

ACCOUNTING FOR INVESTMENT IN ASSOCIATES IN CONSOLIDATED FINANCIAL STATEMENTS

AS
23

Coverage	<p>AS 23 describes the principles procedures for recognizing investments in associates (in which the investor has significant influence, but not a subsidiary or joint venture of investor) in consolidated financial statements of the investor.</p> <p style="padding-left: 40px;">An investor which presents consolidated financial statements should account for investments in associates as per equity method in accordance with this standard but in its separate financial statements, AS 13 will be applicable.</p>
Objective	<p>The objective of this Standard is to lay down principles and procedures for recognizing the investments in associates and its effect on the financial operations of the group in the consolidated financial statements.</p> <p>Reference to AS 23 is compulsory for the companies following AS 21 and preparing consolidated financial statement for their group.</p>
Meaning of Associate	<p>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.</p> <p style="padding-left: 40px;"><i>Significant influence is the power to participate in the financial and/or operating policy decisions of the investee but not control over those policies.</i></p> <p style="padding-left: 40px;">Any enterprise having 20% or more of the voting power or any interest directly or indirectly in any other enterprise will be assumed to have significantly influence the other enterprise unless proved otherwise. Significant influence may be gained by share ownership, statute or agreement.</p>
Examples	<p><u>Example 1</u></p> <p>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.</p> <p>Since B Ltd. holds more than 20% but not more than 50% in C Ltd., C Ltd. will be an associate of B Ltd.</p> <p><u>Example 2</u></p> <p>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. 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 holding of (10 + 11) 21% in C Ltd.,</p> <p>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%).</p>
Accounting as per Equity Method	<p>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.</p>

	<p>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 operations of the investee. Goodwill/capital reserve arising on the acquisition of an associate by an investor should be included in the carrying amount of investment in the associate but should be disclosed separately.</p> <p>From the definition, following broad conclusions can be drawn:</p> <ol style="list-style-type: none"> Investment is initially recorded at cost. Any surplus or deficit in cost and net asset to be recorded as goodwill or capital reserve. Distributions received from an investee reduce the carrying amount of the investment. Any subsequent change in share in net asset is adjusted in cost of investment and goodwill/capital reserve. Consolidated Profit & Loss shows the investor's share in the results of operations of the investee.
Circumstances under which Equity Method is Followed	<p>Equity method of accounting is to be followed by all the enterprises having significant influence on their associates <u>except</u> in the following cases:</p> <ol style="list-style-type: none"> 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. <p>An investor should <u>discontinue the use of the equity method</u> from the date that:</p> <ol style="list-style-type: none"> It ceases to have significant influence in an associate but retains, either in whole or in part, its investment. 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. <p>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.</p>
Applicability of Equity Method	<p>Many of the rules followed under equity method for an associate is similar to consolidated financial statement rules as in case of subsidiary i.e. AS 21. Investment in an associate should be recorded as per the equity method from the date when such relation comes in effect.</p> <p>Investment in the associate is recorded at cost and any difference in the cost and investor's share in equity on the date of acquisition is shown as goodwill or capital reserve</p>

Step Acquisition in case of an associate	An enterprise having 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.
Different Reporting Dates	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 6 months.
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.
Carrying 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.
Contingencies	As per AS 4, the investor discloses in the consolidated financial statements: a. Its share of the contingencies and capital commitments of an associate for which it is also contingently liable; and b. Those contingencies that arise because the investor is severally liable for the liabilities of the associate.
Why Equity method adopted?	Investments in associates cannot be treated as a normal investment under AS 13. The intent of investing to such an extent (i.e.; 20% or more but less than 50% of equity) in an associate is an expression of the fact that the investor is not merely interested in the dividend distribution, but also is interested in the participation of decision-making process in the associate. As the investor has significant influence over the associate, the investor has a measure of responsibility for the associate's performance and, as a result, the return on its investment. The investor accounts for this stewardship by extending the scope of its consolidated financial statements to include its share of results of such an associate and so provides an analysis of earnings and investment from which more useful ratios can be calculated.

	As a result, application of the equity method in consolidated financial statements provides more informative reporting of the net assets and net income of the investor.
Disclosures	<ul style="list-style-type: none"> ❖ In addition to the disclosures required above, an appropriate listing and description of associates including the proportion of ownership interest and, if different, the proportion of voting power held should be disclosed in the consolidated financial statements. ❖ Investments in associates accounted for using the equity method should be classified as long-term investments and disclosed separately in the consolidated balance sheet. The investor's share of the profits or losses of such investments should be disclosed separately in the consolidated statement of profit and loss. The investor's share of any extraordinary or prior period items should also be separately disclosed. ❖ The name(s) of the associate(s) of which reporting date(s) is/are different from that of the financial statements of an investor and the differences in reporting dates should be disclosed in the consolidated financial statements. ❖ In case an associate uses accounting policies other than those adopted for the consolidated financial statements for like transactions and events in similar circumstances and it is not practicable to make appropriate adjustments to the associate's financial statements, the fact should be disclosed along with a brief description of the differences in the accounting policies ❖ If an associate is not accounted for using the equity method the reasons for not doing the same. ❖ Goodwill/capital reserve arising on the acquisition of an associate by an investor should be disclosed separately though it is included in the carrying amount of the investment.
Treatment of Proposed Dividend	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.
Consideration of Potential Equity Share	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.

ASSIGNMENT QUESTIONS

Question 1 *(ICAI Study Material)*

A Ltd. acquire 45% of B Ltd. shares on April 01, 2021, the price paid was ₹ 15,00,000. Following are the extracts of balance sheet of B Ltd. as of 1 April 2021:

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 2022. 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, 2022.

Question 2 *(ICAI Study Material)*

A Ltd. acquired 40% share in B Ltd. on April 01, 2021 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 2021-2022, B Ltd. suffered a loss of ₹ 10,00,000; during 2022-2023 loss of ₹ 12,50,000 and during 2023-2024 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	<u>2,00,000</u>
Net Assets	12,00,000
40% share of Net Assets	4,80,000
Less: Cost of Investment	<u>(10,00,000)</u>
Goodwill	<u>5,20,000</u>

Consolidated Balance Sheet (Extract) as on April 01, 2021: ASSETS

Investment in Associate as per AS 23	₹	₹
Share of Net Assets on April 1	4,80,000	
Add: Goodwill	5,20,000	10,00,000

Calculation of Carrying Amount of Investment as at 31 March 2022:

Investment in Associate as per AS 23	₹
Share of Net Assets on 1 April, 2021	4,80,000
Add: Goodwill	<u>5,20,000</u>
Cost of Investment	10,00,000
Less: Loss for the year (10,00,000 x 40%)	<u>(4,00,000)</u>
Carrying Amount of Investment	<u>6,00,000</u>

Consolidated Balance Sheet (Extract) as on March 31, 2022: ASSETS

Investment in Associate as per AS 23	₹	₹
Share of Net Assets on 1 April, 2021	4,80,000	
Less: Share of Loss as above	<u>(4,00,000)</u>	
	80,000	
Add: Goodwill	<u>5,20,000</u>	6,00,000

Calculation of Carrying Amount of Investment as at 31 March 2023:

Investment in Associate as per AS 23	₹
Carrying Amount of Investment as on 31 March 2022	6,00,000
Less: Loss for the year (12,50,000 x 40%)	(5,00,000)
Carrying Amount of Investment	1,00,000

Consolidated Balance Sheet (Extract) as on March 31, 2023: ASSETS

Investment in Associate as per AS 23	₹	₹
Share of Net Assets on 1 April, 2021	4,80,000	
Less: Share of Loss as above (₹4,00,000 + ₹ 5,00,000)	(9,00,000)	
	(4,20,000)	
Add: Goodwill	5,20,000	1,00,000

Calculation of Carrying Amount of Investment as at 31 March 2024:

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

Consolidated Balance Sheet (Extract) as on March 31, 2024: ASSETS

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

If, under the equity method, an investor's share of losses of an associate equal or exceeds the carrying amount of the investment, the investor ordinarily discontinues recognizing its share of further losses and the investment is reported at nil value.

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.

Question 3 *(ICAI Study Material)*

Bright Ltd. acquired 30% of East India Ltd. shares for ₹ 2,00,000 on 01-06-2021. By such an acquisition Bright can exercise significant influence over East India Ltd.

During the financial year ending on 31-03-2021 East India earned profits ₹ 80,000 and declared a dividend of ₹ 50,000 on 12-08-2021. East India reported earnings of ₹ 3,00,000 for the financial year ending on 31-03-2022 (assume profits to accrue evenly) and declared dividend of ₹ 60,000 on 12-06-2022. Calculate the carrying amount of investment in:

- Separate financial statements of Bright Ltd. as on 31-03-2022.
- Consolidated financial statements of Bright Ltd.; as on 31-03-2022.
- What will be the carrying amount as on 30-06-2022 in consolidated financial statements?

Question 4 *(ICAI Study Material)*

A Ltd. acquired 25% of shares in B Ltd. as on 31.3.2021 for ₹ 3 lakhs. The Balance Sheet of B Ltd. as on 31.3.2021 is given below:

	₹
Share Capital	5,00,000
Reserves and Surplus	5,00,000
	10,00,000

Fixed Assets	5,00,000
Investments	2,00,000
Current Assets	3,00,000
	<u>10,00,000</u>

During the year ended 31.3.2022 the following are the additional information available:

- A Ltd. received dividend from B Ltd., for the year ended 31.3.2021 at 40% from Reserves
- B Ltd., made a profit after tax of ₹ 7 lakhs for the year ended 31.3.2022.
- B Ltd., declared a dividend @ 50% for the year ended 31.3.2022 on 30.4.2022.

A Ltd. is preparing Consolidated Financial Statements in accordance with AS21 for its various subsidiaries. Calculate:

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