Chapter 9 – Audit of Consolidated Financial Statements

Statutory Provisions - Sec. 129(3) of Companies Act, 2013

1 **Requirement of Consolidation**

- Where a company has one or more subsidiaries or associate companies, it shall, in addition to financial statements, prepare a consolidated financial statement of the company and of all the subsidiaries and associate companies in the same form and manner as that of its own and in accordance with the applicable accounting standards.
- Company is also required to attach along with its financial statement, a separate statement containing the salient features of the financial statement of its subsidiary or subsidiaries and associate company or companies in prescribed Form (AOC-1).
- The Central Government may provide for the consolidation of accounts of companies in such manner as may be prescribed.

Manner of Consolidation – Rule 6 of Companies (Accounts) Rules, 2014

The consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III of the Act and the applicable AS.

First Proviso	If a company covered u/s 129(3) which is not required to prepare consolidated F.S. under the ASs, it shall be sufficient if the company complies with provisions on consolidated F.S. provided in Schedule III of the Act.
Second Proviso	Nothing in this rule shall apply in respect of preparation of consolidated F.S. by a company if it meets the following conditions: - (i) it is a wholly-owned or 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 F.S.; (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 F.S. with the Registrar which are in compliance with the applicable ASs.”

Exception to Consolidations under Accounting Standrds

1 **Para 11 of AS 21**

A subsidiary should be excluded from consolidation when:

(a) control is intended to be temporary because the subsidiary is acquired and held exclusively with a view to its subsequent disposal in the near future; or

(b) it operates under severe long-term restrictions which significantly impair its ability to transfer funds to the parent.

In consolidated financial statements, investments in such subsidiaries should be accounted for in accordance with AS 13, Accounting for Investments. The reasons for not consolidating a subsidiary should be disclosed in the consolidated financial statements.

2 **Para 31 of Ind AS 110**

- An 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 in accordance with Ind AS 109 (Financial Instruments).
- However as per 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

Meaning of Investment Company:

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.

Responsibities w.r.t. Consolidated F.S.

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:

(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;

(d) obtaining accurate and complete financial information from components;

(e) making appropriate consolidation adjustments;

(f) Harmonisation 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.

Responsibility of the auditor of the CFS

The 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 the consolidated financial statements have been prepared in accordance with the requirements of 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.

(e) The auditor should also validate the requirement of preparation of CFS for the company as per applicable FRF.

Auditor's Procedures in Auditing the Consolidated F.S.

(a) The auditor should obtain a list of subsidiaries, associates & joint ventures included in CFS.

(b) The auditor should review the information provided by the management of the parent identifying the subsidiaries, associates and joint ventures.

(c) The auditor should verify that all the subsidiaries, associates and joint venture have been included in the consolidated financial statements.

(d) In respect of completeness of this information, the auditor should perform the following procedures:
- review his working papers for the prior years for the known subsidiaries, associates and joint ventures;
- review the parent's procedures for identification of subsidiaries and joint ventures;
- review the investments to determine the shareholding in other entities;
- review the joint venture and other relevant agreements entered into by the parent;
- review the statutory' records maintained by the parent, for example register required under section 186 of the Companies Act, 2013.

(e) The auditor should also identify the changes in the shareholding that might have taken place since the last audit.

(f) 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.

Special Considerations while auditing the Consolidated F.S.

Current Period Consolidation Adjustments

Meaning	Those adjustments which are made in the accounting period for which Consolidated F.S. are prepared.
Types of Adjustments	These adjustments primarily relate to 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) intra-group indebtedness; (d) adjustments relating to harmonising the different accounting policies being followed by the parent and its components; (e) adjustments to the F.S. (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 F.S. 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 consolidated F.S. when the financial statements 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 to convert a component's audited F.S. prepared under the component's local GAAP to the GAAP under which the consolidated F.S. are prepared. (h) determination of movement in equity attributable to the minorities interest since the date of acquisition of the subsidiary. (i) adjustments of deferred tax on account of temporary differences arising out of elimination of profit and losses resulting from intra group transactions and undistributed profits of the component in case of consolidated F.S. prepared under Ind AS.
Verification Points	Adjustments required for preparation of consolidated F.S. are made in memorandum records kept for the purpose by the parent. Auditor should review these records to verify the adjustment entries made in the preparation of consolidated F.S. Besides reviewing the memorandum records, the auditor should verify the following: (a) Elimination of intra group transactions and account balances; (b) Preparation of consolidated F.S. using uniform accounting policies for like transactions; (c) Adequate disclosures have been made in the consolidated F.S. of application of different accounting policies if it was impracticable to harmonize them. (d) Adjustments made to harmonise the different accounting policies including adjustments made by management to convert a component's F.S. prepared under the component's GAAP to the GAAP under which the consolidated F.S. are prepared; (e) Calculation of minorities/non-controlling interest;

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 AS. 2. Determination of the amount of equity attributable to minority.
Verification Points	• Verify that the adjustment of goodwill or capital reserve and minority interest have been made appropriately. • Pay particular attention to the determination of pre-acquisition reserves of the components. • Examine whether the pre-acquisition reserves have been allocated appropriately between the parent and the minority of the subsidiary. • Verify the changes that might have taken place in permanent consolidation adjustments on account of subsequent acquisition of shares in the components, disposal of the components in the subsequent years.

Reporting Considerations while auditing the Consolidated F.S.

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1	**Parent Auditor is also the auditor of all of its components**	• 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. • Auditor of Parent should report whether principles and procedures for preparation and presentation of consolidated F.S. as laid down in the relevant AS(s) have been followed. In case of any deviation, the auditor should make adequate disclosure in the audit report so that users of the consolidated F.S. are aware of such deviation.
2	**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 consolidated F.S., the auditor of the consolidated F.S. 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 consolidated F.S. not audited by him. • It is to be noted that reference in the report of the auditor of consolidated F.S. 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.
3	**Component Auditor Reports on F.S. under an Accounting 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 consolidated F.S., the 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 consolidated F.S. 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. • Alternatively, component may prepare financial statements 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". • 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.
4	**Component Auditor Reports under an Auditing Framework Different than that of the Parent**	• Audits of F.S., including consolidated F.S., 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 consolidated F.S., the components' F.S. should also be audited under a framework that corresponds to Indian Auditing Standards.
5	**Components Not Audited**	• F.S. of all components included in consolidated F.S. should be audited or subjected to audit procedures. Such audits and audit procedures can be performed by the auditor reporting on the consolidated F.S. or by the components' auditor. • Where the F.S. of one or more components continues to remain unaudited, the auditor reporting on the consolidated F.S. should consider unaudited components in evaluating a possible modification to his report on the consolidated F.S. • The evaluation is necessary because the 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 consolidated F.S. using the guidance provided in SA 705, "Modifications to the Opinion in the Independent Auditor's Report".