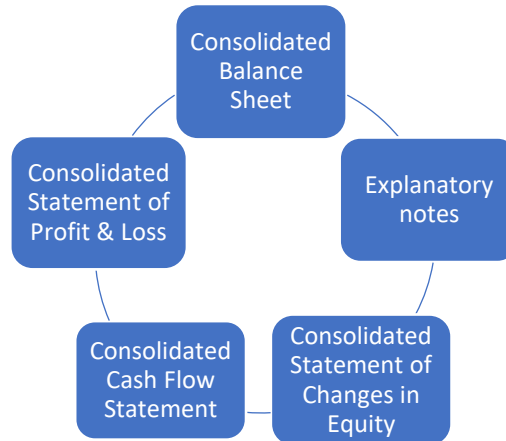


“Group Audit”

Concept of Consolidated Financial Statement (Part-1)

Meaning & Contents of Consolidated Financial Statements (CFS)

- CFS are F.S. of a group in which assets, liabilities, equity, income, expenses and cash flows of parent and its subsidiaries are presented **as those of a single economic entity**.
- CFS is presented, to the extent possible, in same format as adopted by parent for its separate F.S. AS-21 & Ind AS-110 lays down principles & procedures for preparation & presentation.
- CFS includes:



Statutory requirement w.r.t. consolidation - Sec. 129(3) of Companies Act,2013

- Where a company has one or more subsidiaries, JV, Asso, in addition to F.S. provided u/s 129(2), **prepare CFS of company and of all subsidiaries in same form and manner as that of its own** which shall also be laid before AGM along with the laying of its F.S. u/s 129(2).
- Company shall also attach along with its F.S., a separate statement containing salient features of its subsidiaries in Form AOC 1. (time pass)
- C.G. may provide the manner for consolidation of accounts of companies. (time pass)

Manner of consolidation of accounts - Rule 6 of Companies (Accounts) Rules, 2014

Consolidation shall be made in accordance with Schedule III and the applicable AS.

Note- Here, AS does not only mean AS

Rachit's Special

Subsidiary	Line by line consolidation
Associate	Equity method of consolidation
Joint Venture	Proportionate method of consolidation

First Proviso

If a company covered u/s 129(3) which is not required to prepare CFS under applicable ASs, it shall be sufficient if company complies with provisions on CFS as provided in Schedule III. (matlab karna toh padega he)

Note- Here, AS does not only mean AS

Second Proviso (Exception as per Co's ACT Sec-129/ Sch-3)

Requirements related to preparation of **CFS shall not apply** to a company if it meets the following conditions:

- It is a wholly-owned or a partially-owned subsidiary of another company (IHC)

- (ii) Its ultimate or any intermediate holding company files CFS with the Registrar which are in compliance with the applicable ASs. (parent filing cfs)
- (iii) All its other members, do not object to co not presenting CFS (Minority interest does not have interest)
- (iv) 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; (not much public involved)

Exception as per AS 21 (for CFS)

A subsidiary should be excluded from consolidation when:

- (a) Control is intended to be temporary because the subsidiary is acquired exclusively with a view to its subsequent disposal in the near future (12M); (temporary holding/Speculative motive)
- (b) It operates under severe long-term restrictions which significantly impair its ability transfer funds to the parent. (restriction on future cash inflow)

Reasons for not consolidating a subsidiary should be disclosed in the CFS.

Points NOT to remember

There is no such exemption for 'temporary control', or “for operation under severe long term funds transfer restrictions” in Ind AS 110 and consolidation is mandatory.

Exception to consolidation as per Ind AS 110

- **Para 31:** Investment entity shall not consolidate its subsidiaries. Instead, an investment entity shall measure an investment in a subsidiary at **fair value through profit or loss (FVTPL)** in accordance with Ind AS 109 (Financial Instruments).
- **Para 33:** 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.

Points NOT to remember

Meaning of Investment Company: An entity that: (dhyaan se socho, NBFC ki yaad aayegi)

- (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.**

Responsibility of Parent (Part-2)

Management of Parent is responsible for preparation & presentation of CFS and such responsibility included:

- (a) Identifying components, and including financial information of the components to be included in the CFS;
- (b) Where appropriate, identifying reportable segments for segmental reporting; transactions for reporting;
- (c) Identifying related party transactions by components for reporting;
- (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.

Besides, parent ordinarily issues instructions to management of the component specifying its requirements relating to financial information of components to be included in CFS Instructions ordinarily cover:- (time pass)

- ✓ the accounting policies to be applied,
- ✓ statutory & other disclosure requirements applicable to parent,
- ✓ including identification of & reporting on reportable segments and
- ✓ related parties & related party transactions and
- ✓ a reporting timetable.

Steps involved in Preparation of CFS (halka phulka gyan- load nahi lena hai isme)

In accordance with the Companies (AS) Rules, 2006

- F.S. of parent and 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 & unrealised profits etc. are made in accordance with AS 21, “CFS”.
- Investments in associates are accounted for using Equity Method as prescribed in AS 23, “Accounting for Investments in Associates in CFS”.
- A parent that has an interest in a jointly controlled entity, reports its interest in CFS using proportionate consolidation method as per AS 27. (in case of JV)

In accordance with the Companies (Indian AS) Rules, 2015

- F.S. of 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 & cash flows. (same)
- Related goodwill/capital reserve 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 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 Equity Method as prescribed in 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 Ind AS 111, “Joint

Arrangements”.

- In a business combination achieved in stages, acquirer shall remeasure its previously held equity interest in acquire at its acquisition date fair value & recognise resulting gain or loss, if any, in profit or loss or OCI, as appropriate in accordance with Ind AS 103.

Information to be disclosed in CFS (in notes to accounts)

Following information is required to be disclosed in the CFS separately for the parent and each of its components:

- (a) Amount of net assets and net assets as a percentage of consolidated net assets;
- (b) Amount of share in profit or loss and the percentage share in profit or loss as a percentage of consolidated profit or loss;
- (c) Amount in OCI and the percentage of OCI as a percentage of Consolidated OCI.

Information need not to be included in CFS (in notes to accounts) (V V V V NOT IMP) (self)

In case of companies, certain information given in the notes to the separate F.S. of the parent and/or the subsidiary, need not be included in the CFS:

- (i) Source from which bonus shares are issued
- (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 MSME Development Act, 2006.
- (iv) A statement of investments separately classifying trade investments & other investments, showing names of the bodies corporate in whose shares or debentures, investments have been made & 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 FY in respect of:
 - (a) Raw materials;
 - (b) Components and spare parts;
 - (c) Capital goods.
- (vi) Expenditure in foreign currency 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 and value of all indigenous raw materials, spare parts and components similarly consumed and the %age of each to the total consumption.
- (viii) Amount remitted in foreign currencies on account of dividends, with a specific mention of number of non-resident shareholders, 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 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.

Auditor's Considerations (Part-3)

Responsibility/Objectives of the auditor of the CFS (very easy, very halka phulka)

- Sec. 129(4) of the Companies Act, 2013 requires that the provisions of the Act applicable to the preparation, adoption and audit of the F.S. of a holding company shall, mutatis mutandis, apply to the CFS.
- Auditor of the CFS is responsible for expressing an opinion on whether the CFS are prepared, in all material respects, in accordance with the FRF under which the parent prepares the CFS.
- Therefore, the auditor's objectives in an audit of CFS are:
 - (a) To satisfy himself that CFS have been prepared in accordance with the requirements of applicable FRF;
 - (b) To enable himself to express an opinion on the true and fair view presented by the CFS;
 - (c) To enquire into the matters as specified in Sec. 143(1) of the Companies Act, 2013;
 - (d) To report on matters given in clauses (a) to (i) of Sec. 143(3) of Companies Act, 2013; for other matters u/s 143(3)(j) read with Rule 11 of CAAR, 2014.
- Auditor should also validate requirement of preparation of CFS for company as per applicable FRF.

Application of SAs, Statements and Guidance Notes while auditing CFS

- SAs, Statements & Guidance Notes on auditing matters apply in same manner to audit of CFS as they apply to audit of Standalone F.S.
- Hence auditors, while conducting audit of CFS are expected to:
 - (a) Plan work to conduct an effective audit in an efficient and timely manner;
 - (b) Obtain understanding of accounting & IC systems including **IT system** like consolidation tool sufficient to plan the audit & determine NTE of his audit procedures;
 - (c) Use professional judgement to assess audit risk and to design audit procedures to ensure that the risk is reduced to an acceptable level.

General Audit Considerations (time pass)

- Features of CFS having an impact on audit procedures:
 - (a) CFS are prepared on basis of separate F.S. of parent & its components, using consolidation procedures prescribed by ASs; and
 - (b) Auditor of CFS may use work of other auditors as per requirement of SAs unless the auditor of CFS is also the auditor of other components of the group.
- When an auditor accepts audit of CFS, he should assess whether based on his work alone, he would be able to express an opinion on true and fair view presented by the CFS.
- If he is of the view that his own participation may not be enough or sufficient, he should consider using the work of 'other auditors'.
- Such 'other auditors' might be the statutory auditors of the separate F.S. of one or more of components. Where statutory auditors of components are also requested to assist the principal auditor, work to be performed by such statutory auditors for use by the principal auditor would constitute a separate assignment.

Using the Work of Another Auditor - SA 600

- SA 600, 'Using the Work of Another Auditor' establishes standards when an auditor (Principal Auditor - PA), reporting on F.S. of an entity, uses work of another auditor (AO) on financial information of one or more components included in F.S. of the entity. (thankyou)
- PA, if he decides to use work of AO in relation to audit of CFS, should comply with requirements of SA 600. (thankyou again)

- In carrying out audit of standalone F.S., **computation of materiality** for purpose of issuing an opinion on standalone F.S. of each component would be done component-wise on a standalone basis. However, with regard to determination of materiality during audit of CFS, auditor should consider the following:
 - (i) Auditor is required to compute 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 preparation of CFS.
 - (ii) PA can also use the materiality computed on the group level to determine whether the component's F.S. are material to the group to determine whether they should scope in additional components, and consider using the work of other auditors as applicable.
 - (iii) PA also computes materiality for each component and communicates to component auditor, if he believes is required for true and fair view on CFS. (if necessary)
 - (iv) PA also obtains certain confirmations from component auditor like independence. Code of ethics, certain information required for consolidation & disclosure requirement etc.
- While considering observations (for instance modification and/or EOM in accordance SA 705/706) of the component auditor in his report on the standalone F.S., PA should comply with the requirements of SA 600.

Planning the audit of CFS

Before commencing an audit of CFS, 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 F.S. of foreign components;
- (c) Determining and programming the NTE of the audit procedures to be performed based on the assessment of the risk of material misstatement in the consolidation process;
- (d) Determining the extent of use of other auditor's work in the audit; and
- (e) Coordinating the work to be performed.

Auditor's Procedures in Auditing CFS

- (a) Obtain a list of components included in CFS.
- (b) Review information provided by management of the parent identifying the components.
- (c) Verify that all components have been included in the CFS unless these components meet criterion for exclusion.
- (d) In respect of completeness of the information, should perform the following procedures:
 - Review working papers for the prior years for the known components;
 - Review the parent's procedures for identification of components;
 - Review the investments to determine the shareholding in other entities;
 - Review the joint venture and other relevant agreements entered into by the parent;
 - Review statutory records maintained by the parent, for example register required u/s 186 of the Companies Act, 2013;
 - Inquire the management to identify any new components or any component which goes
 - Identify the changes in the shareholding that might have taken place since the last audit.

Auditor should document the procedures performed.

- (e) The auditor should verify that the adjustments required by the relevant AS have been made wherever required and have been properly authorized by the management of the parent. The preparation of CFS gives rise to Permanent Consolidation Adjustments and Current Period Consolidation Adjustments.

Considerations = controlling the composition of BoD of others (De-Facto Control)

- There would be various means by which control (subsidiary) , joint control or significant influence be obtained.
- In this regard, auditor may verify
 - ✓ 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 would have to use his professional judgment to determine whether the parent controls the composition of the BoD of any other entity.
- If yes, whether that entity has been consolidated as a subsidiary in the consolidated financial statements.

Auditor's duties in case of exclusion of subsidiaries/ associates in consolidation

- Where a component is excluded from CFS, auditor should examine reasons for exclusion and whether such exclusion is in conformity with the applicable FRF.
- For Example: In the case of an entity which is excluded from consolidation on the ground of temporary relationship (as per AS 21), auditor should verify that the intention of the parent, to dispose 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.
- Auditor should verify that the reasons for exclusion are given in the CFS.
- If an entity is excluded from the CFS for reasons other than those allowed by the applicable FRF, auditor should consider its effect on his report.
- 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). In such cases, auditor should examine whether these changes have been appropriately accounted for in the CFS as required by the relevant ASs/Ind AS under the applicable FRF.

Special Considerations (Part-4)

Permanent Consolidation Adjustments

Meaning

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.

Types of adjustments

1. Determination of Goodwill or Capital Reserve as per applicable ASs.
2. Determination of the amount of equity attributable to minority/non-controlling interests.

Verification Points

- Auditor should verify that the adjustment of goodwill or capital reserve and minority interest have been made appropriately.
- Auditor should pay particular attention to determination of pre-acquisition reserves of components. Date of investment assumes importance in this regard.
- Examine whether pre-acquisition reserves have been allocated appropriately between parent and minority.
- Verify changes that might have taken place in permanent consolidation adjustments on account of subsequent acquisition of shares, disposal of components in subsequent years.
- If goodwill arise in case of one subsidiary and capital reserve may arise in case of another subsidiary in parent choose to net off these amounts to disclose Single amount in consolidated balance sheet, Should verify that gross amounts of goodwill & cap reserves have been disclosed in notes to CFS.

Current Period Consolidation Adjustment

Meaning

Adjustments which are made in the accounting period which CFS are prepared.

Types of Adjustments

These adjustments primarily relate to elimination of intra-group transactions and account balances including:

- (a) intra-group interest paid & received or management fees, etc.;
- (b) unrealised intra-group profits on assets acquired transferred from/to other subsidiaries;
- (c) intra-group indebtedness;
- (d) adjustments relating to harmonising different accounting policies being followed by parent and its components;
- (e) adjustments to the F.S. for recognized subsequent events or transactions that occur between the balance sheet date and the date of the auditor's report on the CFS of the group;
- (f) adjustments for the effects of significant transactions or other events that occur between date of components balance sheet and not already recognised in its F.S. and the date of the auditor's report on the group's CFS when the F.S. of the component to be used for consolidation are not drawn up to the same balance sheet date as that of the parent;
- (g) in case of a foreign component, adjustments convert a component's audited F.S. prepared under the component's local GAAP to the GAAP under which the CFS are prepared;
- (h) determination of movement in equity attributable the minorities interest since the date of acquisition of the subsidiary;
- (i) Adjustments of deferred tax on account of temporary differences arise out of elimination of profits and losses resulting from intra-group transactions undistributed profits of the component in case CFS prepared under Ind AS.

Verification Points

Adjustments required for preparation of CFS are made memorandum records kept for the purpose by

the parent.

Auditor should review these records to verify adjustment entries made in preparation of CFS.

Besides reviewing memorandum records, auditor should verify the following:

- (a) Elimination of intra-group transactions and account balances;
- (b) Preparation of CFS using uniform accounting policies for like transactions;
- (c) Adequate disclosures have been made in the CFS of application of different accounting policies if it was impracticable to harmonize them;
- (d) Adjustments made to harmonise different accounting policies including adjustments made by management to convert a component's F.S. prepared under component's GAAP to GAAP under which the CFS are prepared;
- (e) Calculation of minorities/non-controlling interest;
- (f) Adjustments relating to deferred tax on account of temporary differences arising out of elimination of profits & losses resulting from Inter-group transactions;
- (g) Income & expenses of subsidiary are included in CFS from the date it gains control until the date when the entity ceases to control the subsidiary.

Verification of adjustment related with Impairment Loss

- Goodwill arising on consolidation is carried at value determined at date of acquisition of component & the same is to be tested for impairment loss at every balance sheet date.
- Examine whether parent has determined impairment loss. If yes, examine the procedure followed for determination of impairment loss.
- Ensure that amount determined is fair.
- In case amount been determined in foreign currency, verify if any amount of loss in local currency need to be adjusted from currency translation reserve due to movement in exchange rate from the date when the goodwill was first accounted for in the CFS of parent, to the date of determination of impairment loss.
- Perform audit procedures to understand and verify whether intragroup losses are indicating an impairment loss that requires recognition in the CFS.

Special Considerations in case of different Reporting dates

- F.S. of components used in consolidation should be drawn up to same reporting date as that of the parent. If it is not practicable, adjustments should be made for effects of significant transactions or other events that occur between those dates and date of the parent's F.S.
- In any case, the difference between reporting dates should not be more than 6 months case of F.S. under AS and 3 months in case of financial statements under Ind AS.
- Auditor of CFS should review other components' results between its financial reporting date and that of parent for significant transactions or other events that have taken place during the period and therefore, need to be reflected in the CFS.
- Recognition should be given by disclosure or otherwise to the effect of intervening event which materially affect the financial position, results of operations or cash flows.
- Auditor should consider whether length of reporting periods and any difference in financial year-ends are the same from period to period. In case of any change that have a material effect on the F.S., ensure that entity discloses such changes and manner of treatment in F.S.

Management Representations (pratha)

- SA 580, "Written Representations" requires auditor to obtain WRs from management and TCWG. Auditor of CFS should obtain evidence that management of the parent acknowledges its responsibility for a true and fair presentation of the CFS in accordance with FRE applicable to the parent and that parent management has approved the CFS.
- In addition, auditor obtains WRs from parent management on matters material to the Examples

of such representations include:

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

Reporting Considerations (Part-5)

Parent Auditor is also the auditor of all of its components

- Auditor should issue an audit report expressing opinion whether CFS 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 CFS also include a cash flow statement, auditor should also give his opinion on the true and fair view of the cash flows presented by the consolidated cash flow statements.
- Auditor of Parent should report whether principles and procedures for preparation and presentation of CFS as laid down in the relevant AS(s) have been followed. In case of any deviation, auditor should make adequate disclosure in the audit report so that users of the CFS are aware of such deviation.

Parent's Auditor is not the Auditor of all of its components

- If the parent's auditor is not the auditor of the components included in the CFS, auditor of the CFS should also consider the requirement of SA 600.
- If the parent's auditor decides that he will make reference to the audit of the other auditors in the report, he should disclose clearly the portion of the F.S. audited by the other auditor(s). This may be done by stating the amount or % age of total assets and total revenue of subsidiary(s) included in CFS not audited by him.
- It is to be noted that reference in report of the auditor of CFS 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

Component Auditor Reports on F.S. under an Auditing Framework Different than that of the Parent

When a component's F.S. are prepared under an accounting framework that is different than that of the framework used by the parent in preparing group's CFS:-

- parent's management perform a conversion of the components' audited F.S. from the framework used by the component to the framework under which the CFS are prepared.
- Conversion adjustments are audited by the principal auditor to ensure that the F.S. of the component(s) is suitable and appropriate for the purposes of consolidation.
- Alternatively, component may prepare F.S. on the basis of the parent's accounting policies, as outlined in the group accounting manual. The local component auditor can then audit and issue an audit report on the components F.S. prepared in accordance with "group accounting policies".
- 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 CFS.

Component Auditor Reports under an Auditing Framework Different than that of the Parent

- Audits of F.S., including CFS are performed under auditing standards generally accepted in India.
- 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 CFS, the components' F.S. should also be audited under a framework that corresponds to Indian Auditing Standards.

Components Not Audited

- F.S. of all components included in CFS should be audited or subjected to audit procedures. Such audits and audit procedures can be performed by the auditor reporting on the CFS or by the components' auditor.

- Where F.S. of one or more components continues to remain unaudited, auditor reporting on the CFS should consider unaudited components in evaluating a possible modification to his report on the CFS.
- Evaluation is necessary because auditor has not been able to obtain sufficient appropriate audit evidence in relation to such consolidated amounts/balances.
- Auditor should evaluate both qualitative and quantitative factors on the possible effect of such amounts remaining unaudited when reporting on the CFS using the guidance provided in SA 705, “Modifications to the Opinion in the Independent Auditor's Report”.