Consolidation of Financial Statements

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Agenda

- Background
- Principles and procedures for preparation of CFS
    - – AS 21 – Consolidated Financial Statement
    - – AS 23 - Accounting for investment in associate in CFS
    - – AS 27 – Financial reporting of interest in joint venture
- Translation of foreign operations
- Audit report on CFS

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Background

As per internationally accepted practices CFS considered as the **primary financial statements** as only standalone financial statement do not present a **true picture** from an **economic entity perspective**

Before Companies Act, 2013

- CFS was mandatory only for listed companies under the clause 32 of listing agreement

After Companies Act, 2013

- CFS is mandatory for all companies having subsidiaries (including associate and joint venture) wef from 1st April 2014 [subject to certain exemptions]

Definition of Subsidiary

As per AS 21:

- *A **subsidiary** is an enterprise that is controlled by another enterprise (known as the parent).*
- **Control** is defined as**:**

(a) the ownership, directly or indirectly through subsidiary(ies), of more than one-half of the voting power of an enterprise; or

(b) control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise so as to obtain economic benefits from its activities.

As per Companies Act, 2013,

Section 2 (87):

*"**subsidiary company**" or "**subsidiary**", in relation to any other company (that is to say the holding company), means a company in which the holding company—*

(i) controls the composition of the Board of Directors; or

(ii) exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies:

Reference Material

- Accounting Standards
  - AS 21 – Consolidated Financial Statements
  - AS 23 – Accounting for Investment in associate in CFS
  - AS 27 – Financial reporting for Investment in JV
  - AS 11 – Effects for changes in Foreign exchange rates

    (for translation of Foreign operations)

- Guidance Note on Audit of CFS

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Principles

Objective : To formulate principles and procedures for preparation of CFS

Scope : Applicable for a group of enterprises under the control of parent entity; and investment in subsidiaries

- CFS to include all subsidiaries [Domestic and Foreign]

Components of CFS : Consolidated Balance Sheet, Profit and Loss Account, Cash Flow Statement, notes and other explanatory material

Consolidation not required

- ✓ Control intended to be for short term & subsidiary acquired with view to its subsequent disposal in the near future
- ✓ It operates under severe long term restrictions, which significantly impair its ability to transfer funds to the parent.

Definitions

Control

>50% of voting power

or

Control of composition of Board, to obtain economic benefits from its activities

Parent

An enterprise that has one or more subsidiaries

Subsidiary

An enterprise controlled by another enterprise

Minority Interest

Part of net result of operations and of net assets of subsidiary attributable to interest which are not owned directly / indirectly by parent

Procedure

- Uniform Accounting policies for like transactions and other events in similar circumstances

  If not practicable – fact to be disclosed together with proportions of the items in CFS to which different accounting polices have been applied

- Consolidation on line by line basis together like assets, liabilities, income and expenses

- Year in which Parent –Subsidiary relationship ceases to exist – CFS to be made till date of cessation. Separate disclosure of Profit / loss on sale of investments to be made

Procedure ... contd.

Eliminate the "cost of investment to parent" and parents portion of equity in the subsidiary at the date on which investment in each subsidiary is made

- If cost of Investment > holding's share in equity = Goodwill
- If cost of investment < holding's share in equity = Capital reserve

In case of multiple acquisitions in subsidiaries

Calculation of Goodwill or Capital Reserve to be made on step-by-step basis

- Consolidation to be done from date when the parent actually acquires control of the subsidiary

If financial statement (FS) on date of investment are not available or impracticable to prepare, FS of immediately preceding financial year to be used and effect of significant transactions to be given

Procedure … contd.

- Eliminate intra group Transactions and resulting unrealized profit and losses as given below :

Transaction*	Elimination
Upstream Transaction [Material sold by subsidiary to parent]	on the basis of shareholding
Down Stream Transactions [Material sold by parent to subsidiary]	whole unrealized profit/ loss to be adjusted from unsold inventory irrespective of % of shareholding

* As per FAQ issued by ICAI

- Unrealized losses to be eliminated unless cost cannot be recovered

- Tax expense in CFS to be aggregate of Tax expense in the standalone financials of the parent and the subsidiary

- If a subsidiary has outstanding cumulative preference shares which are held outside the group – the parent computes its share of profits or losses after adjusting for the subsidiary's preference dividends, whether or not dividends are declared

Procedure…contd.

Identification and accounting for Minority Interest (MI)

- Identify the MI in the net income of the subsidiary and adjust against the income of the group to arrive at the net income attributable to the owners of the parent
- Identify the MI in the net assets of the consolidated subsidiary and present separately in CFS from the liabilities and equity (net worth) of the parent
- In case Losses > MI share in subsidiary, excess or any further losses to be adjusted against majority except to the extent minority has binding obligation to make good the losses
- Subsequent reported profits to be allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered

Disclosures

- List of all subsidiaries giving name, country of incorporation or residence, proportion of ownership and voting power
- Nature of relationship between parent and subsidiary
- Effect of the acquisition and disposal of subsidiaries on the financial position, results and corresponding amounts for the preceding period
- Names of subsidiaries whose FS dates are different than that of parent
- When CFS is prepared for first time, figures for previous year need not be given
- Other notes from separate financial statements which will assist reader in better understanding of CFS and other disclosure required in Schedule III

Examples of Disclosure as per Schedule III

(xi) Additional information as required by Paragraph 2 of the General Instructions for Preparation of Consolidated Financial Statements to Schedule III to the Companies Act, 2013:

	Name of the Entity	Net Assets		Share in Profit or (Loss)		Share in Other Comprehensive Income		Share in Total Comprehensive Income	
		As % of Consolidated Net Assets	Amount (₹ in Crores)	As % of Consolidated Profit or (Loss)	Amount (₹ in Crores)	As % of Consolidated Other Comprehensive Income	Amount (₹ in Crores)	As % of Consolidated Total Comprehensive Income	Amount (₹ in Crores)
Parent									
	ITC Limited	**92.73%**	**43310.96**	**94.60%**	**9911.03**	**165.57%**	**70.12**	**94.88%**	**9981.15**
Subsidiaries									
	Indian								
1	Russell Credit Limited	1.51%	703.88	0.32%	33.44	22.88%	9.69	0.41%	43.13
2	Greenacre Holdings Limited	0.11%	51.28	0.02%	2.25	(0.14%)	(0.06)	0.02%	2.19
3	Wimco Limited	0.01%	2.37	...	(0.07)	(0.05%)	(0.02)	...	(0.09)
4	Prag Agro Farm Limited	...	1.07	...	(0.06)	–	–	...	(0.06)

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Principles

Objective

Set out principles and procedures for recognising, in the consolidated financial statements, the effects of the investments in associates on the financial position and operating results of a group.

Scope

Applied in accounting for investments in associates in the preparation and presentation of consolidated financial statements by an investor.

Definitions

- *An **associate** is an enterprise in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor.*
- ***Significant influence** is the power to participate in the financial and/or operating policy decisions of the investee but not control over those policies.*
- ***Control** – Same as AS 21*

Procedure

- Investment to be accounted using equity method of accounting
- Investment to be initially recorded at cost, identifying goodwill/ capital reserve arising at the time of acquisition
- Carrying amount adjusted thereafter for post acquisition changes in investor's share of net assets of the investee
- Investors share of results of operations of investee to be included in CFS
- Goodwill/ capital reserve arising on the acquisition of an associate included in the carrying amount of investment in the associate but should be disclosed separately

Procedure …contd.

- Unrealized profits and losses resulting from transactions between investor (or its consolidated subsidiaries) and the associate should be eliminated to the extent of the investor's interest in the associate
- Unrealized losses to be eliminated unless cost cannot be recovered
- Carrying amount of investment in an associate to be reduced to recognize a permanent decline in the value of investment. Such recognition should be determined and made for each and every investment
- Uniform accounting policies should be adopted. In case not practicable / not followed, the fact should be disclosed together with brief description of differences
- Equity method not applied when investment is acquired and held for subsequent disposal in near future or there are severe long term restriction that significantly impair associate's ability to transfer funds to its investor
- Investment in such associate to be accounted as per AS 13– Accounting for Investment

Disclosures

- Investment in associates to be listed by proportion of ownership interest/ voting power held in each associate
- Investment to be classified as long term investment
- Investor's share of profit/ loss to be disclosed separately
- Associates having different reporting dates, same to be disclosed
- Investor's share of the contingencies and capital commitments of an associate for which parent is also contingently liable

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Principles

Objective

Set out principles and procedures for accounting for interests in joint ventures and reporting of joint venture assets, liabilities, income and expenses in the financial statements of venturers and investors.

Scope

Applied in accounting for interests in joint ventures and the reporting of joint venture assets, liabilities, income and expenses in the financial statements of venturers and investors, regardless of the structures or forms under which the joint venture activities take place.

Definitions

A **joint venture** is a contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control.

Joint control is the contractually agreed sharing of control over an economic activity.

Control is the power to govern the financial and operating policies of an economic activity so as to obtain benefits from it.

Venturer is a party to a joint venture and has joint control over that joint venture.

Investor in a joint venture is a party to a joint venture and does not have joint control over that joint venture.

Types of JV

Jointly controlled Operations	Use of assets and other resources of ventures instead of establishing separate entity
Jointly controlled Assets	Joint Control / ownership of one or more assets contributed to or acquired for purpose of JV
Jointly controlled Entities	JV involving establishment of separate entity

Procedure

Accounting for Jointly Controlled Operations

To be recognized by venturer in its separate financial statement and CFS as given below:

- Assets and liabilities that it incurs
- Its share of income that it earns and expenses that it incurs

Accounting for Jointly Controlled Assets

- To be recognized by venturer in its separate financial statement and CFS as given below:
- Share of jointly controlled assets classified according to nature of assets
- Liabilities which it has incurred
- Its share of liabilities incurred jointly with other ventures in relation to joint venture
- Any income from the sale or use of its shares of the output of joint venture together with its share of any expenses incurred by joint venture and
- Any expenses which it has incurred in respect of its interest in the joint venture

Procedure.... contd.

Accounting for Jointly Controlled Entities

- Interest to be accounted as per proportionate consolidation except
    - o An interest is acquired and held exclusively with a view to its subsequent disposal in near future
    - o An interest in a jointly controlled entity which operates under severe long-term investment restrictions that significantly impair its ability to transfer funds to the Venturer

- A Venturer should discontinue use of proportionate consolidation from the date

➢ It cease to have joint control over a jointly controlled entity

➢ Where jointly controlled entity operates under severe long-term restrictions that significantly impair its ability to transfer funds to the Venturer

In case of transaction with joint venture, venturer to recognizes only that share of the unrealized gain or loss which pertains to the interests of other Venturer

Procedure… contd.

Transactions between Venturer and Joint Venture

Transaction	Treatment
Contributes or sells assets to a joint venture, and has transferred significant risks and rewards of Ownership	Recognise only that portion of the gain or loss which is attributable to the interests of the other venturer and recognise full amount of any loss when the contribution or sale provides evidence of a reduction in the new realisable value of current assets or an impairment loss
Purchases assets from a Joint Venture	It should not recognise its share of the profits of the Joint Venture from the transaction until it resells the assets to an independent party. Should recognise its share of losses resulting from these transactions when they represent a reduction in the net realisable value of current assets or an impairment loss

Disclosures

- Aggregate amount of contingent liabilities, unless probability of loss is remote, separately from the amount of other contingent liabilities
- Any contingent liabilities that the venturer has incurred in relation to its interests in joint ventures and its share in each of the contingent liabilities which have been incurred jointly with other venturer;
- Its share of the contingent liabilities of the joint ventures themselves for which it is contingently liable
- Those contingent liabilities that arise because the venturer is contingently liable for the liabilities of the other venturer of a joint venture.

Disclosures ... contd.

- Aggregate amount of capital commitments of the venturer in relation to its interests in JV and its share in the capital commitments incurred jointly with other venturer;
- Aggregate amount of venturer's share of the capital commitments of the joint ventures themselves
- List of all joint ventures and description of interests in significant JV
- For JVE's disclose the proportion of ownership interest, name and country of incorporation or residence
- In its separate financial statements, the aggregate amounts of each of the assets, liabilities, income and expenses related to its interests in the jointly controlled entities
- Other disclosure requirements as prescribed in Schedule III of Companies Act, 2013

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Integral / Non Integral Operations

- The method used to translate the financial statement of a foreign operation (Subsidiary, Associate or joint venture) depends on way in which it is financed and operates in relation to reporting enterprise. Foreign operations classified under either "integral Foreign Operation" or "Non-integral Foreign Operation"
- Integral foreign operation, the activities of which are an integral part of those of the reporting enterprise e.g. A foreign operation is integral to the operations of the reporting enterprise carried its business as if were an extension of the reporting enterprise's operation
- Non-integral foreign operation which is no integral operations e.g. Foreign operation accumulates cash and other monetary items, incurs expenses, generates income, arrange borrowing etc.

Method of translation

Integral Foreign Operation	Non Integral Foreign Operation
Foreign currency transactions recorded at exchange rate **on the date of transaction** For practical reasons approximate **actual exchange rate** to be used [E.g. average rate] At balance sheet date foreign currency monetary items to be reported using **closing exchange rate** Non-monetary items carried at historical cost denominated in foreign currency to be reported at using exchange rates at the **dates of transaction** Exchange difference arising on settlement of monetary items or on reporting an enterprise's monetary items should be recognized as income or expenses	Asset and liability (both monetary and non-monetary) to be translated at closing rate • Income and expenses to be translated at exchange rates at the date of transaction o For practical reasons, rate that approximate actual exchange rate to be used [E.g. average rate] • Resulting exchange difference to be accumulated in 'foreign currency translation reserve' until disposal of net investment • On disposal of a non-integral foreign operation, cumulative amount of exchange difference accumulated under 'foreign currency translation reserve' which relates to that operation should be recognized as an income or expenses

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Audit Report on CFS

Auditor of CFS requires to issue

- Audit report under provisions of section 143(3) and section 143(11) of the Companies Act, 2013 (Institute of Chartered Accountant Of India has issued format of audit report to be issued on CFS)
- Companies (Auditor's report) Order, 2015 [CARO] on CFS for financial year starting on or after 1st April 2014
- Report on internal financial controls under Clause (i) of Sub-section 3 of Section 143 of the Companies Act, 2013 for financial year starting on or after 1st April 2015

Points for consideration

Reporting on Subsidiaries, Associate and Joint Venture entities not audited by CFS auditor

- Reporting on total assets, total revenues and cash flows not audited by the auditor
- Calculation of total assets, total revenues and cash flows [eg. Before elimination or after elimination etc.]

Reporting under other regulatory requirements u/s 143(3) and section 143(11) of Companies Act 2013

- Relying on report of other auditors eg. Declaration by Directors u/s 164(2)
- Common error in reporting under CARO

Questions