PVG

PinnValor Group

Preperation of Consolidated Financial Statements

A Guide on Business Combinations Concerned Financial Reporting

Kick-off

PVG has undertaken a comprehensive study on the **preparation of Consolidated Financial Statements** based on **IND AS 110, IND AS 103, and Schedule 3,** with a focus on **real-life case studies, and industry best practices.** This guide presents detailed methodologies for the preparation of consolidated financial statements, specifically addressing **the nuances and complex accounting treatments involved in acquisitions from known non-controlling shareholders, mergers through slump sale and common control transactions, and business combinations.**

However, it's important to note that the results and approaches in this guide should be adapted **based on the specifics of each business scenario,** as every consolidation process may have its unique complexities.

We would appreciate any feedback you may have on this guide, or if you would like to connect with our team of Accounting & Reporting Advisory for further insights or assistance.

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Comprehensive Study on Preparation of Consolidated Financial Statements (CFS) under Ind AS

1. Introduction

Consolidated Financial Statements (CFS) present the **financial position, performance, and cash flows** of a **parent and its subsidiaries** along with **associates** as if they were a single economic entity. This enables stakeholders to understand the overall financial health of the group.

CFS eliminate intra-group transactions and balances and present only the group's transactions with external parties.

2. Applicable Accounting Standards and Legal Framework

a) Ind AS 110 – Consolidated Financial Statements

- Provides the principles for **presentation** and **preparation** of **CFS**.
- Defines the concept of control and sets out how to account for subsidiaries.

  Key clause: As per Para 4 of Ind AS 110, a parent must present consolidated financial statements when it controls one or more entities.

b) Ind AS 103 – Business Combinations

- Applies to the **acquisition** of **subsidiaries**, and mandates the **acquisition method**.
- Outlines how to identify the acquirer, measure goodwill, and recognise net assets.

c) Schedule III of the Companies Act, 2013

- Prescribes the **format** for **financial statements**.
- Requires separate sections for CFS presentation including Balance Sheet, Statement of Profit and Loss, Statement of Changes in Equity, Cash Flow Statement, and detailed Notes to Accounts.

3. Concept of Control under Ind AS 110

An entity controls another when it meets **all three** of the following criteria (Para 7 of Ind AS 110):

1. **Power** over the investee (e.g., voting rights, governing body control)
2. **Exposure to variable returns**
3. **Ability to use power to affect returns**

Control may exist even without majority shareholding, through **contractual arrangements, structured entities, or board control.**

Comprehensive Study on Preparation of Consolidated Financial Statements (CFS) under Ind AS

4. Who is Exempt from Presenting CFS?

According to Para 4 of Ind AS 110, a **parent need not present consolidated financial statements** if:

- It is **itself a wholly-owned** or **partially-owned subsidiary**, and **all owners agree to not require CFS.**
- It is **not publicly traded** or in the process of issuing securities.
- Its **ultimate or intermediate parent prepares CFS** that comply with Ind AS.

5. Steps to Prepare Consolidated Financial Statements

Step 1: Identify the Parent and its Subsidiaries

Determine the entities over which the parent exercises control under Ind AS 110.

Step 2: Ensure Uniform Accounting Policies and Reporting Periods

As per Para 19, the financial statements of all group entities must follow **uniform accounting policies**. If the reporting dates differ, adjust for significant transactions within a maximum difference of three months (Para B92).

Step 3: Apply the Acquisition Method (as per Ind AS 103)

- **Identify** the acquirer and the acquisition date.
- **Measure** and **recognise** the net identifiable assets and liabilities of the subsidiary at **fair value**.
- Compute **Goodwill** or **Capital Reserve**.

Goodwill = Consideration Transferred + NCI + Fair value of previous interest – Net assets acquired

Step 4: Combine Financial Statements Line-by-Line

Add all corresponding items of assets, liabilities, income, and expenses of the parent and subsidiaries.

Step 5: Eliminate Intra-group Transactions and Balances

This **includes**:

- Intercompany **receivables/payables**
- Intercompany **sales** and **purchases**
- **Dividends** between group entities
- **Unrealised profits** from intra-group transactions

5. Steps to Prepare Consolidated Financial Statements (Continued)

Step 6: Recognise and Present Non-Controlling Interest (NCI)

NCI is measured at either:

- **Fair value**, or
- **Proportionate share of the net assets**

NCI is **shown separately** in the equity section of the **balance sheet** and the profit or loss attributable to NCI is presented separately in the statement of **profit and loss.**

Step 7: Disclosures as per Ind AS 110 and Schedule III

Mandatory disclosures include:

- **List** of **subsidiaries** and percentage of holdings
- **Basis** of **consolidation**
- **Details** of **NCI**
- **Goodwill** or **Capital Reserve**
- **Transactions** with NCI

6. Accounting Adjustments in CFS

Adjustment Area	Treatment
Intra-group sales/purchases	Eliminated from revenue and cost
Unrealised profits in inventory/PPE	Eliminate and adjust carrying amount
Intercompany balances	Knocked off
Dividends from subsidiary	Eliminated from income and retained earnings
Foreign subsidiaries	Translate as per Ind AS 21 (closing rate for B/S, average for P&L)
Deferred tax impact	Recognised per Ind AS 12 on fair value adjustments

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7. Schedule III Presentation of CFS

The format is similar to standalone financial statements but includes:

- **Consolidated Balance Sheet**
- **Consolidated Statement of Profit and Loss**
- **Statement of Changes in Equity**
- **Consolidated Cash Flow Statement**
- **Detailed Notes to Consolidated Accounts**

All figures are **post-elimination** and adjusted for goodwill, NCI, and other group effects.

8. Common Mistakes and How to Avoid Them

Common Mistake	Impact
Failing to eliminate intercompany balances	Overstated assets/liabilities
Incorrect NCI computation	Misstatement of equity and profit
Not recognising goodwill properly	Misstated intangible assets
Ignoring deferred tax implications	Non-compliance with Ind AS 12
Not aligning accounting policies	Inaccurate representation of consolidated financials

9. Real-Life Example: Infosys Ltd (FY 2022-23)

Infosys Ltd is a listed Indian company with numerous subsidiaries, including Infosys BPM and various foreign entities.

Key CFS insights from their Annual Report:

- **Goodwill** arising from acquisitions like WongDoody is separately disclosed.
- The group has **eliminated** intra-group revenue (over ₹300 crore).
- **NCI** is presented separately in both the balance sheet and the profit & loss.
- The **foreign subsidiaries'** financials are converted as per Ind AS 21.
- Financials are presented in **Schedule III format** with detailed disclosures.

Comprehensive Study on Preparation of Consolidated Financial Statements (CFS) under Ind AS

10. Final Checklist Before Finalising CFS

- **Group structure** and **control** identified
- **Accounting policies** aligned across entities
- **Intra-group balances** and **transactions** eliminated
- **NCI** and **Goodwill** correctly computed and disclosed
- **Schedule III formats** applied
- Required **disclosures** as per Ind AS 110 and Schedule III made

Advanced Live Illustration: Consolidated Financial Statements (Ind AS 110 + Ind AS 103 + Ind AS 28)

1. Group Structure

Parent: Alpha Ltd

Subsidiary: Beta Ltd (80% held by Alpha Ltd)

Step Subsidiary: Gamma Ltd (60% held by Beta Ltd)

Associate: Delta Ltd (Alpha Ltd holds 30%)

Sister Concern: Theta Ltd (controlled by the same individual shareholder, no consolidation under Ind AS 110)

2. Acquisition Details

- Alpha Ltd acquired **80% of Beta Ltd** on **1st April 2023** for ₹16,00,000
- On that date, Beta Ltd held **60% of Gamma Ltd** (acquired earlier)
- Alpha Ltd acquired **30% of Delta Ltd** (associate) for ₹6,00,000 on the same date
- The reporting period of Gamma Ltd is 31st December; others are 31st March

Advanced Live Illustration: Consolidated Financial Statements (Ind AS 110 + Ind AS 103 + Ind AS 28)

3. Net Assets at Acquisition (on 1st April 2023)

Beta Ltd

- Share Capital: ₹10,00,000
- Reserves: ₹4,00,000

Net Assets = ₹14,00,000

Gamma Ltd

- Share Capital: ₹6,00,000
- Reserves: ₹2,00,000

Net Assets = ₹8,00,000

60% of ₹8,00,000 = ₹4,80,000 → included in **Beta's value**

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4. Post-Acquisition Changes (till 31st March 2024)

Company	Profit (₹)	Dividend Paid (₹)	Unrealised Profit in Inventory (₹)
Beta Ltd	3,00,000	1,00,000	30,000 (goods sold to Gamma Ltd)
Gamma Ltd	2,00,000	Nil	-
Delta Ltd	4,00,000	2,00,000	-

5. Adjustments for Time Period Differences

- Gamma Ltd's statements as of 31 Dec 2023 are used. No material transactions between Jan–Mar 2024. Thus, ***no adjustment* required** (Para B92 of Ind AS 110).

Advanced Live Illustration: Consolidated Financial Statements (Ind AS 110 + Ind AS 103 + Ind AS 28)

6. Consolidation Process

Step 1: Goodwill on Acquisition – Beta Ltd

Particulars	Amount (₹)
Consideration Transferred	16,00,000
NCI (20% of ₹14,00,000)	2,80,000
Total Value	18,80,000
Net Assets of Beta Ltd	14,00,000
Goodwill	**4,80,000**

Step 2: Share of Net Assets – Gamma Ltd (Step Subsidiary)

Beta owns 60%, Alpha owns 80% of Beta → **Alpha's indirect interest = 48%**

Gamma's profit = ₹2,00,000
→ 48% × ₹2,00,000 = ₹96,000 attributed to Alpha

Beta's share = 60% × ₹2,00,000 = ₹1,20,000
NCI in Gamma = 40% × ₹2,00,000 = ₹80,000

Step 3: Investment in Associate (Delta Ltd) – Equity Method (Ind AS 28)

Particulars	Amount (₹)
Investment Cost	6,00,000
Share in Profit (30% of ₹4,00,000)	1,20,000
Less: Dividend received (30% of ₹2,00,000)	60,000
Carrying Amount in CFS	**6,60,000**

Note: Dividend is **not income** under equity method. It reduces the carrying value.

Step 4: Unrealised Profit Elimination

Goods sold by Beta to Gamma – **unrealised profit** ₹30,000
→ **Adjust Gamma's closing inventory** and **Beta's retained earnings**

Since Alpha's indirect interest = 48%, 48% × ₹30,000 = ₹14,400 eliminated from group profits

Advanced Live Illustration: Consolidated Financial Statements (Ind AS 110 + Ind AS 103 + Ind AS 28)

6. Consolidation Process (Continued)

Step 5: Non-Controlling Interest (NCI)

a) In Beta Ltd

Particulars	Amount (₹)
At Acquisition	2,80,000
Share in Profit (20% of ₹3,00,000)	60,000
Total NCI in Beta	3,40,000

b) In Gamma Ltd

Particulars	Amount (₹)
Share in Profit (40% of ₹2,00,000)	80,000
Total NCI in Gamma	80,000

7. Group Reserves

Description	Amount (₹)
Alpha Ltd own reserves	6,00,000
Add: Share in Beta's profit (80% of ₹3,00,000)	2,40,000
Add: Share in Gamma's profit (48%)	96,000
Less: Unrealised profit in Gamma's inventory	(14,400)
Add: Share in Delta (associate)	1,20,000
Total Reserves	**10,41,600**

Advanced Live Illustration: Consolidated Financial Statements (Ind AS 110 + Ind AS 103 + Ind AS 28)

8. Consolidated Balance Sheet (Extract)

A. Equity and Liabilities

Particulars	Amount (₹)
Equity Share Capital (Alpha Ltd)	20,00,000
Reserves and Surplus	10,41,600
Non-Controlling Interest (Beta + Gamma)	4,20,000
Current & Non-current Liabilities	5,80,000
Total	**40,41,600**

B. Assets

Particulars	Amount (₹)
Fixed Assets (all group companies)	18,00,000
Inventory (adjusted)	6,70,000
Trade Receivables (adjusted)	7,00,000
Cash and Bank	2,11,600
Investment in Associate (Delta Ltd)	6,60,000
Goodwill (Beta Ltd)	4,80,000
Total	**40,41,600**

9. Final Notes

- **Sister Concern** (Theta Ltd) is **not consolidated,** as there's no control under Ind AS 110.
- **Associate** (Delta Ltd) is **accounted** using the **equity method** per Ind AS 28.
- **Step Subsidiary** (Gamma Ltd) is consolidated as per **Ind AS 110**, with indirect holding calculations.
- **Reporting period** difference for Gamma is **within 3 months** and **immaterial**, hence **no adjustment** needed.
- **Intra-group profits** and **mutual balances** have been **eliminated.**
- **Dividend** from **associate** is adjusted in carrying amount, **not routed** through **P&L.**

Non-Compliance Metrics in Consolidated Financial Statements:

A Critical Insight for CEOs and CFOs

- In the ever-evolving landscape of financial reporting, ensuring compliance with **IFRS** and **IND AS** during the **preparation** of **consolidated financial statements** is **non-negotiable**. Non compliance can **expose** companies to **significant regulatory actions**, **reputational damage**, and a **loss** of **investor confidence**. Below, we explore a few key real-life instances where non compliance in consolidation has led to regulatory scrutiny. These cases underline the critical need for meticulous attention to **accounting practices**, **internal controls**, and **transparency**.

1. Satyam Computer Services Ltd. (2009)

- **Issue:**

The Satyam scandal is one of the most infamous cases in India, where the company admitted to inflating its financial statements by over ₹7,000 crore. This included fictitious revenue and assets, which directly impacted the accuracy of its consolidated financial statements.

- **Regulatory Action:**

o The case highlighted significant lapses in the verification and cross-checking processes during consolidation, emphasizing the importance of robust internal controls and transparent reporting.

2. General Electric (GE) - 2009 - Financial Restatements

- **Issue:**

General Electric (GE) was found to have failed to properly account for off-balance sheet entities and joint ventures. GE's consolidated financial statements were misleading due to improper accounting of lease obligations and other subsidiary interests.

- **Regulatory Action:**

o The SEC's scrutiny emphasized the need for transparency and the accurate reporting of financial interests in subsidiaries, joint ventures, and other associated entities within consolidated financial statements.

3. Volkswagen (2015)

- **Issue:**

The Volkswagen emissions scandal revealed significant flaws in the company's financial reporting, particularly in the recognition of liabilities for environmental fines, penalties, and legal settlements. These liabilities were not properly consolidated, leading to inaccurate financial reporting.

- **Regulatory Action:**

o The case underlined the importance of timely recognition of contingent liabilities, especially when they arise from legal or regulatory issues, within the consolidated financial statements.

4. Tesla (2020)

- **Issue:**

Tesla's treatment of stock-based compensation and the potential dilution of shares were not clearly disclosed in its consolidated financial statements. This raised questions regarding how stock options were accounted for and how they affected the company's overall financial health.

- **Regulatory Action:**

o This case emphasized the need for accurate and transparent disclosure of stock-based compensation, especially in high-growth companies, as it can have a significant impact on consolidated financial results.

Non-Compliance Metrics in Consolidated Financial Statements:

A Critical Insight for CEOs and CFOs

Key Considerations for CEOs and CFOs in Consolidated Financial

1. **Thorough Verification and Cross-Checking:** Ensure that all subsidiary balances, intercompany transactions, and related party disclosures are meticulously verified and cross-checked to prevent material misstatements. Non-compliance due to erroneous reporting in consolidation can result in significant legal and financial consequences.

2. **Timely Recognition of Liabilities:** Liabilities, especially those arising from legal, regulatory, or contingent issues, must be recognized and disclosed in a timely manner. This includes ensuring that penalties, fines, and legal settlements are correctly reported in the consolidated statements.

3. **Transparency in Consolidation Practices:** Consolidated financial statements must reflect the true financial condition of the parent company and its subsidiaries. Any off-balance-sheet entities, joint ventures, and related party transactions should be fully disclosed to maintain transparency and avoid potential regulatory scrutiny.

4. **Stock-Based Compensation and Dilution Effects:** Companies must ensure accurate accounting of stock-based compensation, particularly when it could affect the dilution of shares and, consequently, the financial performance reflected in consolidated reports. Clear disclosure of these elements is essential to avoid misleading investors.

Conclusion

- Non-compliance with IFRS or IND AS during the preparation of consolidated financial statements can have **significant legal**, **regulatory**, and **reputational consequences**. By ensuring that consolidation practices are rigorous, transparent, and fully compliant, CEOs and CFOs can **protect** their **companies** from the **risks associated** with **inaccurate financial reporting**. The above cases serve as stark reminders of the importance of meticulous attention to detail in the consolidation process, **highlighting the need for continuous improvement in financial governance and reporting practices.**

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Credits

This guide has been prepared based on the personal experience and insights of the author, reflecting her thoughts on IND AS 110, IND AS 103, and Schedule 3. The content represents the author's perspective on these topics, and it is not endorsed or authored by any official authority. Please note that the statements and interpretations within this guide are not conclusive and might contain inadvertent errors or omissions. The guide is for informational purposes only and should not be considered as professional or legal advice.