Lecture – 34

Chapter – 9
"Audit of Consolidated F.S."

(1) Meaning and Content of Consolidated F.S.: Self study from main book

(2) Legal requirements: Sec. 129(3) of Companies Act, 2013:

- Where a company has one or more subsidiaries or associate companies, it shall, in addition to F.S., prepare a consolidated F.S. 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. [Rule 6 of Companies (Accounts) Rules, 2014]

Rule 6: Consolidation shall be in accordance with the provisions of Schedule III and the applicable AS.

(3) Exemptions from requirement of preparation of consolidated F.S.:

(A) AS – 21:

A subsidiary need not be consolidated if:

- it is a temporary subsidiary i.e. shares are acquired by holding company with intention of disposal in near future.

or

- subsidiary is operating under restrictions which impair its ability to transfer funds to holding company.

(For Ex.: Restrictions imposed by banks/financial institutions/other lenders).

Note: In consolidated F.S., 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 F.S.

(B) 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.

Ex. H_1 Ltd. → S_1 Ltd. → S_2 Ltd.
(Investment Co.) (Investment Co.) (Investment Co.)

Ex. H_1 Ltd. → S_1 Ltd. → S_2 Ltd.
(Non Investment Co.) (Investment Co.) (Investment Co.)
No Exemption Exempt

Note: If Company is not required to prepare consolidated F.S. under Accounting Standards, it shall be sufficient if company comply with requirements of Schedule III. (First proviso to Rule 6 of Companies (Accounts) Rules, 2014)

(C) 2nd Proviso to Rule 6:

A Company is not required to prepare its consolidated financial statements if:

(i) it is a wholly owned or partially owned subsidiary of another company and all its other members (i.e. minority shareholders) are being informed that company is not prepared Consolidated F.S.

AND

(ii) such company is not listed or in process of listing, in India or outside India.

AND

(iii) it ultimate or intermediate holding prepares consolidated F.S. and file these F.S. with Registrar.

Example:

H Ltd. → S Ltd. → A Ltd.

(Unlisted Company)

(74% shares held by H Ltd.)

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Consolidated F.S. as per

applicable AS filed with ROC.

Q: Whether S Ltd. is required to prepare its consolidated F.S.:

Ans.: No, if conditions as stated in Rule 6 are complied with.

Ex. H_1 Ltd. → H_2 Ltd. → H_3 Ltd. → S_1 Ltd.

(unlisted) (Listed) (unlisted) (unlisted)

Which of these entities are required to prepare consolidated F.S. assuming that relevant conditions as stated in Rule 6 are complied with:

(a) H_1 Ltd. only

(b) H_2 Ltd. only

(c) H_1 Ltd. and H_2 Ltd.

(d) H_1 Ltd. or H_2 Ltd.

Ans.:

(4) Responsibility of Parent entity:

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.

(5) Auditor's Considerations as to Objective, Planning etc.:

(i) Responsibility of the auditor of the Consolidated FS:

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. 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 FRF;

(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;

(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.

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

(ii) 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 group structure & group-wide controls including assessment of Information Technology (IT) system and related general and applications IT related controls (manual & 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.

(iii) Auditor's Procedures in Auditing the Consolidated F.S.:

(a) Obtain a list of subsidiaries, associates & joint ventures included in CFS.

(b) Review the information provided by the parent identifying the subsidiaries, associates and joint ventures (Components).

(c) Verify that all the components have been included in the CFS.

(d) To ensure completeness of information, perform the following procedures:

- review working papers of prior years for the known components;
- review the parent's procedures for identification of components;
- review the investments;
- review the joint venture and other relevant agreements entered into;
- review the statutory' records maintained by the parent.

(e) Identify the changes in the shareholding since the last audit.

(f) 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.

(iv) Current Period Consolidation Adjustments:

(a) Meaning: Those adjustments which are made in the accounting period for which Consolidated F.S. are prepared.

(b) Types of Adjustments: These adjustments primarily relate to elimination of intra-group transactions and account balances including:

(1) Intra-group interest paid and received or management fees, etc.;

(2) Unrealised intra-group profits on assets acquired / transferred from/to other subsidiaries;

(3) Intra-group indebtedness;

(4) Adjustments relating to harmonising the different accounting policies being followed by the parent and its components;

(5) 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 consolidated F.S. of the group.

(6) 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.

(7) Determination of movement in equity attributable to the minorities interest since the date of acquisition of the subsidiary.

(8) 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.

(v) Permanent Consolidation Adjustments:

(a) **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.

(b) **Types of Adjustments:**

(1) Determination of Goodwill or Capital Reserve as per applicable AS.

(2) Determination of the amount of equity attributable to minority.

(6) Reporting considerations:

Situation I: Auditor of Parent Entity and components are same:

(i) Ensure compliance of AS 21 or Ind AS 110, as applicable.

(ii) Express an opinion on true and fair view of Consolidated F.S.

(iii) If there exist any non-compliance of AS 21 or Ind AS 110, auditor is required to modify the opinion and make adequate disclosures in the audit report as per requirements of SA 705.

(iv) In this situation, requirements of SA – 600 will not apply.

Situation II: Auditor of Parent Company and Components are different:

(i) Auditor is required to perform procedures as prescribed by SA 600.

(ii) SA 600 requires a para in the audit report as to "division of responsibility. This requirement is to be fulfilled through "other Matter Para" as per SA 706.

(iii) OM Para included in the audit report cannot be considered as a qualification required in audit report as per SA 705.

(iv) If auditor of consolidated F.S. concludes that work of another auditor cannot be relied upon, auditor need to modify report as per SA 705.

Situation III: F.S. of Component are prepared on different FRF.

Auditor of parent entity should ask the management of parent entity to arrange a different set of financial statement of components based on FRF of parent Entity.

- F.S. on same FRF are made available
  → Auditor of Component will be required to issue audit report of F.S. prepared on basis of FRF of Parent.
  → Auditor of Parent entity need to apply the procedures as stated in SA 600.
- F.S. on same FRF are not made available
  → Management of Parent Entity will be required to perform adjustments for GAAP Conversion
  → Auditor of Parent Company will examine the appropriateness of adjustments made by parent.

Situation IV: Audit of F.S. of Component is on different GAAS:
(Generally Accepted Auditing Standards)

Request the Parent Entity to arrange audit report of F.S. of component based on INDIAN GAAS

- Audit report arranged
  → Apply the procedures as per requirements of SA 600.
- Audit report not arranged
  → Apply the requirements of SA 705 so as to modify the report. (based on materiality)

Situation V: Components not audited:

- Consider the effect of financial information of unaudited components on audit report over consolidated F.S.
- Evaluate both quantitative and qualitative aspects of such unaudited financial information.
- If considered appropriate, modify the opinion as per requirements of SA 705, as sufficient appropriate audit evidence as to financial information of component is not available.

(8) SA – 600 "Using the work of another auditor".

(i) Definitions:

(a) **Principal Auditor: (PA)** Auditor who expresses opinion on F.S. of an entity which includes financial information of a component audited by other auditor.

(b) **Other Auditor: (OA)** Auditor who expresses opinion on financial information of a component.

(c) **Component:** Branches, subsidiary company, associate company, Joint venture, departments, etc.

(ii) Procedures of Principal auditor (PA) while using work of other auditor:

- Evaluate the competency of other auditor, particularly when he is not a CA.
- Perform the procedures to obtain sufficient appropriate audit evidences to determine the appropriateness of work of other auditor.
  Such procedures may include
  (a) Visiting the component
  (b) Examine the records maintained by the Component.
  (c) Inquire the Management of component.
- Consider significant findings of other auditor.
- Document the following:
  (a) Components audited by another auditor.
  (b) Audit procedures performed and conclusion reached.
  (c) Conclusion as to immateriality of a component.
  (d) Manner of dealing with the audit report of other auditor.

(iii) Reporting consideration and division of responsibility:

- When the Principal auditor rely on work performed by other auditor, he should state in his report as to division of responsibility in "Other Matter Para" as per SA 706.
- If Principal auditor concludes that work of other auditor cannot be used and sufficient appropriate audit evidences are not available

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he need to modify the report as per SA 705.

(iv) Coordination between Principal auditor and other auditor:

- PA and OA should coordinate with each other and for this purpose, PA should inform his requirements to OA as to procedures, timings etc.
- OA knowing the context in which his work is to be used by PA, should ensure
  - (a) adherence to time table.
  - (b) reply to Questionnaire, if any given by PA.
  - (c) share his significant observations with the PA.

Do Practice – Questions and Case Studies