RJA

Rajput Jain & Associates
Chartered Accountants

ACCOUNTING STANDARD 23

Accounting for Investments in Associates in Consolidated Financial Statements

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Commencement

AS - 23 comes into effect from April 1st, 2002.

Objective

The standard deals with the effects of investments in associates on the financial position and operating results of a group.

Scope

'Consolidated Financial Statement' prepared by the investor should account for Investments in associates in accordance with the standard. With regard to 'Separate Financial Statements' prepared by the investor the standard does not apply. For such 'Separate Financial Statements' the investor should apply Accounting Standard 13- Accounting for Investments (AS - 13)

Definitions with Explanations

- **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** is the power of an enterprise to participate in the financial and/ or operating policy decisions of an associate but does not extend to control over such policies. Significant influence may be gained by share ownership, statute or agreement. The existence of significant influence is usually evidenced in one or more ways:

  a) Representation on the Board of Directors or corresponding governing body of the investee;
  b) Participation in policy making processes;
  c) Material transactions between the investor and the investee;
  d) Interchange of managerial personnel; or
  e) Provision of essential technical information.

- Control is exercised either through:
  - **a)** Ownership, directly or indirectly through subsidiaries, of more than half of the voting power of an enterprise; or
  - **b)** 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 its activities.
- **A subsidiary** is an enterprise that is controlled by another enterprise (known as the parent).
- **A parent** is an enterprise that has one or more subsidiaries.
- **A group** is a parent and all its subsidiaries.
- **Consolidated Financial Statements** are the financial statements of a group presented as of a single enterprise.
- **Equity is the residual interest in the assets of an enterprise after deducting all its liabilities. i.e.(Equity + Reserves)**

The Equity Method

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 or to recognize the investor's share of the profits or losses of the investee after the date of acquisition. Distributions received from an investee reduce the carrying amount of investment.

Adjustments to the carrying amount may also be necessary for alterations in the investor's proportionate interest in the investee arising from changes in the investee's equity that have not been included in the statement of profit and loss. Such changes include those arising from the revaluation of fixed assets and investments, foreign exchange translation differences and adjustment of differences arising on amalgamations. In using equity method for accounting for investment in an associate, unrealized profits and losses resulting from transactions between the investor and the associate should be eliminated to the extent of the investor’s interest in the associate. Unrealized losses should not be eliminated, if and to the extent, the cost of the transferred asset cannot be recovered.

Non- Applicability of Equity Method

- **Equity Method does not apply in cases where:**

  a) Investment is acquired and held exclusively with a view to its subsequent disposal in the near future; or
  b) Associate operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor

- **Accounting:**

  Investments in such associates should be accounted for in accordance with AS 13

- **Disclosure:**

  The reasons for not applying the Equity Method in accounting for investments in an associate should be disclosed in the 'Consolidated Financial Statements'.

Discontinuance to Equity Method

- **An investor should discontinue the use of the Equity Method from the date:**

  a) It ceases to have significant influence in an associate but retains, either in whole or in part of its investment; or
  b) The use of 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.

- **Accounting:**

  From the date of discontinuance of the Equity Method, investments in such associates should be accounted for in accordance with AS - 13. For this purpose, the carrying amount of the investment at such date should be regarded as cost thereafter.

Reporting dates of investor and the investee (Associate)

Financial Statement of the investee is usually drawn to the same date as that of the investor. When the reporting dates of the investor and the associate are different, the associate often prepares financial statement drawn to a date that matches the financial statement of the investor. When it is impracticable to have same reporting dates financial statements are drawn with different reporting dates. The consistency principal requires length of reporting periods, and difference in the reporting dates, be consistent from period to period.

When financial statements, with a different reporting date are used, adjustments are made for the effects of any significant events or transactions between the investor (and its consolidated subsidiaries) and the associate that occur between the date of the associate's financial statements and the date of the investor's 'Consolidated Financial Statement.

Accounting Policies

The investor usually prepares 'Consolidated Financial Statements' using uniform accounting policies for the similar transactions and events in similar circumstances. In case associate uses accounting policies other than those adopted by the investor, appropriate adjustments are made to the associate's financial statements when they are used by the investor in applying the Equity Method. If it is impracticable to do so, the fact of difference in accounting policies is disclosed.

Looses on account of investment in associates

In case investor's share of losses in an associate equals or exceeds the carrying amount of investment, the investor ordinarily discontinues recognizing its share of further losses and the investment is reported at nil value. Additional losses are provided for, to the extent the investor has incurred obligations or made payments on behalf of the associate, to satisfy obligations of associate which 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 profits only after its share of profits equals the share of net losses that have not been recognised.

Contingencies

The investor discloses in the 'Consolidated Financial Statements' Contingencies as per Accounting Standard – 4 (Contingencies and Events Occurring after the Balance Sheet Date)

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.

General Disclosure

- Investment in associates are to be listed and described as to the proportion of ownership interest and, in case of difference, the proportion of voting power held should be disclosed in the 'Consolidated Financial Statements'.

- Investments in associates should be classified as long-term investments and disclosed separately in the consolidated balance sheet.

- The investor's share of the profits or losses from 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 different 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

Transitional Provisions

On the first occasion when investment in an associate is accounted for in 'Consolidated Financial Statements' in accordance with this statement, the carrying amount of investment in the associate should be brought to the amount that would have resulted as the Equity Method of accounting had been followed as per this statement since the acquisition of the associate. The corresponding adjustment in this regard should be made in the retained earnings in the 'Consolidated Financial Statements'.

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