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Audit of Consolidated Financial Statements

Question 1

X Limited is the holding company of Y Limited and Z Limited. Explain the nature of current period consolidation adjustments which will be taken into account for the preparation of Consolidated Financial Statements. *(6 Marks, May, 2014)*

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 including-

(i) intra-group interest paid and received, or management fees, etc;

(ii) unrealised intra-group profits on assets acquired from other subsidiaries;

(iii) intra-group indebtedness;

(iv) adjustments related to harmonizing the different accounting policies being followed by the parent enterprise and its subsidiaries;

(v) adjustments made for the effects of significant transactions or other events that occur between the date of the financial statements of the parent and one or more of the components, if the financial statements to be used for consolidation are not drawn upto the same reporting date; and

(vi) determination of movement in equity attributable to the minorities since the date of acquisition of the subsidiary.

Question 2

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. *(4 Marks, November, 2013)*

Answer

Accounting for Investments in Associate: 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 in to 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 3

Write a short note on Permanent Consolidated Adjustments. *(4 Marks, May, 2013)*

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 excess or deficit of the cost to the parent of its investment in a subsidiary over the parent's portion of equity of the subsidiary, at the date on which investment in the subsidiary is made (determination of goodwill or capital reserve);

(b) determination of the amount of equity attributable to minorities at the date on which investment in subsidiary is made; and

(c) determination of goodwill or capital reserve arising on application of equity method to account for investments in associates in consolidated financial statements.

Question 4

Write a short note on Responsibility of holding company for preparation of Consolidated Financial Statements. *(4 Marks, November, 2012)*

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.

Question 5

While doing the audit of consolidated Financial Statements, which current period consolidation adjustments are to be taken into account? (8 Marks, June, 2009)

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:

- Elimination of intra-group transactions relating to interest or management fees etc.
- Elimination of unrealized intra-group profits on assets acquired from other subsidiaries.
- Elimination of intra-group indebtedness.
- Adjustments for harmonizing different accounting policies of parent unit and its subsidiaries.
- Adjustments for impairment loss that might exist for goodwill.

- Adjustment for significant events that occur between date of financial statements of the parent and of its components when the date/s of financial statements of components are different from the reporting date.
- Determination of movement in equity attributable to the minorities since the date of acquisition of the subsidiary.
- Treatment of minority interests' share of the losses, if such losses exceed the minority interests' share in the equity.

Question 6

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? (5 Marks, May, 2008)

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 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 7

C Ltd. holds shares of D Ltd. which also entitles it to 51% voting power. These shares are held as "Stock-in-Trade" since C Ltd.'s intention is to dispose them in the near future. Due to this, C Ltd. is of the view that the financial statements of D Ltd. need not be consolidated. As a statutory auditor, how would you deal? (4 Marks, May, 2006)

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, C 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 Section 129(3) of the Companies Act, 2013 read with Companies (Accounts) Rules, 2014, C Ltd. is required to consolidate the financial statements as per the provisions on consolidated financial statements provided in Schedule III to the Act.