THE RECONCILIATION BETWEEN NET INCOME AND EQUITY OF THE PARENT COMPANY AND CORRESPONDING VALUES IN CONSOLIDATED FINANCIAL STATEMENTS *

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Abstract:

In group accounting, the reconciliation between net income and equity of the parent company and their corresponding value in consolidated financial statements is becoming increasingly relevant. In Italy, the Reconciliation Statement (RS) has been required for all listed companies by the "Commissione Nazionale per le Società e la Borsa" (CONSOB) since 2006.

This paper illustrates the results of a study of the consolidated financial statements of 100 companies listed on the Milan Stock Exchange from 2003 to 2009, and represents around 72.40% of the capitalization of the entire stock market. The study is based on a verification of the presence and location of the RS in the financial statements of our sample companies. The study also consists of an analysis of the RS models studied and their content (consolidation adjustments) that show the differences between Net Income and Equity of the parent company and those of the consolidated financial statement. The study concludes with a proposal for a RS that may provide a solution to the issues emerging from the study.

Keywords: consolidated financial statements, net income and equity, reconciliation statement, listed companies, group accounting

JEL classification: M41

1. THE PURPOSE, INFORMATION FUNCTION AND REGULATORY FRAMEWORK

As regards the structure and transparency of the consolidated financial statements, special care was given to the reconciliation between net income and equity of the parent companies and their corresponding values in consolidated financial statements. "The RS is a quantitative module which demonstrates the effect that the consolidation procedure produces on the group units' partial value systems, the latter being the objects of analytical aggregation" (Rinaldi, 1999, 269).

This document is relevant only in the consolidated financial statement, because its purpose is to reconcile the synthesis values of the parent company's financial statement with the consolidated values and illustrates the adjustments which result from the consolidation procedure. The information flow that must result from the RS is of fundamental importance, as it allows the reader to understand the economic reasons underlying the divergences between the two kinds of net income and equity. In order for the documents to effectively achieve their objective, they must represent not only a mathematical reconciliation of values (Rinaldi, 1999, 270), but also content which is able to represent the economic reasons for the consolidation adjustments.

Readers of the consolidated financial statements will be able to understand the effects of resource transfer between subsidiaries, as well as the origin and quantity of the unrealized intra-group margins, which are eliminated with the consolidation procedure. As a consequence of the lack of transparency (Andrei, 2006, 129) in both national legislation and IAS/IFRS concerning intra-group transfer, the RS should be formulated in such a way as to overcome this legislatory deficiency and provide sufficient information for an analysis of this transfer.

As far as the importance of the RS in the group's financial statement is concerned, neither Decree–Law 127/91 nor International Accounting Standards require this document. In fact, only certain researchers (Azzali, 2008; Bertoni, 2009, 260; Caratozzolo, 2002; Fellegara, 2000; Rinaldi, 1999; Teodori, 2003; Terzani, 1992), Italian professional sources and CONSOB consider the document to be important for groups and as such, think it should be included in the informative notes or in the management report.

In fact, before the introduction of IAS/IFRS, the RS was prepared and included in the consolidated integrative notes, because this was stipulated by Italian Accounting Standards (OIC 17) and especially by CONSOB. As previously mentioned, IAS/IFRS did not require this document, and companies listed on the Milan Stock Exchange or companies which had shares or bonds attributed to the public, prepared and included the RS in their management report, because this was stipulated by CONSOB in its DEM/6064293 of July 28, 2006. The gradual spread of this type of document in consolidated financial statements to Italian groups was determined and enforced by Italian Accounting Standards and CONSOB, but also by the numerous interventions of researchers, who had long recognized the major informational role of the RS. As for the content stipulated by the sources above, only Italian Accounting Standards, in 1996 version, proposed a format with minimal content.

From an analysis of the legislation, and the annexed Accounting Standard report, a significant aspect emerges which, as we will demonstrate, could limit the RS's informational role. Here, particular reference is made to the typology of the values to be reconciled. In Italian Accounting Standards and in CONSOB, the presentation of a statement reconciling equity values and the net income that results from the parent company's financial statements with its consolidated values is regulated. Reconciling these amounts means preparing Reports which, on the one hand, represent only a part of the consolidation adjustments (parent company adjustments) and, on the other, fail to describe other significant consolidation adjustments in many groups (non-controlling partners' consolidation adjustments) .

The representation of partial values, as a consequence of consolidation adjustments, as well as the absence of specific information on non-controlling partners reduce the informational role of the RS prepared using these models, because they do not allow full understanding of the complex effects generated by the consolidation procedure. This model does not enable someone outside the group to know how the internal management policies that drive the intra-branch resource transfer influence the determination of the performances of controlled companies, and especially of those belonging to non-controlling partners that have invested in these companies.

According to Azzini (Azzini, 1975) the group is an enterprise made up of two or more units which are juridically independent but economically dependent on one administration.

The difference between the group and other companies is that the group has juridically independent branches which allows it to acquire resources, such as risk capital, using the stock market. This particular characteristic of the group generates non-controlling partners (Azzali, 2006) who have invested resources in the companies controlled by the parent company, and need the safeguard provided by the Consolidated financial statement. According to this viewpoint, the RS should contain not only the reconciliation of the parent company's synthesis values, but also the reconciliation of non-controlling partners' values.

2.RESEARCH OBJECTIVES AND THE SAMPLE

The role of the RS within consolidated financial statements prompted a study of the companies listed on the Milan Stock Exchange, and aimed at verifying its real informational potential. The objective was to analyze the structure, content, and types of information that financial statement reader can deduce from reading different formats of RS presented by listed Italian parent companies, and to evaluate their effectiveness.

The research was based on a RS analysis made in the financial statements of a number of selected companies from 2003 to 2009 based on the stock market capitalization of April 30, 2010. Of the 328 companies listed on that date, we excluded the following:

- companies listed after December 31, 2009;
- banks;
- insurance companies;
- companies no longer listed on April 30, 2010
- foreign companies.

At the end of the selection, of the companies remaining, those taken into consideration were the 100 enterprises with the greatest stock market capitalization, representing around 72.40% of the companies listed on April 30, 2010, excluding banks and insurance companies.

In the period studied, the legislatory framework for preparing the consolidated financial statements of listed companies evolved as follows: in 2003 and 2004 national regulatory was applied (Decree – law. 127/1991), whereas from 2005 to 2009 consolidated financial statements were prepared according to IAS/IFRS. CONSOB published DEM/6064293 (2006, July) which stipulated that the RS in the management report was to be annexed to the financial statement. CONSOB's action is useful but does not solve the informational problem resulting from IAS/IFRS, i.e., the fact that neither content model nor guidelines are provided makes space/time comparisons difficult.

A verification of the presence of the RS and its position in the financial statements of our sample companies was made, followed by a qualitative analysis of the content of the RS prepared. Finally, two RS models have been proposed which may provide a solution to the issues that have emerged during our study.

3. THE QUALITY OF RS INFORMATION IN SAMPLE COMPANIES

As a result of the evolutionary nature of the regulatory framework, the first two aspects we investigate are the presence and position of the RS in financial statements.

Table 1. – The presence and position of the RS in the consolidated financial statement

Year	Is there an RS in the consolidated financial statement?		If so, where is it collocated?		
	Yes	No	In the notes	In the management report	Between the statements
2003	92.86%	7.14%	100.00%	0.00%	0.00%
2004	95.92%	4.08%	100.00%	0.00%	0.00%
2005	45.92%	54.08%	88.89%	2.22%	8.89%
2006	94.90%	5.10%	37.64%	58.06%	4.30%
2007	97.96%	2.04%	34.38%	60.42%	5.20%
2008	97.96%	2.04%	31.25%	65.63%	3.12%
2009	97.96%	2.04%	28.13%	68.75%	3.12%

In Table 1, we can see that the transfer to IAS/IFRS leads to a net reduction in RS presentation. In fact, in 2003 and 2004 almost all of the consolidated financial statements of the sample applying Decree – Law 127/91 (92.86% and 95.92%, respectively) presented the RS, whereas in 2005, in the first financial statement prepared according to IAS/IFRS only 45.92% of the groups analyzed included this document in their consolidated financial statement (less than half of the groups who had included it in 2004). In 2006, however, there was a net growth of groups tending towards the RS: 94.90% of companies from our sample included it in the management report as stipulated by CONSOB (58.06%) or in the notes (37.64%). As for the 2007, 2008 and 2009 statements, the percentage grew to 97.96. The increase recorded in 2006 justifies the intervention of CONSOB, who imposed the RS in its financial statement at the beginning of that year. This statement recorded a regulatory gap in IAS/IFRS, which meant the absence of this consolidated financial statement format in 2005. From 2003 to 2005 the RS was included in the financial statement notes (Table 1). From 2006 to 2009, however, most of the groups included the statement in their management report, complying with CONSOB specifications: we do not agree with the measure because it lead to the RS being included in a document which is not part of the financial statement. However, the behavior of companies which included the RS in their financial statement from 2005 onwards was considered positive (Table 1).

Table 2. – The reconciled values of the RS

Year	RS reconciles:			Does RS show comparable values?	
	equity	net income	equity and net income	Yes	No
2003	0.00%	0.00%	100.00%	53.85%	46.15%
2004	0.00%	0.00%	100.00%	54.26%	45.74%
2005	0.00%	0.00%	100.00%	37.78%	62.22%
2006	1.08%	0.00%	98.92%	35.48%	64.52%
2007	2.08%	0.00%	97.92%	44.79%	55.21%
2008	2.08%	0.00%	97.92%	46.88%	53.12%
2009	2.08%	0.00%	97.92%	45.83%	54.17%

Keeping in mind the significant growth in the number of RS in this period, we investigated the content of the documents presented by the companies in our sample. As regards reconciled synthesis values, the statements presented reconcile both equity and net income. Similarly (Table 2), almost all financial statements that present RS reconcile both synthesis values (100% in 2003, 2004 and 2005; 98,92% in 2006; 97.92% in 2007, 2008 and 2009), in most cases presenting a single statement, while only a small number prepare financial statements presenting two documents: one reconciling net income and one equity. From Table 2, we can see that few companies from the sample reconciled only equity for the 2006-2009 period, while in no case was only net income reconciliation proposed.

The corresponding values of the previous years are important because they allow the reader to appreciate, in terms of time, the overall impact on the consolidation adjustments and allow a first evaluation of the effects produced by the managerial policies of the group.

As regards these corresponding values, the figures show a less than satisfactory result. In fact, for the whole period under consideration, a significant number of companies presenting the RS (Table 2) describe only one year’s adjustments, with no information with which to make a comparison.

What is also evident is the incongruous behavior of a part of the selected companies who changed their attitude in the period from 2003 to 2009, which meant that:

- some companies presented information about previous years going back only a few years;
- other companies changed their behavior several times, repeatedly altering the indications of the comparative information and their mission.

The absence of information about the consolidation adjustments of previous year and the incongruity of the companies’ behavior reflects negatively on the comparability over time of RS information. Later we will analyze the structure, content and analyticity of the documents presented as these constitute the essential elements on which the usefulness of the statement depends.

As for structure and content, the results of our research prove two prevailing statements: in the first statement (statement A) the values recognized in the parent company's financial statement are reconciled with the parent company values recognized in the consolidated financial statement; in the second statement (statement B) the values indicated in the parent company's financial statement are reconciled with the values of the full consolidated financial statements (including the values of any non-controlling partners). The two formats can be created in two different ways depending on how the consolidation adjustments are represented.

Statement A

Italy's most widely-used statement over the period (Table 3) was the one which reconciled equity and net income of the parent company's financial statement with their consolidated synthesis values .

Table 3. – Companies that used statement A

Year	RS reconciles only the values of the parent company			
	Consolidation adjustment only (e.g. Table 4)		Consolidation adjustment of the group only. With non-controlling partners (C) (e.g. Table 5)	A + B + C
	with non-controlling partners (A)	without non-controlling partners (B)		
2003	42.86%	8.79%	20.88%	72.53%
2004	42.55%	12.76%	18.09%	73.40%
2005	26.67%	15.55%	26.67%	68.89%
2006	27.96%	12.90%	23.66%	64.52%
2007	27.08%	11.46%	25.00%	63.54%
2008	25.26%	16.85%	25.26%	67.37%
2009	28.13%	17.70%	22.92%	68.75%

Statement A provides information on the effects of the consolidation procedure, referring only to the inherent values of the parent company, but does not give any information on the effect produced by the consolidation adjustment on the non-controlling partners in subsidiaries. This limits the informational usefulness of the RS as it does not allow non-controlling partners to appreciate the effects of the consolidation adjustments on their values. The usefulness of a model without information about non-controlling partners does not allow the RS to focus on the informational objective for which it was prepared as it provides only partial information, limited to the parent company, and becomes, as such, unhelpful to non-controlling partners.

The RS, which reconciles only the synthesis values of the parent company, can be prepared in two different ways (statement A1 and A2), which differ only in consolidation adjustment values.

Table 4. – Statement A1

	Equity		Net income	
	X	X-1	X	X-1
Equity and Net Income in the parent company's financial statement Parent Company Consolidation Adjustments: - Business Combination - Unrealized intragroup gain/loss - Tax effect				
Parent company Equity and Net Income in the Consolidated Financial Statement				

Statement A1, which reconciles the equity and net income of the parent company with consolidation values, represents only the parent company's consolidation adjustments. Research has shown that, for the period in question, it is the most widespread model within the groups whose format reconciles only the synthesis values of parent companies (Table 3, column A).

Table 5. – Statement A2

	Equity		Net income	
	X	X-1	X	X-1
Equity and Net Income in the parent company's financial statement Full Consolidation Adjustments: - Business Combination - Unrealized intragroup gain/loss - Tax effect				
Consolidated Equity and Net Income (Non-controlling shareholders Equity and Net Income in the Consolidated Financial Statement)				
Parent company Equity and Net Income in the Consolidated Financial Statement				

Statement A2 illustrates the full consolidation adjustments (see those belonging to the parent company and non-controlling partners). The algebraic sum of these adjustments with the equity and net income values of the parent company's financial statement determines the synthesis values of the group and, takes into consideration the values related to non-controlling partners, the parent company equity and net income in consolidated financial statements.

Statement B

Although to a lesser extent (compared to statement A), the RS of net income and equity recognized in the parent company's financial statement with the consolidated synthesis values of the group are also widely used by the companies: moreover, this statement, does not allow analytical representation of the consolidation adjustments of the subsidiaries' synthesis values.

Table 6. – Companies that used statement B

Year	The RS between the synthesis values of the parent company and those of the group		
	Consolidation adjustment of parent company (A) (example Table 7)	Consolidation adjustment of group (B) (example Table 8)	A + B
2003	21.98%	1.10%	23.08%
2004	21.28%	1.06%	22.34%
2005	26.67%	2.22%	28.89%
2006	30.11%	2.15%	32.26%
2007	28.13%	4.16%	32.29%
2008	26.32%	2.10%	28.42%
2009	25.00%	2.08%	27.08%

Statement B took two different forms in Italy (B1 and B2), which also differed in content. Of the two possible configurations, statement B1 (Table 7) was more wide spread than the format illustrated in Table 8. When reconciling net income and equity of the parent company with the group's consolidated synthesis values, the most widely-used configuration only illustrates the consolidation adjustments of the parent company, providing similar information to that of Statement A1 (Table 4).

Table 7. – Statement B1

	Equity		Net income	
	X	X-1	X	X-1
Equity and Net Income in the parent company's financial statement				
Parent company Consolidation Adjustments: - Business Combination - Unrealized intragroup gain/loss - Tax effect				
Parent company Equity and Net Income in the Consolidated Financial Statement				
Non-controlling shareholders Equity and Net Income in the Consolidated Financial Statement				
Consolidated Equity and Net Income				

Statement B1 shows the net income and equity of non-controlling interests, but with no fractions or analysis of their consolidation adjustments. Usually, the synthesis values of the non-controlling partners are only used to reconcile the net income and equity of the parent company with those of the group.

As illustrated in Table 7, net income equity recognized in the parent company's financial statement, algebraically added to the consolidation adjustments of the parent company, determine the consolidated synthesis values of the parent company. Then, by adding the net income and equity of non-controlling interests we can determine the group's consolidated synthesis values.

Table 8. – Statement B2.

	Equity		Net income	
	X	X-1	X	X-1
Equity and Net Income in the parent company's financial statement Full Consolidation Adjustments: - Business Combination - Unrealized intragroup gain/loss - Tax effect				
Consolidated Equity and Net Income				

Statement B2 (Table 8), however, illustrates full consolidation adjustments (parent company adjustments and non-controlling interest adjustments), providing information similar to that of statement A2 (Table 5).

Of our study show that the use of different RS is the result of the absence of a regulatory framework and mean reduced comparability. Another important aspect that emerges from this study, on the RS structure, refers to the in-time uniformity of the sample companies' behaviors. In the period studied (2003-2009), a significant number of companies used various formats, even modifying their behavior several times. This negative scenario together with the significant percentage of companies that do not include their values from the previous year (Table 2) considerably limit the in-time comparability of the information provided by the RS.

Referring to the content of the documents prepared by the Italian companies, the first element analyzed concerns the effects generated by business combinations (Gavana, 2008); in the period of time studied, this information is represented in the RS of almost all of the companies in the sample (Table 9).

Table 9. – The effects of business combinations.

Year	Does RS describe the effects of business combinations?		Does RS show information about goodwill?	
	Yes	No	Yes	No
2003	92.31%	7.69%	44.05%	55.95%
2004	92.55%	7.45%	45.98%	54.02%
2005	97.78%	2.22%	36.36%	63.64%
2006	97.85%	2.15%	35.16%	64.84%
2007	96.88%	3.12%	36.56%	63.44%
2008	96.88%	3.12%	36.56%	63.44%
2009	95.83%	4.17%	35.87%	64.13%

The majority of companies present synthetic and aggregated information on the effects generated by business combinations; this does not allow an understanding of how the goodwill and revaluation of each acquired company is determined.

Our study also evaluated whether the documents prepared by the Italian companies describe in sufficient detail the consolidation adjustments generated from:

a) recognition of amortization (National Law) and impairment of goodwill;
b) elimination of intra-group transaction;
c) elimination of dividends.

It is significant that the informational quality of the RS depends on the transparency of its content. The detailed presentation of these adjustments is extremely important because it allows the consolidated financial statement reader to study the effects generated by the consolidation procedure thoroughly and also allows the reader to identify the adjustments that had a greater influence on the preparation of the consolidated financial statement. Great importance is also attached to the adjustments seen in letters b), c), useful in understanding the typology of intra-group operations and especially the effects generated on the net income and equity of the group.

In relation to the adjustments indicated in the previous list, the analysis shows (Table 10) that most of the companies offer information on the distribution of dividends, amortization/impairment of goodwill and unrealized intra-group profit. Similarly, some of the companies have an item called “Other consolidation adjustments” (or other synonym), which along with the adjustments deriving from the business combination, when present, are the only RS content of these companies. In such cases, excessive synthesis impairs the informational capacity and transparency of the RS analyzed.

Table 10. – Consolidation adjustments in the RS

Year	Does RS show analytic consolidation adjustments resulting from amortization and/or goodwill impairment, the elimination of unrealized intra-group profits and margins of dividends paid by subsidiaries	
	Yes	No
2003	85.71%	14.29%
2004	80.85%	19.15%
2005	66.67%	33.33%
2006	78.49%	21.51%
2007	83.33%	16.67%
2008	81.25%	18.75%
2009	81.25%	18.75%

The absence of an adequate analytical framework for a significant percentage of the sample companies represents one of the negative elements brought out by the study, which damages the transparency of the statement, not allowing the reader of financial statements to understand the causes of the consolidation adjustments of such values, and significantly limiting the capacity of these statements to fulfill their informational function.

Finally, although none of the RS analyzed contain comment notes able to adequately illustrate the reconciliation adjustment, these details were not imposed by the legislators even though their presence would guarantee that financial statement readers would better understand the effects generated by the consolidation procedure.

4. THE TRANSPARENCY REGARDING THE RECONCILIATION OF SYNTHESIS VALUES OF NON-CONTROLLING PARTNERS

The study conducted on reconciliation statements made by the companies listed on the Milan Stock Exchange from 2003 to 2009 brought to light numerous issues which, impair the informational capacity of the report and the transparency of the consolidated financial statement. In particular:

- the limit of in-time and space comparability generated by a lack of uniformity;

- the abuse of syntheticity that characterizes most of the reports and the absence of information capable of explaining in what way the consolidation procedure;
- the belongingness of the group impacts on the non-controlling partners' synthesis values,

represents, undoubtably, the most important weaknesses of most of the RS analyzed. Taking into account the issues discussed and the reduced informational capacity of the Italian companies' format, hereinafter we propose two types of RS (Table 11 and 13) which differ only in the analytical details of the information concerning non-controlling partners. In fact, both formats present consolidation adjustments that affect the synthesis values of the parent company and those of non-controlling partners, the latter being subdivided according to the subsidiary in which the non-controlling partners are present.

The format in Table 11 describes a synthetic impact of consolidation adjustments on the values belonging to parent company and non-controlling partners. It considers the starting value of non-controlling partners (Table 11, "Non-controlling shareholders Equity and Net Income in the subsidiaries' financial companies") to be the algebraic sum of the shares of equity and net income of non-controlling partners expressed in the financial statements of all subsidiaries in which the parent company does not have 100% of the equity.

Table 11. – Synthetic RS

		200x		200x-1	
		PN	**RN**	**PN**	**RN**
Equity and Net Income in the parent company's financial statement		***0***	***0***	***0***	***0***
Business combinations:					
– elimination of investments in subsidiaries		(0)		(0)	
– elimination of subsidiaries fair value equity		0		0	
composed by:					
equity	0				
tangible assets revaluation/impairment	0/(0)				
intangible assets revaluation/impairment	0/(0)				
– goodwill		0		0	
– badwill		0	0	0	0
Amortization and impairment test:					
– amortization of tangible asset revaluation		(0)	(0)	(0)	(0)
– amortization of intangible asset revaluation		(0)	(0)	(0)	(0)
– goodwill impairment		(0)	(0)	(0)	(0)
Homogenization of the financial reporting. In paticular:					
– of the accounting standards;		(0)/0	(0)/0	(0)/0	(0)/0
– of the currency.		(0)/0	(0)/0	(0)/0	(0)/0
Subsidiaries net income of parent company		(0)/0	(0)/0	(0)/0	(0)/0
Intra-group gain/loss from trade relations:					
– Unrealized in the 200x		(0)/0	(0)/0	(0)/0	(0)/0
– Realized in the 200x		(0)/0	(0)/0	(0)/0	(0)/0
Unrealized intra-group gain/loss from transfer of equipment		(0)/0	(0)/0	(0)/0	(0)/0
Business combinations between subsidiaries		(0)/0	(0)/0	(0)/0	(0)/0
Elimination of dividends distributed by subsidiaries		(0)	(0)	(0)	(0)
Tax effect		(0)/0	(0)/0	(0)/0	(0)/0
Parent company Equity and Net Income in the Consolidated Financial Statement (A)		***0***	***0***	***0***	***0***

Non-controlling shareholders Equity and Net Income in the subsidiaries' financial companies	***0***	***0***	***0***	***0***
Equity group of the non-controlling partners: – tangible assets revaluation/ impairment – intangible assets revaluation/ impairment – goodwill	0/(0) 0/(0) 0		0/(0) 0/(0) 0	
Amortization and impairment test: – amortization of tangible asset revaluation – amortization of intangible asset revaluation – goodwill impairment	(0) (0) (0)	(0) (0) (0)	(0) (0) (0)	(0) (0) (0)
Homogenization of the financial reporting. In paticular: – of the accounting standards; – of the currency.	(0)/0 (0)/0	(0)/0 (0)/0	(0)/0 (0)/0	(0)/0 (0)/0
Intra-group gain/loss from trade relations: – Unrealized in the 200x – Realized in the 200x	(0)/0 (0)/0	(0)/0 (0)/0	(0)/0 (0)/0	(0)/0 (0)/0
Unrealized intra-group gain/loss from transfer of equipment	(0)/0	(0)/0	(0)/0	(0)/0
Business combinations between subsidiaries	(0)/0	(0)/0	(0)/0	(0)/0
Tax effect	(0)/0	(0)/0	(0)/0	(0)/0
Non-controlling shareholders Equity and Net Income in the Consolidated Financial Statement (B)	***0***	***0***	***0***	***0***
Equty and net income in the consolidated financial statement (A+B)	***0***	***0***	***0***	***0***

Unlike the outcome of the reports which reconcile only the synthesis values of the financial statement of the parent company with group values, this format (Table 11) presents more complete and more transparent information to the financial statement reader. In fact, this model allows us to investigate the effects generated by the consolidation procedure on the complex synthetic values of non-controlling partners, providing information that the most widely used Italian reports do not contain.

Despite its high level of transparency, the model proposed is not widespread in our country. Few of our sample companies (Table 12), used this model in the period of time studied, due to the lack of national legislation. National accounting standards (OIC 17) and CONSOB guidelines regulating the preparation of the RS for companies using the IAS/IFRS, explicitly stipulate reconciliation only for the equity and net income of the parent company.

Table 12. – Companies that used synthetic RS

Year	%
2003	4.40%
2004	4.25%
2005	2.22%
2006	3.22%
2007	4.17%
2008	4.21%
2009	4.17%

Table 11 shows the synthetic effects of consolidation on the values of the non-controlling partners in the group but does not allow us to understand the ways in which the consolidation process acted on each subsidiary.

Although not used in Italy, the second format (Table 13) allows us to thoroughly study these effects as it indicates the values of non-controlling partners subdivided into units of subsidiaries.
In Table 13, where the presence of two subsidiaries with non-controlling partners was hypothesized, the separate representation of the equity and net income shares of the non-controlling partners of each unit, guarantees a much higher level of transparency than that of the first format.

The structure of the document analyzed offers informational details which describe how belonging to a certain company group acts on equity and net income of each subsidiary in which non-controlling partners are present. This model illustrates these effects, dividing them according to the synthesis values of each subsidiary statement to enable the reader to understand:

- how much of the subsidiary financial statement in which non-controlling partners are present is the result of internal resource transfer taking place between the units making up the group, and how much represents the results of third-party exchanges;
- the effects of consolidation adjustments on the synthesis values of the statement pertinent to the non-controlling partners.

To enable the reader of consolidated financial statements to understand the economic reasons behind the differences between the synthesis values of the financial statement and the consolidated ones, in the format analyzed the adjustments must be subdivided according to the typology of the consolidation operations they originate from.

With the help of Table 13, we can see the analytical description of the effects induced by the presence of the participants belonging to the subsidiaries, with shares of up to 100%. For some companies, this model shows the economic reasons for the difference between the cost sustained by the parent company and the acquired equity. This difference is divided according to the interest share of the parent company and the non-controlling partners.

The proposed models allow the financial statement reader to appreciate the over/understatement of the group’s net income and equity, (Azzali, 2002, 105 and 152). The second model (Table 13) allows the reader to appreciate the over/understatement of net income pertinent to each subsidiary’s non-controlling partners with non-total participation, while at the same time allowing a deeper level of investigation than the model in Table 11.

Table 13. – Analytical RS

	PARENT COMPANY				SUBSIDIARIE Alfa								SUBSIDIARIE Beta								CONSOLIDATED F.S.			
	200x		200x-1		200x				200x-1				200x				200x-1				200x		200x-1	
	E	**NI**	**E**	**NI**	**Eh**	**Em**	**Eh**	**NIm**	**Eh**	**Em**	**Eh**	**NIm**	**Eh**	**Em**	**Eh**	**NIm**	**Eh**	**Em**	**Eh**	**NIm**	**E**	**NI**	**E**	**NI**
Equity and net income in the financial statement	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***
Business combinations:																								
– elimination of investments in subsidiaries	(0)		(0)		(0)				(0)				(0)				(0)				(0)		(0)	
– elimination of subsidiaries equity	0		0																		0		0	
– tangible assets revaluation/impairment	0/(0)		0/(0)		0/(0)	0/(0)			0/(0)	0/(0)			0/(0)	0/(0)			0/(0)	0/(0)			0/(0)		0/(0)	
– intangible assets revaluation/impairment	0/(0)		0/(0)		0/(0)	0/(0)			0/(0)	0/(0)			0/(0)	0/(0)			0/(0)	0/(0)			0/(0)		0/(0)	
– goodwill	0		0		0	0			0	0			0	0			0	0			0		0	
– badwill	0	0	0	0	0		0		0		0		0		0		0		0		0	0	0	0
Amortization and impairment test:																								
– amortization of tangible asset revaluation	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)
– amortization of intangible asset revaluation	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)
– goodwill impairment	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)
Homogenization of the financial reporting. In particular:																								
– of the accounting standards;	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0
– of the currency.	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0
Intra-group gain/loss from trade relations:																								
– Unrealized in the 200x	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0
– Realized in the 200x	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0
Unrealized intra-group gain/loss from transfer of equipment	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0
Subsidiaries net income	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0
Business combinations between subsidiaries	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0
Elimination of dividends distributed by subsidiaries	(0)	(0)	0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)
Tax effect	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0	(0)/0
Entity and net income of any companies after consolidation	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***	***0***

In fact, the Table 13 model provides a percentage of the non-controlling partners' net income, that is over/understated or generated by intra-group transactions at the reference date of the consolidated financial statement. The RS used by Italian listed companies does not provide a sufficient exchange of information for an evaluation of the group's consolidation adjustments. The analytical details with which the consolidation adjustments are presented assume major importance, because they allow us to eliminate certain weaknesses from the regulatory framework of consolidated financial statements of both National sources and International Accounting Standards. The deficiency concerning intra-group transfers that characterizes the consolidated financial statements made in compliance with Decree – Law 127/91 is not redressed by introducing IAS/IFRS. In fact, the standards do not require inclusion in the notes, of the details which specify the origin, size and effects that the intra-group transfers have on determining net income and the equity. The RS can compensate, at least partially, for this informational deficiency, but in order to achieve this it must be prepared analytically, as illustrated in the proposed models, to specify the economic nature of intra-group operations.

The informational potential of both models would certainly be best presented in the consolidated financial statement notes, and being thus located would offer analytical information regarding the intra-group transfers presented in the RS, as well as the way in which the adjusted values resulting from the consolidation procedure were determined. This solution, which represents a real improvement in consolidated financial statement transparency, should be structured in such a way as to ensure the reader gets an overview of the operations taking place in the administrative period between the group's units, and to allow interdependency, which, in general, characterizes these changes.

As proposed in the literature on the adoption of the International Accounting Standards in Italy (Andrei, 2006, 146), the network of internal relations could be described and the contractual conditions of intra-group transactions could be offered. Moreover, details required to enable the reader to fully understand how the adjusted values were obtained could be added to this information flow.

The quantitative dimension (offered by the RS with structure and analysis as in Table 11 and 13) and the qualitative dimension (offered by the notes) of the information provided on the intra-group exchanges, as well as the informational detail of operations between the group and third-parties should, therefore, enable the consolidated financial statement user to fully understand the managerial policies which, in their complexity, characterize the group.

ENDNOTES

* This study is the result of cooperation between Stefano Azzali and Luca Fornaciari who wrote paragraphs 2 and 3, and paragraphs 1 and 4 respectively

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