

# GROUP AUDITS

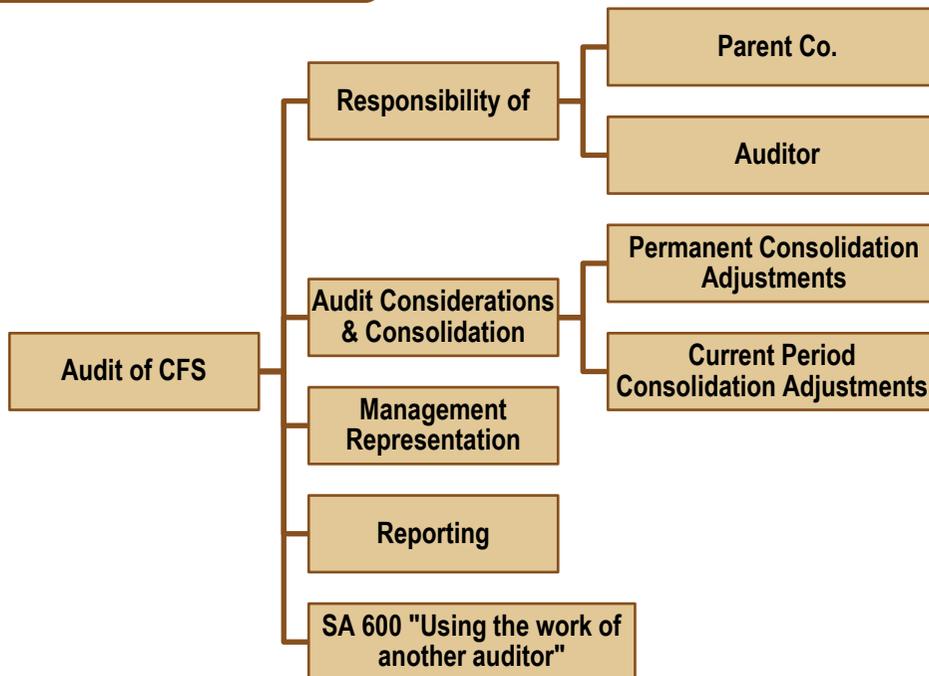


## LEARNING OUTCOMES

**After studying this chapter, you will be able to:**

- ❑ Understand the concept of Audit of Consolidated Financial Statements.
- ❑ Identify the responsibility of Parent and Auditor in Consolidation of Financial Statements.
- ❑ Gain the knowledge of Audit Considerations during the Audit of Consolidated Financial Statements.
- ❑ Recognise the manner of Permanent Consolidation Adjustment and Current Period Consolidation Adjustments.
- ❑ Learn the reporting requirements as per the given circumstance and understand audit of group financial statements including the work of component auditors.
- ❑ Understand and interpret SA 600-“Using the Work of Another Auditor”

## CHAPTER OVERVIEW



CA. Vikram is statutory auditor of a manufacturing company whose financial statements are required to be prepared in accordance with requirements of Ind AS. At the time of planning of audit of current year, it is noticed by him that said company, of which he is auditor, has purchased shares of another company located in USA. He further inquired from the management and found that all shares of US based company were purchased by Indian company.

Section 129 of Companies Act immediately came to his mind. Whether provisions regarding consolidation of financial statements would apply in such a case? Since Indian company has acquired all shares of another company, aren't its financial statements required to be consolidated? Gathering further insight, it became clear to him that financial statements of Indian company are required to be consolidated as it has a wholly owned subsidiary now.

He had another recurring anxiety in his mind. Whether foreign subsidiaries are covered within scope of consolidated financial statements? Exhaustive reading of Ind AS 110 on "*Consolidated financial statements*" came to his help and it became clear to him that a parent which presents consolidated financial statements should consolidate all subsidiaries, domestic as well as foreign. The management of the company was informed to prepare the

groundwork for the preparation of consolidated financial statements in accordance with statutory provisions and applicable accounting standards.

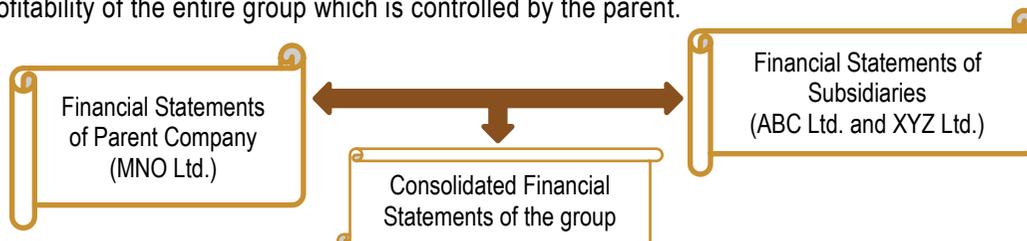
While consolidating financial statements, management was caught in a dilemma. The financial statements were going to be consolidated for the first time. However, the Indian parent company had acquired all shares in foreign subsidiary in the month of June. The question arose as to from which date consolidation is required. Is it required for the whole year or from the date of acquiring shares in foreign subsidiary? The management turned to Ind AS 110 for help. It became clear that the results of the operations of a subsidiary are included in the consolidated financial statements from the date on which the parent gained control of the subsidiary.

The consolidated financial statements were made ready by management by combining like items of assets, liabilities, income and expenses of the parent with that of a foreign subsidiary. There was no minority interest involved.

While auditing such group financial statements prepared by the management, it came to the fore that accounts of foreign subsidiary were unaudited. CA Vikram was caught in a *Catch-22* situation. How should he proceed? What are the implications for unaudited accounts of a component included in group financial statements? What considerations would play in such a case?

## 1. INTRODUCTION

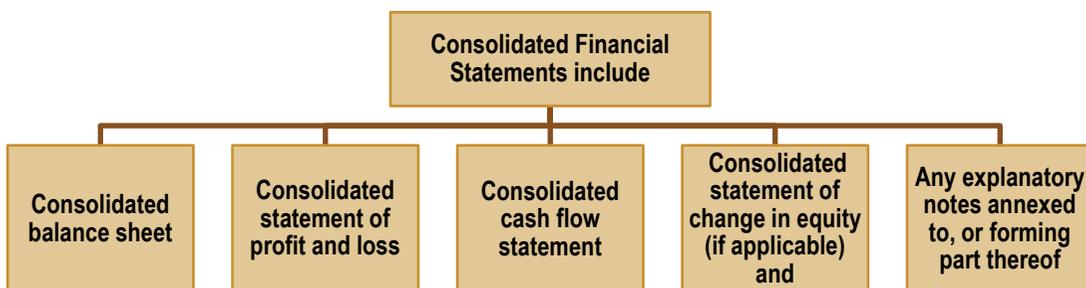
**Consolidated Financial Statements** are the financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity. In other words, consolidated financial statements present the financial position of an entire group including the parent and its group companies. Whereas separate financial statements present the financial position of a single entity for which the financial statements are prepared. Consolidated financial statements provide a complete overview of the operations and profitability of the entire group which is controlled by the parent.



In the above diagram there is one parent company (MNO Ltd.) having two subsidiaries (ABC Ltd. and XYZ Ltd.) The auditor of MNO Ltd. is SS Maheshwari & Co. while the auditor of ABC Ltd. and XYZ Ltd. is RT & Associates. Further, it was decided that SS Maheshwari & Co. will act as the principal auditor (i.e., auditor with reporting responsibilities with respect to the consolidated financial statements of the group). Now the management of all the three companies is responsible for preparation of their respective standalone financial statements which shall then be audited by the respective auditors. Thereafter, the parent company shall prepare the consolidated financial statements for the group. Once the consolidated financial statements are prepared, such financial statements are audited by the principal auditor. Now, we need to consider the following points.

- ◆ The responsibility of the parent company in consolidation of financial statements. (MNO Ltd.)
- ◆ Manner of permanent adjustment and current period consolidation adjustment.
- ◆ The principal auditor's procedures. (SS Maheshwari & Co.)
- ◆ Coordination and division of responsibility between both the auditors.
- ◆ Reporting requirements.

Consolidated financial statements are presented, to the extent possible, in the same format as adopted by the parent for its separate financial statements. The formats for preparation of balance sheet, statement of profit and loss and a statement of change in equity (if applicable) are prescribed under the Schedule III of the Companies Act, 2013.



An entity which prepares the consolidated financial statements, either under any law or regulation governing the entity or *suo motu*, might be required to or otherwise engage the auditor for conducting the audit of consolidated financial statements. However, a law or regulation governing the entity may require the consolidated financial statements to be audited by the statutory auditor of the entity (i.e. the auditor who audits standalone financial statements of the entity). The Guidance Note on Audit of Consolidated Financial Statements provides guidance on the specific issues and audit procedures to be applied in an audit of consolidated financial statements. This Guidance Note can also be used

while auditing consolidated financial statements prepared for special purpose, to the extent applicable but it does not deal with accounting matters arising on consolidation of financial statements.

Accounting Standard (AS) 21 'Consolidated Financial Statements' and Indian Accounting Standard (Ind AS) 110, 'Consolidated Financial Statements' lay down principles and procedures for preparation and presentation of consolidated financial statements under AS and Ind AS respectively. In other words, whenever a parent decides to or is required to prepare and present consolidated financial statements, it should do so in accordance with the requirements of applicable Accounting Standards under the relevant financial reporting framework

### 1.1 Consolidation of Financial Statements - Mandatory under Companies Act, 2013

According to Section 129(3) of the Companies Act, 2013, where a company has one or more subsidiaries, including associate company and joint venture, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own. Further, section 129(4) of the said Act, provides that the provisions applicable to the preparation, adoption and audit of the financial statements of a holding company shall, mutatis mutandis, also apply to its the consolidated financial statements.

The consolidated financial statements shall also be approved by the Board of Directors before they are signed on behalf of the Board, along with its standalone financial statements and shall also be laid before the annual general meeting of the company along with the laying of its standalone financial statement.

The company shall also attach along with its financial statement, a separate statement containing the salient features of the financial statement of its subsidiary(ies) in Form AOC-1.

According to the Companies (Accounts) Rules, 2014, the consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III to the Act and the applicable accounting standards. However, a company which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions of consolidated financial statements provided in Schedule III of the Act.

**However, the requirement related to preparation of consolidated financial statements shall not apply to a company if it meets the following conditions:**

- (i) it is a wholly-owned subsidiary, or is a partially-owned subsidiary of another company and all its other members, including those not otherwise entitled to vote, having been intimated

	in writing and for which the proof of delivery of such intimation is available with the company, do not object to the company not presenting consolidated financial statements;
(ii)	it is a company whose securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India; and
(iii)	its ultimate or any intermediate holding company files consolidated financial statements with the Registrar which are in compliance with the applicable Accounting Standards.

As per sub-section 6 of the section 129 of the Companies Act, 2013, the Central Government may, on its own or on an application by a class or classes of companies, by notification, exempt any class or classes of companies from complying with any of the requirements of section 129 or the rules made thereunder, if it is considered necessary to grant such exemption in the public interest and any such exemption may be granted either unconditionally or subject to such conditions as may be specified in the notification.

Thus, the companies having subsidiaries, which have previously never prepared the consolidated financial statements, must prepare their consolidated financial statements in adherence with this mandatory requirement. This will provide the holding companies' stakeholders more transparency about the companies' businesses.

Further, an investment entity need not present consolidated financial statements if it is required, in accordance with paragraph 31 of Ind AS 110, to measure all of its subsidiaries at fair value through profit or loss. A parent shall determine whether it is an investment entity.

**An investment entity is an entity that:**

(a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;	(b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and	(c) measures and evaluates the performance of substantially all of its investments on a fair value basis.
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However, as per paragraph 33 of Ind AS 110, the parent of an investment entity shall consolidate all entities that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity.

### Case Study - Consolidation of Financial Statement of a Subsidiary

1. Parent Ltd acquired 51% shares of Child Ltd during the year ended 31-3-2021. During the financial year 2021-22, 20% shares of Child Ltd were sold by Parent Ltd. Parent Ltd while preparing the financial statements for the year ended 31-3-2021 and 31-3-2022 did not consider the financial statements of Child Ltd for consolidation. As a statutory auditor how would you deal with it?

**Provisions & Explanation:** As per Ind AS 110, there is no such exemption for 'temporary control', or "for operation under severe long-term funds transfer restrictions" and consolidation is mandatory for Ind AS compliant financial statement in this case.

However, as per section 129(3) of the Companies Act, 2013 where a company having subsidiary, which is not required to prepare consolidated financial statements under the applicable Accounting Standards, it shall be sufficient if the company complies with the provisions of consolidated financial statements provided in Schedule III to the Act.

**Conclusion:** In the given case, Parent Ltd acquired 51% shares of Child Ltd during the year ended 31.03.2021 and sold 20% shares during the year ended 31.03.2022. Parent Ltd did not consolidate the financial statements of Child Ltd for the year ended 31.03.2021 and 31.03.2022.

The intention of Parent Ltd is quite clear that the control in Child Ltd is temporary as the former company disposed off the acquired shares in the next year of its purchase. Parent Ltd is required to prepare Consolidated Financial Statements in accordance with Ind AS 110 as exemption for 'temporary control', or "for operation under severe long-term funds transfer restrictions" is not available under Ind AS 110. Paragraph 20 of Ind AS 110 states that "Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee".

## 2. RESPONSIBILITY OF PARENT

The responsibility for the preparation and presentation of consolidated financial statements, among other things, is that of the management of the parent. This includes:

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| (a) | identifying components, and including the financial information of the components to be included in the consolidated financial statements; |
| (b) | where appropriate, identifying reportable segments for segmental reporting;  |
| (c) | identifying related parties and related party transactions for reporting;  |

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|-----|--|
| (d) | obtaining accurate and complete financial information from components; |
| (e) | making appropriate consolidation adjustments;                          |
| (f) | harmonization of accounting policies and accounting framework; and     |
| (g) | GAAP conversion, where applicable.                                     |

Apart from the above, the parent ordinarily issues instructions to the management of the component specifying the parent's requirements relating to financial information of the components to be included in the consolidated financial statements. The instructions ordinarily cover the accounting policies to be applied, statutory and other disclosure requirements applicable to the parent, including the identification of and reporting on reportable segments, and related parties and related party transactions, and a reporting timetable.

### 3. RESPONSIBILITY OF THE AUDITOR OF THE CONSOLIDATED FINANCIAL STATEMENTS



**Fig.: Responsibility of Auditors\***

Section 129(4) of the Companies Act, 2013 requires that the provisions of the Act applicable to the preparation, adoption and audit of the financial statements of a holding company shall, mutatis mutandis, apply to the consolidated financial statements. Besides other matters, the principal auditor of the consolidated financial statements is responsible for expressing an opinion on whether the consolidated financial statements are prepared, in all material respects, in accordance with the financial reporting

framework under which the parent prepares the consolidated financial statements in addition to reporting on the additional matters as required under the Companies Act, 2013 and any other statute to the extent applicable.

**Therefore, the auditor's objectives in an audit of consolidated financial statements are:**

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| (a) | to satisfy himself that the consolidated financial statements have been prepared in accordance with the requirements of the applicable financial reporting framework; |
| (b) | to enable himself to express an opinion on the true and fair view presented by the consolidated financial statements;   |
| (c) | to enquire into the matters as specified in section 143(1) of the Companies Act, 2013; and.   |

- (d) to report on the matters given in the clauses (a) to (i) of section 143(3) of the Companies Act, 2013 for other matters under section 143(3)(j) read with rule 11 of the Companies (Audit and Auditors) Rules, 2014, to comment on the matters specified in sub-rule (a),(b), (c), **(d), (e), (f) and (g)**<sup>1</sup> to the extent applicable;
- (e) The auditor should also validate the requirement of preparation of CFS for the company as per applicable financial reporting framework.

Standards on Auditing, Statements and Guidance Notes on auditing matters issued by the Institute of Chartered Accountants of India (ICAI) apply in the same manner to audit of consolidated financial statements as they apply to audit of standalone financial statements. It means that the auditors, while conducting the audit of consolidated financial statements are, *inter alia*, expected to:

- (a) plan their work to enable them to conduct an effective audit in an efficient and timely manner;
- (b) obtain an understanding of the accounting and internal control systems including IT system like consolidation tool, sufficient to plan the audit and determine the nature, timing and extent of his audit procedures. Such an understanding would help the auditors to develop an effective audit approach;
- (c) use professional judgement to assess audit risk and to design audit procedures to ensure that the risk is reduced to an acceptable level, etc.

## 4. AUDIT CONSIDERATIONS

**The following features of consolidated financial statements have an impact on the related audit procedures:**

- (a) The consolidated financial statements are prepared on the basis of separate financial statements of the parent and its components, using the consolidation procedures prescribed by Accounting Standards<sup>2</sup> under applicable financial reporting framework; and

<sup>1</sup> The auditor of the consolidated financial statements generally report on the matters pertaining to the component, on the basis of auditors' report of the respective component.<sup>2</sup> Accounting Standard (AS) 21, Consolidated Financial Statements, Accounting Standard (AS) 23- Accounting for Investments in Associates in Consolidated Financial Statements and Accounting Standard (AS) - 27, Financial Reporting of Interests in Joint Ventures OR Indian Accounting Standard (Ind AS) 110 – Consolidated Financial Statements, Indian Accounting Standard (Ind AS) 111- Joint Arrangements, Indian Accounting Standard (Ind AS) 112 –Disclosure of Interests in Other Entities and Indian Accounting Standard (Ind AS) 28 – Investments in Associates and Joint Ventures.

<sup>2</sup> Accounting Standard (AS) 21, Consolidated Financial Statements, Accounting Standard (AS) 23)- Accounting for Investments in Associates in Consolidated Financial Statements and Accounting Standard (AS) - 27, Financial Reporting of Interests in Joint Ventures OR Indian Accounting Standard (Ind AS) 110 – Consolidated Financial Statements, Indian

- (b) The auditor of the consolidated financial statements may use the work of other auditors as per requirement of Standards on Auditing unless the auditor of consolidated financial statements is also the auditor of the other components of the group.

The consolidated financial statements (including the intermediate consolidated financial statements prepared internally)<sup>3</sup> are prepared using the separate financial statements of the parent and its components and also other financial information, which might not be covered by the separate financial statements of these entities. The 'other financial information' would include disclosures to be made in the consolidated financial statements about the components, proportion of items included in the consolidated financial statements to which different accounting policies have been applied where permitted, adjustments made for the effects of significant transactions or other events that occur between the financial statements of parent and its components, as the case may be, etc. Thus, this 'other financial information' would be required to be additionally disclosed.

When an auditor accepts the audit of consolidated financial statements, the auditor should assess whether based on his work alone he would be able to express an opinion on the true and fair view presented by the consolidated financial statements. If the auditor is of the view that his own participation may not be enough or sufficient, he should consider using the work of 'other auditors'.

### Consolidation – Example

- ◆ Group consists of entity A and its subsidiaries B and C
- ◆ B has a loan with A of 100

	A	B	C	Total	Eliminations	Group
PPE	100	50	30	180		180
Shares in subsidiaries	500	-	-	500	-500-	-
Intercompany receivables	100	-	-	100	-100	-
Receivables	-	400	300	700	-	700
Intercompany debt	-	-100	-	-100	100	-
Debt	-100	-50	-130	-280		-280
Equity	-600	-300	-200	-1,100	500	-600

Accounting Standard (Ind AS) 111- Joint Arrangements, Indian Accounting Standard (Ind AS) 112 –Disclosure of Interests in Other Entities and Indian Accounting Standard (Ind AS) 28 – Investments in Associates and Joint Ventures.

<sup>3</sup> Intermediate consolidated financial statements are the consolidated financial statements of an intermediate parent, e.g., Company A has one subsidiary Company B. Company B has a subsidiary Company C. In this case, Company B is the intermediate parent and the consolidated financial statements prepared by Company B will be intermediate consolidated financial statements.

Such 'other auditors' might be the statutory auditors of the separate financial statements of one or more of the components or the auditors appointed specifically for assisting the auditor of the consolidated financial statements (the principal auditor).

Where the statutory auditors of one or more of the components of the parent are also requested to assist the principal auditor, the work to be performed by such statutory auditors for use by the principal auditor would constitute an assignment separate from the assignment to conduct the statutory audit of the respective component.

**Standard on Auditing (SA) 600, 'Using the Work of Another Auditor'** establishes standards when an auditor, reporting on the financial statements of an entity (the group—in the case of consolidated financial statements), uses the work of another auditor on the financial information of one or more components included in the financial statements of the entity (Paragraph 2 of SA 600). The principal auditor, if he decides to use the work of another auditor in relation to the audit of consolidated financial statements, should comply with the requirements of SA 600.

In carrying out the audit of the standalone financial statements, the computation of materiality for the purpose of issuing an opinion on the standalone financial statements of each component would be done component-wise on a standalone basis. However, with regard to determination of materiality during the audit of consolidated financial statements (CFS), the auditor should consider the following:

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| <ul style="list-style-type: none"> <li>• The auditor is required to compute the materiality for the group as a whole. This materiality should be used to assess the appropriateness of the consolidation adjustments (i.e. permanent consolidation adjustments and current period consolidation adjustments) that are made by the management in the preparation of CFS.</li> </ul> |
| <ul style="list-style-type: none"> <li>• The parent auditor can also use the materiality computed on the group level to determine whether the component's financial statements are material to the group to determine whether they should scope in additional components and consider using the work of other auditors as applicable.</li> </ul>                                   |
| <ul style="list-style-type: none"> <li>• The principal auditor also computes the materiality for each component and communicates to the component auditor, if he believes is required for a true and fair view on CFS.</li> </ul>  |
| <ul style="list-style-type: none"> <li>• The principal auditor also obtains certain confirmations from component auditors like independence, code of ethics, certain information required for consolidation and disclosure requirements etc.</li> </ul>  |

However, while considering the observations (for instance modification and /or emphasis of matter in accordance with SA 705/706) of the component auditor in his report on the standalone financial statements, the principles of SA 600 need to be considered. ICAI issued an announcement dated

May 25, 2017 which amended paragraph 17 of Guidance Note and states that while considering the observations (for instance modification and /or emphasis of matter/other matter in accordance with SA 705/706) of the component auditor in his report on the standalone financial statements, the parent auditor should comply with the requirements of SA 600, "Using the Work of Another Auditor". Therefore, the concept of materiality would be considered while considering the observations of the component auditor.

## 5. AUDITING THE CONSOLIDATION

Before commencing an audit of consolidated financial statements, the auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner.

**The auditor should make plans, among other things, for the following:**

(a)	Understanding of the group structure and group-wide controls including assessment of Information Technology (IT) system and related general and applications IT related controls (manual and automated) for consolidation process;
(b)	understanding of accounting policies of the parent and its components as well as of the consolidation process including the process of translation of financial statements of foreign components;
(c)	determining and programming the nature, timing, and extent of the audit procedures to be performed based on the assessment of the risk of material misstatement in consolidation process;
(d)	determining the extent of use of other auditor's work in the audit; and
(e)	coordinating the work to be performed.

A parent which presents consolidated financial statements is required to consolidate all its components in the consolidated financial statements other than those for which exceptions have been provided in the relevant accounting standards under the applicable financial reporting framework.

The auditor should obtain a listing of all the components included in the consolidated financial statements and review the information provided by the management of the parent identifying the components. The auditor should verify that all the components have been included in the consolidated financial statements unless these components meet criterion for exclusion.

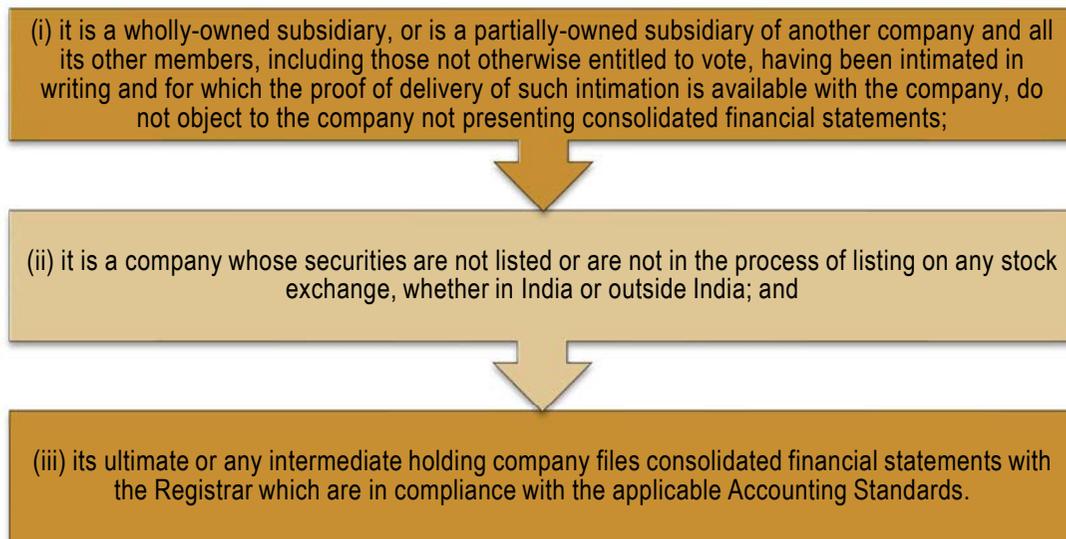
**In respect of completeness of this information, the auditor should perform the following procedures:**

(a)	review his working papers for the prior years for the known components;
(b)	review the parent's procedures for identification of various components;
(c)	make inquiries of the management to identify any new components or any component which goes out of consolidated financial statements;
(d)	review the investments of parent as well as its components to determine the shareholding in other entities;
(e)	review the joint ventures and joint arrangements as applicable;
(f)	review the other arrangements entered into by the parent that have not been included in the consolidated financial statements of the group;
(g)	review the statutory records maintained by the parent, for example registers under section 186, 190 of the Companies Act, 2013;
(h)	Identify the changes in the shareholding that might have taken place during the reporting period.

The auditor should document procedures performed for assessing completeness of the components to be consolidated.

There would be various means by which control, joint control or significant influence can be obtained. In this regard, the auditor may verify the Board's minutes, shareholder agreements entered into by the parent, agreements with the entities to which the parent might have provided any technology or know how, enforcement of statute, as the case may be, etc. The auditor may also review the minutes of the meetings of the Board of Directors subsequent to the year-end to understand if there has been any liquidation of investments or any further investments have been made as these may provide further evidence to understand if the control was meant to be temporary in nature or otherwise.

Where a component is excluded from the consolidated financial statements, the auditor should examine the reasons for exclusion and whether such exclusion is in conformity with the applicable financial reporting framework, for example, under the Companies (Accounting Standards) Rules, 2006, there could be two reasons for exclusion of a subsidiary, associate or jointly controlled entity-one, that the relationship of parent with the subsidiary, associate or jointly controlled entity is intended to be temporary or the subsidiary, associate or joint venture operates under severe long-term restrictions which significantly impair its ability to transfer funds to the parent. Similarly, under the Companies Act, 2013, intermediate subsidiary in India is not required to present consolidated financial statements, if a company meets the following conditions:



Ind AS 110 also prescribes certain criteria where consolidated financial statements are not required. In such cases, the auditor should satisfy himself that the exclusion made by the management falls within these categories, example in the case of an entity which is excluded from consolidation on the ground that the relationship of parent with the other entity as subsidiary, associate or joint venture is temporary, the auditor should verify that the intention of the parent, to dispose off the subsidiary, investment in associate or interest in jointly controlled entity, in the near future, existed at the time of acquisition of the subsidiary, making investment in associate or jointly controlled entity. The auditor should also verify that the reasons for exclusion are given in the consolidated financial statements. If an entity is excluded from the consolidated financial statements for reasons other than those allowed by the applicable financial reporting framework, the auditor should consider its effect on the auditor's report to be issued.

The auditor should also examine whether there is any change in the status of a component (e.g., subsidiary to associate, JV to associate or vice – versa). The auditor, in such cases, should examine whether these changes have been appropriately accounted for in the consolidated financial statements as required by the relevant accounting standards/Ind AS under the applicable financial reporting framework.

- (a) In preparing consolidated financial statements in accordance with the Companies (Accounting Standards) Rules, 2006, the financial statements of the parent and its subsidiaries are combined on a line-by-line basis by adding together like items of assets, liabilities, income, expenses and cash flows and then certain calculations like determination of goodwill or capital reserve, minorities interest and adjustments like elimination of intra group transactions, balances and unrealised profits etc. are made in

accordance with the requirements of Accounting Standard (AS) 21, "Consolidated Financial Statements". Investments in associates are accounted for using the Equity Method as prescribed in Accounting Standard (AS) 23, "Accounting for Investments in Associates in Consolidated Financial Statements". A parent that has an interest in a jointly controlled entity, reports its interest in the consolidated financial statements using proportionate consolidation method in accordance with Accounting Standard (AS) 27, "Financial Reporting of Interests in Joint Ventures". Many of the procedures appropriate for the application of equity method and the proportionate consolidation method are similar to the consolidation procedures set out in Accounting Standard (AS) 21, "Consolidated Financial Statements".

**(b) For consolidation of subsidiaries in accordance with the Companies (Indian Accounting Standards) Rules, 2015:**

- the financial statements of the parent and its subsidiaries are combined as per Ind AS 110, "Consolidated Financial Statements" on a line-by-line basis by adding together like items of assets, liabilities, income, expenses and cash flows;
- related goodwill/ capital reserve (or gain on bargain purchase) and non-controlling interest is determined as per Ind AS 103;
- business combinations involving entities or businesses under common control shall be accounted for using the pooling of interest method in accordance with Ind AS 103;
- adjustments like elimination of intra-group transactions, balances, unrealised profits and deferred tax etc. are made in accordance with the requirements of Ind AS 110;
- investments in associates and joint ventures are accounted for using the Equity Method as prescribed in Indian Accounting Standard (Ind AS) 28, "Investments in Associates and Joint Ventures". Interests in assets, liabilities, revenues and expenses in a joint operation are accounted for as part of separate financial statements of the entity in accordance with Indian Accounting Standard (Ind AS) 111, "Joint Arrangements";
- in a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss or other comprehensive income, as appropriate in accordance with Ind AS 103.

The auditor should verify that the adjustments warranted by the relevant accounting standards under the applicable financial reporting framework have been made wherever required and have been properly approved by the management of the parent. The preparation of consolidated financial statements gives rise to permanent consolidation adjustments and current period consolidation adjustments. The auditor should also pay attention to off balance sheet entities which sometimes do not qualify for the definition of subsidiary, however, parent might have transferred risks of various business ventures to these entities. Further, de-facto control should also be considered.

**De facto control means an investor with less than the majority of the voting rights has the practical ability to direct the relevant activities unilaterally.**

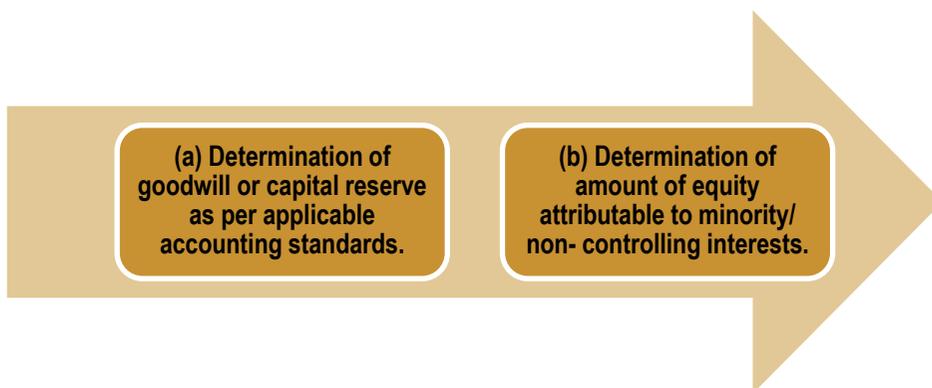
### TEST YOUR UNDERSTANDING 1

CA. Mukund is in the second year of his term as statutory auditor of Style Marks Limited (Holding company), its subsidiaries and joint ventures. At the time of planning audit, he wants to be sure that all the components have been included in the consolidated financial statements. List out some procedures he should perform to verify completeness of this information.

## 6. SPECIAL CONSIDERATIONS

### 6.1 Permanent Consolidation Adjustments

Permanent consolidation adjustments are those adjustments that are made only on the first occasion or subsequent occasions in which there is a change in the shareholding of a particular entity which is consolidated. Permanent consolidation adjustments are:



The auditor should verify that the above calculations have been made appropriately.

- ◆ The auditor should pay particular attention to the determination of pre-acquisition reserves of the components. Date(s) of investment in components assumes importance in this regard.
- ◆ The auditor should also examine whether the pre-acquisition reserves have been allocated appropriately between the parent and the minority interests/ non-controlling interests of the subsidiary.

- ◆ The auditor should also verify the changes that might have taken place in these permanent consolidation adjustments on account of subsequent acquisition of shares in the components, disposal of the components in the subsequent years.

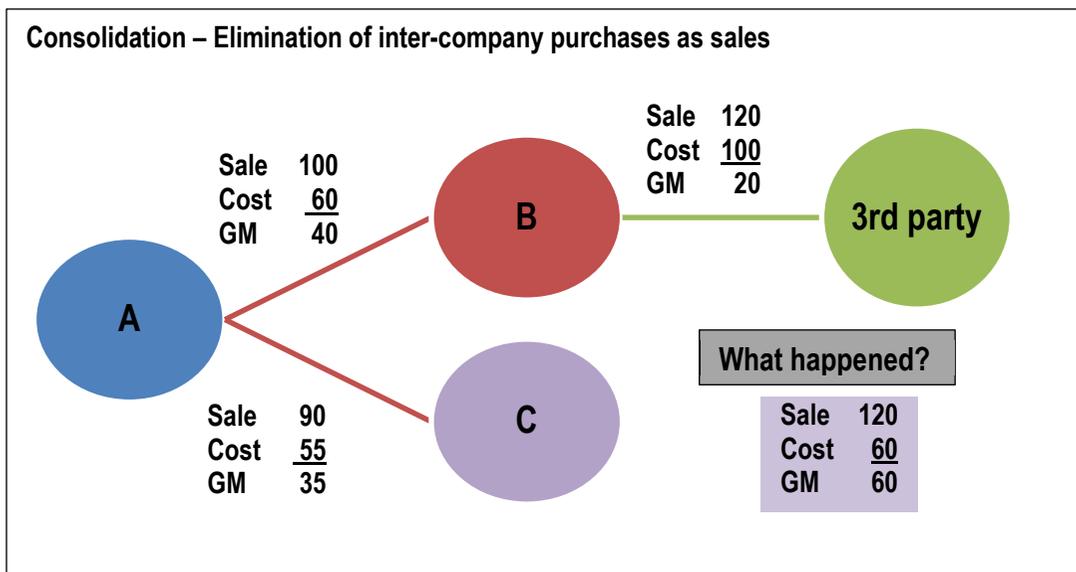
It may happen that while working out the permanent consolidation adjustments, in the case of one subsidiary, goodwill arises and in the case of another subsidiary, capital reserve arises. The parent may choose to net off these amounts to disclose a single amount in the consolidated balance sheet where permitted by the applicable financial reporting framework. In such cases, the auditor should verify that the gross amounts of goodwill and capital reserves arising on acquisition of various subsidiaries have been disclosed in the notes to the consolidated financial statements to reflect the excess/shortage over the parents' portion of the subsidiary's equity.



XYZ Ltd. is a company engaged in the manufacture of tyres for four wheelers and two wheelers through its subsidiaries ABC Ltd. and MNO Ltd. The company has invested 70% in ABC Ltd. During the FY 2021-22, the company reduced the control over ABC Ltd. from 70% to 55%. Consequently, certain adjustments were made to the accounts for the change in share of equity held in XYZ Ltd. whose financials are being consolidated. Such kind of adjustments are known as permanent consolidation adjustments.

## 6.2 Current Period Consolidation Adjustments

Current period adjustments are those adjustments that are made in the accounting period for which the consolidation of financial statements is done.



**Current period consolidation adjustments primarily relate to the elimination of intra-group transactions and account balances including:**

- (a) intra-group interest paid and received, or management fees, etc.;
- (b) unrealised intra-group profits on assets acquired/ transferred from/ to other subsidiaries;
- (c) record deferred taxes on unrealised intercompany profits elimination in accordance with Ind AS 12;
- (d) intra-group indebtedness;
- (e) adjustments related to harmonising the different accounting policies being followed by the parent and its components;
- (f) adjustments to the financial statements (of the parent and the components being consolidated) for recognized subsequent events or transactions that occur between the balance sheet date and the date of the auditor's report on the consolidated financial statements of the group.

**There are two types of subsequent events:**

- (i) The first type of subsequent events consists of events or transactions that provide additional evidence about conditions that existed at the date of the financial statements, including the estimates inherent in the process of preparing financial statements (i.e. adjusting events).
- (ii) The second type of subsequent events consists of events that provide evidence about conditions that did not exist at the date of the financial statements but arose subsequent to that date (i.e. non-adjusting events).

Events occurring after balance sheet date which do not require adjustments would not normally require disclosure, although they may be of such significance that they may require a disclosure in the report of approving authority in the case of accounting standards and in the financial statements in case of Ind AS. For such events, the following shall be disclosed:

- (i) The nature of the event; and
  - (ii) An estimate of its financial effect or a statement that such an estimate cannot be made.
- (g) adjustments for the effects of significant transactions or other events that occur between the date of the components balance sheet and not already recognised in its financial statements and the date of the auditor's report on the group's consolidated financial statements when

the financial statements of the component to be used for consolidation are not drawn upto the same balance sheet date as that of the parent;

- (h) In case of a foreign component, adjustments to convert a component's audited financial statements prepared under the component's local GAAP to the GAAP under which the consolidated financial statements are prepared;
- (i) determination of movement in equity attributable to the minorities interest/non-controlling interest since the date of acquisition of the subsidiary. It should also be noted that under Ind AS, non-controlling interest can also result in negative balance. Unlike earlier AS, as per paragraph 28 of Ind AS 27, if the net worth of subsidiary is negative, non-controlling interest could have deficit balance;
- (j) adjustments of deferred tax on account of temporary differences arising out of elimination of profit and losses resulting from intragroup transactions and undistributed profits of the component in case of consolidated financial statements prepared under Ind AS.

The adjustments required for preparation of consolidated financial statements are made in memorandum records kept for the purpose by the parent. The auditor should review the memorandum records to verify the adjustment entries made in the preparation of consolidated financial statements.

**Apart from reviewing the memorandum records, the auditor should inter alia:**

- (a) verify that the intra group transactions and account balances have been eliminated;
- (b) verify that the consolidated financial statements have been prepared using uniform accounting policies for like transactions and other events in similar circumstances;
- (c) verify that adequate disclosures have been made in accordance with AS 21 in the consolidated financial statements of application of different accounting policies in case, it was impracticable to harmonize them. Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so<sup>4</sup> but while preparing CFS under Ind AS, auditors should ensure that appropriate adjustments are made to that group member's financial statements in preparing the consolidated financial statements to ensure conformity with the group's accounting policies in accordance with Ind AS 110;

<sup>4</sup> AS 21/ AS 23/ AS 27 permit application of different accounting policies, if it is impractical to use uniform accounting policies, that fact should be disclosed together with the proportion of the items in the consolidated financial statements to which the different accounting policies have been applied. Ind AS 28 permits that financial statement of an associate can be prepared using different accounting policies if it is impractical to do so however adjustment shall be made to make the accounting policies conform to those of parent when the financial statements are used by parent in applying the equity method.

(d)	verify the adjustments made to harmonise the different accounting policies including adjustments made by management to convert a component's financial statements prepared under the component's GAAP to the GAAP under which the consolidated financial statements are prepared;
(e)	verify the calculation of minorities/non-controlling interest;
(f)	verify adjustments relating to deferred tax on account of temporary differences arising out of elimination of profit and losses resulting from intergroup transactions (where the parent's accounts are maintained in Ind AS);
(g)	verify that income and expenses of the subsidiary are included in consolidated financial statements from the date it gains control until the date when the entity ceases to control the subsidiary and further such income and expenses are based on the amounts of the assets and liabilities recognised in consolidated financial statements at the acquisition date <sup>5</sup> .

The auditor should gain an understanding of the procedures adopted by the management of the enterprise to make the above mentioned adjustments. This helps the auditor in reducing the audit risk to an acceptably low level.

One of the important adjustment that may be required in the current period is determination of impairment loss that might exist for goodwill arising on consolidation. Goodwill arising on consolidation is carried at the value determined at the date of acquisition of the component, and the same is to be tested for impairment loss at every balance sheet date.

The auditor should examine whether any impairment loss has been determined by the parent. If yes, the auditor should examine the procedure followed for determination of impairment loss. The auditor should satisfy himself that the amount of impairment loss determined is fair. In case the impairment loss in goodwill of a component has been determined in foreign currency, the auditor should verify if any amount of loss in local currency need to be adjusted from currency translation reserve on account of movement in the exchange rate from the date when the goodwill was first accounted for in the consolidated financial statement of parent, to the date of determination of impairment loss.

The auditor should also perform audit procedures to understand and verify whether intragroup losses are indicating an impairment loss that requires recognition in the consolidated financial statements.

Apart from verifying that the calculation and disclosures regarding minorities/non-controlling interest have been made appropriately, the auditor also determines, in cases where the minority interests' share of the losses exceed the minority/non-controlling interests' share of the equity, the excess, and any further losses applicable to the minority interest, have been accounted for in accordance with the relevant accounting standards.

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<sup>5</sup> Where the consolidated financial statements are prepared under Indian Accounting Standards.

The financial statements of the components used in the consolidation should be drawn up to the same reporting date as that of the parent. If it is not practicable to draw up the financial statements of one or more components to such date and, accordingly, those financial statements are drawn up to different reporting dates, adjustments should be made for the effects of significant transactions or other events that occur between those dates and the date of the parent's financial statements. In any case, the difference between reporting dates should not be more than six months in case of financial statements under AS and three months in case of financial statements under Ind AS. The auditor of the consolidated financial statements should review other components' results between its financial reporting date and that of the parent for significant transactions or other events that have taken place during the period and, therefore, need to be reflected in the consolidated financial statements. Recognition should be given by disclosure or otherwise to the effect of intervening events which materially affect the financial position, results of operations or cash flows.

The fundamental accounting assumption of "consistency" requires the auditor of the consolidated financial statements to consider whether the length of the reporting periods and any difference in financial year-ends are the same from period to period. If there have been any changes in the respective reporting periods of the components included in the consolidated financial statements that have a material effect on the financial statements, the auditor should ensure that the entity discloses such changes and the manner of treatment in the financial statements.

The Ministry of Corporate Affairs has issued a Circular number 39/2014 dated October 14, 2014 stating that Schedule III to the Act read with the applicable Accounting Standards does not envisage that a company while preparing its consolidated financial statements merely repeats the disclosures made by it under separate financial statements being consolidated. In the consolidated financial statements, the company would need to give all disclosures relevant to consolidated financial statements only.

Further, Accounting Standard (AS) 21 also lays down certain principles that should be observed while giving the information which is part of the separate financial statements of the Components but that need not be reported in the notes and other explanatory material of the consolidated financial statements.

**The auditor should:**

- (a) examine that the notes required by the applicable standards which are necessary for presenting a true and fair view of the consolidated financial statements have been included in the consolidated financial statements as an integral part thereof; and

- (b) examine that additional statutory information disclosed in the separate financial statements of the subsidiary and/or a parent having bearing on the true and fair view of the consolidated financial statements have been disclosed in the consolidated financial statements.

In addition, the information required pursuant to Schedule III to the Companies Act, 2013 ('general instructions for the preparation of consolidated financial statements') should be disclosed.

**Example 2.** Following information is also required to be disclosed in the consolidated financial statements separately for the parent and each of its components (including foreign component) which has been consolidated:

- (i) amount of net assets and net assets as a percentage of consolidated net assets;
- (ii) amount of share in profit or loss and the percentage share in profit or loss as a percentage of consolidated profit or loss;
- (iii) amount in other comprehensive income (OCI) and the percentage of OCI as a percentage of Consolidated OCI.<sup>6</sup>

As regards consolidation adjustments (including elimination of intra group transactions), it should be ensured that these are either disclosed as a single line item separately or adjusted in the information (e.g. net assets) disclosed for the parent and its each component.

The Ind AS 110 does not give a list of information which is part of the separate financial statement of the components but that need not be reported in the notes and other explanatory material of the consolidated financial statements, however, based on section 129(4) and MCA circular 39/2014 as referred above, it can be construed that, even in consolidated financial statements under Ind AS, only those disclosures should be given which are relevant to consolidated financial statements.

Based on the above discussion, in case of companies, the information such as the following given in the notes to the separate financial statements of the parent and/or the subsidiary, need not be included in the consolidated financial statements.

- (i) Source from which bonus shares are issued, e.g., capitalisation of profits or reserves or from securities premium account.
- (ii) Disclosure of all unutilised monies out of the issue indicating the form in which such unutilised funds have been invested.
- (iii) Disclosure required under Micro, Small and Medium Enterprises Development Act, 2006.

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<sup>6</sup> For companies which are covered by Ind AS.

- (iv) A statement of investments (whether shown under “financial assets or non-financial assets as stock-in-trade) separately classifying trade investments and other investments, showing the names of the bodies corporate (indicating separately the names of the bodies corporate under the same management) in whose shares or debentures, investments have been made (including all investments, whether existing or not, made subsequent to the date as at which the previous balance sheet was made out) and the nature and extent of the investment so made in each such body corporate.
- (v) Value of imports calculated on C.I.F. basis by the company during the financial year in respect of:
  - (a) raw materials;
  - (b) components and spare parts;
  - (c) capital goods.
- (vi) Expenditure in foreign currency during the financial year on account of royalty, know-how, professional and consultation fees, interest, and other matters.
- (vii) Value of all imported raw materials, spare parts and components consumed during the financial year and the value of all indigenous raw materials, spare parts and components similarly consumed and the percentage of each to the total consumption.
- (viii) The amount remitted during the year in foreign currencies on account of dividends, with a specific mention of the number of non-resident shareholders, the number of shares held by them on which the dividends were due and the year to which the dividends related.
- (ix) Earnings in foreign exchange classified under the following heads, namely:
  - (a) export of goods calculated on F.O.B. basis;
  - (b) royalty, know-how, professional and consultation fees;
  - (c) interest and dividend;
  - (d) other income, indicating the nature thereof.

However, notwithstanding the above, the auditor needs to ensure compliance with disclosure requirements of applicable accounting standards and other applicable laws for consolidated financial statements.

## 7. MANAGEMENT REPRESENTATIONS

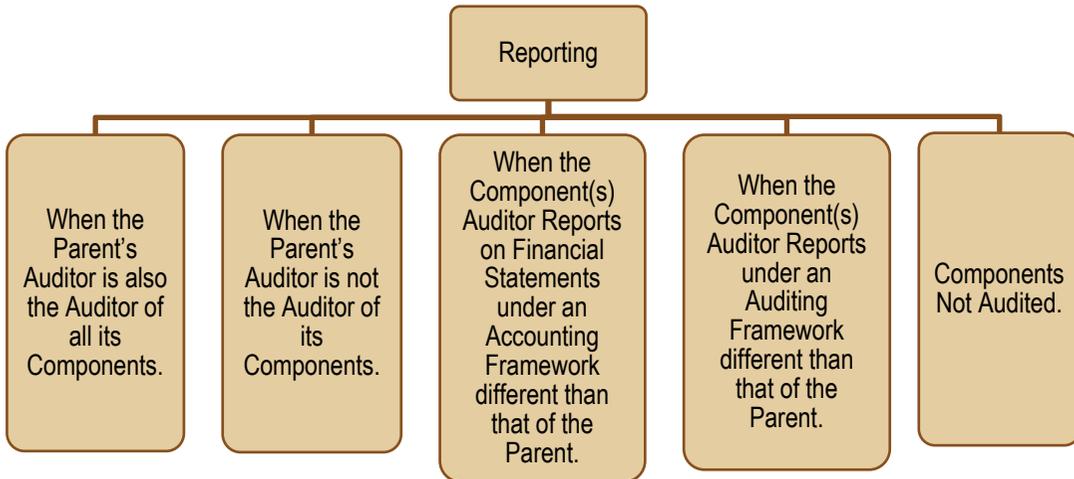
**SA 580, “Written Representations”** requires the auditor to obtain written representations from management and, where appropriate, those charged with governance. The auditor of the consolidated financial statements should obtain evidence that the management of the parent acknowledges its responsibility for a true and fair presentation of the consolidated financial statements in accordance with the financial reporting framework applicable to the parent and that parent management has approved the consolidated financial statements. In addition, the auditor of the consolidated financial statements obtains written representations from parent management on matters material to the consolidated financial statements.

**Examples of such representations include:**

- (a) Completeness of components included in the CFS;
- (b) Identification of reportable segments for segmental reporting;
- (c) Identification of related parties and related party transactions for reporting;
- (d) Appropriateness and completeness of permanent and current period consolidation adjustments, including the elimination of intra-group transactions.

## 8. REPORTING

There could be two situations in an audit of consolidated financial statements—when the parent’s auditor is also the auditor of all the components to be included in the consolidated financial statements and when the parent’s auditor is not the auditor of one or more components and therefore, uses the work of other auditors in the audit. The auditor should, while preparing the report, consider the requirements of Standard on Auditing (SA) 700, “Forming an Opinion and Reporting on Financial Statements”, SA 705, “Modifications to the Opinion in the Independent Auditor’s Report” and SA 706, “Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report. Where, the auditor uses the work of other auditors in the audit of consolidated financial statements, the requirements of SA 600, “Using the Work of Another Auditor” should also be considered.



## 8.1 When the Parent's Auditor is also the Auditor of all its Components

While drafting the audit report, the auditor should report:

- ◆ Whether principles and procedures for preparation and presentation of consolidated financial statements as laid down in the relevant accounting standards have been followed.  
In case of any departure or deviation, the auditor should consider the requirements given in SA 705, Modifications to the Opinion in the Independent Auditor's reports in the audit report so that users of the consolidated financial statements are aware of such deviation.
- ◆ Auditor should issue an audit report expressing opinion whether the consolidated financial statements give a true and fair view of the state of affairs of the Group as on balance sheet date and as to whether consolidated profit and loss statement gives true and fair view of the results of consolidated profit or losses of the Group for the period under audit.
- ◆ Where the consolidated financial statements also include a cash flow statement, the auditor should also give his opinion on the true and fair view of the cash flows presented by the consolidated cash flow statements.

## 8.2 When the Parent's Auditor is not the Auditor of all its Components

In a case where the parent's auditor is not the auditor of all the components included in the consolidated financial statements, the auditor of the consolidated financial statements should also consider the requirement of SA 600.

As prescribed in SA 706, if the auditor considers it necessary to make reference to the audit of the other auditors, the auditor's report on the consolidated financial statements should disclose clearly the magnitude of the portion of the financial statements audited by the other auditor(s).

This may be done by stating aggregate rupee amounts or percentages of total assets, revenues and cash flows of components included in the consolidated financial statements not audited by the parent's auditor.

Total assets, revenues and cash flows not audited by the parent's auditor should be presented before giving effect to permanent and current period consolidation adjustments.

Reference in the report of the auditor on the consolidated financial statements to the fact that part of the audit of the group was made by other auditor(s) is not to be construed as a qualification of the opinion but rather as an indication of the divided responsibility between the auditors of the parent and its subsidiaries.

### **8.3 When the Component(s) Auditor Reports on Financial Statements under an Accounting Framework Different than that of the Parent**

The parent may have components located in multiple geographies outside India applying an accounting framework (GAAP) that is different than that of the parent in preparing its financial statements. Foreign components prepare financial statements under different financial reporting frameworks, which may be a well-known framework (such as US GAAP or IFRS) or the local GAAP of the jurisdiction of the component. Local component auditors may be unable to report on financial statements prepared using the parent's GAAP because of their unfamiliarity with such GAAP.

When a component's financial statements are prepared under an accounting framework that is different than that of the framework used by the parent in preparing group's consolidated financial statements, the parent's management perform a conversion of the components' audited financial statements from the framework used by the component to the framework under which the consolidated financial statements are prepared. The conversion adjustments are audited by the principal auditor to ensure that the financial information of the component(s) is suitable and appropriate for the purposes of consolidation.

A component may alternatively prepare financial statements on the basis of the parent's accounting policies, as outlined in the group accounting manual, to facilitate the preparation of the group's consolidated financial statements. The group accounting manual would normally contain all accounting policies, including relevant disclosure requirements, which are consistent with the requirements of the financial reporting framework under which the group's consolidated financial

statements are prepared. The local component auditor can then audit and issue an audit report on the components financial statements prepared in accordance with “group accounting policies”.

When applying the approach of using group accounting policies as the financial accounting framework for components to report under, the principal/parent auditors should perform procedures necessary to determine compliance of the group accounting policies with the GAAP applicable to the parent’s financial statements. This ensures that the information prepared under the requirements of the group accounting policies will be directly usable and relevant for the preparation of consolidated financial statements by the parent entity, eliminating the need for auditing by the auditor, the differences between the basis used for the component’s financial statements and that of the consolidated financial statements. The Principal auditor can then decide whether or not to rely on the components’ audit report and make reference to it in the auditor’s report on the consolidated financial statements.

#### **8.4 When the Component(s) Auditor Reports under an Auditing Framework Different than that of the Parent**

Normally, audits of financial statements, including consolidated financial statements, are performed under auditing standards generally accepted in India (“Indian GAAS”).

In order to maintain consistency of the auditing framework and to enable the parent auditor to rely and refer to the other auditor’s audit report in their audit report on the consolidated financial statements, the components’ financial statements should also be audited under a framework that corresponds to Indian GAAS.

#### **8.5 Components Not Audited**

Generally, the financial statements of all components included in consolidated financial statements should be audited or subjected to audit procedures in the context of a multi-location group audit. Such audits and audit procedures can be performed by the auditor reporting on the consolidated financial statements or by the components’ auditor.

Where the financial statements of one or more components continue to remain unaudited, the auditor reporting on the consolidated financial statements should consider unaudited components in evaluating a possible modification to his report on the consolidated financial statements. The evaluation is necessary because the auditor (or other auditors, as the case may be) has not been able to obtain sufficient appropriate audit evidence in relation to such consolidated amounts/balances. In such cases, the auditor should evaluate both qualitative and quantitative factors on the possible effect of such amounts remaining unaudited when reporting on the

consolidated financial statements using the guidance provided in SA 705, “Modifications to the Opinion in the Independent Auditor’s Report”.

### TEST YOUR UNDERSTANDING 2

CA. Kajal is nearing completion of audit of consolidated financial statements of Rubic Paints and Chemicals Limited. She requires written representations from the parent’s management on matters material to the consolidated financial statements. What specific matters such written representations can include?

### TEST YOUR UNDERSTANDING 3

CA.M is auditor of consolidated financial statements of “D and D Limited” for year 2022-23. The consolidated financial statements consist of financial statements and financial information of 8 subsidiaries audited by other auditors. Such financial statements, financial information and auditor’s reports of subsidiaries have been furnished by management of the “D and D Limited” to him. Following further information is also available in respect of these 8 subsidiaries for year 2022-23: -

Total assets	₹ 1500 crore
Total revenues	₹ 1000 crore
Net cash outflows	₹ 10 crore

Two of these subsidiaries are located outside India whose financial statements have been prepared in accordance with accounting principles generally accepted in their respective countries and which have been audited by other auditors under generally accepted auditing standards applicable in their respective countries.

Where and how such information should be included in independent auditor’s report on consolidated financial statements of company? Also draft a suitable para by making necessary assumptions.

### Integrated Case Scenario

While auditing consolidated financial statements of YK Industries Limited for the year 2022-23, a manufacturing company whose financial statements are required to be prepared in accordance with Division II of Schedule III of Companies Act, 2013, CA. Palash Shah notices as under: -

(A) The notes to accounts in respect of consolidated financial statements disclose additional information pertaining to the holding company and its subsidiaries. It provides disclosure regarding

percentages of consolidated net assets, of consolidated profit and loss and of total comprehensive income along with their respective amounts pertaining to holding company and its subsidiaries.

(B) It is noticed by him that financial statements of one foreign subsidiary included in consolidated financial statements are drawn up to 31<sup>st</sup> December, 2022 in accordance with legal requirements in US. He feels it to be weird and is of the view that consolidated financial statements of group could present a distorted picture. The management, in turn, informs him that it is not practicable to draw the financial statements of foreign subsidiary to 31<sup>st</sup> March, 2023.

(C) During the year 2022-23, goodwill of Rs.50 crore had arisen on account of the acquisition of a subsidiary during the year and there is no impairment loss as on the balance sheet date. Besides, adjustments have been made in consolidated financial statements with respect to intra-group indebtedness and those related to harmonizing different accounting policies being adopted by parent and its subsidiaries.

(D) It is noticed by him that one subsidiary was acquired on 15.6.22. He is in a dilemma as regards to the correctness of consolidation of its financial statements in group financial statements.

Besides, he is also in the process of finalising audit report including matters to be reported under CARO, 2020 in respect of consolidated financial statements. However, he is in a fix in respect of manner of reporting under CARO,2020 relating to consolidated financial statements.

Based upon above information and description, answer the following questions:-

1. Considering disclosure of additional information in consolidated financial statements as stated in para (A) of case study, which of the following statements is correct?
  - (a) The said disclosure is not proper as percentage of consolidated revenue from operations along with respective amount pertaining to holding company and its subsidiaries is also required.
  - (b) The said disclosure is not proper as percentage of other comprehensive income along with respective amount pertaining to holding company and its subsidiaries is also required.
  - (c) The said disclosure is not proper as percentages of consolidated revenue from operations as well as other comprehensive income along with their respective amounts pertaining to holding company and its subsidiaries are also required.
  - (d) The said disclosure is proper.

2. What should be auditor's proper course of action pursuant to situation highlighted in para [B] relating to financial statements of a foreign subsidiary?
- (a) The auditor should insist for drawing up of financial statements of foreign subsidiary to 31<sup>st</sup> March,2023. The reason for impracticality is a mere excuse. In case of failure to redraw, he can modify his opinion in accordance with SA 705.
  - (b) The auditor can accept management's version.
  - (c) The auditor can accept management's version. However, it is his duty to verify adjustments made for effects of significant transactions or events occurring between 1<sup>st</sup> January 2023 and 31<sup>st</sup> March,2023.
  - (d) The auditor should modify his opinion by quantifying the financial effects of such an inconsistency.
3. Which of the following statements is correct in respect of goodwill and other matters described in the case scenario?
- (a) Goodwill represents current period consolidation adjustments. Adjustments relating to intra-group indebtedness and those relating to harmonizing different accounting policies being adopted by the parent and its subsidiaries represent permanent consolidation adjustments.
  - (b) Adjustments relating to goodwill, intra-group indebtedness and those relating to harmonizing different accounting policies being adopted by parent and its subsidiaries represent current period consolidation adjustments.
  - (c) Goodwill represents permanent consolidation adjustments. Adjustments relating to intra-group indebtedness and those relating to harmonizing different accounting policies being adopted by the parent and its subsidiaries represent current-period consolidation adjustments.
  - (d) Goodwill and adjustments relating to harmonizing different accounting policies being adopted by the parent and its subsidiaries represent permanent consolidation adjustments. Adjustments relating to intra-group indebtedness represent current-period consolidation adjustments.
4. Which of the following statements is most appropriate regarding consolidation of financial statements of a subsidiary acquired on 15.6.22?

- (a) The auditor should verify that income and expenses of subsidiary are included in consolidated financial statements from the date it gains control of subsidiary and further such income and expenses are based on the amounts of the assets and liabilities recognized in consolidated financial statements at the acquisition date.
  - (b) The auditor should verify that income and expenses of subsidiary are included in consolidated financial statements for the complete financial year and further such income and expenses are based on the amounts of the assets and liabilities recognized in consolidated financial statements at the preceding reporting date.
  - (c) The auditor should verify that income and expenses of subsidiary are included in consolidated financial statements from the date it gains control of subsidiary and further such income and expenses are based on the amounts of the assets and liabilities recognized in consolidated financial statements at the preceding reporting date.
  - (d) The auditor should verify that income and expenses of subsidiary are included in consolidated financial statements for the complete financial year and further such income and expenses are based on the amounts of the assets and liabilities recognized in consolidated financial statements at the acquisition date.
5. As regards reporting under reporting CARO,2020 in respect of consolidated financial statements, which of the following is in accordance with requirements of law?
- (a) A separate report providing Clause by Clause reporting under CARO,2020 is required in respect of specified matters pertaining to parent and all subsidiaries incorporated in India.
  - (b) It would be sufficient if report under CARO,2020 in respect of standalone financial statements is supplemented with additional information in respect of all subsidiaries incorporated in India.
  - (c) A separate report under CARO, 2020 in respect of all subsidiaries incorporated in India together is required. It should be annexed with report under CARO,2020 in respect of standalone financial statements.
  - (d) Reporting of details of subsidiaries together with paragraph numbers of reports under CARO, 2020 of auditors of such companies incorporated in India containing qualifications or adverse remarks would serve the purpose.

**Key Takeaways**

- Whenever a parent decides to or is required to prepare and present consolidated financial statements, it should do so in accordance with the requirements of applicable Accounting Standards under the relevant financial reporting framework.
- Accounting Standard (AS) 21 'Consolidated Financial Statements' and Indian Accounting Standard (Ind AS) 110, 'Consolidated Financial Statements lay down principles and procedures for preparation and presentation of consolidated financial statements under AS and Ind AS respectively.
- Consolidated financial statements are presented, to the extent possible, in the same format as adopted by the parent for its separate financial statements.
- According to Section 129(3) of the Companies Act, 2013, where a company has one or more subsidiaries, including associate company and joint venture, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own.
- Section 129(4) of the said Act, provides that the provisions applicable to the preparation, adoption and audit of the financial statements of a holding company shall, mutatis mutandis, also apply to its the consolidated financial statements.
- The responsibility for the preparation and presentation of consolidated financial statements, among other things, is that of the management of the parent.
- The principal auditor of the consolidated financial statements is responsible for expressing an opinion on whether the consolidated financial statements are prepared, in all material respects in accordance with the financial reporting framework under which the parent prepares the consolidated financial statements in addition to reporting on the additional matters as required under the Companies Act, 2013 and any other statute to the extent applicable.
- Standards on Auditing, Statements and Guidance Notes on auditing matters issued by the Institute of Chartered Accountants of India (ICAI) apply in the same manner to audit of consolidated financial statements as they apply to audit of standalone financial statements.
- When an auditor accepts the audit of consolidated financial statements, the auditor should assess whether based on his work alone he would be able to express an opinion on the true and fair view presented by the consolidated financial statements. If the auditor is of the view

that his own participation may not be enough or sufficient, he should consider using the work of 'Other auditors'.

- Before commencing an audit of consolidated financial statements, the auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner.
- Special considerations like Permanent consolidation adjustments and current period consolidation adjustments need to be taken into account while auditing group financial statements.
- Permanent consolidation adjustments are those adjustments that are made only on the first occasion or subsequent occasions in which there is a change in the shareholding of a particular entity which is consolidated. Examples are determination of goodwill or capital reserve, equity attributable to minority shareholders.
- Current period adjustments are those adjustments that are made in the accounting period for which the consolidation of financial statements is done like elimination of intra-group transactions and account balances.
- There could be two situations in an audit of consolidated financial statements—when the parent's auditor is also the auditor of all the components to be included in the consolidated financial statements and when the parent's auditor is not the auditor of one or more components and therefore, uses the work of other auditors in the audit.
- The auditor should, while preparing the report, consider the requirements of Standard on Auditing (SA) 700, "Forming an Opinion and Reporting on Financial Statements", SA 705, "Modifications to the Opinion in the Independent Auditor's Report and SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report. Where, the auditor uses the work of other auditors in the audit of consolidated financial statements, the requirements of SA 600, "Using the Work of Another Auditor" should also be considered.
- Where the financial statements of one or more components continue to remain unaudited, the auditor reporting on the consolidated financial statements should consider unaudited components in evaluating a possible modification to his report on the consolidated financial statements. The evaluation is necessary because the auditor (or other auditors, as the case may be) has not been able to obtain sufficient appropriate audit evidence in relation to such consolidated amounts/balances.

## TEST YOUR KNOWLEDGE

### Theoretical Questions

1. *Whether preparation of consolidated financial statements is mandatory? If yes, please elaborate on the requirements under the statute.*
2. *Please elaborate on the situations wherein the requirement related to preparation of consolidated financial statements may not apply.*
3. *While doing the audit of Consolidated Financial Statements, which current period consolidation adjustments are to be taken into account?*
4. *Write a short note on:*
  - (a) *Responsibility of holding company for preparation of Consolidated Financial Statements.*
  - (b) *Permanent Consolidated Adjustments.*
5. *R Ltd. owns 51% voting power in S Ltd. It however, holds and discloses all the shares as "Stock-in-trade" in its accounts. The shares are held exclusively with a view to their subsequent disposal in the near future. R Ltd. represents that while preparing Consolidated Financial Statements, S Ltd. can be excluded from the consolidation. As a Statutory Auditor, how would you deal?*
6. *A Ltd. holds the ownership of 10% of voting power and control over the composition of Board of Directors of B Ltd. While planning the statutory audit of A Ltd., what factors would be considered by you as the statutory auditors of A Ltd for the audit of its consolidated financial statements prepared under Ind AS?*
7. *You are appointed as an auditor of Nawab Limited, a listed company who is a main supplier to the UK building and construction market. With a turnover of ₹ 2.9 billion, the company operates through 11 business units and has nearly 180 branches across the countries .*

*As an auditor, how will you draft the report in case:*

  - (a) *When the Parent's Auditor is also the Auditor of all its Components?*
  - (b) *When the Parent's Auditor is not the Auditor of all its Components?*
  - (c) *When the Component(s) Auditor Reports on Financial Statements under an Accounting Framework Different than that of the Parent?*

- (d) *When the Component(s) Auditor Reports under an Auditing Framework Different than that of the Parent?*
- (e) *Where the financial statements of one or more components is not audited?*
8. *M Ltd. acquired 51 % shares of S Ltd. on 01-04-2019 and sold 25% of these shares during the financial year 2019-20. M Ltd. did not prepare Consolidated Financial Statements for the financial year 2019-20 on the plea that the control was only temporary. Do you agree with the view of M Ltd.? Decide, assuming, that M Ltd. is required to prepare its financial statements under Ind AS.*
9. *H Limited is an Investment Company preparing its Financial Statements in accordance with Ind AS. The Company obtains funds from various investors and commits its performance for fair return and capital appreciation to its investors. During the year under audit, it had been observed that the Company had invested 25% in S1 Ltd., 50% in S2 Ltd. and 60% in S3 Ltd. of the respective share capitals of the Investee Companies. When checking the investment schedule of the Company, an issue cropped as to whether there would arise any need to consolidate accounts of any such investee companies with those of H Limited in accordance with section 129(3) of the Companies Act, 2013 which contains no exclusion from consolidation. Analyse the issues involved and give your views.*
10. *Venus Ltd. is a company engaged in the manufacture of stainless steel items. The company operates through 5 business units and has 35 branches across India. Manglam & Associates are being appointed as the principal auditor of the company. While accepting the audit assignment as the principal auditor, what will be the points of consideration for the principal auditor of the company?*
11. *Venus Ltd. is a curtain manufacturing company having its corporate office in Punjab. The company is in the process of expansion and has acquired four companies during the year. Pradyuman & Co. is the principal auditor of the company while the audit of all the companies acquired during the year is being conducted by Jha & Jha Associates. During the course of audit, CA Pradyuman, the engagement partner asked the management of Venus Ltd. at the corporate office that in order to conduct the audit of the consolidated financial statements, his audit firm is required to conduct audit of the financial statements of all the components also (Companies acquired during the year). To this, the management asked CA Pradyuman to consider the audit reports of the component auditor already provided to his audit team and to communicate with the component auditor for any discussion they wish to have. CA Pradyuman contended that for the purpose of audit of consolidated financial statements either*

*his firm is required to conduct an audit of all the component's financial statements or he needs the working papers of the component auditors. Is the contention of CA Pradyuman correct?*

12. *Kukreja & Associates is the principal auditor of MN Ltd. The company is engaged in the manufacture of sports items and operates through its 14 branches all over India. With respect to the audit of branches, the company has appointed seven Chartered Accountant firms, each firm conducting the audit of two branches. The audit reports in respect of accounts of branches have already been sent to the principal auditor. While analysing the work of the branch auditors, CA Kukreja, the engagement partner, asked the branch auditors to share with him a summary of the audit procedures and findings in respect of the accounts of the branches examined by them. CA Kukreja also asked one of the branch auditor to share his working paper with respect to the two branches examined by that branch auditor for his review and return. Is the principal auditor correct in asking the branch auditors for sharing the summary and the working papers for his review.*

### **Answers to Test your Understanding.**

1. The auditor should verify that all the components have been included in the consolidated financial statements unless these components meet criterion for exclusion. In respect of completeness of this information, the auditor should perform the following procedures:
- (a) review his working papers for the prior years for the known components
  - (b) review the parent's procedures for identification of various components
  - (c) make inquiries of management to identify any new components or any component which goes out of consolidated financial statements
  - (d) review the investments of parent as well as its components to determine the shareholding in other entities
  - (e) review the joint ventures and joint arrangements as applicable
  - (f) review the other arrangements entered into by the parent that have not been included in the consolidated financial statements of the group
  - (g) review the statutory records maintained by the parent, for example registers under section 186, 190 of the Companies Act, 2013
  - (h) also identify the changes in the shareholding that might have taken place during the reporting period.

2. The auditor of the consolidated financial statements should obtain written representations from parent's management on matters material to the consolidated financial statements. Examples of such representations include:
  - (a) Completeness of components included in the consolidated financial statements;
  - (b) Identification of reportable segments for segment reporting
  - (c) Identification of related parties and related party transactions for reporting
  - (d) Appropriateness and completeness of permanent and current period consolidation adjustments, including the elimination of intra-group transactions.
  
3. In a case where the parent's auditor is not the auditor of all the components included in the consolidated financial statements, then as prescribed in SA 706, if the auditor considers it necessary to make reference to the audit of the other auditors, the auditor's report on the consolidated financial statements should disclose clearly the magnitude of the portion of the financial statements audited by the other auditors. This may be done by stating aggregate rupee amounts or percentages of total assets, revenues and cash flows of components included in the consolidated financial statements not audited by the parent's auditor.

It should be included in Other Matter paragraph of independent auditor's report. The draft "Other Matter Paragraph" is as under: -

#### Other Matter Paragraph

We did not audit the financial statements and other financial information, in respect of eight (8) subsidiaries, whose financial statements include total assets of Rs.1500 crores as at March 31, 2023, and total revenues of Rs.1,000 crores and net cash outflow of Rs. 10 crores for the year ended on that date. These financial statements and other financial information have been audited by other auditors and such financial statements, other financial information and auditor's reports have been furnished to us by the management of the Holding Company.

Our opinion on the consolidated financial statements, in so far as it relates to the amounts and disclosures included in respect of these subsidiaries and joint ventures, and our report in terms of sub-sections (3) of Section 143 of the Act, in so far as it relates to the aforesaid subsidiaries is based solely on the reports of such other auditors.

Two of these subsidiaries are located outside India whose financial statements and other financial information have been prepared in accordance with accounting principles generally accepted in their respective countries and which have been audited by other auditors under

generally accepted auditing standards applicable in their respective countries. The Holding Company's management has converted the financial statements of such subsidiaries from accounting principles generally accepted in their respective countries to accounting principles generally accepted in India.

We have audited these conversion adjustments made by the Holding Company's management. Our opinion in so far as it relates to the balances and affairs of such subsidiaries is based on the report of other auditors and the conversion adjustments prepared by the management of the Holding Company and audited by us. Our opinion on the consolidated financial statements, and our report on Other Legal and Regulatory Requirements is not modified in respect of the above matters with respect to our reliance on the work done and the reports of the other auditors and the financial statements and other financial information certified by the Management.

## Answer to Integrated Case Scenario

1. (b)
2. (c)
3. (c)
4. (a)
5. (d)

## Answers to Theoretical Questions

1. Refer Para 1.1
2. The requirement related to preparation of consolidated financial statements shall not apply to a company if it meets the following conditions:
  - (i) it is a wholly-owned subsidiary, or is a partially-owned subsidiary of another company and all its other members, including those not otherwise entitled to vote, having been intimated in writing and for which the proof of delivery of such intimation is available with the company, do not object to the company not presenting consolidated financial statements;
  - (ii) it is a company whose securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India; and

- (iii) its ultimate or any intermediate holding company files consolidated financial statements with the Registrar which are in compliance with the applicable Accounting Standards.
3. Refer Para 6.2
  4.
    - (a) Refer Para 2
    - (b) Refer Para 6.118
  5. **Consolidation of Financial Statement:** As per Ind AS 110, there is no such exemption for 'temporary control', or "for operation under severe long-term funds transfer restrictions" and consolidation is mandatory for Ind AS compliant financial statement in this case. Paragraph 20 of Ind AS 110 states that "Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee".

However, as per Section 129(3) of the Companies Act, 2013 read with rule 6 of the Companies (Accounts) Rules, 2014, where a company having subsidiary, which is not required to prepare consolidated financial statements under the Accounting standards, it shall be sufficient if the company complies with the provisions on consolidated financial statements provided in Schedule III to the Act.

In the given case, R Ltd's intention is to dispose off the shares in the near future as shares are being held as stock in trade and it is quite clear that the control is temporary, Therefore, R Ltd. is required to prepare Consolidated Financial Statements in accordance with Ind AS 110 as exemption for 'temporary control' is not available under Ind AS 110.

6. **10% Voting Power and Control over the composition of Board of Directors:** In this case, A Ltd. holds only 10 percent of the voting power but has control over the composition of the Board of Directors of B Ltd.

In such a case, A Ltd shall be considered as a parent of B Ltd and, therefore, it would consolidate B Ltd in its consolidated financial statements as a subsidiary.

The auditor should verify A Ltd's management's assessment of having control in B Ltd despite having only 10% voting power as per the requirements of Ind AS 110. Auditor would need to verify as to how A Ltd controls the composition of the Board of Directors or corresponding governing body of B Ltd.

There can be various means by which such kind of control can be established. In this regard, the auditor may verify the minutes of Board meetings, shareholder agreement entered into by the parent, agreements with B Ltd to which the parent might have provided any technology or know how, enforcement of statute, etc.

Further, the auditor should verify that the adjustments warranted by Ind AS 110 have been made wherever required and have been properly authorised by the management of the parent. The preparation of consolidated financial statements gives rise to permanent consolidation adjustments and current period consolidation adjustments. The auditor should make plan, among other things, for the understanding of accounting policies of the A Ltd and B Ltd and determining and programming the nature, timing, and extent of the audit procedures to be performed etc.

Further, the duties of an auditor with regard to reporting of transactions with any other related parties are given in SA 550 on Related Parties. As per SA 550 on, "Related Parties", the auditor should review information provided by the management of the entity identifying the names of all known related parties. A person or other entity that has control or significant influence, directly or indirectly through one or more intermediaries, over the reporting entity are considered as Related Party.

In forming an opinion on the financial statements, the auditor shall evaluate whether the identified related party relationships and transactions have been appropriately accounted for and disclosed in accordance with Ind AS 110 and Schedule III and whether the effects of the related party relationships and transactions prevent the financial statements from achieving true and fair presentation (for fair presentation frameworks) or cause the financial statements to be misleading (for compliance frameworks).

7. Refer Para 8

8. **Consolidation of Financial Statement:** As per Ind AS 110, there is no such exemption for 'temporary control', or "for operating under severe long-term funds transfer restrictions" and consolidation is mandatory for Ind AS compliant financial statement in this case.

Ind AS 110 states that "Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee".

In the given case, M Ltd acquired 51% shares of S Ltd on 01.04.2019 and sold 25% shares during the year ended 2019-20. M Ltd did not consolidate the financial statements of S Ltd for the year ended 31.03.2020 on the plea that control was only temporary. The intention of

M Ltd. is quite clear that the control in S Ltd. is temporary as the former company disposed off the acquired shares in the same year of its purchase.

However, even though the intention of M Ltd. is for temporary holding of shares in S Ltd. as per Ind AS, M Ltd is required to prepare Consolidated Financial Statements in accordance with Ind AS 110 as exemption for 'temporary control' is not available under Ind AS 110. However, "Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee". Here, due to sale of investment in S Ltd. up to 25%, M Ltd. loses control of S Ltd.

Accordingly, M Ltd., is required to prepare consolidated statement till the date of disposal of the 25% shares to comply with the same.

- 9. Consolidated Financial Statements:** According to Section 129(3) of the Companies Act, 2013, where a company has one or more subsidiaries, including associate company and joint venture, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own.

Further, as per Companies (Accounts) Rules, 2014, the consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III to the Act and the applicable accounting standards. However, a company which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act.

However, an investment entity need not present consolidated financial statements if it is required, in accordance with Ind AS 110 'Consolidated Financial Statements', to measure all of its subsidiaries at fair value through profit or loss. A parent shall determine whether it is an investment entity.

(An investment entity is an entity that (a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services; (b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and (c) measures and evaluates the performance of substantially all of its investments on a fair value basis.)

In the given case, H Limited is an investment company preparing its financial statements in accordance with Ind AS and the company had invested 25% in S1 Ltd., 50% in S2 Ltd. and

60% in S3 Ltd. of the respective share capitals of the investee companies. In view of provisions discussed in Ind AS 110, the Company is not required to prepare consolidated financial statements however, for the compliance of Companies (Accounts) Rules, 2014, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act.

Thus, it can be concluded that ultimate authority on consolidation is AS / Ind AS as prescribed by law and if they give some exemption it should be followed. If out of exemption some subsidiaries are not consolidated, then list should be disclosed in notes to accounts with reason.

- 10. Acceptance as Principal Auditor :** The principal auditor, Manglam & Associates, should consider whether their own participation is sufficient to be able to act as the principal auditor. For this purpose, the auditor would consider:
- (a) the materiality of the portion of the financial information which the principal auditor audits;
  - (b) the principal auditor's degree of knowledge regarding the business of the components;
  - (c) the risk of material misstatements in the financial information of the components audited by the other auditor; and
  - (d) the performance of additional procedures as set out in this SA regarding the components audited by other auditor resulting in the principal auditor having significant participation in such audit.
- 11.** As per SA 600, "Using the work of Another auditor", the principal auditor is normally entitled to rely upon the work of component auditor unless there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component. The principal auditor might discuss with the other auditor the audit procedures applied or review a written summary of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list. The principal auditor may also wish to visit the other auditor. The nature, timing and extent of procedures will depend on the circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor.

The principal auditor should consider the significant findings of the other auditor.

The principal auditor may consider it appropriate to discuss with the other auditor and the management of the component, the audit findings or other matters affecting the financial

information of the components. He may also decide that supplemental tests of the records or the financial statements of the component are necessary. Such tests may, depending upon the circumstances, be performed by the principal auditor or the other auditor.

Accordingly, CA Pradyuman, can perform the above mentioned audit procedures. However, the audit of the component's financial statements by the principal auditor is not required.

So, the contention of CA Pradyuman that for the purpose of audit of consolidated financial statements he is required to conduct an audit of the components financial statements is not correct.

Further, SA 230 issued by ICAI on Audit Documentation, and "Standard on Quality Control (SQC) 1, provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor. He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel.

Accordingly, it is the discretion of the component auditor as the working papers with respect to the components examined by the component auditor are the property of the component auditor.

So, the contention of CA Pradyuman is not correct.

12. In terms of SA 600 "Using the Work of Another auditor", where another auditor has been appointed for the component, the principal auditor would normally be entitled to rely upon the work of such auditor unless there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component. When planning to use the work of another auditor, the principal auditor should consider the professional competence of the other auditor in the context of specific assignment if the other auditor is not a member of the Institute of Chartered Accountants of India.

The principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment.

The principal auditor might discuss with the other auditor the audit procedures applied or review a written summary of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list.

Accordingly, CA Kukreja is correct in asking the branch auditors to share with him the summary of their audit procedures and findings in respect of the accounts of the branches examined by them.

Further, CA Kukreja has asked one of the branch auditors to share with him the working papers with respect to the branches examined by such branch auditor for the former's review and return.

SA 230 issued by ICAI on Audit Documentation, and "Standard on Quality Control (SQC) 1, provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor. He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel.

Accordingly, it is the discretion of the branch auditor as the working papers with respect to the branches examined by the branch auditor are the property of the branch auditor.

So, CA Kukreja is not correct in asking the branch auditor to share with him the working papers with respect to the branches examined by the branch auditor.