Young Members Empowerment Committee & Accounting Standard Board of ICAI

CAPSULE PROGRAMME ON ACCOUNTING STANDARDS

AS 21 : Consolidated Financial Statements (CFS)

AS 23 : Accounting for Investments in Associates in CFS

AS 27 : Financial Reporting of Interests in Joint Ventures

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AS-21 – Consolidated Financial Statements

- CFS are the FS of a GROUP* presented as those of a single enterprise
- CFS provides State of Affair and financial results of the Group
- Consolidation of FS was not mandatory under the Old Companies Act (except MCA circular dealing with sec 212)
- Various issues will have to be addressed before Consolidation of FS can be implemented under the new Companies Act
- Under Listing Agreement, CFS is mandatory
- AS 21 is mandatory when an enterprise is required to / wish to present CFS

**Parent and all its subsidiaries*

Applicability of AS 21

AS 21 applicable in

•Preparation and presentation of CFS for a group of enterprises under the control of a parent

•All other ASs are applicable in preparation of CFS

AS 21 not applicable in accounting of:

•Investments in JV – AS 27

•Investments in Associates – AS 23

•Amalgamation – AS 14

Key Definitions in AS 21…..

- Subsidiary

  Enterprise controlled by another enterprise (known as parent)

- Parent

  Enterprise that has one or more subsidiaries

- Control

  Ownership, directly or indirectly through subsidiary/ies, of more than 50% of the voting power of an enterprise

  OR

  Control of the composition of board or governing body so as **to obtain economic benefits from its activities**

Key Definitions in AS 21….. (contd.)

- Minority interest

  is that part of the net results of operations and of the net assets of a subsidiary attributable to interests which are not owned, directly or indirectly by the Parent
- Equity

  Residual interest in the assets of an enterprise after deducting all its liabilities

Definition of "Control" in AS 21 / 23 v/s AS 27

- AS 21 / AS 23

  Ownership, directly or indirectly through subsidiary/ ies, of more than 50% of the voting power of an enterprise

  OR

  Control of the composition of board or governing body so as to obtain economic benefits from its activities
- AS 27

  Power to govern the financial and operating policies of an economic activity so as to obtain benefits from it

What is included in CFS?

- Consolidated Balance Sheet;
- Consolidated Statement of Profit and Loss;
- Notes, Other statements and explanatory material that form an integral part thereof; and
- Consolidated Cash Flow Statement
- Disclosure requirements specified in the Schedule III to the Companies Act, 2013

Exclusion from Consolidation

- Control is intended to be temporary – acquired and held exclusively with a view to its subsequent disposal in "near future"
- Subsidiary operates under severe long-term restrictions which significantly impair its ability to transfer funds to parent
  - ➢ Such subsidiary should be accounted in CFS in accordance with AS 13
  - ➢ Near future – case to case basis; ordinarily not more than 12 months

Consolidation procedure

- Combine FSs on a line by line basis
- Elimination of cost to the Parent of its investments and the Parent's portion of Equity as on the date of investment
- Recognition of Goodwill / Capital Reserve
- Recognition of Minority Interest in the consolidated income and net assets
- Elimination of intragroup balances/ intragroup transactions / un-realised profits or losses from such transactions
- Reporting date related adjustments
- Alignment of accounting policies

Alignment of Accounting Policies for Determining Goodwill / Capital Reserves

- Para 20 of AS 21 states that 'CFS should be prepared using uniform accounting policies for like transactions and other events in similar circumstances. If it is not practicable to use uniform accounting policies in preparing CFS, that fact should be disclosed together with the proportions of the items in the CFS to which the different accounting policies have been applied'

Disclosures…

- List of all subsidiaries including name, country of incorporation, proportion of ownership interest and, if different, the proportion of voting power held
- Nature of relationship between parent and subsidiary, if parent does not own one-half of the voting power
- Effect of acquisition and disposal of subsidiaries on the financial position at the reporting date, the results for the reporting period and on the corresponding amounts for the preceding period
- Names of the subsidiaries of which the reporting dates are different from that of the parent and the difference in reporting dates

Disclosures…

- Under the Companies Act, 2013:
  - To comply with Instructions given for preparation of balance sheet and statement of profit and loss in Schedule III
  - Entity-wise “amount of net-assets” and % of the same w.r.t. consolidated net assets
  - Entity-wise “amount of share in profit & loss and % of the same w.r.t. consolidated profit & loss
  - The above details to be further bifurcated into parent, subsidiary, joint –venture and also into Indian and Foreign

Other Considerations

- Whether all notes of separate FS of parent and subsidiaries need to be included in the notes to CFS?
- Notes necessary for presenting a true and fair view of CFS notes involving items which are material
- Additional statutory information if material
- Scenario after the enactment of the Companies Act, 2013
- AS-21 includes non-corporate entities
- Ownership of > 50% of voting power and not holding of > 50% of nominal value of shares
- Control by way of composition of BOD should be to obtain economic benefits from activities of the entity.

Other matters in preparation of CFS

- Consolidation of subsidiary where full provision is made for diminution

  The fact that entry for diminution has been passed does not effect the position with regard to consolidation as long as the entity is legally satisfying the control criteria as laid down under AS – 21

Disposal of stake in subsidiary

- Consolidation process to be followed till the date parent subsidiary relationship ceases to exist
- Recognition of difference between sale proceeds and Equity on the date of disposal in the consolidated profit and loss account and Capital Reserve / Goodwill to be reversed

Who shall consolidate?

- Enterprise is controlled by two enterprises
  - Investment – > 50% of voting power
  - Control over composition of Board

  Consolidation to be done by both

Contingent Consideration

- In the case where it is highly probable that the consideration would be paid, for the purposes of CFS, the liability should be provided for and the corresponding addition should be made to the cost of investment. Consequently goodwill or capital reserve will be determined on that basis.

Audit of CFS

- The CFS auditor has to *inter-alia* ensure that appropriate instructions are given to auditors of other units in the group that are not audited by him. This communication may cover information and instructions relating to accounting policies, inter-group transactions, review of post balance sheet items, materiality levels, high risk area, audit approach, etc.

AS-23 – Accounting for Investment of Associates in CFS

- 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
- As regards share ownership, if an investor holds, directly or indirectly through subsidiary/ies, 20% or more of the voting power of the investee, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case

AS-23 – Accounting for Investment of Associates in CFS (contd.)

- Consolidation method: Equity method
  - Under the Equity Method - investment is initially recorded at cost, identifying any goodwill / capital reserve arising at the time of acquisition

    and
  - the carrying amount is increased or decreased to recognise the investor's share of the profits or losses of the investee after the date of acquisition
- Elimination of unrealised profit / loss to the extent of investor's interest
- Exclusion from CFS / Cessation : same as AS 21

AS-23 - Adjustments to Carrying Amount of Investments in Associate

- Adjustments to the carrying amount of investment in an associate arising from changes in the associate's equity that have not been included in the statement of profit or loss should be directly adjusted in the carrying amount of investment without routing it through the consolidated statement of profit and loss. The corresponding debit /credit should be 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 associate, 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 should be shown in the consolidated balance sheet.

AS-27 – Financial Reporting of Interests in Joint Ventures

- 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.

AS-27 – Financial Reporting of Interests in JV

- A venturer is a party to a joint venture and has joint control over that joint venture.
- An investor in a joint venture is a party to a joint venture and does not have joint control over that joint venture.
- Proportionate Consolidation is a method of accounting and reporting whereby a venturer's share of each of the assets, liabilities, income and expenses of a jointly controlled entity is reported as separate line items in the venturer's financial statements.

AS – 27: Consolidation procedure

- In its consolidated financial statements, a venturer should report its interest in a jointly controlled entity using **proportionate consolidation** except:
  - an interest in a jointly controlled entity which is acquired and held exclusively with a view to its subsequent disposal in the near future; and
  - an interest in a jointly controlled entity which operates under severe long-term restrictions that significantly impair its ability to transfer funds to the venturer.

AS-27 – Financial Reporting of Interests in JV

- Applicable 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.
- Applicable only where CFS are prepared and presented by the venturer.

Forms of Joint Ventures

- Jointly Controlled Operations
- Jointly Controlled Assets
- Jointly Controlled Entities

Contractual Arrangement

- Contractual arrangement may be evidenced in a number of ways - by a contract between the venturers; minutes of discussions between the venturers….
- Arrangement may be incorporated in the articles or other by laws of JV. Whatever its form, the contractual arrangement is normally in writing and deals with:
  - Nature of activity, duration and reporting obligations of the JV;
  - Appointment of the board of directors or equivalent governing body of JV and the voting rights of the venturers;
  - Capital contributions by the venturers; and
  - the sharing by the venturers of the output, income, expenses or results of JV

Contractual Arrangement (contd.)

- The contractual arrangement indicates whether or not an enterprise has joint control over the venture, along with the other venturers.
- Joint control provides the enterprise with two types of rights:
  - Protective rights
  - Participative rights

Jointly Controlled Operations – Accounting Treatment

- Interests in jointly controlled operations should be recognised by a venturer in its separate financial statements and consequently in its consolidated financial statements as below:
  - The assets that it controls and the liabilities that it incurs; and
  - The expenses that it incurs and its share of the income that it earns from the joint venture.

Jointly Controlled Assets – Accounting Treatment

- Interests in jointly controlled assets should be recognised by a venturer, in its separate financial statements, and consequently in its consolidated financial statements as below:
  - Its share in such assets, classified based on nature of assets;
  - Any liabilities which it has incurred;
  - Its share of any liabilities incurred jointly with the other venturers in relation to the JV;
  - Any income from the sale or use of its share of the output of the JV, together with its share of any expenses incurred by the JV; and
  - Any expenses which it has incurred in respect of its interest in the JV

Jointly Controlled Entities – Accounting Treatment

- Separate financial statements of a venturer:

  Interest should be accounted for as an investment – AS 13
- Consolidated financial statements of a venturer

  Using proportionate consolidation except where:

  ➢Acquisition with a view to disposal in the near future

  ➢Entity operates under severe long-term restrictions
- Interest in such exceptions as mentioned above should be accounted for as an investment in accordance with Accounting Standard 13, Accounting for Investments

Discontinuance of Joint Control

- A venturer should discontinue the use of proportionate consolidation from the date when:
  - It ceases to have joint control over a jointly controlled entity but retains, either in whole or in part, its interest in the entity
  - Where the jointly controlled entity operates under severe long-term restrictions that significantly impair its ability to transfer funds to the venturer

Disclosures…

A venturer should disclose the following information in its separate FS as well as in CFS:

- Aggregate amount of contingent liabilities, unless the 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 venturers
- 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 venturers of a joint venture

Disclosures…(contd.)

A venturer should disclose the aggregate amount of the following commitments in respect of its interests in joint ventures separately from other commitments:

- Any capital commitments of the venturer in relation to its interests in joint ventures and its share in the capital commitments that have been incurred jointly with other venturers; and
- Its share of the capital commitments of the joint ventures themselves.
- A list of all joint ventures and description of interests in significant joint ventures. In respect of jointly controlled entities, the venturer should also 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

Case Study

- Mukesh Ltd sold all its three subsidiaries at different dates during the year. Whether is it required to present CFS?

➢ As per Para 22 of AS-21 – results of operations of subsidiaries where the relationship has ceased during the year are included in CFS profits till the date of cessation. Thus even if the company is a parent at any time during the year the preparation of CFS becomes compulsory.

Case Study

- High Ltd and Low Ltd each hold 50% equity in Middle Ltd. Each company exercises control over the board every alternate year. Who shall consolidate Middle Ltd.?
  - ➢ Control test will fail. Accounting may be in line with AS-27.
- NCP Ltd owns more than 50% voting power of RG Ltd. RG Ltd. has incurred losses. NCP Ltd argues it does not intend to control RG and thus does not want to consolidated. As an auditor, what would be your views?
  - ➢ Intention to control is not relevant in AS-21, hence NCP Ltd will have to consolidate RG Ltd.

Case Study

- M/s Sonia Ltd has four wholly owned subsidiaries which own 25% each in M/s Manmohan Ltd. Whether equity accounting would be required by the intermediary subsidiaries and then consolidated by M/s Sonia Ltd, or would it directly consolidate?
  - ➢ M/s Sonia Ltd is exercising the control of voting power indirectly. Hence it can directly consolidate M/s Manmohan Ltd.

Case Study

- Raju Ltd acquired 60% equity in Satyam Ltd. on March 31, 2004. However due to control restrictions it could not consolidate the entity. But w.e.f April 1, 2008 all restrictions were removed. How should goodwill calculation be done?
  - ➢ As per para 22 of AS-21, " The result of operations of a subsidiary are included in CFS from the date on which the parent-subs relationship came into existence." Thus calculation of goodwill would be with reference to the date of and not with reference to the date on which the subsidiary came out of restriction.

Case Study

- Can gross amount of goodwill be netted off against gross amount of capital reserves in the case of a parent that has several subsidiaries some of which have given rise to goodwill whereas others have given rise to capital reserve on acquisition?
  - ➢ Gross amount of goodwill and capital reserves should be disclosed separately. Alternatively, they could be disclosed in the CFS balance sheet at the net amount and the respective gross amounts can be disclosed in the notes to the financial statements

Case Study

- A large group has several subsidiaries, associates and joint ventures. Whether transaction between (a) parent and subsidiary, (b) subsidiary and subsidiary, (c) parent and associate, (d) parent and joint venture, (e) associate and associate, (f) joint venture and joint venture, (g) associate and joint venture, (h) subsidiary and associate and (i) subsidiary and joint venture need to be eliminated in the CFS?

➢ With AS 21, intra-group transactions are required to be eliminated, i.e. between the parent and the subsidiary. AS 23 requires transactions between the investor (or its consolidated subsidiaries) and the associates should be eliminated to the extent of the investor's interest. AS 27 states that transactions between a venturer and the jointly controlled entity needs to be adjusted where CFS are prepared **….contd.**

Case Study (contd.)

- ➢ Transactions between subsidiary and subsidiary, subsidiary and associate, and subsidiary and joint venture would need intra-group adjustments
- ➢ Transactions between associate and another associate, joint venture entity and another joint venture entity and between associate and a joint venture entity should not be adjusted for intra-group effects

Case Study

- What is the impact on consolidation of cessation of parent subsidiary relationship due to sale or dilution of control below the consolidation threshold?
- ➢ The results of operations are included in the consolidated statement of profit and loss until the date of cessation of the relationship. The difference between the proceeds from the disposal of investment in a subsidiary and the carrying amount of its assets less liabilities as of the date of disposal is recognized in the consolidated statement of profit and loss as the profit or loss on the disposal of the investment in the subsidiary.

…contd.

Case Study (contd.)

Example:

P that follows financial year acquires S (75%) on April 1 whose total net asset is Rs. 80 for Rs. 100, thereby resulting in a goodwill of Rs. 40. S makes a profit of Rs. 5 upto end of September, at which point it is sold for Rs. 130. Assume subsidiary has not distributed any profits. A profit of Rs. 26.25 [130-(75%***85**)-40] would be recognised in the consolidated profit and loss account as profit on sale of investments in S. The six months profit of Rs. 3.75 [5*75%] will be recognised in the CFS as a profit from operations.

Case Study

- Where consolidation is performed for the first time, is it appropriate to charge / credit opening balance of reserves with the adjustments arising due to harmonising the accounting policies followed (to make them uniform for consolidation purposes), in respect of period up to the beginning of the year?

➢ On account of harmonization of the accounting policies, the resultant adjustments (attributable to earlier years) to the value of opening balances of net fixed assets may be adjusted in the opening balance of revenue reserves

Case Study

- In the first CFS, how should unrealised profits / losses arising from intra-group transactions of earlier years be adjusted?
  - ➢ In the case of unrealized profits / losses arising from intra-group transactions of earlier years, such profits / losses should be adjusted against opening balance of reserves and in the case of inadequacy of reserves, to the accumulated losses.

Case Study

- What would be the accounting treatment if the contractual arrangement ceases to apply to the venturers, but the venturers continue to operate in the same manner?

➢ It is the existence of a contractual arrangement that determines whether or not an investment by an enterprise is in the nature of an investment in a JV. Accordingly, in the absence of a contractual arrangement, it may not be appropriate to consider an investee as a JV.

Case Study

- How should venture capitalists and financial institutions account for their investments in JV?

➢ According to circumstances but the investor's relationship to its investment tends to be that of a portfolio investor. In these circumstances, for consistency, such investment is accounted for as an investment according to the method of accounting applied to other investments within that investment portfolio rather than as a JV, even if the investor has joint control.

Case Study

- Whether proportionate consolidation is required for investment in an entity which was a JV for a part of the year (sold off during the year)?

➢ AS 27 requires discontinuance of the use of proportionate consolidation when the venture ceases to have joint control but retains its interest in the entity either in whole or in part. Therefore proportionate consolidation of the profit and loss account for part of the year would be required, ie proportionate consolidation would be required till the time the entity was a JV. The question of proportionate consolidation of the balance sheet does not arise, since at the balance sheet date, there was no joint ownership

Case Study

- A public sector corporation owned by the Central Government is incorporated under the Companies Act, 1956, and has several subsidiaries. The company has offered, on private placement basis, to the Government of India, guaranteed redeemable non-convertible OTS tax free bonds in the nature of debentures which are listed in BSE. Since the shares are unlisted, whether the company would need to prepare CFS and get them audited?

➢ As per SEBI Guidelines, a public company which has any of its securities listed on any recognised stock exchange is a listed company. Further as per clause 32 of the listing agreement, it is mandatory for the CFS to be audited by the statutory auditors of the company and the same should be filed with the Stock Exchange

Case Study

- Dinesh Paper Ltd is controlled by two enterprise, one controls by virtue of ownership of majority of the voting power and the other controls, by virtue of an agreement. The composition of the board of directors so as to obtain economic benefits from its activities. Who should consolidate Dinesh Paper Ltd?

➢ In such rare cases both the controlling enterprise should consolidate the financial statements of Dinesh Paper Ltd. ASI 24 states that the first mentioned enterprise will be considered as subsidiary of both the controlling enterprises within the meaning of AS 21 and therefore, both the enterprises should consolidate the financial statements of the enterprise as per the requirements of AS 21.

Case Study

- Where FS of any of the subsidiaries being consolidated are of a different reporting date, AS 21 requires to make adjustments for significant transaction. Which type of transactions should be considered as significant transactions?

  i.e. whether significance is to be analysed: at transaction level or at line items of CFS level (eg. change in assets/liability/turnover/profit) during the intervening period, or at line items of separate financial statements of subsidiary level.

- ➢ Any significant change at the line item of CFS level may be considered as significant transaction. In case a transaction gets caught up for being included under this definition, all aspects relevant to that particular transaction should be so include, for example. In case of sales, adjustments may be required for sales, cost of sales inventory, unrealized gains, inter group balances, debtors etc.

Thank you…