**Accounting Standard (AS) 23**
**(issued 2001)**

# Accounting for Investments in Associates in Consolidated Financial Statements

## Contents

# Accounting Standard (AS) 23
**(issued 2001)**

# Accounting for Investments in Associates in Consolidated Financial Statements[1]

*[This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective, the Preface to the Statements of Accounting Standards[2] and the 'Applicability of Accounting Standards to Various Entities' (See Appendix 1 to this Compendium).]*

## Objective

The objective of this Standard is to set out principles and procedures for recognising, in the consolidated financial statements, the effects of the investments in associates on the financial position and operating results of a group.

## Scope

***1. This Standard should be applied in accounting for investments in associates in the preparation and presentation of consolidated financial statements by an investor.***

2. This Standard does not deal with accounting for investments in associates

[1] It is clarified that AS 23 is mandatory if an enterprise presents consolidated financial statements. In other words, if an enterprise presents consolidated financial statements, it should account for investments in associates in the consolidated financial statements in accordance with AS 23 from the date of its coming into effect, i.e., 1-4-2002 (see 'The Chartered Accountant', July 2001, page 95).

[2] Attention is specifically drawn to paragraph 4.3 of the Preface, according to which Accounting Standards are intended to apply only to items which are material.

in the preparation and presentation of separate financial statements by an investor.[3]

# Definitions

***3. For the purpose of this Standard, the following terms are used with the meanings specified:***

***3.1 An <u>associate</u> is an enterprise in which the investor has significant influence and which is neither a subsidiary nor a joint venture[4] of the investor.***

***3.2 <u>Significant influence</u> is the power to participate in the financial and/ or operating policy decisions of the investee but not control over those policies.***

***3.3 <u>Control:</u>***

> ***(a) the ownership, directly or indirectly through subsidiary(ies), of more than one-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.***

***3.4 A <u>subsidiary</u> is an enterprise that is controlled by another enterprise (known as the parent).***

***3.5 A <u>parent</u> is an enterprise that has one or more subsidiaries.***

***3.6 A <u>group</u> is a parent and all its subsidiaries.***

***3.7 <u>Consolidated financial statements</u> are the financial statements of a group presented as those of a single enterprise.***

---

[3] Accounting Standard (AS) 13, 'Accounting for Investments', is applicable for accounting for investments in associates in the separate financial statements of an investor.

[4] Accounting Standard (AS) 27, 'Financial Reporting of Interests in Joint Ventures', defines the term 'joint venture' and specifies the requirements relating to accounting for investments in joint ventures.

***3.8 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.***

***3.9 Equity is the residual interest in the assets of an enterprise after deducting all its liabilities.***

4. For the purpose of this Standard significant influence does not extend to power to govern the financial and/or operating policies of an enterprise. Significant influence may be gained by share ownership, statute or agreement. As regards share ownership, if an investor holds, directly or indirectly through subsidiary(ies), 20% or more of the voting power of the investee, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investor holds, directly or indirectly through subsidiary(ies), 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. A substantial or majority ownership by another investor does not necessarily preclude an investor from having significant influence.

Explantion :

In considering the share ownership, the potential equity shares of the investees held by the investor are not taken into account for determining the voting power of the investor.

5. The existence of significant influence by an investor is usually evidenced in one or more of the following 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.

6. Under the equity method, the investment is initially recorded at cost, identifying any goodwill/capital reserve arising at the time of acquisition and the carrying amount is increased or decreased to recognise 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 the 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, from foreign exchange translation differences and from the adjustment of differences arising on amalgamations.

Explanations:

(a) Adjustments to the carrying amount of investment in an investee arising from changes in the investee's equity that have not been included in the statement of profit and loss of the investee are directly made in the carrying amount of investment without routing it through the consolidated statement of profit and loss. The corresponding debit/credit is made in the relevant head of the equity interest in the consolidated balance sheet. For example, in case the adjustment arises because of revaluation of fixed assets by the investee, apart from adjusting the carrying amount of investment to the extent of proportionate share of the investor in the revalued amount, the corresponding amount of revaluation reserve is shown in the consolidated balance sheet.

(b) In case an associate has made a povision for proposed dividend in its financial statements, the investor's share of the results of operations of the associate is computed without taking in to consideration the proposed dividend.

## Accounting for Investments – Equity Method

***7. An investment in an associate should be accounted for in consolidated financial statements under the equity method except when:***

***(a) the investment is acquired and held exclusively with a view to its subsequent disposal in the near future; or***

***(b) the associate operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor.***

***Investments in such associates should be accounted for in accordance with Accounting Standard (AS) 13, Accounting for Investments. The reasons for not applying the equity method in accounting for investments in an associate should be disclosed in the consolidated financial statements.***

***Explanation:***

***The period of time, which is considered as near future for the purposes of this Standard, primarily depends on the facts and circumstances of each case. However, ordinarily, the meaning of the words 'near future' is considered as not more than twelve months from acquisition of relevant investments unless a longer period can be justified on the basis of facts and circumstances of the case. The intention with regard to disposal of the relevant investment is considered at the time of acquisition of the investment. Accordingly, if the relevant investment is acquired without an intention to its subsequent disposal in near future, and subsequently, it is decided to dispose off the investment, such an investment is not excluded from application of the equity method, until the investment is actually disposed off. Conversely, if the relevant investment is acquired with an intention to its subsequent disposal in near future, however, due to some valid reasons, it could not be disposed off within that period, the same will continue to be excluded from application of the equity method, provided there is no change in the intention.***

8. 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.

***9. 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; or***

***(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 Accounting Standard (AS) 13, Accounting for Investments. For this purpose, the carrying amount of the investment at that date should be regarded as cost thereafter.***

## Application of the Equity Method

10. Many of the procedures appropriate for the application of the equity method are similar to the consolidation procedures set out in Accounting Standard (AS) 21, Consolidated Financial Statements. Furthermore, the broad concepts underlying the consolidation procedures used in the acquisition of a subsidiary are adopted on the acquisition of an investment in an associate.

11. An investment in an associate is accounted for under the equity method from the date on which it falls within the definition of an associate. On acquisition of the investment any difference between the cost of acquisition and the investor's share of the equity of the associate is described as goodwill or capital reserve, as the case may be.

***12. 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.***

***13. In using equity method for accounting for investment in an associate, unrealised profits and losses resulting from transactions between the investor (or its consolidated subsidiaries) and the associate should be eliminated to the extent of the investor's interest in the associate. Unrealised losses should not be eliminated if and to the extent the cost of the transferred asset cannot be recovered.***

14. The most recent available financial statements of the associate are used by the investor in applying the equity method; they are usually drawn up to the same date as the financial statements of the investor. When the reporting dates of the investor and the associate are different, the associate often prepares, for the use of the investor, statements as at the same date as the financial statements of the investor. When it is impracticable to do this, financial statements drawn up to a different reporting date may be used. The consistency principle requires that the length of the reporting periods, and any difference in the reporting dates, are consistent from period to period.

15. 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 (or 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 statements.

16. The investor usually prepares consolidated financial statements using uniform accounting policies for the like transactions and events in similar circumstances. In case an associate uses accounting policies other than those adopted for the consolidated financial statements for like transactions and events in similar circumstances, 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 not practicable to do so, that fact is disclosed along with a brief description of the differences between the accounting policies.

17. If an associate has outstanding cumulative preference shares held outside the group, the investor computes its share of profits or losses after adjusting for the preference dividends whether or not the dividends have been declared.

18. 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.

19. Where an associate presents consolidated financial statements, the results and net assets to be taken into account are those reported in that associate's consolidated financial statements.

***20. 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

21. In accordance with Accounting Standard (AS) 4, Contingencies and Events Occurring After the Balance Sheet Date[5], 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.

# Disclosure

***22. In addition to the disclosures required by paragraphs 7 and 12, 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.***

***23. 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***

[5] Pursuant to AS 29, Provisions, Contingent Liabilities and Contingent Assets, becoming mandatory, all paragraphs of AS 4 that deal with contingencies stand withdrawn except to the extent they deal with impairment of assets not covered by other Accounting Standards.

***statement of profit and loss. The investor's share of any extraordinary or prior period items should also be separately disclosed.***

***24. 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.***

***25. 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.***

## Transitional Provisions

***26. On the first occasion when investment in an associate is accounted for in consolidated financial statements in accordance with this Standard the carrying amount of investment in the associate should be brought to the amount that would have resulted had the equity method of accounting been followed as per this Standard since the acquisition of the associate. The corresponding adjustment in this regard should be made in the retained earnings in the consolidated financial statements.***