Guidance Note on Audit of Consolidated Financial Statements*

INTRODUCTION

1. The Council of the Institute of Chartered Accountants of India has issued Accounting Standard (AS) 21 'Consolidated Financial Statements' which lays down principles and procedures for preparation and presentation of consolidated financial statements. Consolidated financial statements are presented for a group of entities under the control of a parent. A 'parent' is an entity that has one or more subsidiaries. A group comprises a parent and its subsidiaries. Thus, consolidated financial statements are the financial statements of a group presented as those of a single entity. AS 21 is applicable to a parent that presents consolidated financial statements. In other words, whenever a parent decides to prepare and present consolidated financial statements, it should do so in accordance with the requirements of Accounting Standard (AS) 21, Consolidated Financial Statements.

2. Consolidated financial statements normally include consolidated balance sheet, consolidated statement of profit and loss, and notes, explanatory material that form an integral part thereof, and also consolidated cash flow statement (in case a parent presents its own cash flow statement). Consolidated financial statements are presented, to the extent possible, in the same format as adopted by the parent for its separate financial statements.

3. An entity which prepares the consolidated financial statements, either under any law or regulation governing the entity or *suo motu*, might be required to or otherwise engage a member for conducting the audit of consolidated financial statements.[1] The auditor of the consolidated financial statements may not necessarily be the auditor of the separate financial statements of the parent or one or more of the components[2] included in the consolidated financial statements. However, a law or regulation governing the entity may require the consolidated financial statements to be audited by the statutory auditor of the entity. This Guidance Note provides guidance on the specific issues and audit procedures to be applied in an audit of consolidated financial statements.

DEFINITIONS

4. Various terms used in this Guidance Note, have the

---

* Issued in September, 2003. With the issuance of this Guidance Note, the Format of Auditor's Report to the Board of Directors on Consolidated Financial Statements which was published in March, 2002 issue of 'The Chartered Accountant' stands withdrawn.

[1] The Securities and Exchange Board of India, vide its circular SMDRP/Policy/Cir.44/01 dated August 31, 2001 has amended clause 32 of the listing agreement which now requires the listed companies to publish consolidated financial statements in addition to the separate financial statements in its annual report. The amended clause further requires that the statutory auditors of the company should audit the consolidated financial statements. The filing of consolidated financial statements with stock exchanges has also been made mandatory.
Similarly, the Reserve Bank of India, vide its circular no. DBOD No. BP.BC. 72/21.04.018/2001-02 dated February 25, 2003 have required the banks to prepare consolidated financial statements to facilitate consolidated financial supervision.

[2] Paragraph 8 of Auditing and Assurance Standard (AAS) 10, Using the Work of Another Auditor defines "components" as a division, branch, subsidiary, joint venture, associated enterprises or other entity whose financial information is included in the financial information audited by the principal auditor.

same meaning as in Accounting Standard (AS) 21, 'Consolidated Financial Statements', Accounting Standard (AS) 23, 'Accounting for Investments in Associates in Consolidated Financial Statements' and Accounting Standard (AS) 27, 'Financial Reporting of Interests in Joint Ventures' respectively.

Responsibility of Parent

5. 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; and

   (e) making appropriate consolidation adjustments.

6. 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.

Responsibility of the Auditor of the Consolidated Financial Statements

7. The auditor of the consolidated financial statements is responsible for expressing an opinion on whether the consolidated financial statements are prepared, in all material respects, in accordance with the financial reporting framework under which the parent prepares the consolidated financial statements.

8. Therefore, the auditor's objectives in an audit of consolidated financial statements are:

   (a) to satisfy himself that the consolidated financial statements have been prepared in accordance with the requirements of Accounting Standard (AS) 21, Consolidated Financial Statements, Accounting Standard (AS) 23, Accounting for Investments in Associates in Consolidated Financial Statements and Accounting Standard (AS) 27, Financial Reporting of Interests in Joint Ventures; and

   (b) to enable himself to express an opinion on the true and fair view presented by the consolidated financial statements.

9. Auditing and Assurance Standards, Statements and Guidance Notes on auditing matters issued by the Institute of Chartered Accountants of India apply in the same manner to audit of consolidated financial statements as they apply to audit of separate financial statements. It means that the auditors, while conducting the audit of consolidated financial statements are, *inter alia*, expected to:

   (a) plan their work to enable them to conduct an effective audit in an efficient and timely manner;

   (b) obtain an understanding of the accounting and internal control systems sufficient to plan the audit and determine the nature, timing and extent of his audit procedures. Such an understanding would help the auditors to develop an effective audit approach;

   (c) use professional judgement to assess audit risk and to design audit procedures to ensure that the risk is reduced to an acceptable level; etc.

Audit Considerations

10. The following features of consolidated financial statements have an impact on the related audit procedures:

   (a) The consolidated financial statements are prepared on the basis of separate financial statements of the parent and its subsidiaries and associates and/or joint ventures, using the consolidation procedures prescribed by Accounting Standard (AS) 21, Consolidated Financial Statements, Accounting Standard (AS) 23, Accounting for Investments in Associates in Consolidated Financial Statements and Accounting Standard (AS) 27, Financial Reporting of Interests in Joint Ventures; and

(b) The auditor of the consolidated financial statements has to use the work of other auditors unless the auditor of consolidated financial statements is not the auditor of the other components of the group. This may, however, not be true in all cases.

11. The consolidated financial statements are prepared using the separate financial statements of the parent, subsidiaries, associates and joint ventures and also other financial information, which might not be covered by the separate financial statements of these entities. The 'other financial information' would include disclosures to be made in the consolidated financial statements about the subsidiaries associates and joint ventures, proportion of items included in the consolidated financial statements to which different accounting policies have been applied, adjustments made for the effects of significant transactions or other events that occur between the financial statements of subsidiaries, associates or joint ventures and the parent, as the case may be, etc. Thus, this 'other financial information' would be required to be additionally generated.

12. When an auditor accepts the audit of consolidated financial statements, the auditor should assess whether based on his work alone he would be able to express an opinion on the true and fair view presented by the consolidated financial statements. If the auditor is of the view that his own participation may not be enough or sufficient, he should consider using the work of 'other auditors'.

13. Such 'other auditors' might be the auditors of the separate financial statements of one or more of the components of the consolidated financial statements or the auditors appointed specifically for assisting the auditor of the consolidated financial statements (the principal auditor).

14. Where the statutory auditors of one or more of the components of the consolidated financial statements are also requested to assist the principal auditor, the work to be performed by such statutory auditors for use by the principal auditor would constitute an assignment separate from the assignment to conduct the statutory audit of the respective component.

15. The Auditing and Assurance Standard (AAS) 1, 'Basic Principles Governing an Audit', states (paragraph 9):

"When the auditor delegates work to assistants or uses work performed by other auditors and experts, he will continue to be responsible for forming and expressing his opinion on the financial information. However, he will be entitled to rely on work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied. In the case of any independent statutory appointment to perform the work on which the auditor has to rely in forming his opinion, such as in the case of the work of branch auditors appointed under the Companies Act, 1956 the auditor's report should expressly state the fact of such reliance".

16. Auditing and Assurance Standard (AAS) 10, 'Using the Work of Another Auditor' establishes standards when an auditor, reporting on the financial statements of an entity (the group-in the case of consolidated financial statements), uses the work of another auditor on the financial information of one or more components included in the financial statements of the entity. 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 AAS 10.

17. While complying with the requirements of AAS 10, 'Using the Work of Another Auditor', the principal auditor should keep the following under consideration:

(a) When planning to use the work of another auditor, the principal auditor is not required to consider the professional competence of the other auditor if the other auditor is a member of the Institute of Chartered Accountants of India.

(b) The principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the audit of consolidated financial statements. When using the work of another auditor, the principal auditor should ordinarily perform the following procedures:

(i) The principal auditor should determine the information/assurance required by the other auditor; this emanates/precludes the principal auditor's determination of how the work of the other auditor would affect the audit of consolidated financial statements, for example, the information required from the auditor of a subsidiary would be different from that required from the auditor of a joint venture.

(ii) Advise the other auditor of the use that is to be made of the other auditor's work and report and make sufficient arrangements for co-ordination of their efforts at the planning stage of the audit. The principal auditor would inform the other auditor of matters such as areas requiring special consideration, procedures for the identification of inter-component transactions that may require disclosure and the timetable for completion of audit. It may, however, be noted that the principal auditor, if using the work of the auditors of one or more of the components unless such other auditors are specifically appointed for the purpose, should not enlarge the scope of the audit of the separate financial statements of the subsidiary or component to be included in the consolidated financial statements. Thus, the instructions that are to be issued should be confined to the other information required for consolidation.

(iii) Advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them.

AUDITING THE CONSOLIDATION

18. Before commencing an audit of consolidated financial statements, 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 accounting policies of the parent, subsidiaries, associates and joint ventures;

(b) determining the extent of use of other auditor's work in the audit;

(c) determining and programming the nature, timing, and extent of the audit procedures to be performed; and

(d) coordinating the work to be performed.

19. A parent which presents consolidated financial statements is required to consolidate all subsidiaries, include all associates and jointly controlled entities in the consolidated financial statements other than those for which exceptions have been provided in the relevant Accounting Standards.

20. The auditor should obtain a listing of subsidiaries, associates and joint ventures included in the consolidated financial statements. The auditor should review the information provided by the management of the parent identifying the subsidiaries, associates and joint ventures. The auditor should verify that all the subsidiaries, associates and joint ventures have been included in the consolidated financial statements unless a subsidiary, associate or joint venture meets a criterion for exclusion. In respect of completeness of this information, the auditor should perform the following procedures:

(a) review his working papers for the prior years for the known subsidiaries, associates and joint ventures;

(b) review the parent's procedures for identification of subsidiaries, associates and joint ventures;

(c) review the investments to determine the shareholding in other entities;

(d) review the joint venture and other relevant agreements entered into by the parent;

(e) review the statutory records maintained by the parent, for example registers under section 302, 372A of the Companies Act, 1956.

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

21. It is also important to note that ownership of voting power is not necessary for an entity to own more than one-half of the voting power of another to control the other enterprise. Control of the composition of the Board of Directors (in the case of a company) or corresponding governing body (in the case of any other enterprise), with a view to obtain economic benefits from its activities, ownership of voting power is not important. For example, an entity holds only 10 percent of the share capital of another entity but it has control over the composition of the Board of Directors/governing body of the second entity. In such a case, the first entity would be considered as a parent of the second entity and, therefore, it would consolidate the second entity in the consolidated financial statements as subsidiary. The auditor, therefore, apart from carrying out above procedures, 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 would have to use his professional judgement to determine whether the parent controls the composition of the Board of Directors of any other entity. If yes, whether that entity has been consolidated as a subsidiary in the consolidated financial statements.

22. Where a subsidiary or an associate or a jointly controlled entity is excluded from the consolidated financial statements, the auditor should examine the reasons for exclusion. There could be two reasons for exclusion of a subsidiary, associate or jointly controlled entity - one, that the relationship of parent with the subsidiary, associate or jointly controlled entity is intended to be temporary or the subsidiary, associate or joint venture operates under several long-term restrictions which significantly impair its ability to transfer funds to the parent. The auditor should satisfy himself that the exclusion made by the

management falls within these two categories. The auditor should verify such long-term restrictions from the relevant laws and regulations, agreements entered by the parent with such entities which prohibit transfer of funds. 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, associate or joint venture is temporary, the auditor should verify that the intention of the parent, to dispose the subsidiary, investment in associate or interest in jointly controlled entity, in the near future, existed at the time of acquisition of the subsidiary, making investment in associate or jointly controlled entity. The auditor should also verify that the reasons for exclusion are given in the consolidated financial statements. If an entity is excluded from the consolidated financial statements for reasons other than those allowed by the relevant accounting standards, the auditor should consider its effect on the report to be issued. The auditor should consider the need to issue a modified report on the consolidated financial statements. The auditor should also verify that in consolidated financial statements, investments in such subsidiaries, associates or jointly controlled entities should be accounted for in accordance with Accounting Standard (AS) 13, Accounting for Investments.

23. The auditor should also examine whether any subsidiary, associate or jointly controlled entity has ceased to be a subsidiary, associate or jointly controlled entity during the period under audit. It is also possible that a subsidiary might have become an associate or an associate might have become a subsidiary of the parent. The auditor, in such cases, should examine whether these changes have been appropriately accounted for in the consolidated financial statements as required by the respective accounting standards.

24. In preparing consolidated financial statements, the financial statements of the parent and its subsidiaries are combined on a line by line basis by adding together like items of assets, liabilities, income and expenses and then certain calculations like determination of goodwill or capital reserve, minorities interest and adjustments like elimination of intra group transactions, balances and unrealised profits etc. are made in accordance with the requirements of Accounting Standard (AS) 21, Consolidated Financial Statements. Investments in associates are accounted for using the Equity Method as prescribed in Accounting Standard (AS) 23, Accounting for Investments in Associates in Consolidated Financial Statements. A parent that has an interest in a jointly controlled entity, reports its interest in the consolidated financial statements using proportionate consolidation method in accordance with Accounting Standard (AS) 27, Financial Reporting of Interests in Joint Ventures. Many of the procedures appropriate for the application of equity method and the proportionate consolidation are similar to the consolidation procedures set out in Accounting Standard (AS) 21, Consolidated Financial Statements.

25. 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.

SPECIAL CONSIDERATIONS

Permanent Consolidation Adjustments[3]

26. Permanent consolidation adjustments are those adjustments that are made only on the first occasion of the preparation and presentation of consolidated financial statements. Permanent consolidation 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 attribut-

[3] Reference may be made to Appendix I Consolidated Balance Sheet of Group for an understanding of permanent consolidation adjustments.

able 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.

27. The auditor should verify that the above calculations have been made appropriately. The auditor should pay particular attention to the determination of pre-acquisition reserves of the subsidiary and associates. Date(s) of investment in subsidiary and associates assumes importance in this regard. The auditor should also examine whether the pre-acquisition reserves have been allocated appropriately between the parent and the minorities of the subsidiary. The auditor should also verify the changes that might have taken place in these permanent adjustments on account of subsequent acquisition of shares in the subsidiary/associates, disposal of the subsidiary/ associate in the subsequent years. The auditor should also examine the joint venture agreements, to establish whether any change has taken place in the interest of the parent in the joint venture.

28. It may happen that in the case of one subsidiary, goodwill arises and in the case of another subsidiary a capital reserve arises. The parent may choose to net off these amounts to disclose a single amount in the consolidated balance sheet. In such cases, the auditor should verify that the gross amounts of goodwill and capital reserves arising on acquisition of various subsidiaries have been disclosed in the notes to the consolidated financial statements to reflect the excess/shortage over the parents' portion of the subsidiary's equity.

Current Period Consolidation Adjustments[4]

29. 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:

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

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

(c) intra-group indebtedness;

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

(e) 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

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

30. The adjustments required for preparation of consolidated financial statements are made in memorandum records kept for the purpose by the parent. 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. Apart from reviewing the memorandum records, the auditor should:

(a) verify that the inter-group transactions and account balances have been eliminated;

(b) verify that the consolidated financial statements have been prepared using uniform accounting policies for like transactions and other events in similar circumstances;

(c) verify that adequate disclosures have been made in the consolidated financial statements of application of different accounting policies in case, it was impracticable to do so;

(d) verify the adjustments made to harmonise the different accounting policies; and

(e) verify that the calculation of minorities interest has been correctly done.

31. The auditor should gain an understanding of the procedures adopted by the management of the enterprise to make the above mentioned adjustments. This helps the auditor in reducing the audit risk to an acceptably low level.

32. One of the important adjustment that may be required in the current period is determination of impairment loss that might exist for goodwill arising on consolidation. Goodwill arising on consolidation is carried at the value determined at the date of acquisition of the

[4]Reference may be made to Appendices I and II for current period consolidation adjustments.

subsidiary, and the same is to be tested for impairment at every balance sheet date. The auditor should examine whether any impairment loss has been determined by the parent. If yes, the auditor should examine the procedure followed for determination of impairment. The auditor should satisfy himself that the amount of impairment loss determined is fair.

33. The auditor should also verify that the disclosures required by Accounting Standard (AS) 21, Consolidated Financial Statements, Accounting Standard (AS) 23, Accounting for Investments in Associates in Consolidated Financial Statements and Accounting Standard (AS) 27, Financial Reporting of Interests in Joint Ventures have been made in the consolidated financial statements.

34. Apart from verifying that the calculation and disclosures regarding minorities interest have been made appropriately, the auditor also determines, in cases where the minority interests' share of the losses exceed the minority interests' share of the equity, the excess, and any further losses applicable to the minority interest, have been accounted for in accordance with the relevant accounting standards. Where the minority interest has a binding obligation to make good losses, the auditor of the consolidated financial statements determines whether it is able to do so.

35. If the financial statements of one or more of the components are drawn upto different financial reporting dates, the auditor of the consolidated financial statements should review the component's results between its financial reporting date and that of the parent for significant transactions or other events that have taken place during the period and therefore, need to be reflected in the consolidated financial statements. For example, where a subsidiary has a different accounting period and after the end of its accounting period, the subsidiary has discontinued its one of the major operations, adjustments would be required to be made to reflect this in the consolidated financial statements.

36. The fundamental accounting assumption of "consistency" requires the auditor of the consolidated financial statements to consider whether the length of the reporting periods and any difference in financial year-ends are the same from period to period.

37. Notes to accounts and other explanatory material are an integral part of any financial statements since they provide information which is *per se* not reflected in the balance sheet and profit and loss account. Consolidated financial statements are not an exception to the need of notes to accounts and other explanatory material. In this regard paragraph 6 of Accounting Standard (AS) 21, Consolidated Financial Statement states as below:

> "6. Consolidated financial statements normally include consolidated balance sheet, consolidated statement of profit and loss, and notes, other statements and explanatory material that form an integral part thereof. Consolidated cash flow statement is presented in case a parent presents its own cash flow statement. The consolidated financial statements are presented, to the extent possible, in the same format as that adopted by the parent for its separate financial statements".

38. The Accounting Standards Board of the Institute has issued General Clarification (GC)-5/2002 on Notes to the Consolidated Financial Statements. The Clarification lays down certain principles that should be observed in respect of notes and other explanatory material that form integral part of the consolidated financial statements. The auditor should verify that the principles enunciated by the Clarification have been followed in preparation of notes to accounts. The auditor to verify, the compliance, should:

    (a) examine that the notes which are necessary for presenting a true and fair view of the consolidated financial statements have been included in the consolidated financial statements as an integral part thereof; and

    (b) examine that additional statutory information disclosed in separate financial statements of the subsidiary and/or a parent having bearing on the true and fair view of the consolidated financial statements have been disclosed in the consolidated financial statements.

39. If as a result of the above examinations, the auditor is of the view that the consolidated financial statements do not disclose all the information which is necessary for presenting a true and fair view, the auditor should give a modified report.

MANAGEMENT REPRESENTATIONS

40. Auditing and Assurance Standard (AAS) 11, "Representations by Management" requires the auditor

to obtain appropriate representations from management. The auditor of the consolidated financial statements should obtain evidence that the management of the parent acknowledges its responsibility for a true and fair presentation of the consolidated financial statements in accordance with the financial reporting framework applicable to the parent and that parent management has approved the consolidated financial statements. In addition, the auditor of the consolidated financial statements obtains written representations from parent management on matters material to the consolidated financial statements. Examples of such representations include:

(a) Completeness of components included in the consolidated financial statements;

(b) Identification of reportable segments for segmental reporting;

(c) Identification of related parties and related party transactions for reporting;

(d) Appropriateness and completeness of consolidation adjustments, including the elimination of intra-group transactions.

REPORTING*

41. There could be two situations in an audit of consolidated financial statements—when the parent's auditor is also the auditor of all the components to be included in the consolidated financial statements and when the parent's auditor is not the auditor of one or more subsidiaries and therefore, uses the work of other auditors in the audit. The auditor should, while preparing the report, should consider the requirements of Auditing and Assurance Standard (AAS) 28, The Auditor's Report on Financial Statements. Where, the auditor uses the work of other auditors in the audit of consolidated financial statements, the requirements of Auditing and Assurance Standard (AAS) 10, Using the Work of Another Auditor should also be considered.

WHEN THE PARENT'S AUDITOR IS ALSO THE AUDITOR OF ITS SUBSIDIARIES

42. While drafting the audit report, the auditor should report whether principles and procedures for preparation and presentation of consolidated financial statements as laid down in the relevant accounting standards have been followed. In case of any deviation, the auditor should make adequate disclosure in the audit report so that users of the consolidated financial statements are aware of such deviation.

43. 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. Suggested format of the audit report to be issued in such circumstance is given as Annexure I to this Guidance Note.

WHEN THE PARENT'S AUDITOR IS NOT THE AUDITOR OF ITS SUBSIDIARY(IES)

44. In a case where the parent's auditor is not the auditor of the components included in the consolidated financial statements, the auditor of the consolidated financial statements should also consider the requirement of AAS 10.

45. When the parent's auditor decides that he will make reference to the audit of the other auditors, the auditor's report on consolidated financial statements should disclose clearly the magnitude of the portion of the financial statements audited by the other auditor(s). This may be done by stating the rupee amounts or percentages of total assets and total revenue of subsidiary(s) included in consolidated financial statements not audited by the parent's auditor. However, reference in the report of the auditor of consolidated financial statements 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. Suggested format of the audit report to be issued by the auditor of consolidated financial statements in this circumstance is given in Annexure II to this Guidance Note.

*With the issuance of the Guidance Note, the format of report on Consolidated Financial Statements issued in March, 2001 shall stand withdrawn,

Annexure I

Illustrative Auditor's Report on the Consolidated Financial Statements When the Parent's Auditor is also the Auditor of all the Components

Auditor's Report

The Board of Directors

__________ (Name of the Parent)[5]

We have audited the attached consolidated balance sheet of XYZ Group, as at 31st March 2XXX, and also the consolidated profit and loss account and the {consolidated cash flow statement}[6] for the year ended on that date annexed thereto. These financial statements are the responsibility of the XYZ's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the auditing standards generally accepted in India. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

We report that the consolidated financial statements have been prepared by the XYZ's management in accordance with the requirements of Accounting Standards (AS) 21, Consolidated financial statements, {Accounting Standards (AS) 23, Accounting for Investments in Associates in Consolidated Financial Statements and Accounting Standard (AS) 27, Financial Reporting of interests in Joint Ventures}[7] issued by the Institute of Chartered Accountants of India.

In our opinion and to the best of our information and according to the explanations given to us, the consolidated financial statements give a true and fair view in conformity with the accounting principles generally accepted in India:

(a) in the case of the consolidated balance sheet, of the state of affairs of the XYZ Group as at 31st March 2XXX;

(b) in the case of the consolidated profit and loss account, of the profit / loss [8]for the year ended on that date; and

(c) in the case of the consolidated cash flow statement, of the cash flows for the year ended on that date.

For ABC and Co.
Chartered Accountants

Signature
(Name of the Member Signing the Audit Report)
(Designation[9])
Membership Number

Place of Signature
Date

---

[5]As per paragraph 8 of AAS 28, "The Auditor's Report on Financial Statements", "The auditor's report should be appropriately addressed as required by the circumstances of the engagement and applicable laws and regulations. Ordinarily, the auditor's report is addressed to the authority appointing the auditor".

[6]Where applicable.

[7]*ibid.*

[8]*ibid.*

[9]Partner or proprietor, as the case may be.

Annexure II

Illustrative Auditor's Report on the Consolidated Financial Statements When the Parent's Auditor is Not the Auditor of All the Components

Auditor's Report

The Board of Directors

__________ (Name of the Parent)[10]

We have audited the attached consolidated balance sheet of XYZ Group, as at 31st March 2XXX, and also the consolidated profit and loss account and the {consolidated cash flow statement}[11] for the year ended on that date annexed thereto. These financial statements are the responsibility of the XYZ's management and have been prepared by the management on the basis of separate financial statements and other financial information regarding components. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the auditing standards generally accepted in India. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

We did not audit the financial statements of certain subsidiaries, whose financial statements reflect total assets of Rs._____ as at 31st March 2XXX, the total revenue of Rs. ______ and cash flows amounting to Rs.______ for the year then ended. These financial statements and other financial information have been audited by other auditors whose report(s) has (have) been furnished to us, and our opinion is based solely on the report of other auditors.

We report that the consolidated financial statements have been prepared by the XYZ's management in accordance with the requirements of Accounting Standards (AS) 21, Consolidated financial statements, {Accounting Standards (AS) 23, Accounting for Investments in Associates in Consolidated Financial Statements and Accounting Standard (AS) 27, Financial Reporting of interests in Joint Ventures}[12] issued by the Institute of Chartered Accountants of India.

Based on our audit and on consideration of reports of other auditors on separate financial statements and on the other financial information of the components, and to the best of our information and according to the explanations given to us, we are of the opinion that the attached consolidated financial statements give a true and fair view in conformity with the accounting principles generally accepted in India:

(a) in the case of the consolidated balance sheet, of the state of affairs of the XYZ Group as at 31st March 2XXX;

(b) in the case of the consolidated profit and loss account, of the profit / loss[13] for the year ended on that date; and

(c) in the case of the consolidated cash flow statement, of the cash flows for the year ended on that date.

For ABC and Co.
Chartered Accountants

Place of Signature:
Date:

Signature
(Name of the Member Signing the Audit Report)
(Designation[14])
Membership Number

---

[10]See Footnote 5.
[11]Where applicable.
[12]*ibid.*
[13]*ibid.*
[14]Partner or proprietor, as the case may be.

Appendix I

Consolidated Balance Sheet of a Group

The appendix is illustrative only and does not form part of the Guidance Note. The purpose of this appendix is to illustrate the application of Accounting Standard (AS) 21, Consolidated Financial Statements.

1. The example shows only current period amounts.
2. The amounts given in the brackets indicate deductions.
3. The working notes given towards the end of this appendix are intended to assist in understanding the manner in which the various figures appearing in the consolidated balance sheet have been derived. These working notes do not form part of the consolidated balance sheet and, accordingly, need not be published.
4. The following are the balance sheets as at 31st March, 2003 of X Limited (the holding company), Y Limited and Z Limited (both subsidiaries of X Limited)

(Rs.'000)

Sources of Funds	**X Limited**	**Y Limited**	**Z Limited**
Share Capital	4,500.00	1,000.00	2,000.00
Reserves and Surplus	150.00	195.00	390.00
6% Debentures	-	250.00	—
Current Liabilities	420.00	210.00	300.00
Total	**5,070.00**	**1,655.00**	**2,690.00**

Application of Funds	**X Limited**	**Y Limited**	**Z Limited**
Fixed Assets	1,600.00	490.00	1,400.00
Investments in Subsidiaries	2,560.00	-	-
Inventories	520.00	650.00	850.00
Cash	200.00	230.00	160.00
Other Current Assets	190.00	285.00	280.00
Total	**5,070.00**	**1,655.00**	**2,690.00**

5. The following additional information is also relevant for the preparation of the consolidated balance sheet:
   (i) The break-up of investments of X Limited is as follows:

	Carrying Cost
(a) 80,000 equity shares of Rs.10 each of Y Limited	880.00
(b) 1,35,000 equity shares of Rs.10 each of Z Limited	1,200.00
(c) 4,000 preference shares of Rs.100 each of Z Limited	400.00
(d) 800 6% Debentures of Rs.100 each of Y Limited	80.00
Total	**2,560.00**

6. All the above investments were made on 30th September, 1998. The summarised balance sheets of Y Limited and Z Limited as on that date were as follows:

(Rs.'000)

Sources of Funds	**Y Limited**	**Z Limited**
Share Capital	1,000.00	2,000.00
Reserves and Surplus	152.50	305.00
6% Debentures	250.00	-
Current Liabilities	300.00	400.00
Total	**1,702.50**	**2,705.00**
Application of funds		
Fixed Assets	500.00	1,450.00
Current Assets	1,202.50	1,255.00
Total	1,702.50	2,705.00

7. The Share Capital of Subsidiary consisted of

	Y Limited	Z Limited
Equity Shares of Rs.10/- each	1,000.00	1,500.00
Pref. Shares of Rs.100/- each	Nil	500.00
Total	**1,000.00**	**2,000.00**

8. Current assets of Y Limited includes bills receivables for Rs.8,000 accepted by X Limited.
9. Current Liabilities of Z Limited. Include Rs.2,000 due to X Limited.
10. Stock of X Limited include goods of Rs.10,000 purchased from Y Limited on which the latter company made a profit of Rs.2,000.

Consolidated Balance Sheet of X Limited and its Subsidiaries Y Limited and Z Limited as at 31st March, 2003

(Rs.'000)

Sources of Funds	X Limited	Y Limited	Z Limited	Elimination Entries	Consolidated Amounts
Share Capital	4,500.00	1,000.00	2,000.00	(3,000.00)[1]	4,500.00
Reserves and Surplus	150.00	195.00	390.00	(476.50)[2]	258.50
Capital Reserve (Negative Goodwill)	-	-	-	466.50[3]	466.50
6% Debentures	-	250.00	-	(80.00)[4]	170.00
Current Liabilities	420.00	210.00	300.00	(28.00)[5]	902.00
Minorities Interest	-	-	-	528.00[6]	528.00
Total	**5070.00**	**1655.00**	**2690.00**	**(2590.00)**	**6,825.00**

Application of Funds	X Limited	Y Limited	Z Limited	Elimination Entries	Consolidated Amounts
Fixed Assets	1,600.00	490.00	1,400.00	-	3,490.00
Investments	2,560.00	-	-	(2,560.00)	NIL
Cash	200.00	230.00	160.00	-	590.00
Inventories	520.00	650.00	850.00	(2.00)[7]	2,018.00
Other Current Assets	190.00	285.00	280.00	(28.00)[5]	727.00
Total	**5070.00**	**1655.00**	**2690.00**	**(2590.00)**	**6,825.00**

WORKING NOTES

1. Elimination of share capital of subsidiaries [15]:

	Y Limited	Z Limited	Total
Equity Share Capital			
(i) Used in elimination of carrying cost of investment in each subsidiary	800.00	1,350.00	2,150.00
(ii) Included in the Minorities Interest	200.00	150.00	350.00
Preference Share Capital			
(i) Held within the Group (held by holding company)	Nil	400.00	400.00
(ii) Included in the Minorities Interest	Nil	100.00	100.00
Total share capital eliminated	1,000.00	2,000.00	3,000.00

2. Break-up of reserves and surplus eliminated:

	Y Limited	Z Limited	Total
(i) Reserves up to the date of investment :[16]			
a) Attributable to the holding company (utilised in eliminating carrying cost of investment)[17]	122.00	274.50	396.50
b) Attributable to Minorities (included in minorities interest)	30.50	30.50	61.00
(ii) Movement in reserves and surplus after the date of investment :			
a) Attributable to Minorities (included in minorities interest)	8.50	8.50	17.00
(iii) Profit earned by the subsidiary Y Limited on account of sale of goods to X Limited.	2.00	--	2.00
Total reserves and surplus eliminated	**163.00**	**313.50**	**476.50**

3. Elimination of carrying cost of investments in equity shares of each subsidiary:

	Y Limited	Z Limited
Carrying Cost	880.00	1,200.00
Less: Equity attributable to the holding company at the date at which investment was made (see working note 8 below)	(922.00)	(1,624.50)
Negative Goodwill (capital reserve)	**(42.00)**	**(424.50)**

4. The elimination of investment in Y Limited's 6% Debentures needs explanation. The holding company acquired debentures at face value of Rs.80,000. The consolidated amounts should represent debentures of the subsidiary Y Limited outside the group.
5. Bills payable of Rs.8,000 and debtors of Rs.20,000 are inter company owings and therefore eliminated.

[15]Permanent consolidation adjustments.

[16]*ibid.*

[17]Current period consolidation adjustments.

6. Computation of Minorities Interest

	Y Limited	Z Limited	Total
(a) Amount of equity attributable to minorities at the date at which investment in each subsidiary is made (as computed in working note 8 below)	230.50	180.50	411.00
(b) Minorities' share in movement in equity since the date of investment in each subsidiary (as computed in working note 9 below)	8.50	8.50	17.00
(c) Amount of Preference Share Capital held outside the Group	Nil	100.00	100.00
Total	**239.00**	**289.00**	**528.00**

7. The profit earned by Y Limited is reduced from the consolidated amount of inventories so that it can be valued at cost to the group as a whole.
8. Equity of the subsidiary companies Y Limited and Z Limited at the date at which investment is made:

	Y Limited	Z Limited
Fixed Assets	500.00	1,450.00
Current Assets	1,202.50	1,255.00
Debentures	(250.00)	-
Current Liabilities	(300.00)	(400.00)
Preference Share Capital	-	(500.00)
Equity on the date of investment	**1,152.50**	**1805.00**
Equity attributable to the holding company {see para 13(a)}	922.00	1,624.50
Equity attributable to the minorities {see para 13 (c)}	230.50	180.50
Total	**1,152.50**	**1,805.00**

9. Movement in equity of subsidiaries since the date of investment in each subsidiary:

	Y Limited	Z Limited
Equity as on 31st March, 1999	1,195.00	1,890.00
Less: Equity on the date of Investment as computed in working note (8) above	(1,152.50)	(1,805.00)
Movement in equity	**42.50**	**85.00**
Movement in Equity attributable to the holding company {see paragraph 13(a)}	34.00	76.50
Movement in Equity attributable to the minorities {see paragraph 13 (c)}	8.50	8.50
	42.50	**85.00**

Appendix II

Consolidated Profit and Loss Statement

The appendix is illustrative only and does not form part of the Guidance Note. The purpose of this appendix is to illustrate the application of the Accounting Standard. (AS) 21, Consolidated Financial Statements.

1. The example shows only current period amounts.
2. The following additional information is also relevant for the preparation of the consolidated profit and loss statement (figures are in Rs.'000):
   (a) The holding company A Limited purchased 2,70,000 equity shares of Rs.10 each (75% of the total equity share capital) and 9,000 9%preference shares of Rs.100 each (50% of the total preference share capital) of the subsidiary company B Limited on 1st November, 1998.
   (b) A Limited proposes to pay a final dividend on equity shares @ 25%. A Limited paid an interim dividend of Rs.1,350 during the financial year 2002-2003.
   (c) B Limited proposes to pay a final dividend on equity shares @ 20%. B Limited paid an interim dividend of Rs.720 on 1st October, 2002. An interim dividend of Rs.81 was paid on preference shares also. The holding company did not participate in the interim dividend.
   (d) B Limited sold to A Limited in March, 1999 material for Rs.750 at cost plus 25% of which A Limited still had unsold stock of Rs.500 as on 31st March, 2003.

Consolidated Profit and Loss Statement of A Limited and its Subsidiary B Limited for the year ended 31st March, 2003

(Rs.'000)

Income	A Limited	B Limited	Elimination Entries	Consolidated Amounts
Sales	16,200.00	15,300.00	(750.00)[1]	30,750.00
Proposed Dividend from B Limited	540.00	-	(540.00)[2]	NIL
Dividend on Preference Shares of B Ltd.	40.50	-	(40.5)[2]	NIL
Total Income (A)	**16,780.50**	**15,300.00**	**(1,330.50)**	**30,750.00**
Expenditure	**A Limited**	**B Limited**	**Elimination Entries**	**Consolidated Amounts**
Consumption of raw materials	8,280.00	8,820.00	(750.00)[1]	16,350.00
Overhead Expenses	2,070.00	945.00	-	3,015.00
Selling Expenses	810.00	1,215.00	-	2,025.00
Provision for Tax	2,700.00	1,944.00	-	4,644.00
Total Expenditure (B)	13,860.00	12,924.00	(750.00)	26,034.00
Net Profit for the year (A-B)	**2,920.50**	**2,376.00**	**(580.50)**	**4,716.00**

Consolidated Profit and Loss Appropriation Account of A Limited and its Subsidiary B Limited for the year ended 31st March, 2003

	A Limited	B Limited	Elimination Entries	Consolidated Amounts
Opening Balance	481.50	576.00	-	1,057.50
Add: Net Profit for the year	2,920.50	2,376.00	(580.50)	4,716.00
Less: Preference Dividend for the year		(162.00)	40.50[2]	(121.50)
Less: Equity Dividend for the year	(2,700.00)	(1,440.00)	540.00[2]	(3,600.00)
Balance to be adjusted for consolidation	**702.00**	**1,350.00**	**000.00**	**2,052.00**

Amount credited to Investment Account	321.75[3]	-	-	321.75
Amount utilised in elimination of the Cost of Investment in Subsidiary	-	-	545.62[4]	545.62
Balance attributable to minorities	-	-	337.50[5]	337.50
Unrealised Profit on Stock (stock reserve)		-	100.00[6]	100.00
Amounts transferred to consolidated Balance Sheet	380.25	1,350.00	(983.12)	747.13
Total	**702.00**	**1,350.00**	**000.00**	**2,052.00**

Working Notes

For the purpose of the working notes, it is assumed that profits accrued evenly throughout the financial year 2003-04. Accordingly, the profits are apportioned as 'Profits upto the date of Investment' and 'Profits after the date of Investment' on the basis of months. An alternative treatment calls for preparation of Profit and Loss Statement and Balance Sheet of the subsidiary company on the date at which investment is made by the Holding Company.

1. Since sales made by the subsidiary company B Limited to A Limited in March, 2003 is an inter-company transaction, it is therefore, eliminated.
2. The holding company did not participate in the interim dividend declared by the subsidiary. The holding company is entitled to receive the final dividend as follows:
   (a) Final dividend on equity shares [72 x 0.75] Rs.540.00
   (b) Final dividend on preference share [81 x 0.5] Rs. 40.50
   Since the above dividends are also inter-company transactions, therefore, eliminated.
3. Amount credited to Investment Account: The holding company A Limited credited to its Profit and Loss Statement the dividends received from the subsidiary B Limited. The dividends pertaining to pre-acquisition period represent recovery of cost and do not form part of income. Therefore, the same is required to be credited to the Investment Account.
   Pre-acquisition period is for 7 months i.e., April 1998 to 1st November 1999
   (a) Pre-acquisition equity dividend [Rs.540 x 7/12] Rs. 31.50
   (b) Pre-acquisition preference dividend [Rs.40.50 x 1/6] Rs. 6.75
4. Holding company's share in the profit upto the date of investment in subsidiary forms part of equity on the date at which investment in subsidiary is made. Therefore, such profits are utilised in eliminating the cost of investments in subsidiary. Profits are computed as under:

(a) Opening Balance of the Profit and Loss Account	Rs. 576.00
(b) Net Profit earned during the period 1.4.98 to 1.11.98 i.e., 2376 x 7/12	Rs.1,386.00
(c) Interim dividend on equity shares	Rs. (720.00)
(d) Final dividend on equity shares for the period 2002-2003 (apportioned in the ratio of months 7:5) [720 x 7/12]	Rs. (420.00)
(e) Interim dividend on preference shares	Rs. (81.00)
(f) Final dividend on preference shares (it relates to the last six months of the financial year, therefore, apportioned in the ratio of 1:5) [Rs.81.00 x 1/6]	Rs. (13.50)
Total profits of the subsidiary upto the date of Investment	Rs. 727.50
Holding Company's share in the profits computed (0.75 x 727.5)	**Rs. 545.62**

5. Minorities have a share of 25% in the total profit of the subsidiary company. [Rs.1,350 x 0.25] Rs. 337.50
6. Computation of Unrealised Profit on Stock
   (i) Value of unsold stock Rs. 500.00
   (ii) Profit included is 20% on costUnrealised profit [Rs.500.00 x 0.20] Rs. 100.00 ■