

10. Audit of Consolidated Financial Statements

Important Point of this chapter

1.

Introduction:

The council of the ICAI 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.

Responsibility of parent

The responsibility for the preparation and presentation of CFS 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 CFS.
- b. Where appropriate, identifying reportable segments for segments reporting;
- c. Identifying related parties and related parties transaction for reporting;
- d. Obtaining accurate and complete financial information from components and;
- e. Making appropriate consolidation adjustments.

Responsibility of Auditor of CFS

Objective

- a. To satisfy himself that the CFS have been prepared in accordance with the requirements of AS 21 and AS 23 and AS 27, financial reporting of interests in joint venture.
- b. To enable himself to express an opinion on the true and fair view presented by the CFS.

Audit Considerations

The CFS is prepared using the separate financial statements of the parent, subsidiaries, associates and joint ventures and also other financial information.

Here 'other financial information' would include disclosures to be made in the CFS account the subsidiaries associates and joint ventures, proportion of items included in the CFS to which different accounting policies have been applied, adjustments made for the effect of significant transactions or other events that occur between the financial statements of subsidiaries, associate or joint ventures and parent, as the case may be. Thus, this other information required to be additionally generated.

When an auditor accepts the audit of CFS, 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 CFS. 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' by applying SA 600.

Auditing the Consolidation

- Before commencing audit of CFS, the auditor should make plans, among other things, for the following
 - a. Understanding of accounting policies of the parent, subsidiaries, associate 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.
- The auditor should obtain a listing of subsidiaries, associate and joint venture included in the CFS. The auditor should review the information provided by the management of the parent identifying the subsidiaries, associate and joint ventures. In respect of completeness of this information, the auditor should review the following procedures:
 - a. Review his working paper for the prior years for the known subsidiaries, associate and joint ventures;
 - b. Review the parent's procedure for identification of subsidiaries in other entities;
 - c. Review the investments to determine the shareholding in other entities;
 - d. Review the joint ventures and other relevant agreements entered into by the parent;
 - e. Review the statutory records maintained by the parent, for example registers under section 303, 372A of the companies act, 1956.
 - The auditor should also identify the changes in shareholding that might have been taken place since the last audit.
 - 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 enterprise. It may be controlled by composing his board of directors. So apart from other procedures, auditor should verify whether the parent controls the composition of the board of directors or corresponding governing body of any entity. If yes, whether that entity has been consolidated as a subsidiary of the consolidated financial statements.
 - Where a subsidiary or an associate or jointly controlled entity is excluded from the consolidated financial statements, the auditor should examine the reason for exclusion. There are mainly two reasons:
 - i. Relationship of parent with the subsidiary, associate or jointly controlled entity 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.
 - ii. If any accounting standard disallows to consolidate that review that AS and also its effect in consolidated financial statements.
 - In preparing CFS, 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 transaction, balances and unrealized profits etc. are made in accordance with the requirements of AS 21.

Special Consideration

1. Permanent Consolidation Adjustment: PCA are those adjustments that are made only on the first occasion of the preparation and presentation of consolidated financial statements. PCA 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.
 - 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.
2. Current period consolidated adjustments: Current period consolidated adjustments are those adjustments that are made in the accounting period for which the consolidation of financial statements is done.
 - The adjustments required for preparation of CFS are made in memorandum records kept for the purpose by parent. The auditor should review the memorandum records to verify the adjustments entries made in the preparation of consolidated financial statements. This would also help the auditor in ascertaining whether any there is any difference in elimination.
 - One of the important adjustments that may be required in the current period is determination of impairment loss that might exist for goodwill arising in consolidation. If any impairment loss is determined by the parent than auditor should review the procedure followed for determination of such loss.
 - Apart from verifying that the calculation and disclosure regarding minorities interest have been made appropriately, the auditor also determines, in cases where the minority interest's share of losses exceed the minority's 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 a subsidiary has different accounting period and after the end of its accounting period, the subsidiary has discontinued its one of the major operation, adjustments would be required to be made reflect this in the consolidated financial statements.

Reporting

1. When the parent's auditor is also the auditor of subsidiaries
 - While drafting the audit report, the auditor should report whether principles and procedures for preparation and presentation of consolidated financial statements as lay 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 CFS are aware of such deviation.
2. When the Parent's auditor is not the auditor of the Subsidiary
 - When the parent's auditor decides that he will make reference to the audit of the other auditors, the auditor report on CFS should disclose clearly the magnitude of the portion of the financial statements audited by the other auditor. This may be done by stating the rupee amounts or percentage of total assets and total revenue of subsidiary included in the CFS not audited by the parent's auditor.