Question 1

While doing the audit of consolidated Financial Statements, which current period consolidation adjustments are to be taken into account?

Answer

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 elimination of intra-group transactions and account balances. While doing the audit of consolidated Financial Statements, current period consolidation adjustments should be taken into account. The auditor should review the memorandum records to verify the adjustment entries made in the preparation of consolidated financial statements. This would also help the auditor in ascertaining whether there is any difference in the elimination. Following are the current period consolidation adjustments while making consolidation of financial statements:

(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 related to harmonising the different accounting policies being followed by the parent and its components;
(e) 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:

a. 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).
b. 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 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:

a. The nature of the event; and
b. An estimate of its financial effect or a statement that such an estimate cannot be made.

(f) 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 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 financial statements prepared under the component's local GAAP to the GAAP under which the consolidated financial statements are prepared.

(h) determination of movement in equity attributable to the minorities interest/non-controlling 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 intragroup transactions and undistributed profits of the component in case of consolidated financial statements prepared under Ind AS.

Question 2
Write a short note on Responsibility of holding company for preparation of Consolidated Financial Statements.

Answer

Responsibility of Holding Company for preparation of Consolidated Financial Statements: As per Section 129(3) of the Companies Act, 2013, where a company has one or more subsidiaries, 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. The responsibility for the preparation and presentation of consolidated financial statements, among other things, is that of the management of the parent/holding company. This includes:

(i) identifying components, and including the financial information of the components to be included in the consolidated financial statements;
(ii) where appropriate, identifying reportable segments for segmental reporting;
(iii) identifying related parties and related party transactions for reporting;
(iv) obtaining accurate and complete financial information from components; and
(v) making appropriate consolidation adjustments.

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.

**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.

**Question 3**

Write a short note on - Permanent Consolidated Adjustments.

**Answer**

**Permanent Consolidated Adjustments** - Permanent consolidated adjustments are those adjustments that are made only on the first occasion of the preparation and presentation of consolidated financial statements. Permanent consolidated adjustments are:

(a) Determination of goodwill or capital reserve as per applicable accounting standards.

(b) Determination of amount of equity attributable to minority/ non-controlling interests.

**Question 4**

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?
10.4 Audit of Consolidated Financial Statements

Answer

Consolidation of Financial Statement: AS 21 “Consolidated Financial Statements”, states that a subsidiary should be excluded from consolidation when:

(i) Control is intended to be temporary because the shares are acquired and held exclusively with a view to its subsequent disposal in the near future or

(ii) Subsidiary operates under severe long term restrictions which significantly impair its ability to transfer funds to the parent.

Where an enterprise owns majority of voting power by virtue of ownership of the shares of another enterprise and all the shares held as ‘stock-in-trade’ 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”.

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 this 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, however for the compliance of provisions related to consolidation of financial statements given under the Section 129(3) of the Companies Act, 2013 read with Companies (Accounts) Rules, 2014, R Ltd. is required to consolidate the financial statements as per the provisions on consolidated financial statements provided in Schedule III to the Act.

Question 5

H Limited, a company registered with SEBI, has three subsidiaries and one associate. While doing the audit of Consolidated Financial Statements (CFS) of H Limited you have come to know that the associate entity had made a provision for proposed dividend in its financial statements. H Limited computed its share of the results of operations of the associate after taking into account the proposed dividend. Comment.

Answer

As per AS 23 on “Accounting for Investments in Associates in Consolidated Financial Statements”, adjustments to the carrying amount of investment in an investee arising from changes in the investee’s equity that have not been included in the statement of profit and loss of the investee are directly made in the carrying amount of investment without routing it through the consolidated statement of profit and loss. The corresponding debit/credit is made in the relevant head of the equity interest in the consolidated balance sheet. For example, in case the adjustment arises because of revaluation of fixed assets by the investee, apart from adjusting the carrying amount of investment to the extent of proportionate share of the investor in the revalued amount, the corresponding amount of revaluation reserve is shown in the consolidated balance sheet.
In case an associate has made a provision for proposed dividend in its financial statements, the investor’s share of the results of operations of the associate is computed without taking into consideration the proposed dividend.

Applying the above provisions to the given problem, H Limited should have computed its share of the results of operations of the associate without taking into consideration the proposed dividend. Therefore, treatment made by H Ltd is not correct.

**Question 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 for audit of financial statements?_

**Answer**

**Voting Power and Control over the composition of Board of Directors:** In this case, A Ltd. holds only 10 percent of the voting power and control over the composition of the Board of Directors of B Ltd. In such a case, A Ltd. would be considered as a parent of B Ltd. and, therefore, it would consolidate B Ltd. in the consolidated financial statements as subsidiary.

The auditor should verify whether the parent controls the composition of the Board of Directors or corresponding governing body of any entity. There would be various means by which such kind of control 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 should verify that the adjustments warranted by the relevant accounting standards 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 plans, among other things, for the understanding of accounting policies of the parent, subsidiaries, associates and joint ventures 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 related parties as required by Accounting Standard 18 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 the applicable financial reporting framework 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).
Question 7

*Parent Ltd. acquired 51% shares of Child Ltd. during the year ending 31-3-2015. During the financial year 2015-16 the 20% shares of Child Ltd. were sold by Parent Ltd. Parent Ltd. while preparing the financial statements for the year ending 31-3-2015 and 31-3-2016 did not consider the financial statements of Child Ltd. for consolidation. As a statutory auditor how would you deal with it?*

**Answer**

**Consolidation of Financial Statement of a Subsidiary:** Accounting Standard 21 “Consolidated Financial Statements”, states that a subsidiary should be excluded from consolidation when control is intended to be temporary because the shares are acquired and held exclusively 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 & 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. The auditor should also verify that the reasons for exclusion are given in the consolidated financial statements.

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 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, Parent Ltd. has acquired 51% shares of Child Ltd. during the year ending 31.03.2015 and sold 20% shares during the year 2015-16. Parent Ltd. did not consolidate the financial statements of Child Ltd. for the year ending 31.03.2015 and 31.03.2016.

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. However, for the compliance of provisions related to consolidation of financial statements given under section 129(3) of the Companies Act, 2013, Parent Ltd. is required to consolidate the financial statements as per the provisions on consolidated financial statements provided in Schedule III to the Act.

Question 8

Describe the relevance of SA 600 while auditing consolidation of Financial Statements.

**Answer**

Relevance of SA 600 While Auditing Consolidation of Financial Statements: Standard on Auditing (SA) 600, ‘Using the Work of Another Auditor’ establishes standards when an
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:

- 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.

- 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.

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 concept of materiality would not be considered. Thus, the component auditor's observations, if any, on the component's financial statements, irrespective of whether the auditors of the component are also the auditors of the CFS or not, are required to be included in the parent auditor's report on the CFS, regardless of materiality.