Accounting standard no 23 Accounting for investments in Associates

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Comparative international standards and highlights

- **IAS 28 investments in associates**
- **Snapshot**
  - **Key objective:**
    - **To provide for the application of equity method of accounting for investments in associates**
    - **To define what is an associate, when is “significant influence” presumed**
  - **Related accounting standards**
    - **Consolidation: AS 21**
    - **Investments in Joint ventures; AS 27**
- **Comparison between IAS and AS**

Scope

- **Provides for adoption of equity method of accounting in consolidated statements**
  - **Does not deal with method of accounting in separate financial statements**
  - **In separate financial statements, AS 30 will continue to apply**
  - **Does not apply in case of**
    - **Joint ventures**
    - **subsidiaries**

Key definitions

- **Associate**
  - Entity over which investor has significant influence
- **Significant influence**
  - Power to participate in financial and/or operating policy decisions of the investee, but not control
  - Presumption of significant influence
    - Investor holding 20% or more of the equity is presumed to be holding significant influence
    - The presumption is rebuttable
    - Conversely, investor holding less than 20% is presumed, subject to rebuttal, to not hold significant influence
- **Control**
  - Defined in the same way as in AS 21

Circumstances indicating significant influence

- Representation on board of directors
- Participation in policy making decisions
- Material transactions between investor and investee
- Interchange of managerial personnel
- Provision of essential technical information

Equity method of accounting

- **Meaning**
  - **At inception**
    - **At cost, adjusting for any goodwill/ capital reserve**
    - **If investment > proportionate net assets, difference is goodwill**
    - **Conversely, difference is capital reserve**
  - **Thereafter, every period, consolidated balance sheet will reflect the proportion of net assets of the associate**
  - **Consolidated P/L account will show the proportionate income of the associate**
  - **Distributions made by the investee reduce the carrying amount of investments**
  - **Adjustments are also made to reflect those changes in equity which are not through P/L**
    - **Revaluation of assets**
    - **Translation of forex items**
    - **Amalgmations**

Exceptions to equity method

- There are two exceptions (as in case of consolidation)
  - Where significant influence is temporary
  - Associate operates under long term restrictions which significantly impair its ability to transfer funds to investor
- Investor should discontinue the equity method
  - When significant influence ceases
  - Use of equity method is no more appropriate
    - Because investee operates under long term restrictions which significantly impair its ability to transfer funds to investor

Equity method procedures

- By and large same procedures as in case of consolidation
  - Investment of the investor in the capital of the investee (A), and investor's portion of the net assets of investee (B), should be treated as follows
    - If is A is more than B, A-B is goodwill
    - If B is more than A, B-A is capital reserve
    - This determination is done on the date of investment
  - Subsequently:
    - Any income received is taken towards the value of the investment
    - Any increase in the value of net investment is income; any decrease is a loss
      - Usually does not recognise any loss above the carrying amount of the investment
  - Unrealised profits should be eliminated to the extent of the investor's share
  - Financial statements should be drawn upto the same date
  - Uniform accounting policies
  - In case of outstanding preference shares, the net income is reduced to provide for preference dividends

Cessation of significant influence

- From the date on which the significant influence ceases, investments are recognised as per AS 13

Accounting in separate financial statements

- **AS 13 (now AS 30) should be applied**