

Mandatory under Companies Act:

- **Section 129(3)**- where a company **has one or more subsidiaries**, including associate company and joint venture, it shall, in addition to its own FS **prepare a CFS of the company and of all the subsidiaries**.
- Co. attach along with its financial statement, a **separate statement** containing the salient features of the FS of its subsidiary's in Form **AOC-1**.
- **Consolidation of F.S** shall be made in accordance with the provisions of **Schedule III to the Act** and the applicable AS.
- Company **which is not required to prepare CFS under the AS** - shall be **sufficient** if the company **complies** with provisions of CFS provided in **Schedule III**

However, the requirement related to preparation of consolidated FS shall not apply to a company if it meets the following conditions: **(Companies act, 2013)**

(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 CFS;

(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 FS** with the **Registrar** which are **in compliance** with the applicable **AS**.

Investment entity

An investment entity need not present CFS if it, to **measure** all of its subsidiaries at **fair value through profit or loss**. (Ind AS 110)

An investment entity is an entity that:

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| (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 <u>returns from capital appreciation, investment income, or both</u> ; & | (c) measures and evaluates the performance of substantially all of its investments on a fair value basis . |
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Q. 1. Parent Ltd **acquired 51% shares** of Child Ltd during the year ended 31-3-2019. During the financial year 2019-20, **20% shares of Child Ltd were sold** by Parent Ltd. Parent Ltd while preparing the FS for the year ended 31-3-2019 and 31-3-2020 **did not consider the FS of Child Ltd for consolidation**. As a statutory auditor how would you deal with it?

Accounting Standard 21 "CFS", states that a **subsidiary** should be **excluded** from consolidation when **control is intended to be temporary** because the **shares are acquired and held** with a view to its subsequent disposal in the near future.

Where an **enterprise owns majority of voting power** by virtue of **ownership of the shares of another enterprise** and all the shares are **acquired and held exclusively** with a view to their **subsequent disposal** in the near future, the **control** by the first mentioned enterprise would be **considered temporary** and the investments in such subsidiaries should be accounted for in accordance with **AS 13 "Accounting for Investments"**.

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 is temporary**, the auditor should **verify that the intention of the parent, to dispose the subsidiary**, in the near future, existed at the time of acquisition of the subsidiary. Also **verify that the reasons for exclusion** are given in the CFS.

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 FS in this case.

As per section 129(3) of the Companies Act, 2013 where a **company having subsidiary, which is not required to prepare CFS** under the applicable AS, it shall be **sufficient** if the company **complies with the provisions of CFS provided in Schedule III to the Act**.

Conclusion: 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. Therefore, **Parent Ltd is not required to prepare CFS as per AS 21**, however, for the compliance of provisions related to consolidation of FS given **under section 129(3)** of the Companies Act, 2013, **Parent Ltd is required to make disclosures in the FS** as per the provisions contained in Schedule III to the Companies Act 2013.

However, if the Parent Ltd is required to prepare its FS **under Ind AS**, it shall **have to prepare CFS 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".

Responsibility of Parent

Responsibility for the preparation & presentation of CFS of the mgt of the parent:

1. **identifying components**, and including the financial information of the components to be included in the CFS;
2. where appropriate, **identifying reportable segments** for segmental reporting;
3. **identifying related parties and related party transactions** for reporting;
4. **obtaining accurate and complete financial information from components**;
5. **making appropriate consolidation adjustments**;
6. **harmonization** of accounting policies and accounting framework; and
7. **GAAP conversion**, where applicable.

Auditor's objectives in an audit of CFS / Auditors responsibility

1. to satisfy that the **CFS have been prepared** in accordance with the **applicable FRF**;
2. to **enable himself to express an opinion on the true and fair view** presented by the **CFS**;
3. to **enquire** into the matters as specified in **section 143(1)** of the Companies Act, 2013; and.
4. to **report** on the matters given in the clauses **(a) to (i) of section 143(3)** of the Companies Act, to the extent applicable;
5. **Validate** the **requirement of preparation of CFS** for the company as per applicable FRF.

Auditor's considerations about Materiality in Audit of CFS

SA 600, 'Using the Work of Another Auditor' establishes standards when an auditor, reporting on the FS of an entity uses the work of another auditor on the financial information of one or more components included in the FS of the entity.

Computation of materiality for the purpose of issuing an opinion on the standalone FS of each component would be done component-wise on a standalone basis.

Determination of materiality during the audit of CFS, the auditor should consider the following:

- a. 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.
- b. Parent auditor **use the materiality** computed on the **group level** to determine whether the **component's FS are material to the group** to determine whether they should **scope in additional components**, and consider using the work of other auditors as applicable.
- c. **Principal auditor also computes materiality for each component and communicates to the component auditor**, if he believes is required for **true and fair view** on CFS.
- d. **Principal auditor** also obtains certain **confirmations** from **component auditor** like independence, code of ethics, certain information required for consolidation and disclosure requirements etc.

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 needs to be considered.

Management representation in audit of CFS

- **Completeness of components included in the CFS**;
- **Identification of reportable segments for segmental reporting**;
- **Identification of related parties and RPT for reporting**;
- **Appropriateness and completeness of permanent and current period consolidation adjustments, including the elimination of intra-group transactions**.

Planning before commencing an audit of CFS

- Understanding** of the group structure and group-wide controls including assessment of IT system and related general and applications IT related controls for consolidation process;
- 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;
- determining and programming the NTE of the audit procedures** to be performed based on the assessment of the risk of material misstatement in consolidation process;
- determining** the extent of use of other auditor's work in the audit; and
- coordinating** the work to be performed.

Procedure for ensuring completeness of components inclusion in CFS

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

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.

Permanent consolidation adjustments are:

- Determination of goodwill or capital reserve as per applicable accounting standards.
- Determination of amount of equity attributable to minority/ NCI.

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

- Attention to the determination of pre-acquisition reserves of the components & Date(s) of investment.
- Pre-acquisition reserves have been allocated appropriately between the parent and the minority interests/ non-controlling interests of the subsidiary.
- Verify the changes taken place in these permanent consolidation adjustments on subsequent acquisition/ disposal of shares in the components.

It may happen that while working out the permanent consolidation adjustments, in the case of one subsidiary, goodwill arises and in 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. 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 CFS.

Current Period 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 elimination of intra-group transactions and account balances including:

- intra-group interest paid and received, or management fees, etc.;
- unrealised intra-group profits on assets acquired/ transferred from/ to other subsidiaries;
- intra-group indebtedness;
- record deferred taxes on unrealised intercompany profits elimination in accordance with Ind AS 12;
- adjustments related to harmonising the different accounting policies being followed by the parent and its components;
- adjustments to the financial statements for recognized subsequent events or transactions that occur between the balance sheet date and the date of the auditor's report on the CFSs of the group.
- Foreign component, adjustments to convert a component's audited financial statements prepared under the component's local GAAP to the GAAP under which the CFS are prepared;
- 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.

Note: FS 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 FS of one or more components to such date and, accordingly, those FS 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 FS.

Difference between reporting dates should not be more than 6 months in case of financial statements under AS and 3 months in case of FS under Ind AS

Info. given in the notes to the separate FS of parent and/or the subsidiary, need not be included in the CFS.

- Source from which bonus shares are issued, e.g., capitalisation of profits or reserves or from securities premium account.
- Disclosure of all unutilised monies out of the issue indicating the form in which such unutilised funds have been invested.
- Disclosure required under MSME Development Act, 2006
- Value of imports calculated on C.I.F. basis by the company during the F.Y. in respect of: (a) raw materials; (b) components and spare parts; (c) capital goods.
- Expenditure in foreign currency during the F.Y. on account of royalty, know-how, professional and consultation fees, interest, and other matters.

Reporting

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

- Auditor should ensure that the principles and procedures for preparing CFS, as per relevant AS, are followed.
- If there are deviations, the auditor must address them as per SA 705.
- The auditor issues an opinion on whether the CFS provide a true and fair view of the group's financial position and results.
- Where CFS include cash flow statement auditor should give opinion on true and fair view of cash flow presented by consolidated CFS.

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

- In this case, SA 600 regarding the use of work by other auditors should also be considered.
- As per SA 706, if auditor make reference to work of other auditor in his audit report, he should clearly disclose the portion of the FS audited by other auditors.
- disclosure of portion can be done by stating aggregate amounts, % of total assets, revenues & cash flows included in CFS but not audited by parent auditor.
- This disclosure indicates shared responsibility between the parent and subsidiary auditors but is not to be construed qualification of the opinion.

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

- Parent's mgt converts the component's FS to the parent's framework.
- These conversion adjustments are audited by the principal auditor for suitability and appropriateness.
- Alternatively, components may adopt the parent's accounting policies based on group accounting manual, aligning them with group requirements, and be audited accordingly.
- Parent Auditor shall check if GAM shall comply with GAAP applicable to Parent

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

- Normally, audits of FS, including CFS, 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 report, the components' FS should also be audited under a framework that corresponds to Indian GAAS.

Components Not Audited

- Ideally, all components in CFS should be audited or subjected to audit procedures.
- If some components remain unaudited, the auditor should evaluate the possible impact and consider modifications to the report, guided by SA 705.
- Evaluation is necessary because the auditor has not been able to obtain SAAE 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.