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The most common challenges in the process of preparing consolidated financial statements

All matters relating to the preparation of consolidated financial statements are governed by the Accounting Act („Accounting Act"), the Regulation of the Minister of Finance on the detailed rules for the preparation of consolidated financial statements of capital groups by entities other than banks, insurance and reinsurance undertakings, and the International Accounting Standards („IAS").

Entities that confirm the obligation to draw up consolidated financial statements must first answer the question of what accounting standards they should use to consolidate their statements. A significant number of entities operating on the Polish market are obliged to prepare reports and thus consolidate in accordance with the Accounting Act. The regulations allow certain entities to prepare consolidated statements in accordance with International Accounting Standards (IAS). The right to choose between the Accounting Act and IAS is given to the entities applying or intending to apply for admission to trading on EEA regulated markets and lower-level parent undertakings where the higher-level parent company has chosen IAS. Real estate capital groups with an extensive territorial structure are often consolidated in other jurisdictions, such as Luxembourg or the Netherlands, where holding companies (Holdco) are located. In such cases, consolidation is often carried out in accordance with International Financial Reporting Standards (IFRS). Separate financial data provided from subsidiaries (PropCo) which own real estate assets in various European countries are included in the consolidated financial statements after adjustments and exclusions. It is important to remember that the consolidated financial statements should present information as if the capital group operated as one separate business entity.

Consolidation affects many aspects of the company's growth. It allows investors to assess the opportunities and gives interested parties a complete financial picture of the company. Effective consolidation is a process that requires accurate figures from all entities subject to consolidation and consistent application of accounting regulations according to which the records of individual entities are kept.

The overriding principle of the consolidation process is its proper planning, including setting reporting deadlines for both the teams responsible for providing data of individual entities and the team responsible for preparing the final consolidated financial statements.

The main stages of the consolidation process include:

1. collection of consolidation packages from individual entities whose data are consolidated with the parent entity,
2. reconciliation of trial balances, costs and revenues related to transactions with related entities (intercompany balances),
3. alignment/transformation of financial data of individual entities to the accounting policy of the entire group,
4. translation of financial data of entities into the functional currency of the entity that consolidates the data,
5. automatic/obvious consolidation exclusions for intercompany transactions,
6. other consolidation adjustments related to the specifics of the business, or the type

of transactions carried out during the year,
7. preparation of consolidated financial statements of the entire group,
8. auditing of the consolidated financial statements by a certified auditor.

Given the comprehensive and complex consolidation process that requires the involvement and close cooperation of many parties, it is necessary to allocate sufficient time to its proper planning. In addition, it is worth involving all participants of the process already at the planning stage to be able to set realistic requirements both as to the scope of data provided and their time. The above will allow for the efficient achievement of the common goal, which is the preparation of financial statements within the statutory deadline and obtaining a positive opinion on the audit of the financial statements.

Issues to consider to ensure they do not become challenges during the process include:

1. Planning and timeliness

The efficient course of the consolidation process is a key challenge for finance and accounting departments. Reporting deadlines should be communicated in advance. With regard to the deadlines, we take into account the audit time, the approval time of the consolidated financial statements, the possibility for all parties to send data, taking into account public holidays in each country. Often, reporting deadlines are very short, mainly after the year/month/quarter close. Even the smallest delays in reporting at each level should be communicated, as it may affect the delay of subsequent stages. The process involves accounting teams, controllers, real estate managers, auditors and the company's management board. Each of the entities has a significant contribution to the process. In large capital groups, e.g. in real estate companies, an important role is played by auditors, who review and approve individual reports prepared by the accounting department.

2. Poor quality of financial data of individual entities

In the era of automation and digitization, we observe that some documents are still entered into the accounting system manually. This significantly increases the risk of error and thus the poor quality of the data provided. To minimize the risk of making a mistake, we recommend to:

- introduce consistent standards and processes within all entities,
- introduce a uniform group chart of accounts,
- introduce a consistent nomenclature within all entities,
- determining the persons responsible for preparing and reviewing the data,
- conducting regular audits

In order to effectively implement the above-mentioned processes, it is important to provide adequate training to teams at all levels of reporting in different countries engaged in the consolidation process.

3. Lack of automation and appropriate systems for the consolidation process

In the case of capital groups that have a small structure and a small number of related transactions, the consolidation process usually takes place in an Excel spreadsheet. However, in other cases, it may be useful to use a dedicated consolidation system. Investing in a professional ERP system and integrated tools for the flow of data from local systems reduces the risk of making mistakes and saves the time and resources involved in the consolidation process.

4. Exclusions of related party transactions

Exclusions of related transactions require an understanding of their nature by all parties involved. In order to properly identify related transactions, it is important for the entities in the group to communicate on a regular basis. This is particularly important in cases where payments under related transactions do not take place directly (parent/subsidiary) but through other related entities, which should be properly and continuously reflected in the entire structure.
To prevent these inconsistencies, settlements within the group should be reconciled on an ongoing basis. For this purpose, it is useful to a keep a report that records all related transactions within the group.

5. Different standards in different countries

Each entity prepares financial statements in accordance with local regulations, which are prepared based on the functional currency of the country in which the entity operates (subsidiary). For the purposes of the consolidated financial statements, financial data should be transformed in accordance with the standards of the entity preparing

the consolidated financial statements and the functional currency of the country should be translated into the functional currency of the entity preparing the consolidated financial statements. The process of transforming the data of subsidiaries starts at the local level. To this end, the accounting team makes appropriate adjustments. Adding adjustments is most often required due to differences between the local accounting policy and the accounting policy of the capital group. In addition, potential adjustments resulting from different balance sheet dates should be considered for the purposes of the consolidated and separate financial statements.

The main difference between local regulations and IAS is that the former are based on rules and the latter is based on principles. The IAS guidelines leave more room for interpretation and may require extensive disclosures in the financial statements. In addition, the IAS regulations are more consistent and logical, which can provide greater transparency and credibility for investors and creditors.

The most common differences between the local regulations and IAS relate to:
- valuation of individual items presented in the financial statements,
- the scope of disclosures in the financial statements,
- the definition of control and principles for determining the composition of the capital group for the purposes of consolidation,
- the method of determining and measuring the value of minority shareholdings,
- valuation of shares using the equity method,
- the method of recognising individual expenses, i.e. capitalisation and/or recognition in the P&L statement,
- recognising and writing off goodwill.

Bearing in mind above, you may see that consolidation process is a comprehensive and challenging undertaking. If you need any assistance in preparing the consolidated financial statements, our multidisciplinary team is here to help. We have extensive experience in the practical aspects related to the implementation of solutions supporting the consolidation of financial statements of capital groups. In addition, we have experts with experience in bookkeeping for companies operating under various local accounting regimes, which will greatly facilitate the interpretation of financial data, and the justification for making corrections, if required.

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