ASSIGNMENT ON MODERN ACCOUNTING THEORY AND REPORTING PRACTICES

TOPIC – Investments in Associates

(IAS – 28) (CHAPTER – 16)

BRIEF HISTORY

- Effective issue date : 18.December, 2003
- Amendments : 10.January, 2008

  22.May, 2008
- Reissue : 12.May, 2011

APPLIES TO ANNUAL PERIODS BEGINNING ON OR AFTER 1.JAN,2013

MEANING OF ASSOCIATE

An associate is an enterprise over which the investor has significant influence.

SIGNIFICANT INFLUENCE ???

INVESTOR ???

MEANING OF INVESTOR AND SIGNIFICANT INFLUENCE

1. **INVESTOR –** **The one who invests money in a company or owns a significant proportion of voting shares.**

2. SIGNIFICANT PROPORTION –

By significant proportion we mean that ownership or voting rights of more that 20% but less than 50% including *POTENTIAL VOTING RIGHTS.*

MEANING OF POTENTIAL VOTING RIGHTS

Potential voting rights may arise by owning share warrants, debt or equity instruments that are convertible into ordinary shares or other instruments.

It also includes power produced from the contractual agreements.

EXAMPLE - **A owns 60% of voting rights and B owns 18% of voting rights of C ltd. B also is the sole supplier of raw material to C ltd.**

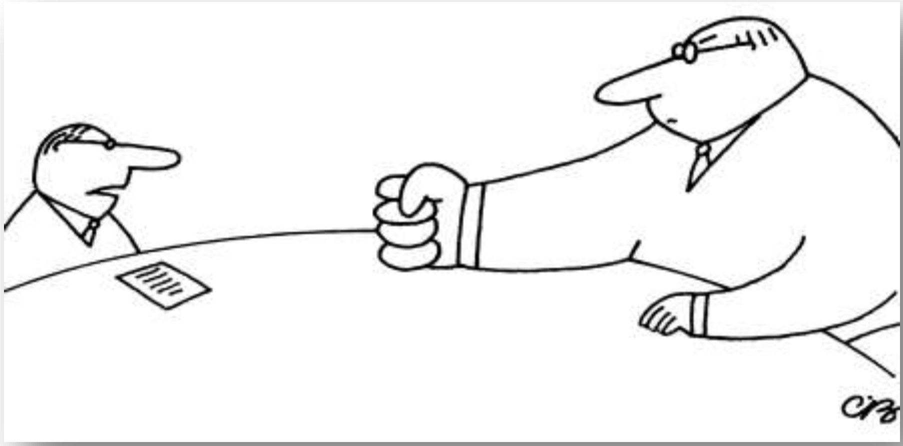
By the virtue of the above contractual agreement B exercises significant influence.

KEY TERMS

CONSOLIDATED FINANCIAL STATEMENTS	• FINANCIAL STATEMENTS OF A GROUP ARE PRESENTED AS THOSE OF A SINGLE ENTITY
CONTROL	• POWER TO GOVERN THE FINANCIAL AND OPERATING POLICIES OF AN ENTITY TO OBTAIN BENEFIT FROM ITS ACTIVITIES
JOINT CONTROL	• CONTRACTUALLY AGREED SHARING OF CONTROL OVER AN ACTIVITY
GOODWILL	• THE AMOUNT BY WHICH THE PRICE PAID BY THE ACQUIRER EXCEEDS THE VALUE OF THE ACQUIRED INTEREST IN NET ASSETS OF THE ACQUIREE

HOW TO IDENTIFY SIGNIFICANT INFLUENCE???

- BY REPRESENTATION ON THE BOARD OF DIRECTORS
- BY PARTICIPATION IN POLICY MAKING PROCESS
- THROUGH MATERIAL TRANSACTIONS BETWEEN INVESTOR AND INVESTEE (ASSOCIATE)
- THERE IS MOVEMENT OF MANAGERIAL PERSONNEL BETWEEN THE INVESTOR AND ASSOCIATE
- THERE IS A PROVISION OF ESSENTIAL TECHNICAL INFORMATION BETWEEN THE INVESTOR AND THE ASSOCIATE



EQUITY METHOD

MEANING – ***It is a method of accounting whereby the investments in shares is initially recorded at the cost of the shares and adjusted thereafter for the post acquisition change in the investor's share of net assets of the investee***

Adjustment for earnings

Increase the carrying value of investment

Adjustment for losses

Decrease the carrying value of investment

METHOD OF ACCOUNTING AT THE TIME OF ACQUISITION

- **Record investment on cost**
- **Determine the proportionate value of net assets I.E. (Assets – liabilities * rate/100)**
- **Calculate value of goodwill or capital reserve by comparing cost of investment with proportion of net assets**
- **The goodwill or capital reserve as determined above should be included in the carrying amount of investment with a separate disclosure**
- **Carrying amount is increased or decreased to recognize post acquisition changes in the equity or net assets**

CONTINUED

- **Change in net assets may arise du to mainly two reasons:**
  1. **profits or losses**
  2. **revaluation of fixed assets**
- **Dividend received from the associate should be reduced from the carrying amount of the investment. If it is *PRE ACQUISITION DIVIDEND* then it should be deducted from cost of investment**

EXAMPLE

- S ltd. Purchased 30% stake in R ltd. On 1st April, 2016 for Rs 34 lacs. Equity of R ltd. On that date was 100 lacs. R ltd reported a profit of 50 lacs for the year 2016-2017.

What would be the balance in consolidated financial statements of S ltd as on 31st March, 2017 ???

SOLUTION :

Cost of investment = 34

LESS: proportional equity of associate = 30

(100*30%)

GOODWILL = 4

Cost(incl. g/w) = 34

ADD : share of post acquisition period reserves = 15

(50*30%)

CARRYING AMOUNT = 49

EXCEPTIONS TO THE EQUITY METHOD

- Where investment is classified as held for sale
- Where investor does not present consolidated financial statements due to the exemption in IAS 27 (consolidated and separate financial statements)
- Investor is not needed to apply equity method when:

If investor is wholly or partially owned subsidiary and its owner does not objects on not applying equity method

Debt or equity instruments of investor are not traded in public

Investor is not in the process of filing its financial statements with securities commission for issuing financial statements

If the ultimate parent of the investor produces consolidated financial statements that are available for public use

SOME OTHER IMPORTANT POINTS

- The investor should compute his share of profits and losses after adjusting preference shares dividend
- The value of the profits/losses and net assets are to be taken from the associate's financial statements
- In case of losses decrease the carrying amount and vice versa in case of profits
- Losses over and above the carrying amount should be recorded as liability only if investor has committed to make payments

BASIS FOR ACCOUNTING AFTER ACQUISITION

ADJUSTMENTS

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IMPAIRMENT LOSSES

DIFFERENT REPORTING PERIOD AND UNIFORM ACCOUNTING POLICIES

- **If the investor and associate are maintaining their accounts on different reporting date then associate will have to change its reporting date to that of the investor.**

- **If the investor and its associate are following different accounting policies then associate will have to change its accounting policies to that of investor.**

CONCEPT OF IMPAIRMENT LOSSES

- After applying equity method, entity applies IAS 39 in order to determine impairment loss

***IMPAIRMENT LOSS*= CARRYING VALUE – RECOVERABLE AMOUNT**

- If impairment is indicated then IAS 36 is applied to calculate the amount
- The entire carrying amount is tested for impairment and goodwill is not tested separately
- The amount of impairment loss is debited to P/L account

DISCONTINUATION OF EQUITY METHOD

The investor should discontinue equity method from the date :

- **When the significant influence ceases to exist**
- **When the associate operates under severe long term restrictions that impact its ability to transfer funds to investor**
- **When an entity ceases to be an ASSOCIATE**
- **When the entity becomes SUBSIDIARY**
- **When an investment in an associate becomes an investment in joint venture**

SOME IMPORTANT DISCLOSURES

- Fair value of investment in associate
- Aggregate amounts of assets, liabilities, revenue and profit/loss
- Reasons for significant influence
- Reasons for different reporting dates of financial statements of associate and investor
- Nature and extent of inability of associates to transfer funds to investor
- Equity method investment should be classified as non current assets
- Reasons for why associate is not accounted for using the equity method

ASSOCIATES OF PNB

- **DOMESTIC ASSOCIATES :**

1. Madhya Bihar Gramin Bank, Patna
2. Himachal Gramin Bank, Mandi
3. Punjab Gramin Bank, Kapurthala
4. PNB Housing Finance Ltd.
5. PNB MetLife

- **INTERNATIONAL ASSOCIATES:**

1. JSC Tengri Bank, Kazakhstan

THANKYOU