

Query No. 32

Subject: Preparation of consolidated financial statements of the Parent Company using Straight Line Method (SLM) with financial statements of some of the subsidiaries using Written down Value (WDV) as the method of depreciation.¹

1. R Limited, (hereinafter called as the 'Parent Company' or 'the Company') is engaged in the business of setting up power generation plants and their operations with the generation capacity of 5945 MW. The Company has 44 subsidiaries, of which 41 subsidiaries are wholly owned subsidiaries (WoS).
2. The Parent Company was incorporated on 17th January, 1995 and since its inception, the Company has been following Straight Line Method (SLM) of depreciation. Financials of the financial year 2004-05 being the year before its first subsidiary came into existence specified the same vide significant accounting policies, Note 1(e).
3. A Limited became its first subsidiary on 1st November, 2006. The Parent Company and all other subsidiaries adopted Straight Line Method (SLM) of depreciation except for the two subsidiaries namely; S Limited and D Limited. S Limited and D Limited consistently continue to follow their respective methods of depreciation till date and same, as per the querist, is also in accordance with paragraph 14 of Indian Accounting Standard (Ind AS) 101, 'First-time Adoption of Indian Accounting Standards'.
4. S Ltd., an Ultra Mega Power Plant (UMPP), WoS of R Ltd., is engaged in the generation of power and since the inception, Board of Directors determined its depreciation method for each significant component considering various factors including consumption of economic benefits during the Power Purchase Agreement (PPA) of 25 years along with corresponding lease of coal mines, technical evaluation of useful life, assessment of expected repairs and maintenance cost, etc. Based on the said assessment, depreciation of certain major assets of Power Plant comprising of Boiler, Turbine and Generator Units (employing Super Critical Technology), ash handling plants and coal handling plants has been determined using written down value (WDV) method and for the balance assets including coal mine assets, straight line method (SLM) has been determined as the appropriate method.
5. For D Ltd., fixed assets are depreciated under the straight line method as per the rates and in the manner prescribed under Schedule XIV of the Companies Act, 1956 (now Schedule II to the Companies Act, 2013) except in case of the Solar Photo Voltaic Assets i.e. Plant and Equipment block, wherein depreciation has been charged at the accelerated rate of 7% p.a. for the first ten years and thereafter 1.33% p.a. for the remaining years as prescribed under the Central Electricity Regulatory Commission (CERC) Regulations, 2009, read with General Circular No. 31/2011 dated May 31, 2011, issued by the Ministry of Corporate Affairs.
6. The Parent Company continued to adhere to the provisions of the Companies Act, 2013, rules/regulations as applicable from time to time as well as prevalent and applicable Accounting Standards including Indian GAAP and Indian Accounting Standards (Ind ASs) when the same became applicable to the group with effect from financial year (F.Y.) 2016-17. The financial statements were prepared in accordance with the relevant provisions of the Companies Act, 1956/2013 complying with all material aspects of the Accounting Standards, issued by the Institute of Chartered Accountants of India (ICAI) as notified under section 211(3C) of the Companies Act, 1956/2013 and the same were duly accepted and audited by the respective joint statutory auditors.

¹ Opinion finalised by the Committee on 5.2.2021.

7. The consolidated position of fixed assets base of Rs. 46,68,040 lakhs as on 31st March 2020 comprising of the consolidated net block of Rs. 38,52,600 lakhs, lease receivable being Property, Plant and Equipment (PPE) of Rs. 4,53,961 lakhs and Capital Work-in-Progress (CWIP) of Rs. 3,61,479 lakhs, in terms of their treatment of their respective depreciation method is as under:

Rs. In Lakhs

Sr. No.	Particulars	Net Block as on 31.03.2020	Net Block as on 31.03.2019
1	Consol PPE- SLM	3,852,600	3,585,180
2	D Ltd. (WDV in standalone to SLM in Consol basis)	69,812	69,405
3	S Ltd. (Consol basis)		
a	SLM-SLM	1,235,120	1,208,012
b	WDV in Standalone to SLM in consol	2,091,935	2,116,706
4	Total S Ltd. UMPP & D Ltd. (2+3)	3,396,867	3,394,123
5	Consol PPE-all other SPVs & R Ltd.	455,733	191,057
6	Consol PPE on SLM basis (4+5)	3,852,600	3,585,180
7	PPE converted to Lease receivables (A Ltd. & V Ltd.) (Earlier in Indian GAAP regime depreciated on SLM basis)	453,961	849,970
8	Total consol CWIP	361,479	427,638
9	Total Consol PPE incl. CWIP & Finance lease (SLM) (6+7+8)	4,668,040	4,862,788
10	PPE : WDV - SLM (2+3b)	2,161,747	2,186,111
11	Consol PPE : SLM - SLM (9 - 10)	2,506,293	2,676,677
12	Impact of change in depreciation on the P & L Account as percentage to Total Consol PPE	53,859 (1.15%)	50,191 (1.03%)

8. The Parent Company had joint statutory auditors, M/s C & S and M/s P upto F.Y. 2015-16, whereas M/s P & A replaced M/s C & S in F.Y. 2016-17 and M/s B replaced M/s P as joint auditor in F.Y. 2017-18.

- a. The audit reports by the statutory auditors of the Parent Company of all the years except for F.Y. 2017-18 and 2018-19 were without any qualification and/ or modification in this regard. In F.Y. 2017-18, Emphasis of Matter (EoM) was added in the audit report by the statutory auditors, whereas in F.Y. 2018-19, the statutory auditors qualified the report instead of EoM on the same issue. The accounting treatment and consolidation methodology has remained the same in all these years even after adoption of Ind AS.
- b. The audit reports of S Ltd. and D Ltd. by the statutory auditors of all the years including F.Y. 2019-20 were without any qualification and/or modification and/or EoM in this regard. During these years, joint statutory auditors of the Parent Company were also the joint statutory auditors/statutory auditors of the subsidiaries.

9. R Ltd., the Parent Company continues to follow the same method of depreciation till date, which as per the querist, is in line with paragraph 14 of Ind AS 101. As per paragraph 14

of Ind AS 101 titled as 'Estimates', "An entity's estimates in accordance with Ind ASs at the date of transition to Ind ASs shall be consistent with estimates made for the same date in accordance with previous GAAP ... unless there is objective evidence that those estimates were in error". (Emphasis supplied by the querist.)

10. The R Ltd. and its subsidiaries have not only consistently followed their respective depreciation methods but also ensured to carry out the impairment testing of their assets from time to time and provided for the impairment accordingly. Based on the impairment testing done by the valuation experts, assets of Rs. 1419 crore were impaired during the F.Y. ending on 31st March 2019. Similarly, during the financial year ending 31st March 2020, V Limited and S Power Limited have provided for the impairment of Rs. 1094 crore and Rs. 862 crore respectively.

11. Thus, as accepted by the statutory auditors of R Ltd., S Ltd. and D Ltd. can be considered to have made an appropriate estimate of the amount of depreciation to be charged as prescribed and in compliance with Ind AS 16, 'Property, Plant and Equipment'; and also that the Companies and the statutory auditors are in agreement that the depreciation amount chargeable to the profit and loss account has been allocated on a systematic basis over the useful life of assets in accordance with the applicable Ind ASs. In preparing the consolidated financial statements (CFS), the management of the Parent Company recognises that as prescribed by Ind AS 110 'Consolidated Financial Statements', the statements have to be prepared as *the financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity*. (Emphasis supplied by the querist.)

12. Referring the definition of CFS as given in Appendix A of Ind AS 110, the management has taken cognizance that unlike the earlier applicable accounting standard (AS 21), the Ind AS does not go by a simple *line by line consolidation but requires the Parent Company to take into consideration the estimates of the entities in the group and to the extent possible, ensure that these are prepared on a harmonious* basis for all the entities within the group. In fact, according to the querist, paragraph 19 of Ind AS 110 mandates that "**A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.**" Further, the application guidance in paragraph B87 of Ind AS 110 provides that "*If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to that group member's financial statements in preparing the consolidated financial statements to ensure conformity with the group's accounting policies*". The Parent Company recognises that pursuant to the guidance given in regard to accounting policies, *the method of depreciation is undoubtedly an estimate. However, upon consideration of the fact that though useful life has been considered in consonance with Part C of the Schedule II of the Companies Act, 2013 by both Parent and subsidiaries except for few assets in view of their internal assessment and technical evaluation, the subsidiary and their respective Board of Directors adopted WDV method to depreciate its assets in view of the Power Purchase Agreements (PPA) and lease of coal mines available for the tenor of 25 years etc.* (Emphasis supplied by the querist.)

13. The Parent Company has reached to a conclusion that a fair estimate of depreciation would be a method that enjoys statutory recognition and which is such that the value of the asset held by the subsidiary should be allocated in a systematic manner over its useful life, considering collective capacity to not only extend PPA or get the fresh PPA but also get the coal from national / international sources (coal which shall be lesser abrasive in nature as compared to coal of the captive mine) arranged for long term so as to operate all the plants at desired/stipulated capacity with robust operation and maintenance for the rest of the life

estimated by the parent. More so, in view of the fact that most of the other power plants operating in India follow SLM method, which was duly considered by the statutory auditors until they gave an EoM in F.Y. 2017–18 and later issued a modified report in F.Y. 2018–19 as well as 2019-20. (Emphasis supplied by the querist.)

14. In this regard, it is worth noting that the Parent Company considering its SLM method of depreciation in view of this being the policy under the GAAP, harmonised the WDV method of depreciation of its SPVs on on-going basis. The subsidiary and the Parent Company, both were following their accounting policies under applicable GAAP. Apart from the depreciation being considered as an estimate under paragraph 14 of Ind AS 101, there is also no bar in the accounting standards to making any adjustment in the same manner as is made pursuant to paragraph B87 of Ind AS 110. The managements of the Parent Company and the subsidiary have taken due care to disclose full particulars and quantified the impact about the adjustments that it has considered necessary to make in drawing up the CFS in accordance with the above principles of presenting like items in similar manner.

15. The managements of the Parent Company and the subsidiaries are of the view that for a true and fair view being reported in the CFS, the CFS has to be viewed independently as a single economic entity and not with reference to the component financial statements. In view of above, a true and fair view of the CFS requires that the same is to be made on the basis of the views of the management of the Parent Company (which takes ownership for the selection of accounting policies and making of estimates).

16. In F.Y. 2016–17, when the companies transited to Ind AS, the Parent Company continued to consolidate the financial statement on SLM basis and the statutory auditors issued the audit report without any EoM and/or qualification in the audit report. For the presentation of CFS, necessary adjustment to give effect to the different methods of depreciation was made in CFS so as to continue the consolidation on SLM basis.

17. The ITFG, vide its clarification (Bulletin no. 11 - Clarification No. 6) on 31st July, 2017, has *inter alia* made observations regarding method of estimating depreciation adopted for preparing standalone financial statements of the subsidiaries and for preparing consolidated financial statements. Perhaps, considering this observation by ITFG, the statutory auditors in their report for F.Y. 2017-18 had included an EoM stating that “*Note 36 of the consolidated Ind AS financial statement regarding the method of depreciation adopted by the Parent Company for the purpose of consolidated financial statements being different from the depreciation method adopted by the subsidiaries for reasons stated therein*”. Note 36 to the CFS, citing *inter alia* observations made by the ITFG specified that, the Parent Company has been following the method since inception of SPVs in CFS, including that under Ind AS regime. Based on such opinions, the Company has continued to provide depreciation in its CFS which is different as compared to that considered by two subsidiaries based on the decisions of their respective managements.

The Statutory Auditors (no change in Statutory Auditors) have expressed an unmodified report with respect to this matter i.e. the methods of depreciation SLM and WDV in the standalone financial statements of R Ltd. and S Ltd. & D Ltd. respectively, for the F.Y. 2017-18, F.Y. 2018-19 and 2019-20. Thus, it may be fairly concluded that in the standalone financial statements, the statutory auditors had no reservation with respect to the method of depreciation, its estimate and methodology for the same adopted by respective management of R Ltd. and S Ltd. and D Ltd. In case of the Parent Company as well as the subsidiary company, the accounting policy for preparation of CFS has also remained unchanged. However, in F.Y. 2018-19, the qualified audit report by the statutory auditors stated the basis of qualification as “*As explained in Note 33 of the consolidated financial statements,*

regarding method of depreciation adopted by the Parent Company for the purpose of preparing its consolidated financial statements being different from the depreciation method adopted by two of its subsidiaries which is a departure from the requirements of Ind AS 8 Accounting Policies, Changes in accounting estimate and errors, since selection of the method of depreciation is an accounting estimate and depreciation method once selected in the standalone financial statements is not changed while preparing consolidated financial statements in accordance with Ind AS 110, Consolidated Financial Statements. Had the method of depreciation adopted by certain subsidiaries of the Parent Company, been considered for the purpose of preparation of consolidated financial statements of the Parent Company, the loss after tax in the consolidated financial statements would increase by Rs. 50,191 lakhs and other equity and property, plant and equipment would have reduced by Rs. 50,191 lakhs and Rs. 72,952 lakhs respectively". On the same lines, Statutory Auditor qualified for the year 2019-20.

However, to the above qualification, the Company submitted that, how as per the qualification "Had the method of depreciation adopted by subsidiary been adopted", a parent can adopt the WDV method specifically for the assets of two of its subsidiaries, more so when it has been following the SLM since inception much before the subsidiaries came into existence.

(Emphasis supplied by the querist.)

18. The querist has further submitted as under:

The "pattern of consumption" is agreed to as the basis of conclusion. However, it may be submitted that ITFG presumed the pattern of consumption to be similar for both subsidiary and parent whereas same is different in our case in view of facts presented hereunder.

Upon consideration of the view of the ITFG, it is agreed that the pattern of consumption used as the basis for estimation of the depreciation is appropriate. Further as stated by the ITFG "*the entity should select the method that most closely reflects the expected pattern of consumption of the future economic benefits*". In this context, attention may be drawn to Appendix A which forms part of the Standard and defines the 'Consolidated Financial Statements' for the purpose of Ind AS 110 (which directly deals with consolidated financial statements). This definition states, "The financial statements of a **group** in which the assets, liabilities, equity, income, expenses and cash flows of the **parent** and its **subsidiaries** are presented as those of a single economic entity". This would necessarily imply that when preparing the CFS, the management of the parent would have to consider the pattern of consumption of future economic benefits independently, and not with the constraints that may have been considered by the management of the subsidiary. Further, it is submitted as under:

- a. **Compliance of Section 129 of the Companies Act, 2013** - Section 129 (3) of the Companies Act 2013 requires the parent company to prepare CFS and Section 129 (1) mandates that the financial statements must comply with the notified Accounting Standards.
- b. **Ind AS 110** - Ind AS 110 provides that a parent shall prepare consolidated financial statements using uniform accounting policies. The condition of uniformity is not applicable in case of accounting estimates made while preparing CFS as depreciation being considered as an estimate.

Paragraph B87 of Ind AS 110 reads as under:

“If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to that group member’s financial statements in preparing the consolidated financial statements to ensure conformity with the group’s accounting policies.”

In view of above, the Parent Company prepared the consolidated financial statements as defined in Ind AS 110 presenting the assets, liabilities, equity, income, expenses and cash flows of the parent and subsidiary as those of single economic entity complying with the accounting standards, which covered both judgements around accounting policies and estimates.

c. Ind AS 16

- Paragraph 56 of Ind AS 16 specifies that the future economic benefits embodied in an asset are consumed by an entity principally through its use; further it suggests that there are other factors which will also have to be considered in arriving at the pattern in which the asset’s future economic benefits are expected to be consumed. The choice of depreciation method by the management and the Board of directors of the subsidiary should be reflective of the pattern in which they expect power plant’s future economic benefits to be considered under the group’s technical and commercial circumstances. The circumstances that impact the group cannot necessarily be the same as the circumstances that impact the standalone subsidiary when making appropriate choice of depreciation method.
- Parent Company after due consideration of the various factors for its power plants provided for depreciation on SLM basis while preparing the CFS by making the adjustments to the figures of the depreciation on power plants of the subsidiary companies which are following the WDV.
- Paragraph 60 of Ind AS 16 states that the depreciation method used shall reflect the pattern in which the asset’s future economic benefits are expected to be consumed by the entity.
- Paragraph 61 of Ind AS 16 states that the depreciation method applied to an asset shall be reviewed at least at each financial year-end, and if there has been significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method shall be changed to reflect the changed pattern. Such a change shall be accounted for as a change in an accounting estimate in accordance with Ind AS 8.
- Ind AS 16 defines the term ‘useful life’ as:

“Useful life is: (a) the period over which an asset is expected to be available for use by an entity; or ...”
- In the light of above provisions, the method should be applied consistently from period to period unless there is a change in the pattern of consumption of those future economic benefits in separate financial statements as well as in consolidated financial statements.

- d. Ind AS 1** - Ind AS 1 asserts that users must be able to compare the financials of an enterprise through the time in order to identify trends in its financial position, performance and cash flows. R Ltd. has also carried out benchmark

study of the Ind AS financial statements of other power companies and all have been following the SLM method in consolidation of financial statements.

- e. **Compliant Transition from GAAP to Ind AS** - Standalone financial statements and consolidated financial statements are, by their nature and under law, distinct financial statements. For a first time adopter, Ind AS 101 provides that the estimates used under previous GAAP cannot be changed. Accordingly, if under previous GAAP, the WDV method of depreciation was used in the standalone financial statements and SLM method was used in the consolidated financial statements, these are required to be continued as methods of estimate under Ind AS keeping in view the requirement of using uniform accounting policies as envisaged by Ind AS 110.

As per paragraph 14 of Ind AS 101, titled as 'estimates', **“An entity’s estimates in accordance with Ind ASs at the date of transition to Ind ASs shall be consistent with estimates made for the same date in accordance with previous GAAP ... unless there is objective evidence that those estimates were in error”**.

- In view of depreciation rates and methods being an accounting estimate whereas Ind AS 110 (Consolidated Financial Statements) stipulating accounting policy needs to be similar, the accounting estimates can be different.
- Though the ITFG clarification No. 20 talks about holding and subsidiary in different countries but by virtue of the same principle and on plain reading of paragraphs 60, 61 and 62 of Ind AS 16 (Property, Plant and Equipment), it is submitted that, basis of different depreciation method for each entity is driven from the different pattern of consumption and same be considered in view of parent considering different pattern of consumption vis-a-vis subsidiary.

Based on the above, it is submitted that the Parent Company and its subsidiary company can follow the different methods of depreciation for its assets.

19. Upon a consideration of the above-mentioned facts, the Parent Company having made full disclosure of the relevant facts in the Notes is of the opinion that there is no non-compliance with the Ind AS. More so, also in view of the fact that in the 54% of the net block, SLM is being followed by the subsidiary as well as parent. Furthermore, even if the view taken by the Parent Company is not in agreement with the understanding of the Ind AS in view of the auditors, the resultant variation of less than 2% of the net block does not fit within a matter that can call for a modified opinion. The brief reasoning for the same is as under:

- a. It is submitted that paragraphs 32 to 38 of Ind AS 8 deal with changes in accounting estimates. It is well established and accepted by the ICAI that the selection of method of depreciation is an accounting estimate and therefore, any other explanation in the said Ind AS related to change in accounting policy would not apply to the above facts and circumstances of the case. The querist is, therefore, of the view that there is no non-compliance with the requirements of Ind AS 8 that is cited as the basis of qualified opinion or qualification.
- b. A careful study of Ind AS 110 including the paragraphs cited above does not indicate any statement in the said Ind AS, which prohibits making necessary adjustments. Undoubtedly, it is a good practice that when making any adjustment, it would require

full disclosure with regard to the same. The management is fully conscious of the same and in its Notes to Accounts, has already made full disclosure (Refer Note 33). If the Expert Advisory Committee (EAC) directs, the management is agreeable to make such further disclosure as is considered warranted under the circumstances.

- c. The querist has also requested attention to the application guidance under the head 'Consolidation Procedures', wherein paragraph B86 of Ind AS 110 refers to 'combine' rather than 'add', as would have been done on a line by line consolidation in earlier applicable Accounting Standard (AS) 21, 'Consolidated Financial Statements'. Various adjustments are also envisaged in the guidance and paragraph B87 specifically requires adjustments to be made in the CFS in order to follow the principle that "like should be combined" and "presented with like".
- d. It is submitted that the accounting standards are principle based and Parent Company has consistently followed the same. Furthermore, every situation that may arise may not be envisaged by the standards.
- e. There is no explicit bar and therefore, no specific violation of any requirement of the standards, which arises when the adjustment as effected herein by the management is considered. More so, its continuity in pre GAAP and post GAAP i.e. Ind AS including transition year has been accepted by the Auditors.
- f. The adjustment carried out by the management of the Parent Company in preparation of the CFS is in accordance with the principles expressed in paragraphs B87 and 19 of Ind AS 110. More so, when transition to Ind AS being done in consonance with Ind AS 101 and continued in similar manner thereafter.
- g. The management of the Parent Company is required under its governance obligations to not merely incorporate statements submitted by its subsidiaries but to make estimates based on the available facts and circumstances, prevalent for the group as a whole. Thereby, the true and fair view of the group as a whole is to be presented in the CFS by the management of the Parent Company. For this reason, it is not just desirable but imperative that the management of the Parent Company makes its own estimates in preparation of the CFS. Undoubtedly, where there are differences in the estimates adopted by the Subsidiary, a full disclosure of the facts is warranted and the management has done the needful in this regard.

20. Having considered the above facts, the querist draws attention to paragraph 6(a) of Standard on Auditing (SA) 705, 'Modifications to the Opinion in the Independent Auditor's Report', read with the definition of 'material misstatement' as given in SA 450, 'Evaluation of Misstatements Identified during the Audit' for considering the circumstances, which call for the modification of the auditor's opinion: "*The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement*"; The narration on nature of material misstatement is represented as under:

"A2. SA 700 (Revised) requires the auditor, *in order to form an opinion on the financial statements, to conclude as to whether reasonable assurance has been obtained about whether the financial statements as a whole are free from material misstatement. This conclusion takes into account the auditor's evaluation of uncorrected misstatements, if any, on the financial statements in accordance with SA 450.*

A3. SA 450 defines a misstatement as *a difference between the amounts, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in*

accordance with the applicable financial reporting framework. Accordingly, a material misstatement of the financial statements may arise in relation to:

- (a) The appropriateness of the selected accounting policies;*
- (b) The application of the selected accounting policies; or*
- (c) The appropriateness or adequacy of disclosures in the financial statements.”*

(Emphasis supplied by the querist.)

In reference to above, an attention is drawn more particularly to the fact that,

- a. Depreciation being an estimate and not policy, it is submitted that sub-paragraphs (a) & (b) from paragraph A3 of SA 705 would have no application in the given facts.
- b. The Parent has consistently followed the Straight Line Method of depreciation over the period of time since inception as well as transited to Ind AS accordingly.
- c. The Parent Company barring two subsidiaries has all other subsidiaries comprising net block of around 54% at the CFS level depreciating assets on SLM in consonance with the Parent Company.
- d. The Parent Company makes appropriate and adequate disclosures in the Consolidated Financial Statements.
- e. In furtherance to above, the Company is willing to make all such disclosures as are considered necessary by the EAC to bring out the facts with the adequate clarity.
- f. The paragraphs A2 to A7 of SA 705 would have no relevance to the facts and circumstances of the case. Therefore, unless one can come to a conclusion of the existing material misstatement as referred to in paragraphs 6(a) and 7(a) of SA 705, a qualification in the audit report may not be warranted.
- g. It is respectfully submitted that considering the balance sheet size, as on 31st March 2019, the net block of fixed assets (comprising the assets considered on finance lease and CWIP) of Rs. 48,627 crore whereas the quantum of adjustment being Rs. 501 crore, being 1.03% of total assets held, made and fully disclosed in the notes to the accounts, it should not be considered as material in the facts and circumstances of the case.
- h. In any event, considering that full disclosure of the facts is being made, and even an additional disclosure is agreed to be made as is considered necessary; coupled with the fact that there is no express breach of any of the contents of the applicable accounting standards, it would not be proper to come to conclusion that the CFS contain a ‘misstatement’.

21. Undoubtedly, there may be two views on the method of depreciation in view of both being accepted by the standard to arrive at a true and fair presentation of financial statements. The auditors being independent are entitled to their view. It is, however, submitted that the view of the querist is reasonably possible, considering:

- a. both methods being acceptable as per standards and depreciation being an estimate;
- b. adequate quantified disclosure being made to ensure that consolidation as adopted in the CFS is, in fact, the better and more appropriate method; and
- c. the Parent Company being listed company also need to make its CFS comparable with the other listed entities of the sector.

It would not be possible to conclude that there is a 'material misstatement' also from the perspective that auditors have accepted the position in pre-GAAP as well as post transition to Ind AS in F.Y. 2016-17 and issued unmodified audit report accordingly. As a corollary, it is submitted that since the stand taken by the Company (and the rationale and accounting principles and theory underlying this approach) has been fully explained in the Notes on Account, no qualification is warranted.

22. Considering the above referred facts and circumstances, the querist is of the view that there is no misstatement when the CFS are viewed in the perspective of a single entity as required by Ind AS 110 and not as a mere conglomeration of various group entities' financial statements. It is further respectfully submitted by the querist that the said items having been suitably clarified by way of a note to accounts, may not fall within the meaning of key audit matters as given in paragraph 9 of SA 701, 'Communicating Key Audit Matters in the Independent Auditor's Report'.

B. Query

23. On the basis of the above, the querist has sought the opinion of the Committee on the following issues:

- a. Whether in the given facts, R Ltd. following SLM in its standalone financial statements and S Ltd. following WDV method for its plant and SLM method of depreciation for its heavy earth moving machinery in its standalone financial statements can be both considered to be compliant with the applicable accounting standards?

If the answer is in the negative, which standard / paragraph may be considered to be the provision from which it can be concluded that there is a variation resulting in a material misstatement?

- b. Whether the management and those charged with governance (TCG) of the Parent Company when applying Ind AS 110 for the preparation of the consolidated financial statements (CFS) have to keep in mind the requirement that the CFS should be presented treating the entire group as a single economic entity and considering its estimates of pattern of consumption uniform for the assets of the group as a whole or simply aggregate the estimates contained in the underlying financial statements of the various individual entities of the group. Whether the Committee would like to suggest any additional disclosure to be made in the CFS in addition to what was already disclosed in Note 33 of the CFS (for example, explaining the technical reasons for the difference in estimation by Parent and subsidiary).
- c. Whether in the facts of the case wherein the Company considers to have complied with the standard including transition of Ind AS with no qualification, can one conclude that there is a non-compliance of Ind AS 110 or of Ind AS 16 and if so, of which particular provision(s) contained in the said standards. (More so, in view of the principle based Ind AS and the related authoritative literature not leading to absolute contradicting guidance above.)
- d. Whether the said standards anywhere prohibit adjustments to be made in preparation of CFS for presenting a 'true and fair view' and whether paragraph 19 of Ind AS 110 read with paragraph B87 are only to explicitly permit adjustments to be made in order to harmonise the accounting policies of parent and subsidiary and explicitly or implicitly prohibit necessary adjustments to be made (with appropriate

disclosure); in order to attain the main purpose of presenting a ‘true and fair view’ of the Group’s CFS as a single economic entity.

C. Points considered by the Committee

24. The Committee, while expressing its opinion has restricted itself to the issue raised in paragraph 23 above in the context of whether adjustments should be made in the method of depreciation followed for the separate financial statements of the subsidiary company while consolidating the same in the consolidated financial statements; and has not examined any other issue that may arise from the Facts of the Case, such as, whether the determination of pattern of consumption of the future economic benefits embodied in the asset by the Parent Company and the subsidiary company for their respective assets is appropriate or not, consolidation of financial statements of subsidiary companies with that of the parent’s financial statements, accounting for transition to Ind ASs, impairment of assets, accounting for mining lease, accounting for PPA, applicability of service concession arrangement, depreciation rate prescribed by regulations, reporting requirements by the auditor, compliance with the provisions of Companies Act, Electricity Act and various circulars and other Regulations applicable to power generation companies, etc. Further, the opinion expressed hereinafter is purely from accounting perspective and not from the perspective of legal interpretation of various enactments applicable to the Company in the extant case.

25. With regard to the issue whether any adjustment may be made in the method of depreciation while consolidating the financial statements of the subsidiary company with Parent Company’s financial statements when the subsidiary is following different method of depreciation for the same PPE, the Committee notes the following requirements of Ind AS 110, ‘Consolidated Financial Statements’:

“19 A parent shall prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.”

“B87 If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to that group member’s financial statements in preparing the consolidated financial statements to ensure conformity with the group’s accounting policies.”

From the above, the Committee notes that the consolidated financial statements are to be prepared using uniform accounting policies for like transactions and events in similar circumstances. However, there is no such explicit requirement in the Standard with respect to accounting estimates.

26. Further, in the context of the issue raised, the Committee notes the following requirements of Ind AS 16, ‘Property, Plant and Equipment’:

“Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.”

“60 The depreciation method used shall reflect the pattern in which the asset’s future economic benefits are expected to be consumed by the entity.

61 The depreciation method applied to an asset shall be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method shall be changed to reflect the changed pattern. Such a change

shall be accounted for as a change in an accounting estimate in accordance with Ind AS 8.

- 62 A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. Straight-line depreciation results in a constant charge over the useful life if the asset's residual value does not change. The diminishing balance method results in a decreasing charge over the useful life. The units of production method results in a charge based on the expected use or output. The entity selects the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. That method is applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits.”
- “75 Selection of the depreciation method and estimation of the useful life of assets are matters of judgement. Therefore, disclosure of the methods adopted and the estimated useful lives or depreciation rates provides users of financial statements with information that allows them to review the policies selected by management and enables comparisons to be made with other entities. For similar reasons, it is necessary to disclose:
- (a) depreciation, whether recognised in profit or loss or as a part of the cost of other assets, during a period; and
 - (b) accumulated depreciation at the end of the period.
- 76 In accordance with Ind AS 8 an entity discloses the nature and effect of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in subsequent periods. For property, plant and equipment, such disclosure may arise from changes in estimates with respect to:
- (a) residual values;
 - (b) the estimated costs of dismantling, removing or restoring items of property, plant and equipment;
 - (c) useful lives; and
 - (d) depreciation methods.”

The Committee notes that the depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. Such allocation depends on the method of depreciation selected by the entity and should reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. The Committee further notes that Ind AS 16 requires change in the method of depreciation *only if there has been a significant change in the pattern of consumption of the future economic benefits embodied in the asset*. The Committee further notes that as per the above-reproduced paragraphs 75 and 76 of Ind AS 16, selection of the depreciation method is a matter of judgement and that the change in the method of depreciation is required to be disclosed as a change in estimates as per the requirements of Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors'. In this regard, the Committee also notes the following paragraphs of Ind AS 8:

“A change in accounting estimate is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits

and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.”

- “32 As a result of the uncertainties inherent in business activities, many items in financial statements cannot be measured with precision but can only be estimated. Estimation involves judgements based on the latest available, reliable information. For example, estimates may be required of:
- (a) bad debts;
 - (b) inventory obsolescence;
 - (c) the fair value of financial assets or financial liabilities;
 - (d) the useful lives of, or expected pattern of consumption of the future economic benefits embodied in, depreciable assets; and
 - (e) warranty obligations.
- 33 The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.
- 34 An estimate may need revision if changes occur in the circumstances on which the estimate was based or as a result of new information or more experience. By its nature, the revision of an estimate does not relate to prior periods and is not the correction of an error.”

Thus, it is clear from the above that change in expected pattern of consumption of the future economic benefits embodied in depreciable assets which is reflected by the method of depreciation, is a change in estimates and not a change in accounting policy and therefore, paragraphs 19 and B87 of Ind AS 110 are not applicable.

Further, the Committee notes from the above that an accounting estimate may need to be revised if changes occur in circumstances on which the estimates was based or as a result of new information or new developments and it should not be related to correction of errors. Also, as per the requirements of Ind AS 16, change in the method of depreciation is allowed *only when there is change in the pattern of consumption*. The Committee is of the view that ‘Pattern of consumption’ is generally understood as the way the asset is actually being or expected to be consumed/used over its useful life, which depends on various factors, such as, number of shifts, capacity at which the asset being operated, etc. The Committee notes that in the extant case, the Parent Company in its consolidated financial statements is making certain adjustments in the method of depreciation followed by the subsidiary considering its overall context and circumstances. In this context, the Committee is of the view that although while preparing consolidated financial statements, the group as a whole should be considered as a single economic entity but mere consolidation of subsidiary’s financial statements with those of the parent company would not ordinarily change the actual/expected usage or pattern of consumption of an asset and therefore, does not lead to any change in estimates. Therefore, in the extant case, merely on the basis of consolidation, adjustments should not be made in the method of depreciation in the CFS. It is only in exceptional circumstances, where it can be properly justified on the basis of adequate evidences that there is a change in the pattern of consumption of an asset leading to changes in estimates as per the requirements of Ind AS 8 and Ind AS 16, as discussed above, that the depreciation method may be changed in the CFS.

D. Opinion

27. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 23 above:

- (a) As discussed in paragraph 26 above, change in the method of depreciation is a change in accounting estimates and not a change in accounting policy. Different methods of depreciation can be followed by R Ltd. and S Ltd. in their separate financial statements provided those methods reflect the expected pattern of consumption of the future economic benefits embodied in the asset, as per the requirements of Ind AS 16; and the same would be considered to be compliant with the accounting standards. However, if the pattern of consumption of future economic benefits embedded in the asset is same for similar assets, the method of depreciation cannot be different.
- (b) and (c) Although while the consolidated financial statements are prepared considering the group as a whole as an economic entity but mere consolidation of subsidiary's financial statements with those of the parent company would not ordinarily change the actual/expected usage or pattern of consumption of an asset and therefore, does not lead to any change in estimates. Therefore, in the extant case, merely on the basis of consolidation, adjustments should not be made in the method of depreciation in the CFS. It is only in exceptional circumstances, where it can be properly justified on the basis of adequate evidences that there is a change in the pattern of consumption of an asset leading to changes in estimates as per the requirements of Ind AS 8 and Ind AS 16, as discussed above, that the depreciation method may be changed in the CFS.
- (d) This being a generic issue cannot be answered by the Committee.