

AS 23

**ACCOUNTING FOR INVESTMENTS
IN ASSOCIATES**

Question 1 (RTP Nov 18, Nov 20)

NB Pg. No.

A Ltd. acquire 45% of B Ltd. shares on April 01, 20X1, the price paid was ₹ 15,00,000. Following are the extracts of balance sheet of B Ltd. as of 1 April 20X1:

Paid up Equity Share Capital	₹ 10,00,000
Securities Premium	₹ 1,00,000
Reserve & Surplus	₹ 5,00,000

B Ltd. has reported net profits of ₹ 3,00,000 and paid dividends of ₹ 1,00,000 for the year ended 31 March 20X2. Calculate the amount at which the investment in B Ltd. should be shown in the consolidated balance sheet of A Ltd. as on March 31, 20X2.

Solution

Calculation of Goodwill/Capital Reserve under Equity Method

Particulars	₹	₹
Investment in B Ltd. (A)		15,00,000
Equity Shares	10,00,000	
Security Premium	1,00,000	
Reserves & Surplus	5,00,000	
Net Assets	16,00,000	
45% of Net Asset (B)		7,20,000
Goodwill (A-B)		7,80,000

Calculation of Carrying Amount of Investment in the year ended on 31st March, 20X2

Particulars	₹
Investment in Associate as per AS 23:	
Share of Net Assets on 1 April 20X1	7,20,000
Add: Goodwill	7,80,000
Cost of Investment	15,00,000
Add: Profit during the year (3,00,000 × 45%)	1,35,000
Less: Dividend paid (1,00,000 × 45%)	(45,000)
Carrying Amount of Investment	15,90,000

Question 2 (RTP Jan'25)

NB Pg. No.

A Ltd. invested Rs.1,00,000 to acquire 10% stake (Investment I) in B Ltd. and later invested Rs.3,00,000 to acquire additional 20% (Investment II). The net asset value of the B Ltd. at the respective investment dates was Rs.7,50,000 and Rs.12,50,000 respectively. Determine whether B Ltd. is an associate of A Ltd. Also, calculate goodwill arising on the acquisition of the associate.

Solution :

As per para 3 of AS 23 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 may be gained by share ownership, statute or agreement. 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. In this case, A Ltd. has invested 30 % in B Ltd. so B Ltd. is to be considered as an associate of A Ltd.

The goodwill arising on the acquisition of the associate will be computed as follows:

		Rs.
Investment I	(10 percent of Rs.7,50,000)	1,00,000
Share of net assets		(75,000)
Goodwill (A)		25,000
Investment II		3,00,000
Share of net assets	(20 percent of Rs.12,50,000)	(2,50,000)
Goodwill (B)		50,000
Total goodwill (A + B)		75,000

Question 3

NB Pg. No.

Bright Ltd. acquired 30% of East India Ltd. shares for ₹ 2,00,000 on 01-06-20X1. By such an acquisition Bright can exercise significant influence over East India Ltd. During the financial year ending on 31-03-20X1 East India earned profits ₹ 80,000 and declared a dividend of ₹ 50,000 on 12-08-20X1. East India reported earnings of ₹ 3,00,000 for the financial year ending on 31-03-20X2 (assume profits to accrue evenly) and declared dividends of ₹ 60,000 on 12-06-20X2.

Calculate the carrying amount of investment in:

- Separate financial statements of Bright Ltd. as on 31-03-20X2;
- Consolidated financial statements of Bright Ltd.; as on 31-03-20X2;
- What will be the carrying amount as on 30-06-20X2 in consolidated financial statements?

Solution:

(i) Carrying amount of investment in Separate Financial Statement of Bright Ltd. as on 31.03.20X2

	₹
Amount paid for investment in Associate (on 1.06.20X1)	2,00,000
Less: Pre-acquisition dividend (₹ 50,000 × 30%)	(15,000)
Carrying amount as on 31.3.20X2 as per AS 13	1,85,000

(ii) Carrying amount of investment in Consolidated Financial Statements of Bright Ltd. as on 31.3.20X2 as per AS 23

	₹
Carrying amount as per separate financial statements	1,85,000
Add: Proportionate share of 10-month profit of investee as per equity method (30% of ₹ 3,00,000 × 10/12)	75,000
Carrying amount as on 31.3.20X2	2,60,000

(iii) Carrying amount of investment in Consolidated Financial Statement of Bright Ltd. as on 30.6.20X2 as per AS 23

	₹
Carrying amount as on 31.3.20X2	2,60,000
Less: Dividend received (₹60,000 × 30%)	<u>(18,000)</u>
Carrying amount as on 30.6.20X2	<u>2,42,000</u>

Question 4

NB Pg. No.

A Ltd. acquired 25% of shares in B Ltd. as on 31.3.20X1 for ₹ 3 lakhs. The Balance Sheet of B Ltd. as on 31.3.20X1 is given below:

	₹
Share Capital	5,00,000
Reserves and Surplus	<u>5,00,000</u>
	<u>10,00,000</u>
Fixed Assets	5,00,000
Investments	2,00,000
II. Current Assets	<u>3,00,000</u>
	<u>10,00,000</u>

During the year ended 31.3.20X2 the following are the additional information available:

- (i) A Ltd. received dividend from B Ltd., for the year ended 31.3.20X1 at 40% from the Reserves.
- (ii) B Ltd., made a profit after tax of ₹ 7 lakhs for the year ended 31.3.20X2.
- (iii) B Ltd., declared a dividend @ 50% for the year ended 31.3.20X2 on 30.4.20X2.

A Ltd. is preparing Consolidated Financial Statements in accordance with AS 21 for its various subsidiaries. Calculate:

- (i) Goodwill if any on acquisition of B Ltd.'s shares.
- (ii) How A Ltd., will reflect the value of investment in B Ltd., in the Consolidated Financial Statements?
- (iii) How the dividend received from B Ltd. will be shown in the Consolidated Financial Statements?

Solution:

In terms of AS 23, B Ltd. will be considered as an associate company of A Ltd. as shares acquired represent to more than 20%.

(i) Calculation of Goodwill

	(₹ in lakhs)
Amount paid towards acquisition of stake in B Ltd.	3.00
Less: Pre-acquisition dividend	
(₹ 5,00,000 × 40% × 25%)	<u>0.50</u>
Cost of Investment in B Ltd.	2.50
Less: Share in the value of Equity of B Ltd. as at the date of investment	
[25% of ₹ 10 lakhs (₹ 5 lakhs + ₹ 5 lakhs - ₹2 lakhs)]	<u>(2.00)</u>
Goodwill	<u>0.50</u>

(ii) A Ltd. Consolidated Profit and Loss Account for the year ended 31st March, 20X2 (An extract)

		₹ in lakhs
Other income:		
Share of profits in B Ltd. (7×25%)		1.75
Pre-acquisition Dividend received from B Ltd.	0.50	
Transfer to investment A/c	(0.50)	Nil

(iii) A Ltd.

Consolidated Balance Sheet as on 31.3.20X2 (An extract)

		₹ in lakhs
Non-current investments		
Investment in B Ltd. (including goodwill)	2.50	
Share of profit for year 20X1 – 20X2	1.75	4.25

Working Notes:

- Pre-acquisition dividend received from B Ltd. amounting to ₹ 0.50 lakhs will be reduced from investment value in the books of A Ltd.
- B Ltd. made a profit of ₹ 7 lakhs for the year ended 31st March, 20X2. A Ltd.'s share in the profits of ₹ 7 lakhs is ₹ 1.75 lakhs. Investment in B Ltd. will be increased by ₹ 1.75 lakhs and consolidated profit and loss account of A Ltd. will be credited with ₹ 1.75 lakhs in the consolidated financial statement of A Ltd.
- Dividend declared on 30th April, 20X2 will not be recognized in the consolidated financial statement of A Ltd.

Question 5

NB Pg. No.

A Ltd. acquired 40% share in B Ltd. on April 01, 20X1 for ₹ 10 lacs. On that date B Ltd. had 1,00,000 equity shares of ₹ 10 each fully paid and accumulated profits of ₹ 2,00,000. During the year 20X1-20X2, B Ltd. suffered a loss of ₹ 10,00,000; during 20X2-20X3 loss of ₹ 12,50,000 and during 20X3-20X4 again a loss of ₹ 5,00,000.

Show the extract of consolidated balance sheet of A Ltd. on all the four dates recording the above events.

Solution :

Calculation of Goodwill/Capital Reserve under Equity Method

Particulars	₹
Equity Shares	10,00,000
Reserves & Surplus	2,00,000
Net Assets	12,00,000
40% share of Net Assets	4,80,000
Less: Cost of Investment	(10,00,000)
Goodwill	5,20,000

Consolidated Balance Sheet (Extract) as on April 01, 20X1: ASSETS

Investment in Associate as per AS 23	₹	₹
Share of Net Assets on April	14,80,000	
Add: Goodwill	5,20,000	10,00,000

Calculation of Carrying Amount of Investment as at 31 March 20X2:

Investment in Associate as per AS 23		₹
Share of Net Assets on 1 April, 20X1		4,80,000
Add: Goodwill		5,20,00
Cost of Investment		10,00,000
Less: Loss for the year (10,00,000 × 40%)		(4,00,000)
Carrying Amount of Investment		6,00,000

Consolidated Balance Sheet (Extract) as on March 31, 20X2: ASSETS

Investment in Associate as per AS 23		₹	₹
Share of Net Assets on 1 April, 20X1		4,80,000	
Less: Share of Loss as above		(4,00,000)	
		80,000	
Add: Goodwill		5,20,000	6,00,000

Calculation of Carrying Amount of Investment as at 31 March 20X3:

Investment in Associate as per AS 23		₹
Carrying Amount of Investment as on 31 March 20X2		6,00,000
Less: Loss for the year (12,50,000 × 40%)		(5,00,000)
Carrying Amount of Investment		1,00,000

Consolidated Balance Sheet (Extract) as on March 31, 20X3: ASSETS

Investment in Associate as per AS 23		₹	₹
Share of Net Assets on 1 April, 20X1		4,80,000	
Less: Share of Loss as above (₹ 4,00,000 + ₹ 5,00,000)		(4,20,000)	
Add: Goodwill			1,00,000

Calculation of Carrying Amount of Investment as at 31 March 20X4:

Investment in Associate as per AS 23		₹
Carrying Amount of Investment		1,00,000
Less: Loss for the year (5,00,000 × 40% = 2,00,000, restricted to Carrying amount of Investment in B Ltd.) - refer note below Carrying Amount of Investment		

Consolidated Balance Sheet (Extract) as on March 31, 20X4: ASSETS

Investment in Associate as per AS 23		₹
Investment in B Ltd.		-

Question 6

Hill Ltd. has a share capital of 50,000 shares @ ₹ 100 per share. Sun Ltd. acquired 15% shares in Hill Ltd. on 1.4.2024. It also acquired all the 5,000, 12% convertible debentures of ₹ 100 each of Hill Ltd. These debentures will be converted at par into equity shares of Hill Ltd. after 3 years. State whether, as per AS 23, Hill Ltd. is an Associate of Sun Ltd. or not with reasons?

Solution:

As per para 3 of AS 23 'Accounting for Investments in Associates in Consolidated Financial Statements', 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.

Standard further explains in para 4 that 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. Conversely, if the investor holds, directly or indirectly through subsidiary (ies), less than 20% of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated.

Further as per an explanation to para 4 of the standard, for the purpose of classification of associate, the potential equity shares of the investee held by the investor will not be taken into account for determining the voting power of the investor. In other words, the voting power should be determined on the basis of the current outstanding securities with voting rights.

As per the information given in the question, Sun Ltd. presently holds indirectly 22.7% shares (with and without voting rights) (Refer W.N.) in Hill Ltd. However, the current outstanding securities with voting rights in Hill Ltd. is only 15% and the remaining holding is on account of potential equity shares. Since potential equity shares do not have voting rights they will not be taken into consideration while determining the significant influence of Sun Ltd. on Hill Ltd. Hence, Hill Ltd. is not an associate of Sun Ltd.

Working Note:

Calculation of percentage of holding of shares after conversion

	₹
Current holding is 15% i.e. 7,500 shares of ₹ 100 each	7,50,000
Potential equity shares i.e. 5,000 shares of ₹ 100 each	5,00,000
	12,50,000

Total share capital of Hill Ltd. after conversion of debentures into equity shares will be = ₹ 50,00,000 + ₹ 5,00,000 = ₹ 55,00,000

Percentage of holding = ₹ $(12,50,000 / 55,00,000) \times 100 = 22.7\%$ approx.

Question 7

Describe the cases when AS 23 does not allow the use of equity method of accounting?

Solution:

Equity method of accounting is to be followed by all the enterprises having significant influence on their associates **except in the following cases:**

- Control is intended to be temporary because the investment is acquired and held exclusively with a view to its subsequent disposal in the near future.

Or;

- It operates under severe long-term restrictions, which significantly impair its ability to transfer

funds to the investor.

In both the above cases, investment of investor in the share of the investee is treated as investment according to AS 13.

Question 8

NB Pg. No.

When is an investor required to discontinue the use of the equity method of accounting?

Solution:

An investor should discontinue the use of the equity method from the date that:

- a. It ceases to have significant influence in an associate but retains, either in whole or in part, its investment.
- b. The use of the equity method is no longer appropriate because the associate operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor.

From the date of discontinuing the use of the equity method, investments in such associates should be accounted for in accordance with AS 13,

Accounting for Investments. For this purpose, the carrying amount of the investment at that date should be regarded as cost thereafter.