THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

INVESTMENT IN ASSOCIATES I LKAS 28

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If Investor has Significant Influence over Investee, that is called an Associate Investment

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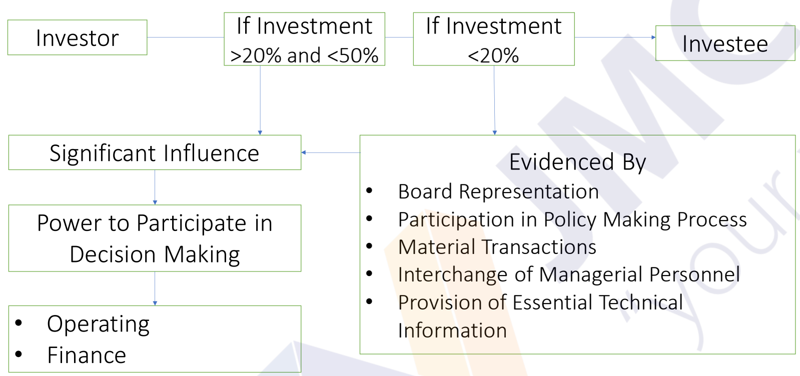

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Accounting for Associate Investments

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Accounting for Associate

- In Investors Books
  - Cost
  - Fair Value
    - Fair Value through OCI
    - Fair Value through PnL
  - Equity Method
- In Consolidated Books
  - Equity Method

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Exceptions to Apply Equity Method

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Exempted from Applying Equity Method

- If Investor is an Investment Entity (SLFRS 09)
- If Associate Investment is Held for Sale (SLFRS 05)
- If ALL following Criteria Met
  - Owners of Investor Agree for Not Applying
  - Investor is Not Listed
  - Not in the Process of Getting Listed
  - Ultimate or Intermediate Parent Prepares and Publish Consolidated Financials

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What if Associate Year End is Different to Investor's Year End?

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Year End Difference

- Less than 03 Months
  - Ignore and Apply Equity Method
  - Adjust Significant Transactions
- More than 03 Months
  - Associate Needs to Prepare
  - Separate Set of Financials

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Equity Method

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Equity Method

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Investment in Associate Valued @

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Share of Net Assets (% of NA)

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Initial Investment + Gain on Bargain Purchase ± Share of Change in Net Assets ± Other Adjustments

Other Adjustments:

- Fair Value Adjustments
- Share of Depreciation
- Share of Unrealized Profits
- Dividend Adjustments

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Question 23

P invested Rs.100,000/- in 25% of equity shares of A on 01 April 2020. As at the date of Investment A had book value of net assets to the value of Rs.320,000/-. There were no fair value adjustments.

1. Calculate the Goodwill on Investment in Associate
2. Explain the Accounting Treatment

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Question 24

P invested Rs.60,000/- in 25% of equity shares of A on 01 April 2020. As at the date of Investment A had a book value of net assets to the value of Rs.320,000/-. There were no fair value adjustments.

1. Calculate the Gain on Bargain Purchase on Investment in Associate
2. Explain the Accounting Treatment

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Question 25

P invested Rs.100,000/- in 25% of equity shares of A on 01 April 2020. As at the date of Investment A had a book value of net assets to the value of Rs.300,000/- and Fair value gain on Property plant and equipment is Rs.20,000/-

1. Calculate the Goodwill on Investment in Associate
2. Explain the Accounting Treatment for Fair Value Gain
3. The particular property plant and equipment item is subject to depreciation of 20% per annum. Calculate the Depreciation for the year ended 31/3/2021
4. Explain the Accounting Treatment for Depreciation

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Understanding EQUITY Method (Share of Net Assets)

JMC Jayasekera Management Centre

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Investment in Associate in Consolidated Books

Equity Method = Share of Net Assets

Normal Method
- Initial Share of Net Assets
- + Share of Subsequent Profits
- + Share of Subsequent OCI
- (-) Share of Dividends

Other Method

Share of Assets of Associate − Share of Liabilities of Associate

Share of Assets of Associate	Share of Liabilities of Associate
Examples	*Examples*
Share of PPE	Share of Bank Loans
Share of IA	Share of Gratuity
Share of Investments	Share of Debentures
Share of Inventory	Share of Payables
Share of Receivables	Share of Accruals
Share of Cash	Share of Overdraft

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Associate's Share of Profits and Share of OCI will be transferred to Console Reserves

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Question 26

A Plc bought 40,000 ordinary shares on 01/04/2019 in B Plc at a cost of Rs 38,000 when the statement of financial position of B Plc was as follows.

	Rs.	Rs.
Non-Current Assets		
Intangible Assets	30,000	
Tangible Assets	120,000	150,000
Current Assets		40,000
Total Assets		190,000
Equity		
Stated Capital (Rs.1/- per share)	100,000	
Retained Earnings	40,000	140,000
Non-Current Liabilities		30,000
Current Liabilities		20,000
Total Equity and Liabilities		190,000

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Question 26

During the year to 31 March 2020 B Plc made a profit before tax of Rs. 82,000 and the taxation charge on the year's profits was Rs 32,000. A dividend of Rs 20,000 was paid on 31 March 2020 out of these profits.

Calculate the entries for the associated company which would appear in the consolidated accounts of the A Plc, in accordance with the requirements of LKAS 28.

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Question 27

On 01 January 2019, the net tangible assets of A Ltd amount to Rs 2,400,000 financed by 1,000,000 Rs 1 ordinary shares and revenue reserves of Rs. 1,400,000. H Ltd, a company with subsidiaries, acquires 300,000 of the shares in A Ltd for Rs 1,000,000. During the year ended 31 December 2019 A Ltd.'s profit after tax is Rs. 500,000, from which preference dividends of Rs. 280,000 are applicable to cumulative preference shares. H has not made any investments in preference shares of A.

Show how H Ltd.'s investment in A Ltd would appear in the consolidated statement of financial position at 31 December 2019.

Goodwill and Gain on Bargain Purchase on Associate

Goodwill on Associate Investment will be Implicitly included in Investment in Associate. However, the Gain on Bargain Purchase shall be Recognized.

Calculation

P → **Step 01** — Investment Percentage / Investment Date → A

Step 02
FV of Consideration

Step 03
Fair Value of Associate Net Assets

	@ Invest Date	Change in NA	@ Rptng Date
Share Capital	XX		XX
Retained Earnings	X	(XX-X)	XX
Book Value of Net Assets	XXX		
Fair Value Adjustments	X		
Fair Value of Net Assets	XXX		

Step 04
Share of FV of Net Assets = FV of NA X Invest %

Step 05 = 2 - 4
Positive = Goodwill
Negative = Gain on Bargain Purchase

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Accounting for Goodwill and Gain on Bargain Purchase on Associate

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Accounting for Goodwill and Gain on Bargain Purchase on Associate

Goodwill on Associate → Included in Investment in Associate Itself → No Adjustment

Gain on Bargain Purchase on Associate → Not Included in Investment → Dr Investment in Associate / Cr Console RE

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Investment Day Fair Value Adjustments on Associate's Net Assets

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Share of Investment day Fair Value Adjustments will be Implicitly included in Investment in Associate. However, the Subsequent Share of Depreciation shall be Recognized.

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Accounting for Fair Value Adjustments and Share of Depreciation

Fair value Adjustments on Net Assets → Included in Investment in Associate Itself → No Adjustment

Depreciation on Fair Value Adjustments → Not Included → Share of Depreciation → Dr Console RE / Cr Investment in Associate

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Other Adjustments for Associate

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Intercompany Balances between Associate and Group

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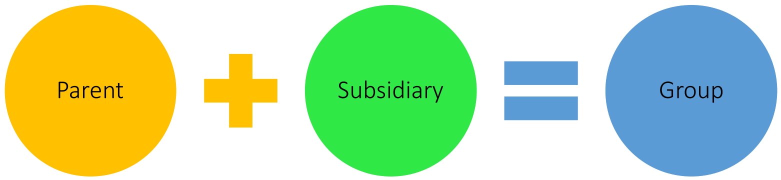

Associate is Not a Part of The Group
Associate Assets Liabilities are not Line by Line Added

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Intercompany Balances between Group and Associate SHALL NOT be ELIMINATED

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Share of Unrealized Profits in Inventory

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Share of Unrealized Profits on Inventory will Overstate Seller's Profits and Buyer's Inventory. That shall be Eliminated.

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Why We Should Eliminate Share of Unrealized Profits in Inventory?

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Seller Parent -> Buyer Associate

Seller Subsidiary -> Buyer Associate

Unsold Inventory

Unrealized Profits in Buyer Associate's Inventory

Associate's Share of Inventory is Included in Investment in Associate

Seller's Profit Included in Consolidated Retained Earnings

Seller's Profit Included in Subsidiary Post Acquisition Retained Earnings

From Share of Unrealized Profits

Investment in Associate Overstated
Seller Parents Console Profit Overstated

Investment in Associate Overstated
Seller Subsidiary's Post Acquisition Profit shared among parent and NCI is Overstated

Needs to be Eliminated

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Seller Associate -> Buyer Parent

Seller Associate -> Buyer Subsidiary

Unsold Inventory

Buyer Parent's Inventory Included in Consolidated Inventory

Buyer Subsidiary's Inventory Included in Consolidated Inventory

Seller Associate's Share of Profits included in Consolidated Retained Earnings

Share of Unrealized Profits

Console Inventory Overstated
Console Profit Overstated

Eliminated

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How to Eliminate Share of Unrealized Profits in Inventory?

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Accounting for Elimination of Share of Unrealized Profits on Inventory

Share of Unrealized Profits

- Calculate Unrealized Profits: Unit Profit/Unit Selling Price X Inventory
- Calculate Share of Unrealized Profits: URP X Associate Investment %

Seller

- Parent
  - Dr. Console RE
  - Cr. Investment in Associate
- Subsidiary
  - Dr. Console RE (%URP X P%)
  - Dr. NCI (%URP X NCI%)
  - Cr. Investment in Associate
- Associate
  - Dr. Console RE
  - Cr. Console Inventory

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Question 28

P owns 40% of the equity shares of A. During the year P has sold Rs. 3,000,000 of goods to A at a markup on cost of 20%. At the reporting date 80% of these items remain in A's inventory.

Determine the accounting entries relating to share of unrealized Profit
Determine the accounting entries relating to share of unrealized Profit if A has sold goods to P

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Share of Unrealized Profits on Property Plant and Equipment

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Share of Unrealized Profits on PPE will Overstate Seller's Profit and Buyer's PPE. Buyer will Recognize Share of Excess Depreciation on such Unrealized Profits. Both Share of Unrealized Profits and Share of Depreciation Shall be Eliminated.

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Why We Should Eliminate Share of Unrealized Profits in PPE?

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Why We Should Eliminate Share of Unrealized Profits and Share of Depreciation?

Seller Parent	Buyer Associate
Share of Profit Included in • Seller Parent's Profit (Console RE) • Buyer Associate's PPE (Investment in Associate)	Share of Over Depreciation included in • Buyer Associate's PPE (Investment in Associate) • Buyer Associate's Profit (Console RE)
Eliminated to Overcome Overstatements	Eliminate Over Depreciation

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Why We Should Eliminate Share of Unrealized Profits and Share of Depreciation?

Seller Subsidiary	Buyer Associate
Share of Profit Included in • Seller Subsidiary's Profit (S' Post Acquisition RE shared among parent and NCI) • Buyer Associate's PPE (Investment in Associate)	Share of Over Depreciation included in • Buyer Associate's PPE (Investment in Associate) • Buyer Associate's Profit (Console RE)
Eliminated to Overcome Overstatements	Eliminate Over Depreciation

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Why We Should Eliminate Share of Unrealized Profits and Share of Depreciation?

Seller Associate	Buyer Parent
Share of Profit Included in • Seller Associate's Profit (Console RE) • Buyer Parent's PPE (Console PPE)	Share of Over Depreciation included in • Buyer Parent's PPE (Console PPE) • Buyer Parent's Profit (Console RE)
Eliminated to Overcome Overstatements	Eliminate Over Depreciation

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Why We Should Eliminate Share of Unrealized Profits and Share of Depreciation?

Seller Associate → Buyer Subsidiary

Seller Associate

Share of Profit Included in
- Seller Associate's Profit (Console RE)
- Buyer Subsidiary's PPE (Console PPE)

Eliminated to Overcome Overstatements

Buyer Subsidiary

Over Depreciation included in
- Buyer Subsidiary's PPE (Console PPE)
- Buyer Subsidiary's Profit (S' Post Acquisition RE shared among parent and NCI)

Eliminate Over Depreciation

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How to Eliminate Share of Unrealized Profits in PPE?

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How to Eliminate Share of Unrealized Profits?

Share of Unrealized Profits on Seller

Calculate Unrealized Profits	Disposal Value – Carrying Value
Calculate Share of Unrealized Profits	URP X Associate Investment %

Seller

Parent	Subsidiary	Associate
Dr. Console RE Cr. Investment in Associate	Dr. Console RE (%URP X P%) Dr. NCI (%URP X NCI%) Cr. Investment in Associate	Dr. Console RE Cr. Console PPE

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How to Eliminate Share of Depreciation?

Share of Depreciation by Buyer

Calculate Share of Depreciation	Share of URP/Remaining Useful Life X Period Used

Buyer

Associate	Parent	Subsidiary
Dr. Investment in Associate Cr. Console RE	Dr. Console PPE Cr. Console RE	Dr. Console PPE Cr. Console RE (%URP X P%) Cr. NCI (%URP X NCI%)

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Dividends from Associate

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Associate's Dividends Reduces the Net Assets, Thus it'll Reduce the Value of Investment In Associate. If Investor has recognized the Share of Dividends as Other Income such shall be Adjusted to Investment in Associate.

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Dividend Adjustment

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Steps to Follow to Eliminate Associate's Dividend

Share of Dividends from Associate

Associate Paid Investor Received	Associate Paid Investor has not Received	Associate Recognized Div. Payable Investor Recognized Div Receivable	Associate Recognized Div. Payable Investor Has Not Recognized Div Receivable
No Adjustment	Dr. C. Cash Cr. C. RE	No Adjustment	Dr. Dividend Receivable Cr. Console RE

Reduction of Share of Net Assets Get's Adjusted, As We Take the Share of Change in Net Assets

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Question 29

Below are the statements of financial position of three entities as at 31 December 2019.

	Tom	James	Emily
	Rs.000	Rs.000	Rs.000
Non-current assets			
Property, plant & equipment	959	980	840
Investments: 630,000 shares in James	805	-	-
168,000 shares in Emily	224	-	-
	1,988	**980**	**840**
Current assets			
Inventory	380	640	190
Receivables	190	310	100
Cash and cash equivalents	35	58	46
Total assets	**2,593**	**1,988**	**1,176**

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Question 29

	Tom	James	Emily
	Rs.000	Rs.000	Rs.000
Equity			
Share capital (Rs 1 shares)	1,120	840	560
Retained earnings	1,232	602	448
	2,352	**1,442**	**1,008**
Current liabilities			
Trade payables	150	480	86
Dividend Payable	-	-	50
Taxation	91	66	32
Total Equity & Liabilities	**2,593**	**1,988**	**1,176**

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Question 29

(1) Tom acquired its shares in James on 1 January 2019 when James had retained earnings of Rs 160,000. NCIs are to be valued at their fair value at the date of acquisition. The fair value of the NCI holding in James at 1 January 2019 was Rs 250,000.

(2) Tom acquired its shares in Emily on 1 January 2019 when Emily had retained earnings of Rs 140,000. There's a fair value excess of Rs.100,000/- relevant to PPE which had a remaining useful of 05 years.

(3) An impairment test at the year-end shows that the goodwill for James remains unimpaired but that the investment in Emily is impaired by Rs 2,000.

(4) During the year Emily sold Rs.100,000/- worth of goods to Tom of which 50% remain at Tom's inventory. Emily keeps 20% profit margin.

(5) During the year James sold Rs.200,000/- worth of goods to Emily of which 60% was sold to outsiders. James keeps 25% profit markup.

(6) On 1/7/2019 Tom sold a motor vehicle to Emily for Rs.500,000/-. The motor vehicle had a carrying value of Rs.400,000 and a remaining useful life of 4 years.

(7) On 1/10/2019 Emily sold an Equipment to Tom for Rs.400,000/-. It had a carrying value of Rs.600,000 and a remaining useful life of 5 years.

(8) Emily has a declared a dividend of Rs.50,000/- on 31 December 2019. Tom has not accounted for it's share of dividend.

Prepare the consolidated statement of financial position for the year ended 31 December 2019.

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