolidated statement totals for us in the final column. The worksheet is complete.

Table 2.7 Completing the Worksheet
Parent Corporation and Subsidiary Consolidation Worksheet for the Year Ended December 31, 2011 (in Thousands) (Beams, Advanced accounting, 2012)

			Adjustments and	*Eliminations*	
(in thousands)	Parent	70% Subsidiary	Debits	Credits	Consolidated Statements
Income Statement					
Sales	3,100	1,000			4,100
Income from Subsidiary	105		a 105		0
Cost of goods sold	(2,000)	(650)			(2,650)
Operating expenses	(770)	(200)			(970)
Noncontrolling interest share			b 45		(45)
Controlling share of net income	**435**	**150**			**435**
Retained Earnings Statement					
Retained earnings—Parent	650				650
Retained earnings—Subsidiary		110	c 110		0
Controlling share of Net income		435	150		435
Dividends	(300)	(100)		a 70	
				b 30	(300)
Ret earnings—ending	**785**	**160**			**785**
Balance Sheet					

Cash	455	150			605
Receivables—net	600	300			900
Inventories	240	200			440
Plant & equipment—net	1,200	350			1,550
Investment in Subsidiary	490			a 35	0
				c 455	
Total assets	**2,985**	**1,000**			**3,495**
Accounts payable	300	180			480
Other liabilities	200	120			320
Capital stock, $10 par	1,500	500	c 500		1,500
Other paid-in capital	200	40	c 40		200
Retained earnings	785	160			785
Total equities	**2,985**	**1,000**			
Noncontrolling interest				c 195	210
				b 15	
			800	800	**3,495**

2.2.2.4.7. Summary of CFS Techniques and Procedures

- GAAP usually requires CFSs for the fair presentation of financial position and the results of operations of a parent company and its subsidiaries.
- CFSs are not merely summations of parent-company and subsidiary financial statement items. Consolidated statements eliminate reciprocal amounts and combine and include only nonreciprocal amounts.
- We eliminate the investment in subsidiary and the subsidiary stockholders' equity accounts in the preparation of CFSs because they are reciprocal, both representing the net assets of the subsidiary.
- Sales and borrowing transactions between parent and subsidiaries also give rise to reciprocal amounts that we eliminate in the consolidating process.
- The stockholders' equity amounts that appear in the consolidated balance sheet are those of the parent company, except for the equity of noncontrolling stockholders, which we report as a separate item within consolidated stockholders' equity.
- Consolidated net income is a measurement of income to the stockholders of the consolidated group. Incomes accruing to the benefit of controlling and noncontrolling stockholders are components of consolidated net income. Parent-company net income and retained earnings are equal to the controlling share of net income and consolidated retained earnings, respectively.
- Workpapers are prepared to produce meaningful financial reports for a consolidated business entity. Preparation of meaningful CFSs is the objective.
- The workpapers are tools for organizing and manipulating data. Throughout the chapter it was assumed that the parent uses the complete equity method to account for its investment in the subsidiary.
- The consolidated statement of cash flows can be prepared from the consolidated balance sheets and income statements (Beams, Advanced accounting, 2012).

2.2.3. Auditing Process Procedures

In this study, the external auditing has been considered, and it is as one of the most important types of auditing being done by an independent professional from outside of the institution whose is named differently across nations such names include a governor of accounts, an auditor, a chartered accountant, etc. The procedures adopted under international auditing standards.

The auditor's role is seen in all stages of the life of the organization, where the organization goes through the following important events:

- Establishment of the organization.
- Account closure.
- Raising capital.
- Capital reduction.
- Issuance of bonds or shares.
- Converting the legal status of the company.
- Distribution of profits.
- Merger.
- Entry to the stock exchange.
- Risks.

2.2.3.1. Tasks of external auditors

The following tasks may be performed by the external auditor:

- Legal auditing.
- Limited checking of accounts.
- Specific tasks ruled by conventions.
- Specific investigations and information
- Interventions stipulated in law or system.
- Exceptional tasks.

2.2.3.1.1. Legal auditing

This type of audit is mainly related to commercial law, which regulates this aspect for shareholding companies, limited liability, and solidarity, simple and joint recommendation. This reference is also found in the regulations of the auditing profession and other special laws such as the Associations Law.

2.2.3.1.2. Limited examination of accounts

The auditor (legal accountant) may be assigned the task of auditing certain accounts or all accounts for a certain period of time, either in the frame of a legal audit or even a contractual audit.

2.2.3.1.3. Specific tasks governed by convention (Contractual Audit)

Contractual audit functions are performed at the request of the institution or another party.

2.2.3.1.3.1. Audit task at the request of the organization

The contractual audit functions most requested by the corporation are:

- The organization needs a reliable financial information to be provided to others.
- Evaluating the current organization of the corporation in order to improve it.
- Avoiding cheating or theft.

2.2.3.1.3.2. The task of checking at the request of another party

Other parties may request a certain audit and in some cases the organization is forced to resort to certain auditors such as the case with some banks in order to grant loans.

2.2.3.1.4. Specific investigations and information

An organization can use the audit to verify information it has.

2.2.3.1.5. Interventions stipulated in law or system

The legal texts oblige organizations, sometimes, to audit some elements such as the obligating the annual inventory check.

2.2.3.1.6. Exceptional tasks

Exceptional tasks are associated with exceptional events such as raising or reducing equity capital.

2.2.3.2. Types of External Audit

2.2.3.2.1. Periodic legal review

The main function of the auditor is to express an opinion about the FSs, as he audits the accounts using different techniques in order to obtain an image on these accounts. The auditor also performs a series of special checks which are prescribed by law.

2.2.3.2.2. Non-periodic legal audit

2.2.3.2.2.1. Tasks prescribed by the organization

The auditor may be assigned tasks determined by the board of directors of the organization, such as audits of certain elements of the FSs (such as cash audits) or specific operations (such as the acquisition of significant investments).

2.2.3.2.2.2. Tasks assigned following emergent events on the organization

Some special tasks may be assigned to the auditor following certain events within the organization, such as raising or reducing capital or mergers with other organizations, the auditor shall prepare special reports which their form and contents are regulated by the law.

2.2.3.2.2.3. Contractual Audit

The auditor may be based on tasks that are not defined by legal or legislative rules that arise from specific needs of the organization, such as the need to audit a particular course or position, like the human resources position, for which the organization resorts to the auditor due to his professional experience and competence.

The content of this type of task can be very diverse, but the method of compiling reports is more flexible than the previous two ones.

During performing his tasks, the auditor relies on a sufficient knowledge and personal efficiency that requires constant and continuous development in order to improve performance and keep abreast of the rapid developments of economic life, legislation and the effects of globalization that evoke new and more complex economic processes and greater skills.

2.2.3.3. Efficiency and environment of the auditor

When the auditor performs his normal functions related to legal scrutiny, he depends on his personal expertise and at the same time develops this expertise and increases his own competencies.

During the performance of his mission, the auditor is associated with institutions (organizations) that each have considerable expertise in the field of its activity in addition to the expertise of its employees in other fields of management.

The auditor also monitors other professionals who have an important knowledge base that would increase their competencies and expertise.

When the auditor performs contractual tasks, he or she will gradually be used to analyze the problems he or she is dealing with and to control the evaluation techniques.

In addition, the contractual functions of the specificities that can enable the auditor to open up to other fields related to auditing such as collection, legal affairs and human resources management.

2.2.3.4. Basic characteristics of the auditor's environment

The audit surrounding has the following characteristics:

- Internationalization of exchanges.
- Capital movement.
- Increasing recourse to financial markets in order to obtain capital.
- Customers search for a unified and common reference to communicate.

Which requires the auditor to control and understand this international language that comprises several international standards and ethics.

So that the auditor can accomplish his objectives in the current environment, he must choose an organized method of action that is subject to particular procedures that are consistent with these data.

2.2.3.5. Audit procedures

The practical procedures for the audit task can be summarized in the following steps:

- Preparatory stage.
- Examination of the internal control system (and examination of individual FSs).
- Value tests.
- Compiling of the final report.

2.2.3.5.1. Preparatory stage

This stage is usually done after assigning the task to the auditor who commences the task by holding a meeting with the administration during which the auditor will be introduced with other parties.

2.2.3.5.1.1. Objectives of the stage

- ❖ Understanding the establishment: During this stage, the auditor shall identify the establishment, the pattern of its organization, the nature of its activity, its environment and its characteristics. Before starting work, the auditor must explore of the offices of the establishment and the various departments, workshops and stores.
- ❖ Risk identification: The risks to be determined are both the risks related to the audit and the risks surrounding the entity and its assets and their continuity.
- ❖ Determination of the overall orientation of the task: After familiarized with the elements mentioned above, the following shall be determined:
  - Task plan.
  - The estimated budget for the task.
  - Admission threshold, the limit at which the results of an audit are accepted and accounted as representative for all operations of the entity.

2.2.3.5.1.2. Documents used during this stage

During this stage, an action document is prepared in the form of a technical card that includes the task plan and an appropriate timetable.

2.2.3.6. International standards applicable during this stage

The International Standards for Auditing are applied during the process of this stage as follows:

2.2.3.6.1. Accept the task

- "ISA 200: Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing".
- "ISA 210: Agreeing the Terms of Audit Engagements".
- "ISA 220: Quality Control for an Audit of FSs".

2.2.3.6.2. Preparatory Processes

- “ISA 240: The Auditor’s Responsibilities Relating to Fraud in an Audit of FSs”.
- “ISA 300: Planning an Audit of FSs”.
- “ISA 315: (Revised), Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment”.
- “ISA 320: Materiality in Planning and Performing an Audit”.

2.2.3.7. Inspection of the internal control system (examination of periodic FSs)

During this stage, a meeting is held between the auditor and the management of the establishment. This stage is ended up with preparing a report directed to the establishment, which includes a set of advice and information about the recorded contradictions.

ISA 315 (Revised), states (identifying and assesing the risks of material misstatement through understanding the entity and its environment). The auditor must identify the entity and its environment, including its internal control system.

2.2.3.7.1. Objectives of the stage

- Understanding the information system: The auditor should check the information system of the establishment and all its components.
- Identifying strengths and weaknesses: The examination and understanding of an information system leads to the identification of both strengths and weaknesses in this system.
- Amendment of audit work: At the end, the auditor will make the necessary amendments to the action plan and make the procedures suitable to the particularities of the establishment.

2.2.3.7.2. Documents used during this stage

During this stage, work file will be adopted which contains all the information and documents related to the organization, where the auditor performs certain conformity tests, and eventually prepares the final action plan.

2.2.3.7.3. International standards applicable during this stage

- “ISA 230: Audit Documentation”.
- “ISA 330: The Auditor’s Responses to Assessed Risks”.

- “ISA 402: Audit Considerations Relating to an Entity Using a Service Organization”.

2.2.3.8. Value Tests

2.2.3.8.1. Objectives of the stage

- Account auditing: It is one of the most important operations during the task of the auditor where the accounts of the establishment are examined in general while doing an in-depth examination of some important accounts that represent the risky areas.
- Specific checks: This is a set of checks and investigations carried out by the auditor based on mandatory legal texts governing this process. The auditor must formulate special reports like formulating a special report on the best paid wages throughout the year and a special report on the evaluation of the internal control system.

2.2.3.8.2. Documents used during this stage

During this stage, a large amount of written or other bonds are used to record notes and conclusions of auditing process.

2.2.3.8.3. International standards applicable during this stage

- “ISA 250: Consideration of Laws and Regulations in an Audit of FSs”.
- “ISA 260: Communication with Those Charged with Governance”.
- “ISA 500: Audit Evidence”.
- “ISA 501: Audit Evidence—Specific Considerations for Selected Items”.
- “ISA 505: External Confirmations”.
- “ISA 510: Initial Audit Engagements— Opening Balances”.
- “ISA 520: Analytical Procedures”.
- “ISA 530: Audit Sampling”.
- “ISA 540: Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures”.
- “ISA 550: Related Parties”.
- “ISA 560: Subsequent Events”.
- “ISA 570: Going Concern”.
- “ISA 580: Written Representations”.

2.2.3.9. Compiling the final report

2.2.3.9.1. Objectives of the stage

The aim of this stage is to take notes and write down conclusions and to cite them in a general report as well as special reports subject to a certain regular form specified by some special criteria.

2.2.3.9.2. Documents used during this stage

At this stage, a final file containing the collection of abstracts reached by the auditor will be relied upon, and he will be able to fill out forms containing final abstracts.

2.2.3.9.3. International standards applicable during this stage

- "ISA 700: Forming an Opinion and Reporting on FSs".
- "ISA 701: Communicating Key Audit Matters in the Independent Auditor's Report".
- "ISA 705: (Revised), Modifications to the Opinion in the Independent Auditor's Report".
- "ISA 706: (Revised), Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report".

2.2.3.10. An important note

There are international auditing standards that are not specific to a given stage but adopted during all stages and they are called overlapping or horizontal criteria:

- The Code of Professional Ethics;
- "ISA 220: Quality Control for an Audit of FSs".
- "ISA 230: Audit Documentation".
- "ISA 240: The Auditor's Responsibilities Relating to Fraud in an Audit of FSs".
- "ISA 320: Materiality in Planning and Performing an Audit".
- "ISA 570: Going Concern".

2.2.4. Audit of Consolidated Financial Statements

The majority of BCs are the result of one entity bidding for and taking over another entity – one entity purchases another. After businesses combine consolidated or group FSs will have to be prepared. The accounting and disclosure required for group accounts is covered by IAS 27 – Consolidated and Separate FSs (icaiknowledgegateway, 2017).

The Consolidating of IAS 27 and Separating the FSs can outline them the time the entity must be consolidated by an entity that is different , the way of accounting for a different in interest that is ownership, the way of preparing FSs that is separate, and has a relation to the disclosures. It depends on the concept of changing and controlling interests that are ownership but the control is maintained .It is responsible to the transactions in equity among owners as owners (Tiffin, 2014).

In January 2008, it , IAS 27, was reissued in addition it was applied to periods that are annual and starting after 1 July 2009, and it was replaced by what so called IAS 27 Separate FSs as well as IFRS 10 CFSs in addition to the influences from periods that are annual starting after 1 January 2013 (Tiffin, 2014).

It was established by IFRS 10 CFSs the principles to present and prepare the CFSs in the time the entity can cover more than one entity. IFRS 10 (iasplus, 2017):

- Requiring an entity that describes as “the parent” which can cover more than one entity that describes as “subsidiaries” for CFSs that will be presented ;
- The principle of control will be defined , and establishing the control like basis for consolidation;
- Setting out the way of applying the principle of control by clarifying if an investor will control what so called “an investee “ in addition to know it can consolidate the investee;
- Setting out the requirements that are accounting for preparing CFSs.
- Defining the entity of investment in addition to setting out some exceptions to consolidate subsidiaries that are particular of an investment entity.

The assets are presented as CFSs that equal FSs, the terms, cash flows, liabilities income, expenses and equity of a parent and subsidiaries that are sharing it are an entity of single economic.

2.2.4.1. Responsibility of Parent

It is the responsibility to present and to prepare the CFSs .It is the management of the parent and that including (ifrs, 2017):

(a) The components are identified , in addition ,it is included by information that describes as financial elements that are included in the CFSs;
(b) Identifying segments that are reportable for report that is segmental;
(c) Clarifying the parties that have a relation to the party transactions for reporting;
(d) Getting the information that is financial complete and accurate from components.
(e) Preparing consolidation adjustments that are appropriate.

2.2.4.2. Responsibility of the Auditor of the CFSs

It is responsible for presenting an opinion upon it if CFSs are prepared. According to framework of financial reporting under which the parent making the CFSs, in all material respects, (ifrs, 2017).

The auditors' aims in an audit of CFSs are:

- Giving the satisfaction to him that the CFSs were prepared according to the needs of the (IAS) that stands for International Accounting Standard 27, the investments in Joint Ventures Consolidated and Associates IAS 28 and standards that are different.
- Enabling him by giving his opinion on the truth and the view that are fair and given by the CFSs.

On Auditing, the Statements of International Standards have been applied the manner that is the same according to the audit of CFSs like it was applied to audit of separate FSs. While conducting the audit of CFSs that can be suggested such as:

- By conducting an effective audit in an efficient and a timely manner , It has to plan their work to encourage them
- Getting the knowledge of the systems of accounting and control that is internal and enough by planning the audit and determining the nature,

extending and timing the audit procedures of him. Like such a knowledge can enable them ,namely , auditors by enabling them to be in an effective audit approach;

- Using judgment that is professional by evaluating the audit risk as well as designing procedures that are audit to make certain of the risk that is low for a level that is acceptable; etc.

2.2.4.3. Audit Considerations

There are features of CFSs that contain an impact upon audit that has a relation to procedures (ifrs, 2017).

(a) They prepared CFSs on the basis of separating FSs of the parent and the subsidiaries and associates that are shared them as well as ventures that are joint, by utilizing the prescribed consolidation procedures by the Standards of International Accounting.

(b) It, the auditor of the CFSs, has to utilize auditors' labors if the auditor of CFSs is impossible to be the auditor of the components that are different group. Anyway, it will be in some cases.

They prepared the CFSs to utilize the separate FSs of the parent, associates, subsidiaries as well as ventures that are joint in addition different information that are financial, that may not be comprehensive by the separate FSs of the entities. Some of the information' that are financial include what so called the disclosures by preparing it in the CFSs about the joint ventures , associates , and subsidiaries proportion of items that contained in the CFSs to which the policies of different accounting that were applied, the adjustments were prepared because of the effects of the transactions that are significant or different incident that take place among the subsidiaries FSs, joint ventures or associates as well as the parent as well . The case may be like this... etc. 'Other financial information' can be needed to be added and generated (ifrs, 2017).

The auditor should assess, when an auditor agrees the audit of CFSs. It is significant to depend on the work of him by himself in addition he should present his opinion on the truth and the view that is fair and given by the CFSs. He has to studies the use of the work for 'different auditors'.

Different auditors can be the separate FSs of more of the ingredient of the auditors appointed or CFSs specifically to help the auditor of the CFSs.

Here, the auditors that are auditors of more of the ingredient of the CFSs that are needed to aid him with the principal in addition to the work to be made by such auditors that are statutory to be utilized by the principal auditor. It would consist of assignment separate from it, namely, the assignment by carrying out the audit that is statutory of the component that is respective.

'Using the Work of Another Auditor', International Standards on Auditing (ISA) 600, can base the standards in the time an auditor reporting on the FSs of an entity (the group—in the case of CFSs), it is used a labor of auditor that is different upon the information that is financial of more ingredients contained in the FSs of the entity. If he decides to utilize the work of another auditor according to the principal auditor that has a relation to the audit of CFSs, it can be the same with the needs of ISA 600. Comply

The time we can make a harmonization with the needs of ISA 600, 'utilizing different auditors, this principal of the auditor can keep what are coming, thought of:

- The plane by utilizing another auditor's work in addition to the principal auditor can be considered to be the competence that is professional of different auditor in its context of assignment that is specific by condition another one is impossible to be a person of the Institute of Chartered Accountants of India.
- The auditor that is principal can do course of actions by getting audit evidence that is appropriate, the work of the different auditor is sufficient for the principal auditor's purposes, in the context of the specific assignment. In the time by utilizing the work of different one, the auditor that is principal can do the following procedures:
  - ❖ The auditor that is principal can decide whether the assurance or even the instruction needed by different one; this precludes the auditor's determination that is principal of the way of the work of different auditor that can influence the CFSs's audit , for instance , the data that is needed from the auditor of a subsidiary can be not

the same according to that needed of the auditor of a joint venture.

- ❖ Giving a recommendation to different auditor of the utilize which can be prepared by different auditor's work and reporting as well as making arrangements that are sufficient for efforts of co-ordination of them at the stage of planning of the audit.
- ❖ Giving a recommendation of different auditor of the accounting that is significant, reporting and auditing needs and getting a representation as to compliance them to each other.

2.2.4.4. Auditing the Consolidation

Before starting CFSs's audit, he can do the work of him by helping him to connect an audit that is effective in a manner that is efficient and accurate. He has to make some plans, with different plans, like the coming (ifrs, 2017):

- Comprehending the policies that are accounting of the parent, associates, joint ventures and subsidiaries as well.
- Deciding the extent by utilizing different auditor's work in the audit;
- Deciding the timing, nature and extent of the procedures of the audit being done.
- Coordinating the work being done.

It was presented by a parent that CFSs can be needed by consolidating the them as a whole ,namely , the subsidiaries, and they contain the entire associates as well as the entities of controlled in the CFSs.

He, namely the auditor, can get a list of, associates, subsidiaries in addition to joint ventures contained the CFSs. He can revise the given data by the management of the parent clarifying them, namely, associates, joint ventures and the subsidiaries. He can verify all of them by included them in the CFSs unless they meet a criterion for exclusion (ifrs, 2017).

He can do the coming plans:

(a) Revising the papers for the previous years to know them, namely, joint ventures, associates and subsidiaries.

(b) Revising the procedures of the parent to clarify them.

(c) Revising the investments by deciding in different entities, the shareholding.

(d) Revising different agreements that are relevant and the joint venture and put them into the parent.

(e) Revising the records that are statutory saved by the parent.

He can clarifies, in the shareholding, some changes that taken place since the last audit.

He can verify if the parent covering corresponding governing body and the composition of the Board of Directors of any entity.

He can use his judgment that is professional by deciding if the parent covering the combination of the Board Directors of any different entity. If the answer ok, that entity can be consolidated in the CFSs as a subsidiary.

He can verify in CFSs, the investments, in such associates, controlled entities or subsidiaries that can be responsible according to the Standards of the Accounting.

He can examine if any one of them has ceased to be a, jointly controlled associate and subsidiary during the period under audit. The subsidiary can be or an associate as well as it can be a subsidiary of the parent.

He can verify the warranted adjustments by the accounting standards that are relevant and made anything needed. They have been authorized by the management of the parent. A rise was presented by the preparation of CFSs to non-stopping consolidation adjustments and period consolidation adjustments that is current (ifrs, 2017).

2.2.4.5. Special Considerations

2.2.4.5.1. Permanent Consolidation Adjustments

The adjustments of permanent consolidation are these made just for the initial time to prepare and to present the CFSs (ifrs, 2017).

The adjustments of permanent consolidation are:

(a) Deciding the deficit or excess of the price towards the parent of the investors in a subsidiary over the portion of parent of equity of the subsidiary, at the date they made investment in the subsidiary (determination of capital reserve or goodwill) .

(b) Deciding this amount for equity attributable towards minorities at the date on which they made in subsidiary the investment.

(c) Deciding capital reserve or goodwill that raised upon the apps of equity method to be responsible in associates in CFSs towards the investments.

He can verify the calculations that are above and preparing them in a very good manner. He can pay attention that is accurate to determine the pre-acquisition reserves of the associates in addition to subsidiary. In subsidiary and associates assuming the significance in this case, namely, Date(s) of investment. He has to examine if the reserves that is pre-acquisition and allocated in accurate manner between the minorities and the parent of the subsidiary. He can verify the changes that taken place in these adjustments that are permanent on account of subsequent acquisition as well as sharing them in the associates or even subsidiary, the disposal subsidiary/associate's disposal in the subsequent years. He has to test agreements towards the joint venture, to build any change that took place before in the interest of the parent in the joint venture.

In the case of one subsidiary, it may take place. The goodwill arises and in different subsidiary of a reserve that is capital arises. They, the parent, can select net off these amounts by disclosing an amount that is single in the consolidated balance sheet. He has to verify the amounts of goodwill that is gross and reserves arising that is capital on acquisition of different subsidiaries disclosed in the notes to the CFSs to mirror the shortage or even excess over the portion of the parents for the equity of subsidiary.

2.2.4.5.2. Current Period Consolidation Adjustments

The adjustments of current period are these, adjustments, that prepared in the period that is accounting for which the consolidation of FSs is done (ifrs, 2017).

The adjustments of current period consolidation has relation to leave out transactions that are intra-group and the account balances containing:

(a) The interest that described as intra-group that received and paid and, managing fees etc.;
(b) The profits that are unrealized intra-group on assets got from different ones, namely, subsidiaries.
(c) Indebtedness that is intra-group.
(d) The adjustments that has a harmonizing in the policies of different accounting because of followed by the enterprise of parent and subsidiaries that are shared it.
(e) The prepared adjustments for the transactions of significant and different incident that take place among the date of the FSs of the parent in addition to more of the elements , if the FSs used for consolidation , it is impossible to be drawn up to the reporting date that is the same .
(f) In equity attributable to the minorities, the determination of movement since the date of subsidiary's acquisition.

They made the adjustments that needed for to prepare CFSs in memorandum records that left to be purposed by the parent. He has to revise the records that are memorandum by verifying the adjustment entries prepared in the preparation of CFSs. It can be useful for the auditor in ascertaining if we have any difference in the elimination.

Except for revising the records that are memorandum, he can do:

(a) Verifying the transactions of the inter-group as well as the balances in account that left out.

(b) Verifying the CFSs that made by utilizing the policies of uniform accounting for the transactions in addition to different incident in circumstances that are similar .

(c) Verifying disclosures that are adequate for making it in the CFSs of apps of the policies of different accounting in case, to do so, it was impracticable.

(d) Verifying the adjustments prepared by harmonizing the policies of different accounting; and Verifying the interest of calculation of minorities that correctly done.

He can get a comprehension of the adopted procedures by the management of the enterprise by doing what is aforementioned about the adjustments. It can be useful to him in making the audit risk lower towards the level that is low.

It may be required, the essential adjustment, in the period that is current and determining the loss that is impairment in addition to being existed for goodwill arising on consolidation. It is carried out at the determined value, namely, goodwill arising on consolidation, at the date of acquiring the subsidiary, in addition to test them for impairment at balance to each sheet date. He can examine anything of loss that is impairment and determined by the parent. If the answer is ok, he can test the followed plans for determining impairment. He has to satisfy one's self towards the impaired mount loss that suggested is fair.

He has to verify the required disclosures by IAS 27 Separate FSs and IFRS 10 CFSs, IAS 28 Investments in Joint Ventures in addition to associates as well as the standards that are different such as IAS 22 — BCs etc.

He has to verify the enunciated principles by the followed explanation in preparing the notes towards the accounts. He has to verify and expect what can be:

(a) Examining the notes that are significant to give a view that is true and fair of the CFSs that included in the CFSs as an integral part thereof.

(b) Examining further information that is statutory and disclosed in separate FSs of the subsidiary. A parent that carrying the view of truth and fairness of the CFSs that disclosed in the CFSs.

If a result of the examinations that are above, he will be of the view that is consolidated. The FSs is impossible to disclose the entire information that necessary to give a view that is true and fair. A modified report should be given.

2.2.4.6. Management Representations

International Standard on Auditing (ISA) 580, "Written Representations" It requires him, namely, the auditor to get representations that is written from management, where it is appropriate, theses was charged by the governance. The (ISA) that stands for " International Standard " on Auditing handles with the responsibility of him to get representations that are written from management, where it is accurate , these was charged by the governance in an audit of FSs (ifrs, 2017).

The CFSs's auditor can get obtain a clue by the management of the parent acknowledge in addition to the responsibility of it for a presentation that is true and fair of the CFSs according to the reporting that is financial and framework applied to the management of parent that approved the CFSs. The CFSs's auditor can get representations that are written from parent management on material of the matters to the CFSs.

Such e.g. of the representations contain:

(a) The wholeness of included components in the CFSs;

(b) Clarifying segments that are reportable for segmental reporting.

(c) Clarifying parties that are related and party transactions that are the same for reporting.

(d) The completeness and appropriateness of consolidation adjustments containing the elimination of the transactions of intra-group.

2.2.4.7. Reporting

Two situations are in an audit of CFSs in the time of the auditor of parent is also the same for the entire components that contained in the CFSs , where he is of the parent that not the same of one or more subsidiaries .Here , utilizing different work with auditors that are different in him. while making the report, he can study the requirements of ISA 700 (Revised), "to form the opinion and to report it on FSs" Where, he can use the work of different auditors in the CFSs's audit, the needs of ISA 600-699 ISA: utilizing the labor from different ones , 700-799 ISA: Audit Reports and Conclusions, it can be studied (ifrs, 2017).

2.2.4.7.1. When the Parent's Auditor is also the Auditor of its Subsidiaries:

Drafting the audit report, in this case, he has to report the procedures in addition to principles .To operate and give the CFSs as put below in the standards that are relevant accounting followed. The cases of deviation, he can make disclosure that is adequate in the report of the audit for the users of the CFSs that can be aware of such deviation.

He has to issue an audit report presenting the opinion if the CFSs presenting a view that is true and fair towards the state of those affairs of the Group as on balance of sheet date. If profit that is consolidated and statement that is loss can present the view of truth and fairness of the results of profit or losses consolidated of the Group for the period under audit. The CFSs contain a statement of cash flow, he can present the opinion of him on the view of truth and fairness of the presented cash flows by the cash flow of the consolidated statements.

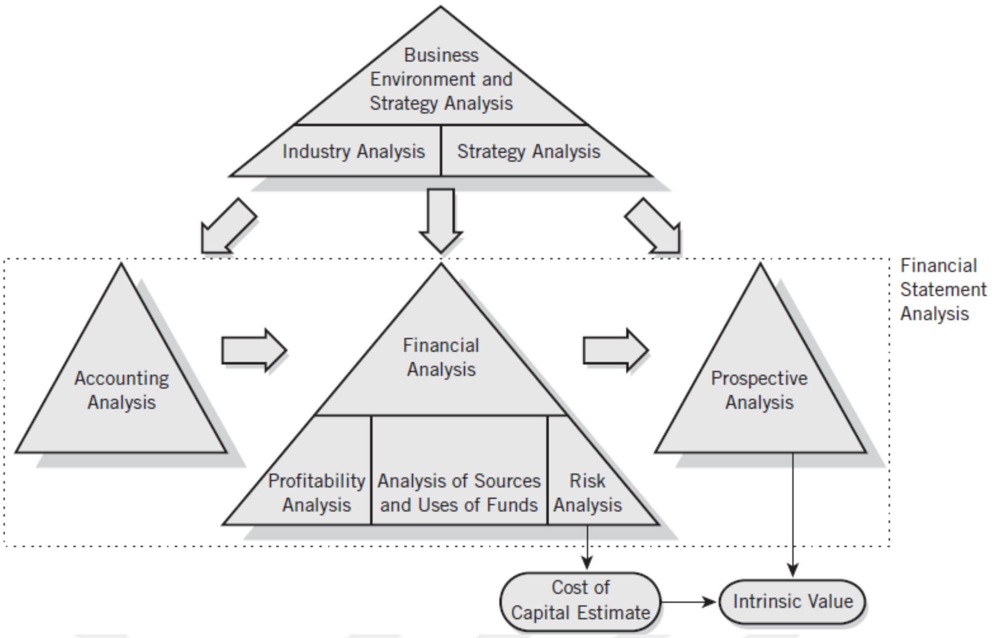
2.2.4.7.2. When the Parent's Auditor is not the Auditor of its Subsidiary:

The auditor of the parent is not the same of the components contained in the CFSs, he is of the CFSs that can be the needs of SA 600.

Where the auditor of the parent can determine that will prepare a reference to him of different auditors, his report on CFSs has to disclose in a clear manner as well as the portion's magnitude of the FSs examined by different auditor(s). By stating the amounts of rupee or percentages of total assets, this may be done. The entire revenue of subsidiary(s) contained in CFSs but not examined by the auditor of the parent. Anyway, in the report of the auditor of CFSs, the reference to the part of him, the prepared group by different auditor(s) is impossible to be built as the same opinion but instead reoffering to the responsibility divided in the middle of the auditors of subsidiaries that shared and the parent.

2.2.5. Theoretical Background of Analyzing Individual & Consolidated and Audited Financial Statements

Analyzing FSs comes under the wider task of business analysis. The diagram below illustrates this process (Wild, 2004)



2.2.5.1. FSs Analysis

Several methods and approaches are utilized by analysts for the sake of converting FS data into formulas that enable assessing firm's financial status and functioning, and doing synchronous and diachronic comparisons. They include *common-size FSs* that represent all accounts on alongside balance sheets estimated by percentages of total assets and all account on the balance sheets as percentages of total assets and accounts on the income statement as percentages of net sales. Meanwhile, *financial ratios* systematize financial data related to mathematical linkages represented as percentages or times; trend analysis that necessitates assessing financial data over more than one accounting period (Fraser, 2010).

2.2.5.1.1. Common-Size FSs

Both the *Income Statement* and the *Balance Sheet* can be converted into "common size" statements for analysis. Common size statements present each item as a percentage of the statement's largest item (Fraser, 2010).

2.2.3.1.1.1. Common Size Income Statement

Normally, the largest item in the *Income Statement* is sales. Thus, when the *Income Statement* is converted into a common size statement, all items are presented as a percentage of sales. Reviewing the common size income statement focuses on the proportion of sales dollar absorbed by various cost and expense items (Fraser, 2010).

2.2.3.1.1.2. Common Size Balance Sheet

To convert the *Balance Sheet* into a common size statement, all components are expressed as a percentage of total assets (Fraser, 2010).

2.2.5.1.2. Financial Ratios

Coca-Cola utilizes FSs to calculate a number of chief financial percentages for several years. These ratios will be evaluated of context of Coca-Cola for several years (Fraser, 2010).

The ratios that shall be discussed are

1- Liquidity ratios: it reveals firm's capability of meeting cash requirements when they emerge.

2- Activity ratios: it reveals the liquidity of given assets and the proficiency of how assets are being managed.

3- Leverage ratios: reveals the level of a firm's financing with loans regarding equity and its capability of covering interest and fixed costs.

4- Profitability ratios: it reveals the gross functioning of the firm and its success in the management of assets, liabilities, and equity.

Nevertheless highly important in analysis, financial ratios are tagged with several shortcomings. They may be harnessed in screening, as they may unveil areas of possible strengths or weaknesses, and discover topics that require more elaborated study.

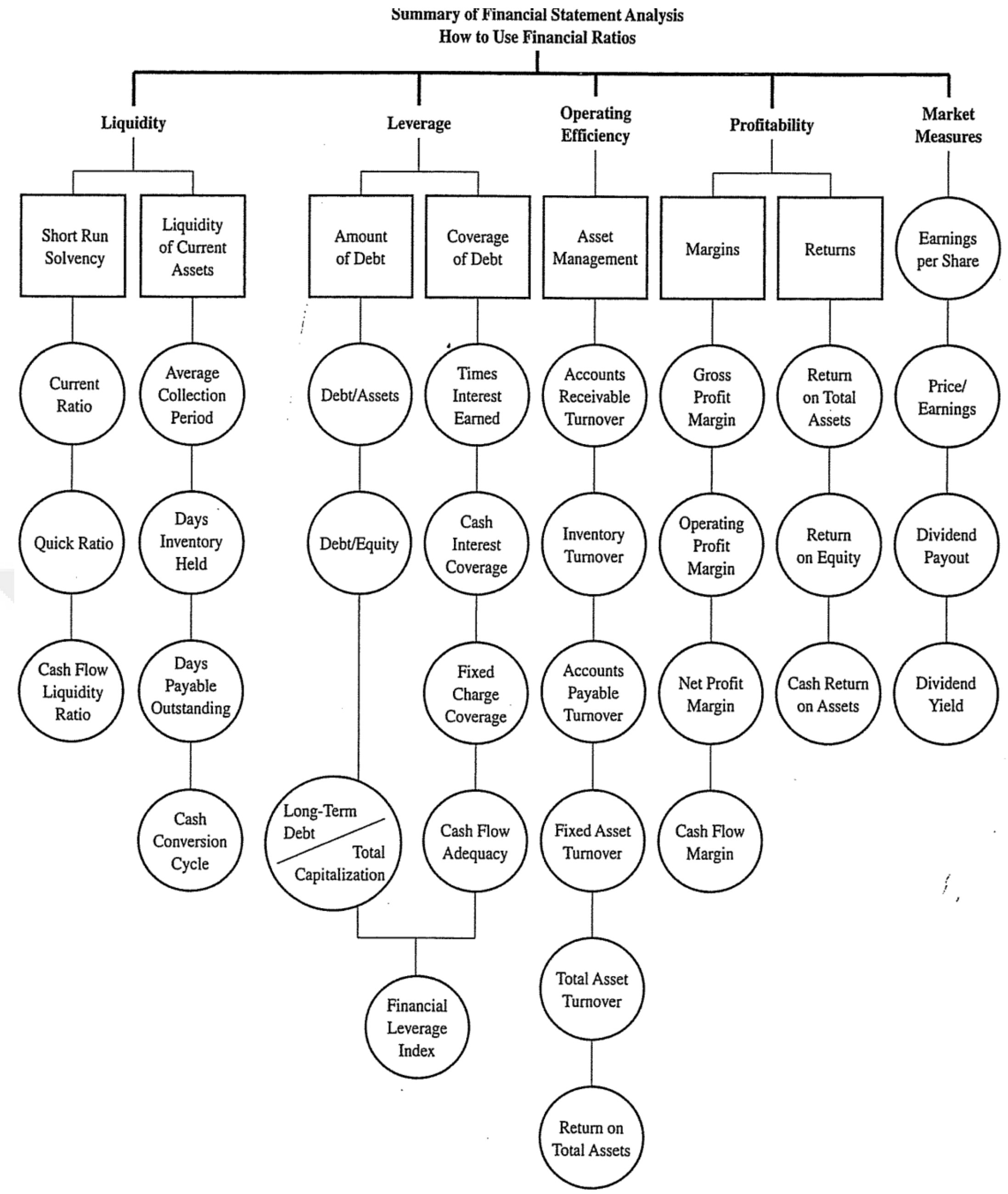


Figure 2.4 Summary of Financial Ratio (Fraser, 2010)

2.2.3.1.1.3. Liquidity Ratios

Short-Term Solvency

$$Current\ Ratio = \frac{Curren\ assets}{Current\ liabilities} \qquad (Times)$$

This ratio is utilized for assessing short-run solvency, firm capability of meeting its due loan necessities. Current liabilities may be harnessed as an indicator for the ratio since they indicate to the most urgent debts, which requires retirement in one year or one operation cycle.

It is crucial to utilize other liquidity assessments like cash flow from operations and financial ratios that assess the liquidity of particular assets, to support the this ratio.

Quick or Acid-Test Ratio

$$Quick\ or\ Acid - Test\ Ratio = \frac{Current\ assets - Inventory}{Current\ liabilities} \qquad (Times)$$

This ratio is more robust than the current ratio since the numerator disregards inventory, considered the least liquid current asset and the most likely source of losses.

Cash Flow Liquidity Ratio

$$Cash\ Flow\ Liquidity\ Ratio = \frac{Cash + Marketable\ securities + CFO^{*}}{Current\ liabilities}\ (times)$$

$*$ Cash flow from operation activities

Cash flow liquidity gauges short-term solvency trough considering cash flow from operation activities (via the statement of cash flows). This ratio utilizes in the numerator, as an estimation of cash capitals, cash and marketable securities, which are the real liquid current assets, and cash flow from operating activities that denotes the amount of cash produced by the firm’s operations, like the capability of selling inventory and collecting cash.

Average Collection Period

$$Average\ Collection\ Period = \frac{Net\ accounts\ recivable}{Average\ daily\ sales} \qquad (days)$$

$$Average\ daily\ cost = \frac{net\ sales}{365}$$

The collection period that describes as average of receivable accounts can be number of days that is and it is needed by converting the receivable into cash. This ratio can be calculated like the relation in the middle of accounts receivable that are net (for doubtful accounts, net of the allowance).

Days Inventory Held

$$Days\ Inventory\ Held = \frac{Inventory}{Average\ daily\ cost\ of\ sales} \qquad (days)$$

$$Average\ daily\ cost\ of\ sales = \frac{cost\ of\ goods\ sold}{365}$$

The day's inventory held comprises the average sum of days it lasts to trade inventory to clients. It estimates firms' effectiveness in the management of its inventory. Broadly speaking, fewer days inventory is an indicator for proficient management; the quicker inventory trades, the fewer capitals tied up in inventory. Moreover, lower numbers might designate understanding and lost directions, declined prices, a scarcity of materials, or higher sales than prearranged.

Days Payable Outstanding

$$Days\ Payable\ Outstanding = \frac{Accounts\ payables}{Average\ daily\ cost\ of\ sales} \qquad (days)$$

The days payable outstanding comprises the average number of days it needs to pay payable in cash. It gives an understanding about firm's method of payments to dealers. Postponing payment of payables to the maximum possible date, but still making payment by the due date, is necessary.

Cash Conversion Cycle or Net Trade Cycle

C.C.C. or vet trade cycle is the standard operation sequence of a firm that is made up of purchasing or manufacturing inventory, with some purchase on loans and the generation of accounts payable; selling inventory, with certain sales on loans and the generation of accounts receivable; and cash collection.

This cycle assists analysts in understanding the reasons behind the improvement or deterioration of cash flow generation through examining the chief balance sheet accounts-accounts receivable, inventory and accounts payable- which may have an impact on cash flow from opening activities.

Such a cycle gauges the process of days which is computed as follows

$$Cash\ Conversion\ Cycle$$
$$= Avearge\ collection\ period + Days\ inventory\ held$$
$$- Days\ payable\ outstanding$$

2.2.5.1.2.2. Activity Ratios: Asset Liquidity, Asset Management Efficiency

Accounts Receivable Turnover

$$Accounts\ Receivable\ Turnover = \frac{Net\ Sales}{Net\ account\ receivable} \quad (times)$$

Inventory Turnover

$$Inventory\ Turnover = \frac{Cost\ of\ goods\ sold}{Inventory} \quad (times)$$

Accounts Payable Turnover

$$Accounts\ Payable\ Turnover = \frac{Costs\ of\ goods\ sold}{accounts\ payable} \quad (times)$$

Fixed Asset Turnover

$$Fixed\ Asset\ Turnover = \frac{Net\ sales}{Net\ property, plant, equipment} \quad (times)$$

Total asset Turnover

$$Total\ asset\ Turnover = \frac{Net\ sales}{Total\ assets} \quad (times)$$

2.2.5.1.2.3. Leverage ratios: Debt Financing and Coverage

Debt Ratio

$$Debt\ Ratio = \frac{Total\ liabilities}{Total\ assets} \times 100 \quad (\%)$$

Long-term Debt to Total Capitalization

$$Long - term\ Debt\ to\ Total\ Capitalization$$
$$= \frac{Long\ term\ debt}{Long\ term\ debt + Stockholders'equity} \times 100 \qquad (\%)$$

Debt to Equity

$$Debt\ to\ Equity = \frac{Total\ liabilities}{Stockholders'equity} \quad (times)$$

All three-debt ratios gauges firm’s financing with loan. The sum and proportion of loan in firm’s capital structure is vital to financial analysts because of the trade-off between risk and revenue.

The loan ratio reflects the proportion of all assets, which are funded with loan. The ratio of long-term loan to total capitalization discloses to what extent long-term loan may be utilized for firm’s constant funding (both long-term loan and equity). The loan-to-equity ratio gauges the insecurity of firm’s capital structure regarding the link between the funds provided by creditors (loan) and investors (equity).

Times Interest Earned

$$Times\ Interest\ Earned = \frac{Operation\ profit}{Interest\ expense} \quad (times)$$

Cash Interest Coverage

$$Cash\ Interest\ Coverage = \frac{CFO + interest\ paid + taxes\ paid^{1}}{Interest\ paid} \quad (times)$$

So that a firm can take advantage from loan funding, the fixed interest expenses that accompany loan must be more than satisfied from operation earnings.[2] Actually, the company seeks to achieve higher interests earned ratio; however, if it achieves high profits without cash flow from operations, this ratio is deemed misrepresentative. The cash-interest coverage ratio gauges how many folds interest expenses might be retrieved by cash flow from operations prior to interest and taxes.

[1] Interests and taxes remunerated exist in the supplementary disclosure of the account of cash flow

[2] The operational return, operational profit divided by assets, should be higher than the expenses of loans, interest expenses divided by liabilities.

Covering Fixed Charges

$$Fixed\ Charge\ Coverage = \frac{Operating\ profit + Rent\ expense^{*}}{Interest\ expens + Rent\ expense^{*}} \quad (times)$$

$*$ Rent expense=operating lease payments

This ratio is a general indicator for covering capacity than the times interest earned ratio since it comprises the fixed expenses linked to leasing. There is resemblance between operational lease expenses and interest expenses in their nature as they both denote commitments that should be fulfilled every year. This ratio is significant for institutions that work expansively with operational leases.

Adequacy of Cash Flow

$$Cash\ Flow\ Adequacy = \frac{cash\ flow\ from\ operating\ activities}{Capital\ expenditures + debt\ repayments + dividends\ paid}\quad (times)$$

This indicator is utilized at this place for probing firm's capability of covering capital expenses, loan maturities, and divided expenses annually.

Financial Leverage Index (FLI) is utilized to examine the effectiveness of the institution, as follows:

Financial Leverage index (FLI)

$$FLI = \frac{Return\ on\ equity}{Adjusted\ return\ on\ assets}$$

The *accustomed return on assets* in the denominator of the above ratio is computed as

$$Adjusted\ return\ on\ assets = \frac{Net\ earning + \big(interest\ expense \times (1 - tax\ rate)\big)}{Total\ assets}$$

and

$$Return\ on\ Equity = \frac{Net\ earnings}{Stockholder's\ equity} \times 100 \qquad (\%)$$

Then FLI become as following

$$FLI = \frac{Return\ on\ equity}{\dfrac{Net\ earning + \big(interest\ expense \times (1 - tax\ rate)\big)}{Total\ assets}}$$

The real tax rate to be utilized in above ratio may be determined as mentioned in chapter 3 (Fraser, 2010).

2.2.5.1.2.4. Profitability Ratios: Overall Efficiency and Performance

<u>Margins</u>

Gross Profit Margin

$$Gross\ Profit\ Margin = \frac{Gross\ profit}{Net\ sales} \times 100 \quad (\%)$$

Operating Profit Margin

$$Operating\ Profit\ Margin = \frac{Operating\ profit}{Net\ sales} \times 100 \ \ (\%)$$

Net Profit Margin

$$Net\ Profit\ Margin = \frac{Net\ earnings}{Net\ sales} \times 100 \quad (\%)$$

Gross profit margin, operating profit margin, and net profit margin are all indicators for the institution capability of translating sales dollars (for instance) into profits at various phases of measurement.

The gross profit margin, that illustrates the link between sales and the expenses of products sold, gauges the capability of an institution both of controlling expenses of inventories or manufacturing of products and of passing along price rises through sales to clients. *The operating profit margin*, refers to the gross operational efficacy, comprises all of the expenses related to ordinary business activities. *The net profit margin* refers to the profitability after taking into account of all revenue and expense, including interest, taxes, and non-operational items.

Cash Flow Margin

$$Cash\ Flow\ Margin = \frac{Cash\ flow\ from\ operating\ activities}{Net\ sales} \times 100 \quad (\%)$$

<u>Returns</u>

Return on Total Assets (ROA) or Return on Investment (ROI)

$$Return\ on\ Total\ Assets = \frac{Net\ earnings}{Total\ assets} \times 100 \quad (\%)$$

Return on Equity (ROE)

$$Return\ on\ Equity = \frac{Net\ earnings}{Stockholder's\ equity} \times 100 \qquad (\%)$$

Return on investment and return on equity are a couple of values that determine the gross efficacy of the institution in handling its gross investment in assets and in creating return to stockholders. Return on equity determines the return to common stockholders; this value is also computed as return on common equity if an institution has favored stock outstanding.

Cash Return on Assets

$$Cash\ Return\ on\ Assets = \frac{Cash\ flow\ from\ operating\ activities}{Total\ assets} \times 100 \quad (\%)$$

The cash return on assets can be helpful when comparing to return on investment.

Return on Total Assets – ROTA

ROTA is a parameter that determines institution's earnings prior to interest and taxes (EBIT) against its gross net assets. The value might serve as an index of company's effectiveness in utilizing its assets to create earnings prior to contractual commitments should be paid (investopedia, 2017).

$$ROTA = \frac{EBIT}{Total\ net\ assets}$$

2.2.5.1.2.5. Market ratios

There are 4 market ratios of interest that is specific towards the investor that can earn a share of per common, the ratio of dividend payout, and the price-to-earnings ratio and the yield that is dividend.

Earnings per share

$$Earnings\ per\ share = \frac{Net\ earnings}{Average\ shares\ outstanding}$$

Earnings per share numbers have to be declared on the face of the income statement for publicly operated institutions.

The ratio of price-to-earnings (P/E ratio) re-counts earnings per stock that is common to the price of the market at which the stock trades, referring to the "multiple" that the stock of the market puts on a firm's earnings.

Price earnings

$$Price\ earnings = \frac{Market\ price\ of\ common\ stok}{Earnings\ per\ share}$$

Dividend payout

$$Dividend\ payout = \frac{Dividends\ per\ share}{Earnings\ per\ share}$$

Dividend yield

$$Dividend\ yield = \frac{Dividends\ per\ share}{Market\ price\ of\ common\ stock}$$

Dividends per share (thebalance, 2017)

$$Dividends\ per\ share\ = \frac{total\ dividends\ paid}{total\ shares\ outstanding}$$

Earnings per share (investopedia, 2017)

$$Earnings\ per\ share\ = \frac{net\ income}{average\ outstanding\ common\ shares}$$

Relating the Ratios- The Du Pont System

After reviewing individual financial ratios in addition to groups of financial ratios, that estimates short-term liquidity, operating efficacy, capital structure and long-term solvency, and profitability, the assessment of the firm can be performed through examining the interlinks among the individual ratios. In other words, how individual financial ratios function together in order to create the gross return? The Du Pont System may be helpful for analysts analyze how the firm’s decisions and tasks throughout the course of an accounting duration and how they interrelate to create the gross return to the firm’s stockholders, the return on equity. The summary ratios utilized are set forth below:

$$Net\ profit\ margin \times Total\ asset\ turnover = Return\ on\ investment$$

$$\frac{Net\ income}{Net\ sales} \times \frac{Net\ sales}{Total\ assets} = \frac{Net\ income}{Total\ assets}$$

So that,

$$Return\ on\ investment = \frac{Net\ income}{Total\ assets}$$

$$Return\ on\ investment \times Financial\ leverage = Return\ on\ equity$$

$$\frac{Net\ income}{Total\ assets} \times \frac{Total\ assets}{Stockholders'equity} = \frac{Net\ income}{Stockholders'equity}$$

Therefore,

$$Return\ on\ equity = \frac{Net\ income}{Stockholders'equity}$$

After reviewing the aforementioned links, analysts may determine advantages and disadvantages, and they might be capable of tracing possible sources of challenges that may arise in the general financial status and functioning of the institution. Through utilizing such a system, analysts may assess variations in the deterioration or more combination. The assessment may then emphasize on particular fields that are behind such variations.

CHAPTER THREE

FSs ANALYSIS, RESULTS & DISCUSION FOR COCA-COLA COMPANY

3.1. THE COCA COLA COMPANY (CCC)

The Coca Cola Company consolidated and audited annual reports for four years has been selected in the financial analysis of this study, depend on mentioned background in the previous section (2.2.5.).

3.1.1. The CCC Established

The company established 1886 in Atlanta: In the first year Coca-Cola creator John Pemberton sold an average of nine servings of Coca-Cola each day. Today that number has increased to 1.9 billion. This well-known brand was first tested in the United States in 1886. Dr. It was introduced by a local druggist in the form of a syrup, then each glass had been sold for five cents. Carbonated water was added to the drink to make it more delicious. The same recipe is still used today (coca-colacompany, 2017).

Coca-Cola is a major international beverage producer. The company operational reach encompasses + 200 countries worldwide across 6 operating regions: Eurasia & Africa, Europe, Latin America, North America, Pacific and Bottling Investments – in addition to Corporate. The company owns or licenses and markets over 500 drink products, especially fizzy drinks in addition to other drinks such as water, enhanced water, juices, teas and coffees, and energy drinks.

3.1.2. The People in CCC

• In 2014, the Company had 129,200 associates worldwide.

• It was ranked among the world's best ten private firms that hires over 700,000 workers.

3.1.3. The Brands

They lead the beverage industry, with a portfolio featuring 20 billion-dollar brands. It was the biggest supplier of fizzy drinks, juices, teas and coffees.

Tables 3.1 & 3.2 are represent the parent and subsidiaries consolidated Balance sheets and statements of income for CCC respectively.

Table 3.1 Coca-Cola Company and Parent and Subsidiaries Consolidated Balance Sheets (In millions except par value) (coca-colacompany, 2017).

Assets	2011	2012	2013	2014
Current Assets				
Cash, including cash equivalents	12803	8442	10414	8958
Short Term Investments	1088	5017	6707	9052
Net cash ,Cash Equivalents and short -Term Investments	13891	13459	17121	18010
Marketable securities	144	3092	3147	3665
Trade accounts receivable, less allowances of $53 and $83, respectively	4920	4759	4873	4466
Inventories	3092	3264	3277	3100
Prepaid expenses and other assets	3450	2781	2886	3066
Assets held for sale	0	2973	0	679
Total current assets	25497	30328	31304	32986
Equity method investments	7233	9216	10393	9947
Other investments, principally bottling companies	1141	1232	1119	3678
Other assets	3495	3585	4661	4407
Property, plant and equipment’s-net	14939	14476	14967	14633
Trademarks with indefinite lives	6430	6527	6744	6533

Bottlers' franchise rights with indefinite lives	7770	7405	7415	6689
Goodwill	12219	12255	12312	12100
Other intangible assets	1250	1150	1140	1050
Total long-term assets	54477	55846	58751	59037
Total assets	79974	86174	90055	92023
Liabilities and Shareholders' Equity				
Current Liabilities				
Accounts payable and accrued expenses	9009	8680	9577	9234
Accounts payable	2926	2693	2722	2952
Loans and notes payable	12871	16297	16901	19130
Current maturities of long-term debt	2041	1577	1024	3552
Accrued income taxes	362	471	309	400
Liabilities held for sale	0	796	0	58
Total current liabilities	24283	27821	27811	32374
Long-term debt	13656	14736	19154	19063
Other liabilities	5420	5468	3498	4389
Deferred income taxes	4694	4981	6152	5636
Total long-term liabilities	23770	25185	28804	29088
Total liabilities	48053	53006	56615	61462
Equity				
Common stock, $0.25 par value; Authorized — 11,200 shares; Issued __ 7,040 and 7,040 shares , respectively	1760	1760	1760	1760
Capital surplus	10332	11379	12276	13154

Reinvested earnings	53621	58045	61660	63408
Accumulated other comprehensive income (loss)	(2774)	(3385)	(3432)	(5777)
Treasury stock, at cost — 2,571 and 2,514 shares, respectively (35,009) (31,304)	(31304)	(35009)	(39091)	(42225)
Equity attributable to Shareowners of the Coca-Cola Company	31635	32790	33173	30320
Equity attributable to noncontrolling interests	286	378	267	241
Total Equity	31921	33168	33440	30561
Total liabilities + Equity	79974	86174	90055	92023

Table 3.2 Coca-Cola Company and Subsidiaries Consolidated Statements of Income (In millions except per share data) (coca-colacompany, 2017).

Income Statement	2011	2012	2013	2014
Net operating revenues	46542	48017	46854	45998
Cost of goods sold	18215	19053	18421	17889
Gross margin	28327	28964	28433	28109
Operating expenses:				
Selling, general and administrative expenses	17422	17738	17310	17218
Other operating charges	732	447	895	1183
Operating Income	10173	10779	10228	9708
Interest income	483	471	534	594
Interest expense	417	397	463	483
Equity income (loss) — net	690	819	602	769
Other income (loss) — net	529	137	576	(1263)
Income before income taxes	11458	11809	11477	9325
Income taxes	2812	2723	2851	2201

Consolidated net income	8646	9086	8626	7124

3.2. FINANCIAL ANALYSIS OF COCA-COLA COMPANY

Theoretical background of financial analysis is mentioned in the previous chapter, and includes the following:

3.2.1. Common Size FSs Results

3.2.1.1. Common Size Balance Sheet

The results of common size balance sheet are illustrated in Table 3.3.

Table 3.3 Common Size Balance Sheet

Assets	2011	2012	2013	2014
Current Assets				
Cash, including cash equivalents	16.01	9.80	11.56	9.73
Short Term Investments	1.36	5.82	7.45	9.84
Net cash ,Cash Equivalents and short -Term Investments	17.37	15.62	19.01	19.57
Marketable securities	0.18	3.59	5.56	3.98
Trade accounts receivable, less allowances of $53 and $83, respectively	6.15	5.52	5.41	4.85
Inventories	3.87	3.79	3.64	3.37
Prepaid expenses and other assets	4.31	3.23	3.20	3.33
Assets held for sale	0.00	3.45	0.00	0.74
Total current assets	31.88	35.19	34.76	35.85
Equity method investments	9.04	10.69	11.54	10.81
Other investments, principally bottling companies	1.43	1.43	1.24	4.00
Other assets	4.37	4.16	5.18	4.79
Property, plant and equipment’s-net	18.68	16.80	16.62	15.90
Trademarks with indefinite lives	8.04	7.57	7.49	7.10
Bottlers’ franchise rights with indefinite lives	9.72	8.59	8.23	7.27
Goodwill	15.28	14.22	13.67	13.15

Other intangible assets	1.56	1.33	1.27	1.14
Total long-term assets	68.12	64.81	65.24	64.15
Total assets	100.00	100.00	100.00	100.00
Liabilities and Shareholders' Equity				
Current Liabilities				
Accounts payable and accrued expenses	18.75	16.38	16.92	15.02
Accounts payable	6.09	5.08	4.81	4.80
Loans and notes payable	26.79	30.75	29.85	31.12
Current maturities of long-term debt	4.25	2.98	1.81	5.78
Accrued income taxes	0.75	0.89	0.55	0.65
Liabilities held for sale	0.00	1.50	0.00	0.09
Total current liabilities	50.53	52.49	49.12	52.67
Long-term debt	28.42	27.80	33.83	31.02
Other liabilities	11.28	10.32	6.18	7.14
Deferred income taxes	9.77	9.40	10.87	9.17
Total long-term liabilities	49.47	47.51	50.88	47.33
Total liabilities	100.00	100.00	100.00	100.00
Equity				
Common stock, $0.25 par value; Authorized — 11,200 shares; Issued __ 7,040 and 7,040 shares , respectively	5.51	5.31	5.26	5.76
Capital surplus	32.37	34.31	36.71	43.04
Reinvested earnings	167.98	175.00	184.39	207.48
Accumulated other comprehensive income (loss)	-8.69	-10.21	-10.26	-18.90
Treasury stock, at cost — 2,571 and 2,514 shares, respectively (35,009) (31,304)	-98.07	-105.55	-116.90	-138.17

Equity attributable to Shareowners of the Coca-Cola Company	99.10	98.86	99.20	99.21
Equity attributable to noncontrolling interests	0.90	1.14	0.80	0.79
Total Equity	100.00	100.00	100.00	100.00
Total liabilities + Equity	100.00	100.00	100.00	100.00

3.2.1.2. Common Size Income Statement

The results of common size balance sheet are illustrated in Table 3.4.

Table 3.4 Common size income statement

Income Statement	2011	2012	2013	2014
Net operating revenues	100.00	100.00	100.00	100.00
Cost of goods sold	39.14	39.68	39.32	38.89
Gross margin	60.86	60.32	60.68	61.11
Operating expenses:				
Selling, general and administrative expenses	37.43	36.94	36.94	37.43
Other operating charges	1.57	0.93	1.91	2.57
Operating Income	21.86	22.45	21.83	21.11
Interest income	1.04	0.98	1.14	1.29
Interest expense	0.90	0.83	0.99	1.05
Equity income (loss) — net	1.48	1.71	1.28	1.67
Other income (loss) — net	1.14	0.29	1.23	-2.75
Income before income taxes	24.62	24.59	24.50	20.27
Income taxes	6.04	5.67	6.08	4.78
Consolidated net income	18.58	18.92	18.41	15.49

3.2.2. Financial Ratios Results

Tables (3.5- 3.9) represent the financial ratios results of Coca Cola Company (Set Key of Financial Ratios).

Table 3.5 Liquidity ratios

Liquidity ratios	2011	2012	2013	2014
Short Run Solvency				
Current Ratio (times)	1.05	1.09	1.13	1.02
Quick or Acid Test Ratio (times)	0.92	0.97	1.01	0.92
Cash Flow Liquidity Ratio (times)	0.88	0.73	0.77	0.70
Liquidity of Current Assets				
Average Collection Period (days)	39	36	38	35
Days Inventory Held (days)	62	63	65	63
Day Payable Outstanding (days)	181	166	190	188
Cash conversion or net trade cycle (days)	281	265	293	287
Cash Flow from Operating activities (CFO) ($ in millions)	9474	10645	10542	10615

Table 3.6 Activity ratios (operating efficiency)

Activity ratios	2011	2012	2013	2014
Accounts Receivable Turnover (times)	38.58	36.18	37.96	35.44
Inventory Turnover (times)	5.89	5.58	5.81	5.94
Accounts Payable Turnover (times)	6.23	7.08	6.77	6.06
Fixed asset Turnover (times)	3.12	3.32	3.13	3.14
Total asset Turnover (times)	0.58	0.56	0.52	0.50
Return On Total Assets	0.14	0.14	0.13	0.10

Table 3.7 Leverage ratios: Debt Financing and Coverage

Leverage ratios	2011	2012	2013	2014
Debt to Total Assets (Debt Ratio) (%)	60.09	61.51	62.87	66.79
Long Term Debt to Total Capitalizations (%)	29.96	30.76	36.42	38.41
Debt to Equity (times)	1.51	1.60	1.69	2.01
Times Interest Earned (times)	24.40	27.15	22.09	20.10
Cash Interest Coverage (times)	30.46	34.67	29.93	27.53
Fixed charge Coverage (times)	2.77	14.43	15.03	15.30
Cash Flow Adequacy (times)	0.32	0.23	0.23	0.24
Financial Leverage Index	2.42	2.51	2.59	2.86

Table 3.8 Profitability ratios: overall efficiency and performance

Profitability ratios	2011	2012	2013	2014
Gross Profit Margin (%)	60.86	60.32	60.68	61.11
Operating Profit Margin (%)	21.86	21.19	23.01	22.24
Net Profit Margin (%)	18.58	18.92	18.41	15.49
Cash Flow Margin (%)	20.36	22.17	22.50	23.08
Return Profit Margin (Net Return on Sales) (%)	18.58	18.92	18.41	15.49
Return on Total Assets (Return on Investment)(%)	10.81	10.54	9.58	7.74
Return on Equity (ROE) %	27.09	27.39	25.80	23.31
Cash Return on Assets	11.85	12.35	11.71	11.54

Table 3.9 Market Ratios

Market Ratios	2011	2012	2013	2014
Earnings Per Share	1.89	2.02	1.95	1.62
Price Earnings Ratio	17.65	18.61	20.42	25.07
Dividend Payout Ratio (%)	50.00	51.00	57.73	75.31
Dividend Yield (%)	2.83	2.74	2.83	3.00

Financial ratios can also be represented in figures, to show the situation of the firm more clearly, and can be observed in the following figures.

3.2.2.1. Liquidity Ratios

Figures 3.1 & Figure 3.2 refer to liquidity ratios analysis for Coca-Cola firm:

The current ratio for (C.C.C.) indicates that during four-year period covered current liabilities 1 time approximately. The quick ratio for C.C.C. indicates some improvement between 2011 and 2012, and 2013 then back to same situation in 2014. The cash flow ratio decreased between 2011 and 2012 then increased in 2013 whereas decreased in 2014. It is noted the current ratio and the quick ratio are not steady during the four-year period 2011 to 2014. As well as cash flow ratio is not steady, because there is a decrease between 2011 and 2012, then growth between 2012 and 2013 then decrease slightly between 2013 and 2014.

The average collection period ratio for C.C.C. points out that in 2014 the company has compiled its accounts usually in 35 days; it is better than collecting it in over 39 days in 2011.

Days inventory of C.C.C. has increased slightly from 2011, slightly deterioration over 2014. A minimized period inventory may be the outcome of implementing normal or stocking inventory that is obsolete, quickly-moving, and there is no strike and does not require opening novel retailers. Although payables are postponed as long as possible, however making payment by the due date desirable. The company needed lengthier periods to reimburse dealers in 2014 in comparison to 2011.

The company enhanced its cash conversion cycle through enhancing gathering of accounts receivable, moving inventory quicker, and requiring lengthier periods to pay accounts payable in 2012. The company has somewhat weakened its cash conversion cycle by undermining the compiling of accounts receivable, moving inventory slightly shorter to pay accounts payable in 2012 and 2013. Meanwhile, in 2014 the company has enhanced its cash conversion cycle by enhancing the compiling of accounts receivable, making inventory lengthier to pay accounts payable. For C.C.C. the significant issue annually is that improvement in cash conversion cycle and inventory performed in the last year.

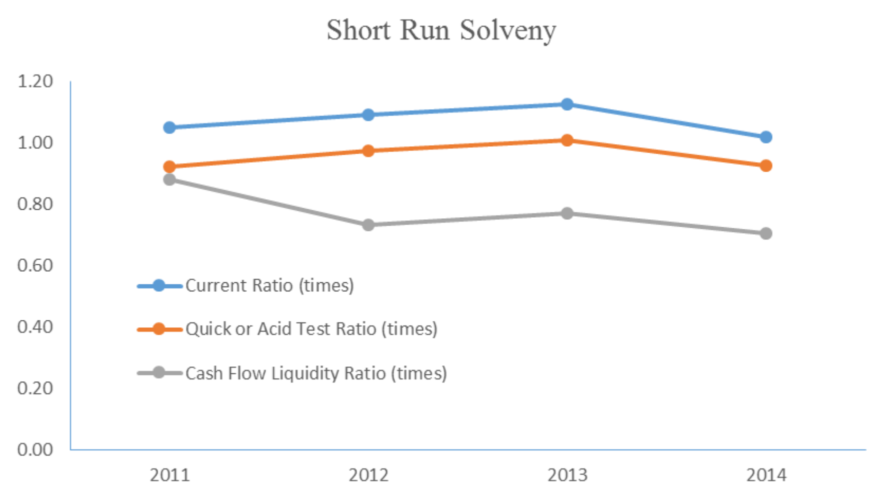


Figure 3.1 Liquidity ratios (Short Run Solvency)

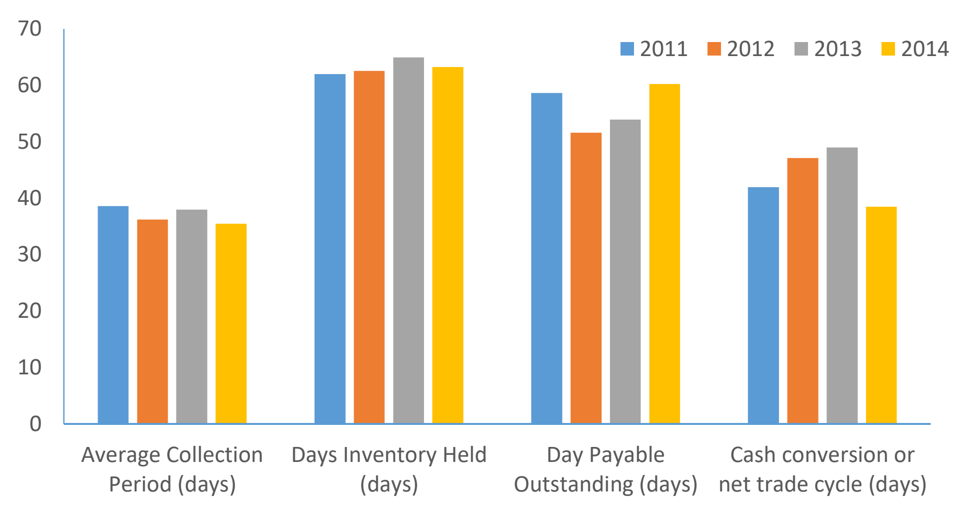


Figure 3.2 Liquidity ratios (Liquidity of Current Assets)

3.2.2.2. Activity Ratios (Operational Effectiveness)

Figure 3.3 indicates that C.C.C. converted accounts receivable into cash 35 times in 2014, up from 38.60 times in 2011. Inventory turned over 5.94 times in 2014 in comparison to 5.89 times in 2011. Consequently, inventory were sold more quickly. Lesser payables turnovers points out that the firm needs more time for repaying payables. For C.C.C., fixed asset income was provided swiftly in 2012, and in 2011 and 2013, however there was a faintly surge in 2014. The decline in overall asset turnover was triggered by the declining inventory and accounts receivable turnover.

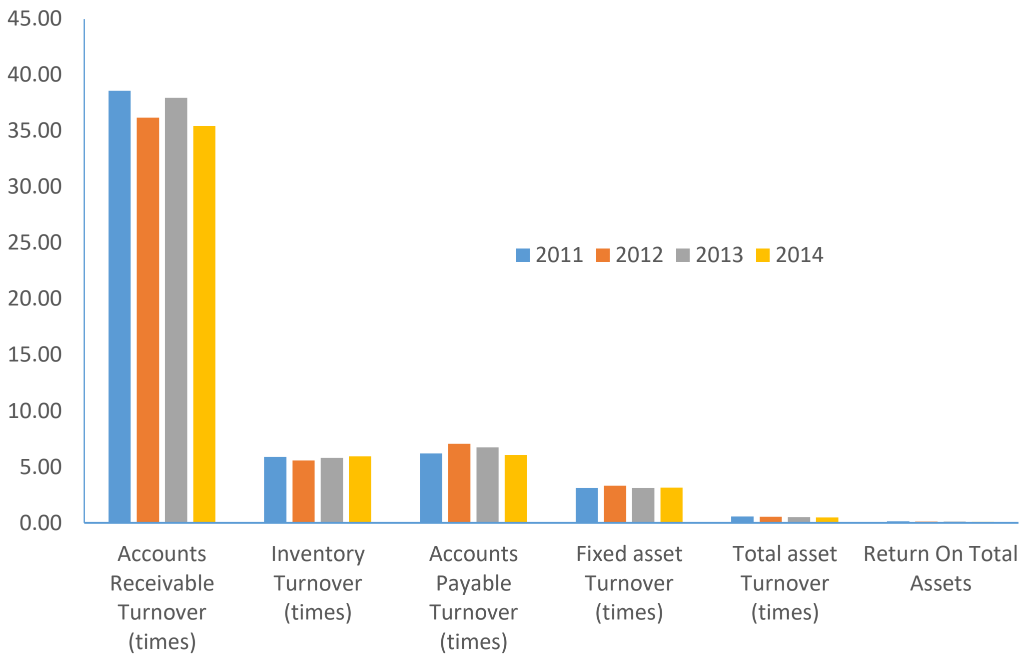


Figure 3.3 Activity Ratios

3.2.2.3. Leverage Ratios: Loan Sponsoring and Coverage

Figures 7.4 & 7.5 illustrate that all three ratios of debt, long-term debt to overall capitalizations, and loan to equity have been amplified to some extent for C.C.C. within four years through utilizing a more risky capital organization. Time reduction obtained and covering cash interest for C.C.C. has risen its loan usage in 2012. Moreover, firm's capability to recover interest payments from operating profits and cash from operations was also enhanced. It should be noted that in 2011, the institution was able to cover interest payments only 24.4 times, which is attributed to underprivileged cash produced by operations prior to interest and taxes. Meanwhile, the condition was inversed in 2013 and 2014.

In terms of fixed charge coverage, the C.C.C. witnessed a significant rise in annual lease payments in 2012, 2013 and 2014, but it was still capable of enhancing its fixed charge coverage to some extent. In 2014, C.C.C. had a cash flow adequacy ratio of about 0.23 times for four years, and a deterioration when contrasted to 2011.

Financial leverage index (FLI) for C.C.C. has risen annually which is an indicator for the effectiveness of financial leverage for the duration of four-year, meanwhile, borrowing dropped to some extent.

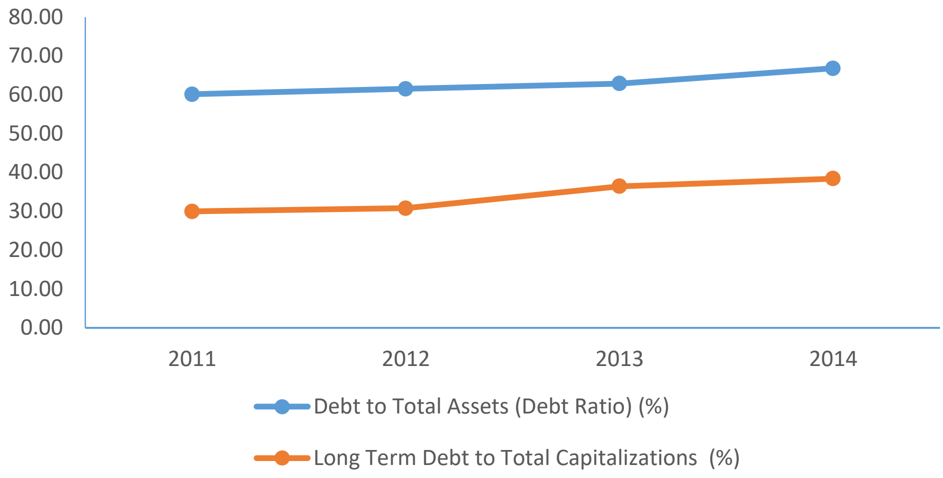


Figure 3.4 Leverage Ratios

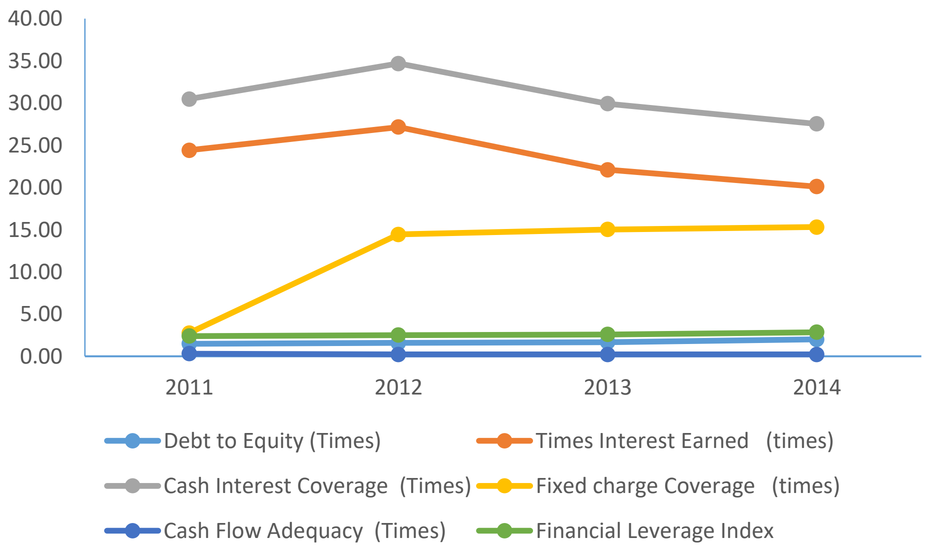


Figure 3.5 Leverage Ratios

3.2.2.4. Profitability Ratios: Inclusive Proficiency and Performance

C.C.C. witnessed moderate alterations in gross profit boundary, but the there was an enhancement in the operating boundary particularly in 2013 and 2014. Moderate rise in net profit boundary was also recorded particularly in 2012 and 2014, as illustrated in Figure 3.6.

In next three years, cash flow boundary for C.C.C. has been higher than the net profit boundary, which is attributed to the strong positive cash. A remarkable functioning in 2014 has been recorded over previous three years once the company was incapable of generating cash from operations and there was a negative cash flow boundary. There was a moderate rise in return profit boundary for C.C.C. in 2012 followed by a moderate decline in 2013 and another graduated rise in 2014. A moderate decline in return on total assets and on equity was recorded for C.C.C. for the years 2012 and 2013, followed by a bigger declines in 2014 for return on total assets, whereas return on equity has risen in 2012 then declined in 2013 & 2014. There was a rise in Cash return on assets for C.C.C. in 2012 followed by a decline in 2013 & 2014.

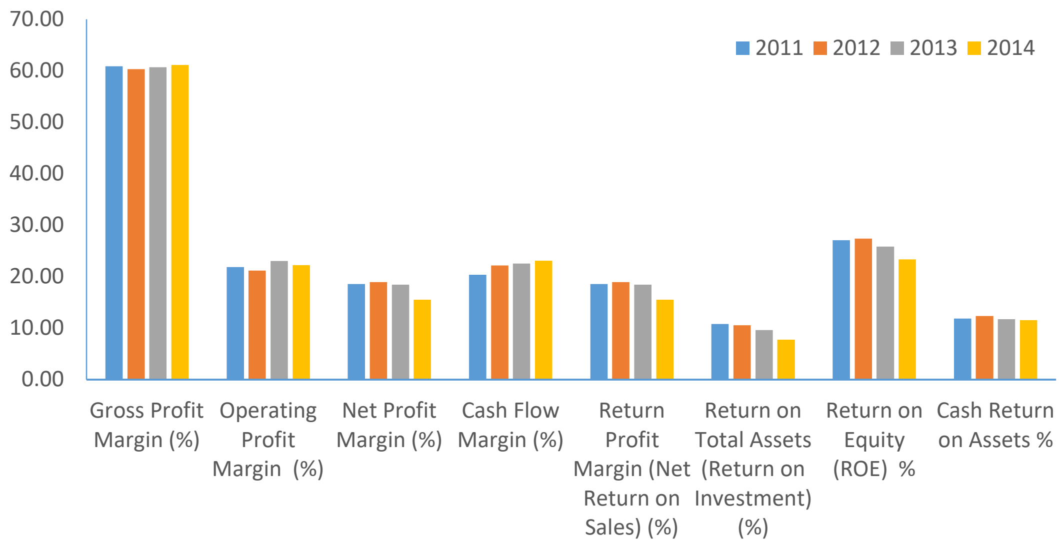


Figure 3.6 Profitability Ratios

3.2.2.5. Market Ratios

Figure 3.7 illustrates that there is a moderate rise in the earning per share for C.C.C in 2012, followed by a decline in the following two years. The price earnings ratio for C.C.C. is higher in 2012 than 2011 and the next years. This might be attributable the enhancement of the market generally and its cautious reaction to firm’s good year.

C.C.C amplified its cash dividend payment in the next years. Typically, there is rises in company’s cash dividends because of the decision that can be read as a positive indicator concerning the outlook.

Dividend yield for C.C.C. stocks yielded a 2.74% return relying on the market price at year-end 2012, followed by a rise in the following two years.

Investors perhaps seek to select C.C.C. as an investment for long-term capital appreciation rather than for its dividend yield.

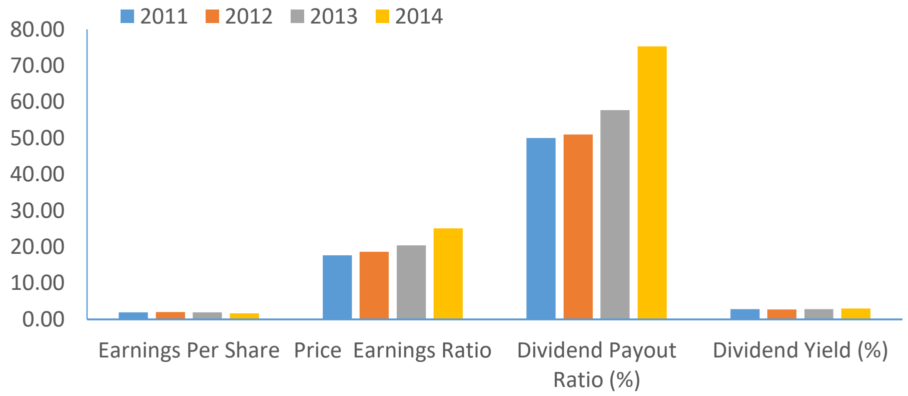


Figure 3.7 Market Ratios

3.3. DATA ANALYSIS AND HOW FINANCIAL STATEMENTS ARE ANALYZED IN FIRMS

1. The objectives of the analysis are identified.
2. The domain of the firm is studied and related to the climate of current and anticipated economic advances.
3. Knowledge is developed about the firm, and how it is managed.
4. FSs are assessed
    - Devices: the size of FSs is Common, the ratios of key is financial, structural analysis, trend analysis and compared by competitions that is industry.
    - Major domains: liquidity that is Short-term, capital structure that is capital, operating efficiency, and solvency that is long-term, segmental analysis, market ratios, profitability (when relevant), and the reporting of quality of finance.
5. Outcomes are summarized and conclusions are reached about firm objectives.

3.3.1. Liquidity Ratios

Analyzing short-term liquidity is of great significance for creditors, dealers, managers, and other parties interested in firm's capability of covering near-term demands for cash.

Assessing Coca-Cola's short-term liquidity position started through preparing and interpreting firm's common-size balance. Such an assessment illustrated that there was a relative decline in inventories once compared to cash and marketable securities in the existing asset section. There was also a rise in short term investments and long-term debts. Further proof that are helpful in analyzing short-term liquidity has been delivered by a four-year trend of given financial ratios.

Liquidity ratios

Coca-Cola Company	2011	2012	2013	2014
Current Ratio (times)	1.05	1.09	1.13	1.02
Quick or Acid Test Ratio (times)	0.92	0.97	1.01	0.92
Cash Flow Liquidity Ratio (times)	0.88	0.73	0.77	0.70
Liquidity of Current Assets				
Average Collection Period (days)	39	36	38	35
Days Inventory Held (days)	62	63	65	63
Day Payable Outstanding (days)	59	52	54	60
Cash conversion or net trade cycle (days)	42	47	49	38
Cash Flow from Operating activities (CFO) ($ in millions)	9474	10645	10542	10615

Analyzing liquidity requires forecasting firm's capability of meeting prospective cash requirements. Such forecasting is retrieved from historical records of the company. For C.C.C., the financial ratios are inconsistent to some extent.

The existing swift values were risen to some extent within the four-year period, which is indicator for the development of short-term liquidity. Nevertheless, the cash flow liquidity ratio dropped within four-year period. The mean collecting period for accounts receivable exacerbated to some extent while the day's inventory held ratio was enhanced. These parameters can determine the quality or liquidity of accounts receivable and inventory. The mean collecting duration has dropped to days in 2014, which indicates that there was a relative enhancement in 2012 and recession in 2013, and enhancement in 2014. The net trade cycle has enhanced within four-year duration because of the declined collecting duration and almost the same number of day's inventory. In 2014, a remarkable enhancement in managing the existing assets and liabilities have pushed the cash conversion cycle to decline by 11 days from high of 49 days in 2013.

The common-size balance sheet for C.C.C. has shown that inventories now are below 4% of the total assets. Therefore, the growth of inventories was essential for the satisfaction of the requirements associated. This indicates a highly trade of liquidity assets for hypothetically high liquid assets. Managing inventories effectively is pivotal for the firm's constant liquidity.

The main issue in the outlook for liquidity is firm's capability of producing cash from operations. Inventories and receivables has grown constantly for the limited sale rise of a recessionary year, and C.C.C. witnessed little rise of credit disposal from dealers that felt the economic pay. This led to a positive cash flow from operations.

In four- year duration, C.C.C. witnessed substantial enhancement, high quantity in cash from operations and advancing management of inventories and receivables. Seemingly, there are no main troubles with the short-term liquidity condition now.

3.3.2. Operational Effectiveness

Activity ratios (operating efficiency)

Coca-Cola Company	2011	2012	2013	2014
Accounts receivable turnover (times)	38.58	36.18	37.96	35.44
Inventory turnover (times)	5.89	5.58	5.81	5.94
Accounts payable turnover (times)	6.23	7.08	6.77	6.06
Fixed asset turnover (times)	3.12	3.32	3.13	3.14
Total asset turnover (times)	0.58	0.56	0.52	0.50

Turnover values gauge the operational effectiveness of the company. There was a moderate rise in C.C.C.'s fixed asset turnover within the last four years. The asset turnover ratios indicates for a constant effectiveness. There was a moderate decline in the total asset turnover in the year duration, progress that is attributable to exacerbation in managing the inventories and receivables.

3.3.3. Capital Structure and Long-Term Solvency

The analysis involves assessing debts in a firm's capital structure in addition to the capacity of debt serving. Debts entails risks since they involve meeting of fixed financial pledges. The shortcoming of debt supporting is that the fixed pledges should be fulfilled so that the firm can carry on its operations. The main benefit of debt supporting is that, if it is utilized effectively, stockholder returns are exaggerated through financial leverage.

Capital Structure and Long-Term Solvency

Coca-Cola Company	2011	2012	2013	2014
Debt to total assets (debt ratio) (%)	60.09	61.51	62.87	66.79
Long term debt to total capitalizations (%)	29.96	30.76	36.42	38.41
Debt to equity (times)	1.51	1.60	1.69	2.01

Debt rates for C.C.C. make clear that a constant rise in the utilization of borrowed funds. Overall debts have grown when compared to total assets, long-term debts have grown as a proportion of the firm's long-lasting financing, and exterior or debt financing has grown when compared to interior financing. Due to the higher of risks associated to borrowing, it is crucial to decide

(1) Why debts have grown;
(2) Whether the firm is utilizing debt effectively; and
(3) To what extent firms are able to cover their fixed charges.

The following table illustrates the efficiency of C.C.C. in utilizing financial leverage.

Financial Leverage Index Results

Coca-Cola Company	2011	2012	2013	2014
Financial Leverage Index	2.42	2.51	2.59	2.86

The progressive growth in FLI for C.C.C. for four-year duration may be an indicator for the efficient utilization of financial leverage. The company has produced adequate operational returns to cover the interest payments on borrowed funds.

The coverage rates are shown in the following table:

Coverage Ratios Results

Coca-Cola Company	2011	2012	2013	2014
Times interest earned	24.40	27.15	22.09	20.10
Cash Interest Coverage	30.46	34.67	29.93	27.53
Fixed charge Coverage	2.77	14.43	15.03	15.30
Cash Flow Adequacy	0.32	0.23	0.23	0.24

Due to the decline in borrowing, the times interest obtained and cash interest coverage rates grew throughout the four-year duration. Cash interest coverage points out that C.C.C. is producing adequate cash to make the payment in 2012, and then return to beginning year situation almost in 2013, the drop progressively in 2014. C.C.C. rents most of its retailers. Therefore, the fixed charge coverage ratio, which considers rent payments in addition to interest costs, is more relevant than times interest obtained. This rate grew as well, because there were no store expansion and fewer payments for leases and interest. Fixed charge coverage rate should be examined carefully in the future. The cash flow adequacy rate was under 1.0 for four-year duration, which is an indicator to the fact that the company is not producing adequate cash from operations for financing capital expenditures, debt repayments, and cash dividends. In order to such as rate, the company should minimize accounts receivables and inventories, which leads to rise in the cash from operations.

3.3.4. Profitability

Coca-Cola Company	2011	2012	2013	2014
Gross Profit Margin (%)	60.86	60.32	60.68	61.11
Operating Profit Margin (%)	21.86	21.19	23.01	22.24
Net Profit Margin (%)	18.58	18.92	18.41	15.49
Cash Flow Margin (%)	20.36	22.17	22.50	23.08

Following a relatively non-fruitful year in 2012 caused by economic decline, opposing ski circumstances, and the expenses of opening novel stores, the overall profit boundary was almost unchanging within the first three-year duration meanwhile risen in 2014. There was a rise in operational profit boundary. The net profit boundary enhanced as well. The cash flow boundary risen.

Coca-Cola Company	2011	2012	2013	2014
Return on Total Assets (%)	10.81	10.54	9.58	7.74
Return on Equity (%)	27.09	27.39	25.80	23.31
Cash Return on Assets (%)	11.85	12.35	11.71	11.54

Returns on assets, return on equities, and cash returns on assets declined progressively. Returns on assets and returns on equities rates gauge the whole firm's effectiveness in making profits, Meanwhile the cash returns on assets gauges firm's capability of making cash from its investments and managing policies.

3.4. RELATING THE RATIOS- THE DU PONT SYSTEM

Du Pont System is helpful for analysts in giving an idea about firm's decisions and actions throughout an accounting duration-that are gauging the interaction required for the production of the over-all returns to the firm's stockholders, the returns on equities.

The Du Pont System provided to C.C.C.

Years	NPM	TAT	ROI	FL	ROE
2011	18.58	0.58	10.81	2.53	27.35
2012	18.92	0.56	10.60	2.63	27.87
2013	18.41	0.52	9.57	2.71	25.94
2014	15.49	0.50	7.75	3.04	23.54

where

NPM: Net profit margin
TAT: Total asset turnover
ROI: Return on investment
FL: Financial leverage
ROE: Return on equity

Both net profit boundary and the total asset turnovers have declined in 2014 when compared to previous years. When risen debts and low profitability are associated with asset utilization, it triggered the production of low overall returns progressively. Particularly, the firm has supplemented debts for financing capital asset growth somewhat and has not utilized its debts efficiently. Although debts are associated with risks and added cost as interest costs, debts have a value of financial leverage when loans are utilized well. The year duration faintly low in inventory organization has influenced the firm undesirably, appearing in the declined overall assets turnover rates. Firm's capability of controlling operational sales properly in particular in 2012 and 2013, which worsened in 2014, has worsened the net profit boundary in particular in 2014. The gross returns on investment are declined progressively during the year duration due to all these factors.

3.5. ANALYSIS SUMMARIZATION

Analyzing FSs involves several interrelated steps and parts. Individual sections of the analysis cannot be interpreted separately. Short-term liquidity influences profitability; probability starts with sales, that is linked to the liquidity of assets. The efficacy of asset managing has an impact on the cost and obtainability of loans that outlines the capital structure. All aspects of company's financial status, functioning, and outlook have impact upon the stock price. The final procedure in FS analysis is the integration of discrete components into a whole, which opens the way for conclusions regarding the business enterprise. The particular conclusions reached sall be influenced by the original aims set at the beginning of the analysis.

The chief outcomes of the analysis of C.C.C. FSs may be summarized in the points below:

Advantages

1. Convenient economic and industry stance. The firm is has a good geographical location so it can take advantages from predictable economic and industry growth.
2. Aggressive marketing and expansion policies.
3. Effective utilization of financial leverage and profound coverage of loan service necessities.
4. Active control of operational expenses.
5. Remarkable sales rise in particular in 2012, in part due to market enlargement and reflective of future functioning possibilities.
6. Risen profitability, positive operational production of cash flow.
7. Seemingly, C.C.C. a proper position for future growth.
8. Risen cash flow from operational activities

Disadvantages

1. Latest declined in the managing of accounts receivable and inventory.
2. Extremely sensitive to economic variations and weather conditions.

CONCLUSIONS

This study dealt with the consolidation of FSs as well as the concept of economic complexes. The study focused generally on auditing of FSs and particularly of auditing the CFSs.

The study concluded that auditing the FSs is primarily an accounting process though it may some economic, legal, taxing, and social dimensions. Hence, the accountant of any national economic complex is expected to be aware of all laws and regulations imposed by governments to control various domains relevant consolidation process. Similarly, the accountant of a multinational company (or one of its subsidiaries) has to be acquainted with the rules and regulations imposed by the government where the headquarters of the company is based.

Auditing has witnessed a remarkable advancement as it acquired a theoretical framework that accommodates a set of concepts, fundamentals and hypotheses, in addition to the empirical framework that includes an array of procedures, steps, and standards adopted by the auditor which altogether comprises an attempt to formulate a general theory of auditing. Consequently, auditing turned to be an organized process that complies to a scientific methodology and governed by national and international standards.

In this regard, there are two influential global organizations that issue these standards. The first is AICPA which are specialized in what is known as GAAS (Generally Accepted Auditing Standards) and the other is IFAC that issues the ISA (International Standards of Auditing) which both seek to figure out a common language and unify the vocational behavior for the sake of serving investors on the international level.

Although auditing the CFSs is not different from that of individual statements, it has some particularities that cope with the nature of CFSs. Complexes comprise an old economic phenomenon that has seen developments after globalization. It can be defined as a group of companies that are separate legally and interconnected economically under the supervision of parent company.

Despite the abundance of these complexes as giant entities, they are not recognized legally as they lack the moral entity. Hence, every country legislates law that regulate the economic, legal, tax and administrative aspects and determines the various relationship between parent and subsidiary companies and between the subsidiary companies themselves.

Consolidation is an accounting and technical phenomenon that aims at giving a more comprehensive image about the financial status of the complex that expresses economic, tax, financial and social processes. Consolidation is based on a set of techniques controlled by international accounting standards. It is also based on domestic regulations in addition to the fundamental accounting conceptions of consolidation.

All national and international standards aim at highlighting all elements of the financial status of subsidiary companies and seek to add thoroughness to the CFSs. However, changes that occur on the consolidation scale and the variation in the characteristics and activities of each individual firm may limit the accurate expression of complex fortune.

Meanwhile, the firms that utilize CFSs according to the international accounting standards were actually governed by two in international standards IAS 27 for aggregate FSs and IAS 28 investments in associates and joint ventures for investment accounting in the co-firms. After the advent of the international accounting standard IFRS 10 for the CFSs, the concept of control was more clearly defined as it replaced part of IFRS 27 to some degree. Hence, the standards IFRS 10, IFRS 11 and IFRS 12 governed this domain since 2013.

The major conclusion from the financial analysis of C.C.C. FSs can be observed for strengths that; convenient economic and industry stance. The firm is has a good geographical location so it can take advantages from predictable economic and industry growth, aggressive marketing and expansion policies, effective utilization of financial leverage and profound coverage of loan service necessities, active control of operational expenses, remarkable sales rise in particular in 2012, in part due to market enlargement and reflective of future functioning possibilities, risen profitability, positive operational production of cash flow, seemingly, C.C.C. a proper position for future growth, and risen cash flow from operational activities. But regarding to weakness of C.C.C., latest declined in the managing of accounts receivable and inventory, extremely sensitive to economic variations and weather conditions, and there is a little decline in the managing of inventories and receivables.

Hypotheses Testing

Concerning hypotheses testing, the study has reached the following conclusions:

Regarding the first hypothesis that presumes the existence of complex techniques for consolidating FSs, these statements are clear and well-structured and aims primarily at controlling and organizing consolidation process.

The second hypothesis presumes the existence of economic, legal and administrative links between the various subsidiary companies themselves on the one hand and between these subsidiary companies and the parent company on the other hand. These links actually are based on the control adopted by the parent firm to issue recommendations through which it implement the strategy of the firm.

The third hypothesis assumes that the goal of the CFSs is the accurate expression of the real wealth and the financial status of a group of companies that form the complex. The study found that sharing bonds and shares may not alone represent the financial status of a subsidiary company and they will not offer a comprehensive image. Conversely, CFSs give more accurate and thorough information about the subsidiary companies as these statements may contain information about the wealth of the companies and their financial status and the output of their activities.

The fourth hypothesis assumes that the financial analysis highlights a clear insight about the financial status of the company whether it was a single firm or a holding firm because the analysis deals with the holding firm as a single entity. Therefore, holding companies are subjected to all financial techniques used in financial analysis. Moreover, the analysis of financial data is crucial whether performed after consolidating the FSs (for newly-mergered companies) or holding companies (the parent company) that offered their shares in the global stock markets so that investors can have a complete idea about the financial status of the CFSs of the company through the financial report announced in global markets.

The last hypothesis indicates that FSs aims at bringing the points of strength and weakness of the firm into light. From the financial analysis presented in previous chapter it is noted that these techniques shed light on most environments that surround the financial status of the company which their stocks to be purchased, lent, etc. for investors, creditors, etc.. Consolidation alone may not give a clear image about the financial status; however, it requires a financial analysis through using the mentioned techniques which were utilized in this study especially for users and creditors.

Recommendations

- Complexes should be controlled in terms of frameworks, accountants and professionals due to their national and international implications.
- Constructing all elements which are crucial to complexes like frameworks, accountants, management, banks, etc. in order to control consolidation techniques.
- The significance of exploiting the techniques of financial data analysis accurately for the parent firm. Furthermore, the consolidation and auditing of FSs may shape a complete idea whether the investor was a purchaser or seller of stocks so that the formula of supply and demand can be accredited.

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