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## ACCOUNTING STANDARD – 23 ACCOUNTING FOR INVESTMENTS IN ASSOCIATES IN CONSOLIDATED FINANCIAL STATEMENTS

Be miserable. Or motivate yourself. Whatever has to be done, it's always your choice.

### 1. NEED OF AS 23

- AS 23 describes the principles and procedures for recognizing **Investments in Associates** (in which the investor has significant influence, but not a subsidiary or joint venture of investor) in the **Consolidated Financial Statements (CFS) of the investor**.
- An investor which presents consolidated financial statements should account for investments in associates **as per Equity Method** in Consolidated Financial Statements accordance with this standard.
- For Standalone Financial Statements, AS 13 shall be applied for Investments.

### 2. IMPORTANT DEFINITIONS

- 1) A **subsidiary** is an enterprise that is controlled by another enterprise (known as the parent).
- 2) A **parent** is an enterprise that has one or more subsidiaries.
- 3) A **group** is a parent and all its subsidiaries.
- 4) 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.
- 5) **Significant influence** is the **power to participate in the financial and/or operating policy decisions** of the investee **but not control** over those policies.
- 6) The **equity method** is a method of accounting whereby the investment is initially recorded at cost, identifying any goodwill/capital reserve arising at the time of acquisition. The carrying amount of the investment **is adjusted thereafter for the post acquisition change in the investor's share of net assets** of the investee. The consolidated statement of profit and loss reflects the investor's share of the results of the operations of the investee.
- 7) **Equity** is the residual interest in the assets of an enterprise after deducting all its liabilities.
- 8) **Consolidated financial statements** are the financial statements of a group presented as those of a single enterprise.

**Note 1: Presumption of significant influence:**

- If an entity holds (directly or indirectly through a subsidiary) **20% or more** of the voting rights of an investee then it is presumed that the entity has significant influence, **unless it can be clearly demonstrated that it is not the case.**
- Conversely, if the entity holds, (directly or indirectly through a subsidiary), less than 20% of the voting power of the investee, it is presumed that the entity does not have significant influence, **unless such influence can be clearly demonstrated.**
- It should be noted that a substantial or majority ownership by another investor does not necessarily preclude an entity from having significant influence.

**Note 2:**

The potential equity shares of the investee held by the investor should not be taken into account for determining the voting power of the investor

**Example 1**

A Ltd. has 70% holding in C Ltd. and B Ltd. also has 28% holding in the same company. So, A Ltd., with the majority holding i.e., more than 50% is the parent company i.e., a holding company. Since B Ltd. holds more than 20% but not more than 50% in C Ltd., C Ltd. will be an associate of B Ltd.

**Example 2**

A Ltd. holds 90% shares in B Ltd. and 10% shares in C Ltd., and B Ltd. is holding 11% shares in C Ltd. In this case, A Ltd. is parent of B Ltd.

As far as the relationship between A Ltd. and C Ltd. is concerned, A Ltd. has a total of direct and indirect holdings of (10 + 11) 21% in C Ltd., Thus, C Ltd. is an associate of A Ltd. It may however be noted that for consolidated financial statement purposes, the holding will be 19.9% (10% + 90% of 11%).

### 3. EQUITY METHOD

In a Simple Language, Equity means Net Assets. Therefore, Equity Method means Measuring the value of Investments in Proportion to Fair Value of Net Assets of Investee (i.e. Associate Entity).

Value of Investment shall be increased or decreased by-	Rs.	2 <sup>nd</sup> effect to-
Cost of Investments (Including Goodwill)	xxxx	
<b>Add/Less:</b> Post acquisition share in P&L of Associate Co. (EAESH)	xxx	CPL of investor
<b>Less:</b> Distributions received by way of dividend	xxx	CPL of Investor
<b>Less:</b> Additional depreciation on revaluation profit of PPE (if any)	xxx	CPL of Investor
<b>Less:</b> Un-realised profit on downstream transaction to the extent of Investor's share in gain/loss of Associate/JV	xxx	CPL of Investor
<b>Value of Investments as per Equity Method</b>	<b>XXXX</b>	

#### Note:

##### 1. Goodwill:

If cost of Investment is greater than investor's share of investees' net assets - it is not separately presented. It is included in the carrying amount of investment.

##### 2. Capital reserves:

If the cost of investment is less than investor's share of investee's net assets - it is recognised directly in Reserves & Surplus in the period in which investment is made.

#### Journal Entry as on acquisition date:

Investment A/c Dr.  
To Capital Reserve A/c

#### Example 3: -

On 1/4/24, B Ltd. acquired 20% Equity interest in A Ltd. at a cost of 2,40,000/-

Fair Value of Net Assets of A Ltd. on 1/4/24 is 10,00,000/-

Apply Equity Method on DOA.

#### Solution:

Cost of Investment @ 20%	2,40,000
(-) Proportionate Value of Net Assets @ 20%	2,00,000
<b>Goodwill</b>	<b>40,000</b>

#### SFS of B Ltd. as on 1/4/24 (AS 13)

Investment @ 20%	2,40,000
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**CFS of B Ltd. as on 1/4/24 (AS 23)**

Investment @ 20% (Including Goodwill 40,000)	2,40,000
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As per AS 23, Goodwill is not required to be recognized separately, it is just a part of Investment Cost.

**Example 4: -**

Same as Example 3, But Fair Value of Net Assets on DOA is 15,00,000

**Solution:**

Cost of Investment @ 20%	2,40,000
(-) Proportionate Value of Net Assets @ 20%	3,00,000
	<b>60,000</b>

Investment are under-valued, We have to record 60,000 to make it @3,00,000

Investment A/c	Dr.	60,000	
	To Capital Reserve A/c		60,000

**CFS of B Ltd. as on 1/4/24 (AS 23)**

Reserves & Surplus : CR	60,000
Investment @ 20%	3,00,000

**Example 5: -**

On 1/4/24, B Ltd acquired 20% Equity Interest in A Ltd. at a cost of 2,40,000/-

On 1/4/24, Equity share Capital of A Ltd. was 8,00,000/- and Reserves & Surplus was 3,00,000

On 31/3/25 Reserves & Surplus of A Ltd was 5,00,000

Apply AS 23 on DOA & Balance Sheet Date.

**Solution:**

Fair Value of Net Assets = 11,00,000

Hence Proportionate Investments should be = 2,20,000

Therefore, Goodwill = 20,000

**Equity Method (AS 23)**

Investment Cost as on DOA (Including Goodwill 20,000)	2,40,000
+ 20% Share in Post-Acquisition Profits of Associate (2,00,000 × 20%)	40,000
Investment 31/3	<b>2,80,000</b>

Post Acquisition Profit Earned by Associate = 2,00,000

Share of Investor in Post Acquisition Profit = 40,000

Investor Shall Increase its Value of Investment by 40,000

**31/3 Journal Entry**

Investment A/c	Dr.	40,000
To Consolidated P&L A/c		40,000

**Consolidated Balance Sheet of Investor**

Reserves & Surplus: Consolidated P&L will be increased by-	40,000
Investment @ 20% (Including Goodwill)	2,80,000

**Example 6: -**

On 1/4/24 B Ltd. acquired 20% Equity interest in A Ltd. at a cost of 2,40,000/-

On 1/4/24 Equity Share Capital of A Ltd was 8,00,000 and Reserves & Surplus of A Ltd. was 3,00,000

On 31/3/25 Reserves & Surplus of A Ltd. was 5,00,000

During 24-25, Dividend Paid by A Ltd. to its Share Holders 15%

Apply AS 23 on DOA & Balance Sheet Date.

**Solution:****Analysis of Profit of A Ltd.**

	Capital Profit	Post - Acquisition	Balance Sheet
Reserves & Surplus	3,00,000	2,00,000	5,00,000
+ Dividend	-	1,20,000	
	<b>3,00,000</b>	<b>3,20,000</b>	

- 3,20,000 is the Total Earning of A Ltd. for the year
- Post-Acquisition share in Profit (20%) = 64,000

**Equity Method**

Investment Cost as on DOA (Including Goodwill 20,000)	2,40,000
(+) 20% share in Post - Acquisition Profit @ 20%	64,000
(-) Dividend Received	(24,000)
<b>Investment @ 20% as per Equity</b>	<b>2,80,000</b>

**1/4/24 - Investment Purchased**

Investment A/c	Dr.	2,40,000
To Bank A/c		2,40,000

**31/3/25 - Consolidation**

Investment A/c	Dr.	64,000
To Consolidated P&L		64,000

During 24-25 - Dividend Received

Bank A/c	Dr.	24,000
To Investment A/c		24,000

(This is not Income. This is Recovery)

## 4. EXEMPTIONS FROM APPLYING THE EQUITY METHOD

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

- a. Significant Influence (Control over Investment) is intended to be *temporary* because the investment is acquired and held exclusively with a view to its subsequent disposal in the near future.
- b. Or Associate Entity 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.

## 5. STEP ACQUISITION IN CASE OF AN ASSOCIATE:

- An enterprise having a share of profits of more than 50% in other company, they are said to be in Parent-Subsidiary relationship. However, if the share in profits is more than 20% but upto 50% then this relationship is termed as associate relationship.
- This stake of 20% can be acquired either in one go or in more than one transaction.
- This share of stake can be increased further say from 25% to 30%. Adjustment should be made with each transaction.

**Case 1: Conversion from a passive investor to an associate in the same year:**

**Example 7:** A Ltd. acquired 10% stake of B Ltd. on April 01 and further 15% on October 01 during the same year. Other information is as follow:

Cost of Investment for 10% ₹ 1,00,000 and for 15% ₹ 1,45,000

Net asset on April 01 ₹ 8,50,000 and on October 01 ₹ 10,00,000.

**Calculations for April 01:**

<b>Cost of investment</b>	<b>₹ 1,00,000</b>
10% share in net asset	<u>₹ 85,000</u>
Goodwill	<u>₹ 15,000</u>

**Calculations for October 01:**

<b>15% share in net asset</b>	<b>₹ 1,50,000</b>
Cost of investment	<u>₹ 1,45,000</u>
Capital Reserve	<u>₹ 5,000</u>
Total goodwill (15,000 - 5,000)	<u>₹ 10,000</u>

**Example 8:** A Ltd. acquired 10% stake of B Ltd. on April 01 and further 15% on 1<sup>st</sup> October of the same year. Other information is as follow:

Cost of Investment for 10% ₹ 1,00,000 and for 15% ₹ 1,55,000

Net asset on 1<sup>st</sup> April ₹ 8,50,000 and on 1<sup>st</sup> October ₹ 10,00,000.

**Calculations for April 01:**

<b>Cost of investment</b>	<b>₹ 1,00,000</b>
10% share in net asset	<u>₹ 85,000</u>
Goodwill	<u>₹ 15,000</u>

**Calculations for October 01:**

<b>Cost of investment</b>	<b>₹ 1,55,000</b>
15% share in net asset	<u>₹ 1,50,000</u>
Goodwill	<u>₹ 5,000</u>
Total goodwill (15,000 + 5,000)	<u>₹ 20,000</u>

**Case 2: Further acquisition in an associate in the same year:**

**Example 9:** A Ltd. acquired 25% stake of B Ltd. on 1<sup>st</sup> April and further 5% on 1<sup>st</sup> October of the same year. Other information is as follow:

Cost of Investment for 25% ₹ 1,50,000 and for 5% ₹ 20,000

Net asset on 1<sup>st</sup> April ₹ 5,00,000.

Profit for the year ₹ 90,000 earned in the ratio 2:1 respectively.

**Calculations for April 01:**

<b>Cost of investment</b>	<b>₹ 1,50,000</b>
25% share in net asset	<u>₹ 1,25,000</u>
Goodwill	<u>₹ 25,000</u>

## Calculations for October 01:

Profits for the first half $(90,000/3) \times 2$	₹ 60,000
Additional share of A Ltd.	5%
Pre-acquisition profits i.e. capital reserve $(60,000 \times 5\%)$	₹ 3,000
5% share in net asset	₹ 25,000
Cost of investment	<u>₹ 20,000</u>
Capital Reserve	<u>₹ 5,000</u>
Cost of Investment on April 01	₹ 1,50,000
Less: Goodwill	<u>₹ 25,000</u>
Carrying Amount on April 01	₹ 1,25,000
Add: Additional Share in Net Asset on October 01	₹ 25,000
Add: Capital share of Profits for first half	₹ 3,000
Add: Revenue shares of Profits for first half $(60,000 \times 25\%)$	₹ 15,000
Add: Revenue shares of Profits for second half $(30,000 \times 30\%)$	<u>₹ 9,000</u>
<b>Total Carrying Amount on March 31</b>	<b><u>₹ 1,77,000</u></b>

## 6. MISCELLANEOUS POINTS UNDER AS 23

### 1. Loss Making Associate Entity:

If, under the equity method, an investor's share of losses of an associate equals or exceeds the carrying amount of the investment, the investor **ordinarily discontinues recognising 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. If the associate subsequently reports profits, the investor resumes including its share of those profits **only after its share of the profits equals the share of net losses that have not been recognised**.

### 2. Different Reporting Periods:

- As far as possible the reporting date of the financial statements **should be same** for consolidated financial statement. If practically it is not possible to draw up the financial statements of one or more enterprise to such date and, accordingly, those financial statements are drawn up to reporting dates different from the reporting date of the investor, adjustments should be made for the effects of significant transactions or other events that occur between those dates and the date of the consolidated financial statements.
- In any case, the difference between reporting dates of the concern and consolidated financial statement **should not be more than six months**.

### 3. Uniform Accounting Policies:

- Accounting policies followed in the preparation of the financial statements of the investor, investee and consolidated financial statement **should be uniform for like transactions and other events** in similar circumstances.
- If accounting policies followed by different enterprises in the group are not uniform, then **adjustments should be made in the items of the individual financial statements to bring it in line with the accounting policy of the consolidated statement**.

### 4. Decline in the Value of Investment:

The carrying amount of investment in an associate should be reduced to recognise a decline, other than temporary, in the value of the investment, such reduction being determined and made for each investment individually.

### 5. Proposed Dividend in Associate Entity:

In case an associate has made a provision for proposed dividend (i.e. dividend declared after the reporting period but it pertains to that reporting year) in its financial statements, the investor's

share of the results of operations of the associate should be computed without taking into consideration the proposed dividend.

## 6. Treatment of Un-realised Profit on Unsold Stock

S.No.	Downstream Transaction (Sale of goods by Investor to Associate)	Upstream Transaction (Sale by Associate to Investor)
1.	Profit is earned by investor	Profit is earned by Associate
2.	Unsold Inventory is lying with Associate	Unsold Inventory is lying with Investor
3.	Investor shall reverse in its own share of profit earned a such Inventory in Consolidated Financial Statement.	Investor shall reverse its own share of profit in Consolidated Financial Statement.
4.	Consolidated Profit and Loss A/c Dr. To Investment A/c  (Since Inventory is lying with Associate, hence Investor can-not credit inventory a/c)	Consolidated Profit and Loss A/c Dr. To Inventory A/c  (Here Inventory is lying with Investor, hence the same is credited)

### Example 10:

B Ltd. (Investor) has 30% Investment in A Ltd. (Associate)

A Ltd. has sold goods costing Rs. 1,00,000 to B Ltd. @Rs. 1,50,000.

All goods are Unsold at year end.

How to eliminate Unrealised Profit?

#### Solution:

Associate has sold goods to Investor so this is an Upstream Transaction

A Ltd. must have recognised profit on sale of Rs. 50,000 in its P&L.

Therefore, Investor's Share in above Profit is Rs. 15,000 (30% of Rs. 50,000) & through equity method this must have been a part of Investment A/c and P&L A/c of B Ltd.

Investment A/c	Dr.	15,000	
To Consolidated P & L A/c			15,000

Now, Investor B Ltd. has unsold Inventory of Rs. 1,50,000 Which includes Rs. 15,000 Profit Shares of Investor (B Ltd.)

Therefore, 15,000 Profit shall be eliminated as under:

Consolidated P & L A/c	Dr.	15,000	
To Inventory A/c			15,000

**In case of A Ltd. is a Subsidiary:**

Consolidated P & L A/c	Dr.	12,000	
Minority Interest A/c		3,000	
To Investment A/c			15,000

**Example 11:**

In Above Example assume B Ltd. (Investor) has Sold goods to A Ltd. (Associate)

**Solution:**Downstream Transaction

- 1) Full 50,000 earned by Investor (B Ltd.) from sale of goods.
- 2) Unsold Inventory lying at Associate at 1,50,000/-

Since Inventory is a part of Net Assets of Associates, we can conclude that Net Assets of Associate Company includes Un-realised profit of 50,000/-

Equity Method means Proportionate Share of Net Assets of Associates. Therefore, when we will apply equity method, Investment must be shown in Proportion of Net Assets i.e., 30% of Net Assets

Which means Investment Value must include 15,000 Un-realised Profit which is to be eliminated.

Consolidated P&L A/c Dr.	15,000
To Investment A/c	15,000

## 7. (MCQ's from ICAI Material)

1. Identity which of the statements are correct.

An enterprise can influence the significant economic decision making by many ways like:

- (i) Representation on the board of directors or governing body of the investee.
- (ii) Participation in policy-making processes.
- (iii) Interchange of managerial personnel.
- (iv) Provision of essential technical information.

- (a) Statement (i) and (ii) are correct.
- (b) Statement (i), (ii) and (iii) are correct.
- (c) Statement (i), (ii), (iii) and (iv) are correct.
- (d) Statement (ii) and (iii) are correct.

2. A Ltd. is holding 90% share in B Ltd. and 10% shares in C Ltd., and B Ltd. is holding 11% shares in C Ltd.

Identity which of the statements are incorrect.

- (i) In this case, A Ltd. is parent of B Ltd.
- (ii) As far as the relationship between A Ltd. and C Ltd. is concerned; A Ltd. has a total of direct and indirect holding of (10% + 90% of 11%) 19.9 % in C Ltd.
- (iii) C Ltd. is an associate of A Ltd.

- (a) Statement (ii) is incorrect.
- (b) Statement (iii) is incorrect.
- (c) Statement (ii) and (iii) both are incorrect.
- (d) All statements are incorrect.

3. A Ltd. acquired 10% stake of B Ltd. on April 01 and further 15% on October 01 of the same year.

Other information is as follows:

Cost of Investment for 10% ₹ 1,00,000 and for 15% ₹ 1,55,000

Net asset on April 01 ₹ 8,50,000 and on October 01 ₹ 10,00,000.

What is the amount of goodwill or capital reserve arising on significant influence?

- (a) Goodwill = ₹ 10,000.
- (b) Goodwill = ₹ 20,000.
- (c) Capital Reserve = ₹ 10,000.
- (d) Capital Reserve = ₹ 20,000.

4. A Ltd. acquired 10% stake of B Ltd. on April 01 and further 15% on October 01 during the same year. Other information is as follow:

Cost of Investment for 10% ₹ 1,00,000 and for 15% ₹ 1,45,000

Net asset on April 01 ₹ 8,50,000 and on October 01 ₹ 10,00,000.

What is the amount of goodwill or capital reserve arising on significant influence?

- (a) Goodwill = ₹ 10,000.

- (b) Goodwill = ₹ 20,000.
- (c) Capital Reserve = ₹ 10,000.
- (d) Capital Reserve = ₹ 20,000.

**5. Identify which of the statements are correct.**

- (i) In case an associate has made a provision for proposed dividend (i.e. dividend declared after the reporting period but it pertains to that reporting year) in its financial statements, the investor's share of the results of operations of the associate should be computed without taking into consideration the proposed dividend.
  - (ii) In case an associate has made a provision for proposed dividend (i.e. dividend declared after the reporting period but it pertains to that reporting year) in its financial statements, the investor's share of the results of operations of the associate should be computed after taking into consideration the proposed dividend.
  - (iii) The potential equity shares of the investee held by the investor should not be taken into account for determining the voting power of the investor.
  - (iv) The potential equity shares of the investee held by the investor should be taken into account for determining the voting power of the investor.
- (a) Statement (i) and (iii).
  - (b) Statement (ii) and (iv).
  - (c) Statement (i) only.
  - (d) Statement (iii) only.

ANSWERS	1	2	3	4	5
	c	a	b	a	a