

## UNIT 2: ACCOUNTING STANDARD 23

### ACCOUNTING FOR INVESTMENTS IN ASSOCIATES IN CONSOLIDATED FINANCIAL STATEMENTS

#### LEARNING OUTCOMES

After studying this unit, you will be able to:

- ◆ Define the terms 'Associates', 'Significant influence', 'Control', 'Equity method' and other related terms used in the standard.
- ◆ Examine the circumstances under which the Equity Method is used.
- ◆ Apply the Equity Method in the accounting of investments in the associates.
- ◆ Disclose the contingences in the consolidated financial statements.
- ◆ Comply with other disclosure requirements as stated in the standard.



### 2.1 INTRODUCTION

AS 23, came into effect in respect of accounting periods commenced on or after 1-4-2002. 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 of the investor. 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.



### 2.2 OBJECTIVE

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. Reference to AS 23 is compulsory for the companies following AS 21 and preparing consolidated

financial statement for their group. For disclosing investment in associates in the separate financial statement of the investor itself, one should follow AS 13.



## 2.3 DEFINITIONS OF THE TERMS USED IN THE ACCOUNTING STANDARD

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. 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.
5. **Equity** is the residual interest in the assets of an enterprise after deducting all its liabilities.
6. **Consolidated financial statements** are the financial statements of a group presented as those of a single enterprise.
7. **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.
8. **Significant influence** is the power to participate in the financial and/or operating policy decisions of the investee but not control over those policies.

This definition excludes the subsidiaries or joint venture from the scope of an associate but apart from these any other enterprises, which are significantly influenced by the investor, is an associate for the purpose of this standard. 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. Similarly any enterprise that does not

have 20% or more control then it is assumed not having significant influence on the enterprise unless proved otherwise.

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

- ◆ Having some voting power.
- ◆ Representation on the board of directors or governing body of the investee.
- ◆ Participation in policy-making processes.

Material transactions between the investor and the investee (Influencing inter-company transactions i.e. sale of goods and services, sharing technical knowledge etc.

- ◆ Interchange of managerial personnel.
- ◆ Provision of essential technical information.

As a general rule, significant influence is presumed to exist when an investor holds, directly or indirectly through subsidiaries, 20% or more of the voting power of the investee.

As with the classification of any investment, the substance of the arrangement in each case should be considered. If it can be clearly demonstrated that an investor holding 20% or more of the voting power of the investee does not have significant influence, the investment will not be accounted for as an associate.

A substantial or majority ownership by another investor does not necessarily preclude an investor from having significant influence.

If the investor holds, directly or indirectly through subsidiaries, 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. The presence of one or more of the indicators as above may indicate that an investor has significant influence over a less than 20% owned corporate investee.

**Control exists when parent company has either:**

- a. The ownership, directly or indirectly through subsidiary(ies), of more than one-half of the voting power of an enterprise.
- b. Or control of the composition of the board of directors in the case of a

company or of the composition of the corresponding governing body in case of any other enterprise so as to obtain economic benefits from subsidiary company's activities.

If any company is controlling the composition of governing body of gratuity trust, provident fund trust etc., since the objective is not the economic benefit and therefore it will not be included in consolidated financial statement.

An enterprise is considered to control the composition of the board of directors of a company or governing body in case of an enterprise other than a company, if it has the power, without the consent or concurrence of any other person, to appoint or remove all or a majority of directors of that company or members of the body. An enterprise is deemed to have the power to appoint a director/member, if any of the following conditions is satisfied:

- (i) A person cannot be appointed as director/member without the exercise in his favour by that enterprise of such a power as aforesaid; or
- (ii) A person's appointment as director/member follows necessarily from his appointment to a position held by him in that enterprise; or
- (iii) The director/member is nominated by that enterprise or a subsidiary thereof.

To understand the above definitions let us take few examples:

### 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. 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., 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%  $(10\% + 90\% \text{ of } 11\%)$ .*



## 2.4 ASSOCIATES ACCOUNTED FOR USING THE EQUITY METHOD

**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 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.

From the definition, following broad conclusions can be drawn:

- In CFS, investment is to be 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.

### Illustration 1

*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:*

<i>Paid up Equity Share Capital</i>	<i>₹ 10,00,000</i>
<i>Securities Premium</i>	<i>₹ 1,00,000</i>
<i>Reserve &amp; Surplus</i>	<i>₹ 5,00,000</i>

*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	<u>5,00,000</u>	
Net Assets	<u>16,00,000</u>	
45% of Net Asset (B)		<u>7,20,000</u>
Goodwill (A-B)		<u>7,80,000</u>

**Calculation of Carrying Amount of Investment in the year ended on 31<sup>st</sup> March, 20X2**

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



## 2.5 CIRCUMSTANCES UNDER WHICH EQUITY METHOD IS FOLLOWED

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. The term 'Near Future' is explained with AS 21.

- b. 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.

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. The reasons for not applying the equity method in accounting for investments in an associate should be disclosed in the consolidated financial statements.



## 2.6 APPLICATION OF THE EQUITY METHOD

- ◆ 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.
- ◆ 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.

### Case 1:

A Ltd. holds 22% share of B Ltd. on 1<sup>st</sup> April of the year and following are the relevant information as available on the date are Cost of Investment ₹ 33,000 and Total Equity on the date of acquisition ₹ 2,00,000.

A Ltd.'s share in equity (2,00,000 x 22%)	₹ 44,000
Less: Cost of Investment	₹ (33,000)
Capital Reserve	₹ 11,000

**Extract of Balance Sheet: ASSETS**

<b>Investment in Associate as per AS 23</b>	<b>₹</b>	<b>₹</b>
Share of Net Assets as on 1 April	44,000	
Less: Capital reserve	(11,000)	33,000

**Case 2:**

A Ltd. holds 22% share of B Ltd. on 1<sup>st</sup> April of the year and following are the relevant information as available on the date are Cost of Investment ₹ 55,000 and Total Equity on the date of acquisition ₹ 2,00,000.

Cost of Investment	₹ 55,000
Less: A Ltd.'s share in equity (2,00,000 x 22%)	₹ 44,000
Goodwill	₹ 11,000

**Extract of Balance Sheet: ASSETS**

<b>Investment in Associate as per AS 23</b>	<b>₹</b>	<b>₹</b>
Share of Net Assets as on 1 April	44,000	
Add: Goodwill	11,000	55,000

◆ **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.



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

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	₹ 85,000
Goodwill	₹ 15,000

***Calculations for October 01:***

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

**Case 2 - Conversion from a passive investor to an associate in the same year:**

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 follow:

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.

***Calculations for April 01:***

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

**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)	₹ 20,000

**Case 3 – Further acquisition in an associate in the same year:**

A Ltd. acquired 25% stake of B Ltd. on April 01 and further 5% on October 01 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 April 01 ₹ 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:**

<b>Profits for the first half <math>(90,000/3) \times 2</math></b>	<b>₹ 60,000</b>
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 x 25%)	₹ 15,000
Add: Revenue shares of Profits for second half (30,000 x 30%)	<u>₹ 9,000</u>
Total Carrying Amount on March 31	<u>₹ 1,77,000</u>

- ◆ If there is any transaction between the Investor Company and investee concern then the unrealised profits on such goods to the extent of investor's share should be eliminated from consolidated financial statement.
- ◆ Any loss on such transactions are not eliminated to the extent that such loss is not recoverable. Otherwise such losses are written off from consolidated financial statement fully.

### Illustration 2

*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	<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, 20X1: ASSETS**

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

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

<b>Investment in Associate as per AS 23</b>	<b>₹</b>
Share of Net Assets on 1 April, 20X1	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, 20X2: ASSETS**

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

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

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

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

<b>Investment in Associate as per AS 23</b>	<b>₹</b>	<b>₹</b>
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:**

<b>Investment in Associate as per AS 23</b>	<b>₹</b>
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	
Carrying Amount of Investment	

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

<b>Investment in Associate as per AS 23</b>	<b>₹</b>
Investment in B Ltd.	-

- ♦ 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.
- ♦ 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.

- ◆ 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.

- ◆ 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.



## 2.7 CONTINGENCIES

In accordance with 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.



## 2.8 WHY IS EQUITY METHOD OF ACCOUNTING ADOPTED FOR INVESTMENT IN ASSOCIATES?

- ◆ 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.

- ◆ Thus, recognition of income on the basis of distributions received may not be an adequate measure of the income earned by an investor on an investment in an associate because the distributions received may bear little relationship to the performance of 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.



## 2.9 DISCLOSURE

- ◆ 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.



## **2.10 RELEVANT EXPLANATIONS TO AS 23**

### **2.10.1 Treatment of Proposed Dividend in Associates in Consolidated Financial Statements**

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.

### **2.10.2 Consideration of Potential Equity Shares for Determining whether an Investee is an Associate**

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.

**Reference:** The students are advised to refer the full text of AS 23 "Accounting for Investments in Associates in Consolidated Financial Statements" (issued 2001).



## TEST YOUR KNOWLEDGE

### MCQs

1. *Identify 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.*

*Identify 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. Identity 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.*

### Theory Questions

- 6. *Describe the cases when AS 23 does not allow the use of equity method of accounting?*
- 7. *When is an investor required to discontinue the use of the equity method of accounting?*

### Practical Questions

- 8. *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:*

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

9. 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>
PPE	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 for 31.3.20X2 on 30.4.20X2 from B Ltd. will be shown in the Consolidated Financial Statements?

## ANSWERS/SOLUTION

### MCQs

1.	(c)	2.	(a)	3.	(b)	4.	(a)	5.	(a)
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### Theory Questions

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

- a. 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.

The term 'Near Future' is explained with AS 21.

Or;

- b. 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.

7. 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.

### Practical Questions

**8. (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 x 30%)	<u>(15,000)</u>
Carrying amount as on 31.3.20X2 as per AS 13	<u>1,85,000</u>

**(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 x 10/12)	<u>75,000</u>
Carrying amount as on 31.3.20X2	<u>2,60,000</u>

**(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 x 30%)	<u>(18,000)</u>
Carrying amount as on 30.6.20X2	<u>2,42,000</u>

**9.** 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 x 40% x 25%)	<u>0.50</u>

\*It is assumed that Bright Ltd. has a subsidiary company and it is preparing Consolidated Financial Statements.

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 ₹ 8 lakhs (₹ 5 lakhs + ₹ 5 lakhs – ₹ 2 lakhs)]	(2.00)
Goodwill	<u>0.50</u>

**(ii) A Ltd.**

**Consolidated Profit and Loss Account for the year ended  
31st March, 20X2 (An extract)**

		<b>₹ in lakhs</b>
Other income:		
Share of profits in B Ltd.		1.75
Pre-acquisition Dividend received from B Ltd.	0.50	
Transfer to investment A/c	<u>(0.50)</u>	Nil

**(iii) A Ltd.**

**Consolidated Balance Sheet as on 31.3.20X2 (An extract)**

		<b>₹ in lakhs</b>
Non-current investments		
Investment in B Ltd.		
Cost of Investment in B Ltd.	2.50	
Share of profit for year 20X1 – 20X2	<u>1.75</u>	
	4.25	
Add: Goodwill	<u>0.50</u>	4.75

**Working Notes:**

1. Pre-acquisition dividend received from B Ltd. amounting to ₹ 0.50 lakhs will be reduced from investment value in the books of A Ltd.
2. 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.

3. Dividend declared on 30th April, 20X2 will not be recognized in the consolidated financial statement of A Ltd.