Refresher Course on Accounting Standards (AS) - Case studies and Practical matters

AS - 21 “Consolidated Financial Statements”

AS - 23 “Accounting for Investments in Associates in Consolidated Financial Statements”

AS - 27 “Financial Reporting of Interests in Joint Venture”

Presented for WIRC

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CA AMIT HUNDIA

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% of Holding of Investments by a Company in an Enterprise and its implications:

a) Between 0 and 20% - Generally not considered for consolidation – As no influence or control is demonstrated.

b) Higher than 20% but less than 50% - Generally considered as an Associate for the purpose of Consolidation – As it is considered that influence can be made.

c) Higher than 50% - Generally considered as a Subsidiary for the purpose of Consolidation.

   Accounted as per AS-21 “Consolidated Financial Statements” by following line by line consolidation.

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Relevant Concepts:

1. Line by Line Consolidation – AS 21.

2. Equity accounting – One line consolidation – AS 23.

3. Proportionate consolidation – AS 27.

4. No existence of control, significant influence or joint control, then accounted simply as an investment in the books of acquirer as per the requirement of AS – 13.

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Question 1:

In case if a Company holds investment in any other Enterprise, then whether Consolidation is Mandatory in case of Unlisted Companies, if the required parameters are triggered?

Answer:

Yes, as per the provisions of section 129 of Companies Act, 2013, consolidation is mandatory for all the Companies.

Question 2:

Where an enterprise, which does not have a subsidiary but has an associate and / or a joint venture, whether such an enterprise is required to carry out the consolidation?

Answer:

Yes, as per paragraph 9 of AS – 21 (revised), even in such circumstance's consolidation will be mandatory and it should prepare the consolidated financial statements in accordance with AS – 23 and AS – 27 respectively.

Question 3:

Whether consolidation is required only of Companies or non corporate entities should also be considered for consolidation?

Answer:

Yes, entities other than Companies such as Partnership Firm, LLP, Trust etc.. should also be considered for consolidation, as AS – 21 deals with the concept of “enterprises” and enterprises will cover non corporate entities also.

Question 4:

Whether group covers Associate and Joint Ventures?

Answer:

No, As per AS – 21, group covers only parent and its subsidiaries. Associate and Joint Ventures are not captured in this definition.

Question 5:

Is there any exemption from carrying out the consolidation?

Answer:

Yes, Rule 6 of Companies Account Rules, 2016 provides exemption from carrying out the consolidation in certain scenarios. It states as :

Nothing in this rule shall apply in respect of preparation of consolidated financial statements by a company if it meets the following conditions:-

(i) it is a wholly-owned subsidiary, or is a partially-owned subsidiary of another company and all its other members, including those not otherwise entitled to vote, having been intimated in writing and for which the proof of delivery of such intimation is available with the company, do not object to the company not presenting consolidated financial statements;

(ii) it is a company whose securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India; and

(iii) its ultimate or any intermediate holding company files consolidated financial statements with the Registrar which are in compliance with the applicable Accounting Standards.

Question 6:

Whether an LLP or a Partnership firm holding 60 % voting power in a Company should carry out the consolidation for the investment it has made in it?

Answer:

Example 1: ABC LLP holds 60% equity shares of PQR Ltd. And PQR Ltd. 90% equity shares of XYZ Ltd.

Here in this scenario, consolidation will be mandatory for PQR Ltd. But it won’t be mandatory for ABC LLP, as the provisions of Companies Act, 2013 are applicable only to Companies and not all Enterprises.

Further, AS – 21 prescribes the manner of consolidation. It does not state to whom it will be applicable. It only states, whenever consolidation is carried out, principles prescribed in AS 21 should be followed.

Question 7:

Whether potential equity shares i.e. compulsorily convertible debentures, compulsorily convertible preference shares etc.. should be considered for determining control?

Answer:

No, potential equity shares will not be considered for the purpose of determination of control.

Question 8:

Whether comparatives figures are required to be given in the CFS?

Answer:

First time consolidation does not require comparative figures. In Subsequent years it will be required.

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Example 2:

ABC Ltd. hold 60% voting power in PQR Ltd. Whereas XYZ Ltd. hold 25% in PQR Ltd. but by virtue of an agreement it holds the composition of board of directors so as to obtain economic benefits from its activities.

How PQR Ltd. will be considered in the CFS of ABC Ltd. and XYZ Ltd.?

Answer:

This is a rare case, where PQR Ltd. will be considered as a subsidiary in the CFS of ABC Ltd. and XYZ Ltd.

During this kind of peculiar situation, AS permits an entity to be considered as a subsidiary simultaneously in the books of two enterprises.

Question 9:

How to consider an enterprise such as Partnership Firm or LLP for the purpose of consolidation, who can follow cash basis of accounting, follows it, whereas a Company does not have the option to follow cash basis of accounting?

Hence there are two different types of accounting – Company follows mercantile basis and its subsidiary follows cash basis.

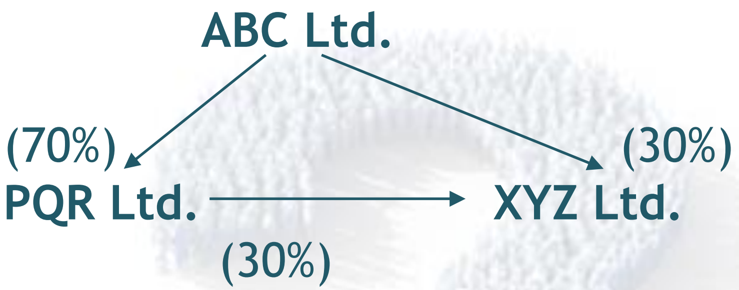
Answer:

CFS of the Company is required to be prepared on mercantile basis. Hence, FS of Partnership firm or LLP is required to be converted into mercantile basis for the purpose of CFS.

However, if it is not practicable to prepare the CFS by making appropriate adjustments to the FS of such enterprises for the purpose of consolidation, a disclosure of the fact should be made with the disclosure of proportions of the items in the CFS in respect of which different accounting policies have been applied (EAC volume XXI Query 39).

Example 3:

Consolidation when direct ownership is less than 51%



Whether XYZ Ltd. will be accounted as a subsidiary or as an associate in the CFS of ABC Ltd.

Answer:

XYZ Ltd. will be accounted as a subsidiary in the CFS of ABC Ltd.

ABC Ltd. holds 21% (70% * 30%) through PQR in XYZ and directly holds 30% in XYZ. Hence its total holding is of 51%.

Question 10:

Can a subsidiary be excluded from consolidation?

Answer:

Yes, in certain scenarios, a subsidiary can be excluded from consolidation. They are:

A subsidiary should be excluded from consolidation when:

(a) control is **intended to be temporary** because the subsidiary **is acquired and held exclusively with a view to its subsequent disposal in the near future**; or

(b) it operates under severe long-term restrictions which significantly impair its ability to transfer funds to the parent.

AS states that "ordinarily, the meaning of the words 'near future' should be considered as not more than twelve months from acquisition of relevant investments unless a longer period can be justified on the basis of facts and circumstances of the case".

Question 11:

What should be the date from which a subsidiary should be consolidated, after it comes out of the exception rule prescribed in AS – 21.

E.X. Investments in DEF Ltd. was made by HIG Ltd. on 1/1/2018. However, it was acquired with an intent to dispose of in next 12 months and hence, it was not considered for consolidation on 31/3/2018. Now, on 31/10/2018, HIG Ltd. has decided to hold this investments for a long-term purpose. From which date the computation of Goodwill / Capital Reserve should be done?

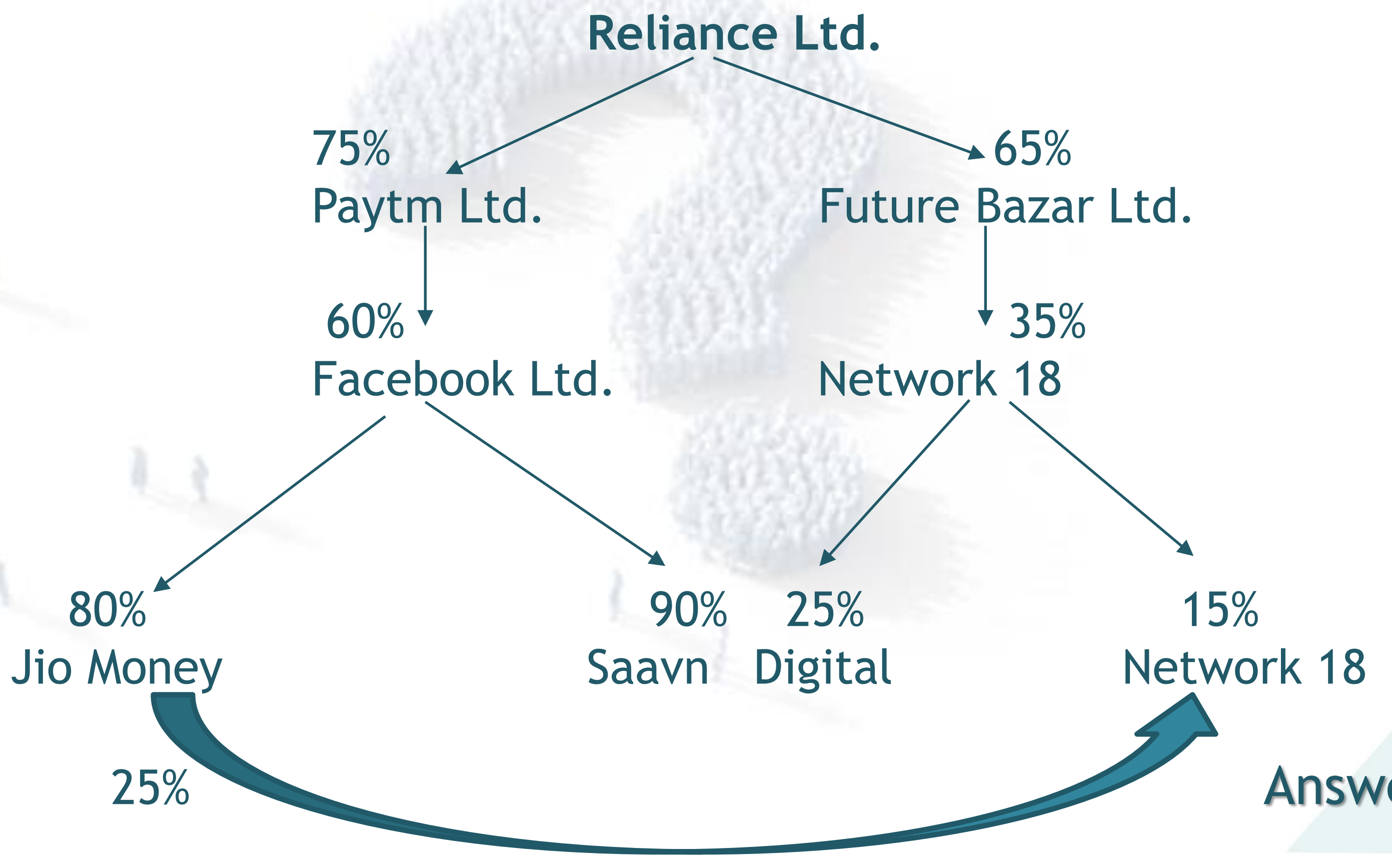
Answer:

Para 22 of As 21 states that "The results of operations of a subsidiary are included in the consolidated financial statements as from the date on which parent-subsidiary relationship came in existence".

Hence, in this case, the computation will be done as on 1/1/2018 and not as on 31/10/2018.

Question 12: Example 4:

Whether all investments which are made by the Parent Company or its subsidiaries, associates or Joint Venture are required to be evaluated for the purpose of preparing CFS?



Answer: Yes, this is called chain holding.

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Question 13:

Whether consolidation of subsidiary is required in case full provision for diminution has already been made in the books of standalone FS of Parent Company?

Answer:

Yes, even in such situation consolidation will be required and any assets of subsidiary Company reflecting in the CFS should be impaired in CFS.

Question 14:

Whether accounting policies of all the enterprises considered for CFS should be uniform?

Answer:

Yes, it is unless and until it is impracticable. In such case, that fact should be disclosed together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.

Question 15:

For the purpose of determination of Goodwill / Capital Reserve, whether it should be seen that uniform accounting policies are followed in the books of subsidiaries?

Answer:

Para 14 of AS 21 states that: The parent's portion of equity in a subsidiary, at the date on which investment is made, is determined on the basis of information contained in the financial statements of the subsidiary as on the date of investment.

Hence, it does not state about the alignment of uniform accounting policies.

Question 16:

Whether Goodwill and Capital Reserve arising on account of different subsidiaries should be presented separately or should be netted of?

Answer:

Gross amount of Goodwill and Capital Reserves should be disclosed separately in CFS.

Alternatively, as per the Guidance Note on Consolidation issued by ICAI, net amount can be shown in the CFS and the respective gross amounts can be disclosed in the notes to the financial statements.

Question 17:

Whether Goodwill arising on consolidation can be amortized?

Answer:

Goodwill on consolidation can not be amortized but it can be tested for impairment.

Question 18:

Minority interest (MI) should be presented where?

Answer:

It should be presented separately in the CFS i.e. it should be separate from Equity and Liabilities. Even MI in the income of the group should also be separately presented.

Question 19:

Whether minority interest can have a debit balance?

Answer:

Yes, generally MI bears the loss to the extent of its investment. However, it may have to bear the loss if it has a binding obligation to do so and is able to make good the losses.

Question 20:

If MI of one subsidiary is having credit balance and another subsidiary is having debit balance, can it be netted of and presented accordingly in CFS?

Answer:

No. MI of each subsidiary is separate and it can not be clubbed together.

Question 21:

In CFS, whether Deferred Tax Assets of Foreign subsidiaries can be netted of with Deferred Tax Liabilities of Indian subsidiaries?

Answer:

No. Para 28 of AS – 22 "Accounting for taxes on income" state that "An enterprise will normally have a legally enforceable right to set off an asset and liability representing current tax **when they relate to income taxes levied under the same governing taxation laws and the taxation laws permit the enterprise to make or receive a single net payment**".

Question 22:

In some exceptional cases, an enterprise by a contractual arrangement establishes joint control over an entity which is a subsidiary of that enterprise within the meaning of Accounting Standard (AS) 21,Consolidated Financial Statements. In such cases, should the enterprise be consolidated as a subsidiary under AS 21 by the said enterprise or treated as a joint venture?

Answer:

As per paragraph 6 of AS-27, in such cases, the entity is consolidated under AS 21 by the said enterprise, and is not treated as a joint venture. The consolidation of such an entity does not necessarily preclude other venture (s) treating such an entity as a joint venture.

E.x. 5: ABC Ltd. enters into a JV agreement with XYZ Ltd. and they both holds 60% and 40% stake respectively in IRR Ltd.

In this scenario, even though there is a JV agreement, ABC Ltd. will consider IRR Ltd. as a subsidiary for the purpose of its CFS and XYZ Ltd. will consider it as a JV for the purpose of its CFS.

Question 23:

How profits for Parent will be computed in case a subsidiary has outstanding cumulative preference shares which are held outside the group, where dividends have not been declared by the subsidiary?

Answer:

Para 27 of AS 21 state that “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 have been declared”.

Question 24:

Whether unrealized losses should be eliminated in case of inter-group transactions?

Answer:

Unrealized losses are not eliminated unless the costs can be recovered by following the principles of conservative concept.

Question 25:

Whether elimination effect of unrealized profit / losses arises in the same manner in CFS when the transaction happens in upstream (subsidiary to holding) or downstream (holding to subsidiary) mode?

Answer:

The elimination effect is different in both the cases. In downstream circumstances, the entire adjustment is made against parents interest, whereas in an upstream circumstance, the adjustment is allocated between the majority and minority shareholders.

Question 26:

Can the financials be of different dates for the purpose of consolidation?

Answer:

Financial statement should be of the same reporting date. However, on account of practical difficulties, exception is given, wherein the difference in reporting date should not be of more than 6 months.

Question 27:

Foreign subsidiaries having different GAAP i.e. IFRS or another local GAAP, then how such subsidiaries should be considered for the purpose of consolidation?

Answer:

Such subsidiaries financials should be first converted into IGAAP and then such FS should be considered for the purpose of CFS.

Question 28:

At what rate the P & L items and Assets & Liabilities of foreign subsidiary should be translated?

Answer:

As per AS – 11, it will fall under the category of non integral operations and hence its P&L items should be translated at average rate of the period and assets & liabilities will be translated at closing rate. Equity share capital will be transferred at the historical rate.

Question 29:

Whether in CFS transactions should be eliminated between?

(A) Parent & Subsidiary.
(B) Subsidiary & Subsidiary.
(C) Parent & Associate.
(D) Parent & Joint Venture.
(E) Associate & Associate.
(F) Joint Venture & Joint Venture.
(G) Associate & Joint Venture.
(H) Subsidiary & Associate.
(I) Subsidiary & Joint Venture.

Answer:

A group in AS 21 is defined as Parent and all its subsidiaries.

As 21 state intra-group transactions are required to be eliminated.

Paragraph 13 of AS 23 requires transactions between the investor (or its consolidated subsidiaries) and the associate should be eliminated to the extent of the investor's interest.

As per AS 27, transactions between a venture and the jointly controlled entity needs to be adjusted where CFS are prepared. Paragraph 45 state that the venturer recognizes in CFS only that portion of gain or loss which is attributable to the interest of other venturers.

Hence transactions between following parties will be adjusted:
(A), (B), (C), (D), (H), (I).

And transactions between following parties will not be adjusted:
(E), (F), (G).

Example 5:

BOT Ltd. sells the investments it held in subsidiary PPP Ltd., on 30/05/19. Whether PPP Ltd. will be required to be considered in consolidation of BOT Ltd. as on 31/03/20, presuming BOT Ltd. has other subsidiaries for the purpose of its CFS?

Answer:

Yes, till the time parent subsidiary relationship was there, BOT Ltd. will be required to include the figures of PPP Ltd. in its CFS i.e. its CFS will comprises P&L figures of PPP Ltd. whereas the CFS Balance Sheet will not include any figure of PPP Ltd.

Question 30:

How accounting should be done when a subsidiary gets converted into associate or vice-versa on account of partial disposal or partial acquisition of equity shares?

Answer:

Such investments will be accounted in CFS as per there respective relationship till the date of its holding.

Question 31:

Whether all the notes appearing in the separate financial statements of the parent enterprise and its subsidiaries should be included in the notes to the consolidated financial statements?

Answer:

As per the requirement of AS:

All the notes appearing in the separate financial statements of the parent enterprise and its subsidiaries **need not be included** in the notes to the consolidated financial statements. For preparing consolidated financial statements, the following principles should be observed in respect of notes and other explanatory material that form an integral part thereof:

(a) Notes which are necessary for presenting a true and fair view of the consolidated financial statements should be included in the consolidated financial statements as an integral part thereof.

(b) Only the notes involving items which are material need to be disclosed. Materiality for this purpose should be assessed in relation to the information contained in consolidated financial statements. In view of this, it is possible that certain notes which are disclosed in separate financial statements of a parent or a subsidiary would not be required to be disclosed in the consolidated financial statements when the test of materiality is applied in the context of consolidated financial statements.

(c) Additional statutory information disclosed in separate financial statements of the subsidiary and/or a parent having no bearing on the true and fair view of the consolidated financial statements need not be disclosed in the consolidated financial statements.

For e.x.:

(i) Source from which bonus shares are issued, e.g., capitalisation of profits or Reserves or from Share Premium Account.

(ii) Disclosure of all unutilised monies out of the issue indicating the form in which such unutilised funds have been invested etc…

Question 32:

If consolidated financial statements are not prepared how investments in associates are accounted?

Answer

AS 23 shall not be applicable. Thus AS-13, "Accounting of Investments" shall be applicable. Accordingly such investments shall be initially carried at cost.

Question 33:

Whether loss of an associate can exceed the cost of investment in an associate?

Answer:

If an investor's share of losses of an associate equals or exceeds the carrying amount of the investment, the investor ordinarily discontinues recognizing its share of further losses and the investment is reported at nil value. Additional losses are provided for to the extent that the investor has incurred obligations or made payments on behalf of the associate to satisfy obligations of the associate that the investor has guaranteed or to which the investor is otherwise committed.

Question 34:

What should be the manner of disclosure of the parent's / venturer's share in the post acquisition reserves of a subsidiary/jointly controlled entity in the consolidated balance sheet?

Answer:

As per the requirement of AS :

The parent's share in the post-acquisition reserves of a subsidiary, forming part of the corresponding reserves in the consolidated balance sheet, is not required to be disclosed separately in the consolidated balance sheet.

While applying proportionate consolidation method, the venturer's share in the post-acquisition reserves of the jointly controlled entity should be shown separately under the relevant reserves in the consolidated financial statements.

Question 35:

Is Joint Venture Agreement required to be in Writing?

Answer:

Paragraph 7 of AS – 27 states that:

Whatever its form, the contractual arrangement is normally in writing and deals with such matters as:

(a) the activity, duration and reporting obligations of the joint venture;

(b) the appointment of the board of directors or equivalent governing body of the joint venture and the voting rights of the venturers;

(c) capital contributions by the venturers; and

(d) the sharing by the venturers of the output, income, expenses or results of the joint venture.

Question 36:

While consolidating jointly controlled entity, are contingent liabilities fully picked up or only a proportionate share is picked up?

Answer:

A venturer should disclose the aggregate amount of the following 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; and

• those contingent liabilities that arise because the venturer is contingently liable for the liabilities of the other venturers of a joint venture.

Question 37:

Whether any separate and specific disclosure is required to be given in the separate financial statement of a venturer i.e. in standalone financial statement?

Answer:

Yes, para 50 of AS 27 requires a separate disclosure to be given in respect of Joint Venture Activities in the standalone financial statement of the venturer, in addition to consolidated financial statement.

It states, disclosure should be given as per para 51,52 and 53 in separate financial statement also i.e.

a) Disclosure about contingent liability
b) Disclosure about capital commitment
c) List of all J.V. and description of interest in significant J.V.
d) In respect of JCE, proportion of ownership interest, name and country of incorporation or residence.

Question raised by Participants:

1. How dividend distribution tax is to be treated in consolidated financial statement when both holding and subsidiary company declares dividend and holding company is allowed set off of dividend received from subsidiary company as per Income Tax Act?

Answer:

DDT has been abolished now, hence this question will not be relevant.

2. Further AS-21 and AS-23 requires that if subsidiary has outstanding Cumulative preference share held outside the group, parent to compute its share of profit or losses after adjusting for subsidiary's preference dividend, whether or not dividend declares. Treatment to be given for DDT?

Answer:

As DDT has been abolished now, this will not be relevant. Otherwise, yes impact of DDT would also have been considered.

3. Academically adjustment of unrealised gain or loss is done in minority share. How practical is this? Whether in real scenario, effect of unrealised gain or loss is given while computing minority interest?

Answer:

Yes, it is practical and the effect is being given.

4. Y Ltd (SPV) is a wholly owned company of X Ltd. Y Ltd has sub contracted the entire project as EPC contract to X Ltd. In the books of X Ltd there is sales to Y Ltd, whereas in the books of Y Ltd. it is PPE/CWIP. How should the elimination of inter-company transactions be done while preparing Consolidated Financial Statements of X Ltd.

Answer:

In earlier slides, inter company elimination have been discussed i.e. upstream and downstream. It should be done on similar lines. Further, the profit element should be removed from the cost of PPE / CWIP and then reworked depreciation should be provided in CFS.

5. **A Ltd is holding 10% in B Ltd and majority shareholders of A Ltd hold 30% in B Ltd. There are no common directors in both the company, whether it can be said that A ltd has significant influence on B Ltd and it needs to consolidate as B Ltd as their associate company?**

Answer:

No, A ltd. does not exercise significant influence in its capacity. Its shareholders are exercising in their individual capacity. Hence, B ltd. won't be treated as an associate of A ltd.

Disclaimer:

This write up is illustrative in nature and has been made with utmost cautiousness. However, reader of this write up has to exercise its own diligence and the organization or any of its member will not be responsible for any act carried out / not carried out, on account of this write up.

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