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LKAS 28 - Investments in Associates and SLFRS 11 - Joint Arrangement

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JAYASEKERA MANAGEMENT CENTRE (PVT) LTD
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"An associate is an entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture"

1. Significant influence – Associates

- 20% or more of voting power
- Indicators
  - ➢ Representation on board of directors
  - ➢ Participation in policy making process
  - ➢ Material transactions between investor and investee
  - ➢ Interchange of managerial personnel
  - ➢ Provision of essential technical information
- Potential voting rights included

2. Accounting for associates

- Consolidated financial statements
  - ➢ Must apply the equity method
  - ➢ Except when:
    - ✓ investee classified as held for sale (SLFRS 5)
    - ✓ exemption applies
- Separate financial statements
  - ➢ at cost; or
  - ➢ in accordance with SLFRS 39
  - ➢ equity method of accounting

3. Equity method

- Method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for changes in the investor's share of net assets of the investee

	Initial cost
+/-	Share of profits / losses (including amortisation of FV adjustments)
-	Distributions received (Dividends Received)
+/-	Share in direct changes in equity
=	Carrying amount

- Goodwill is included in the carrying amount of the investment; it is not shown separately and is not amortized

Equity method – Example

- On 1 January 2008 Rodney Co. purchases 35% of Franck Co. for 40,000. The fair value of net identifiable assets is 100,000. Goodwill is not amortized.

Value of purchase:	
Net identifiable assets	100,000
Percentage	35%
	35,000
Goodwill	5,000
	40,000
31 December 2008	
Net profit in 2008	20,000
Dividend declared and paid in 2008	6,000

Equity method issues

- Unrealized profits / losses
  - Unrealized profits / losses from transactions between investor and associate must be eliminated
- Recognition of losses
  - In recognizing losses, consider the carrying amount of the investment and other long-term interests in writing down the investment

Consolidated Financial Statements Investments in Associates – Exercises

Ex 01 – Basic Statement of Financial Position

Statements of Financial Position of P S and A are given below as at 31st March 2012

Non-current assets	P Ltd	S Ltd	A Ltd
PPE	10,000	5,000	4,000
Investment in S Ltd	6,000	-	-
Investment in A Ltd	2,000	-	-
Current assets	5,000	2,500	2,000
Total Assets	**23,000**	**7,500**	**6,000**
Equity and Liabilities			
Stated Capital	12,000	3,000	4,000
Retained Earnings	5,000	2,500	1,000
Liabilities	6,000	2,000	1,000
Total Equity and liabilities	**23,000**	**7,500**	**6,000**

- On 1-4-2009 P acquired 75% of S when S Ltd.'s retained earnings stood at 1000.
- On 1-4-2011 P acquired 30% in A when A Ltd.'s retained earnings stood at 600.
- During the year ended 31-3-2012 A ltd made a profit of 1000 and paid a dividend of 600
- P Ltd has accounted for the dividends received as other income

Prepare the Consolidated Statement of Financial Position of P Ltd Group.

……………. Ltd
Statement of Financial Position
As at ……………. (in Rs'………)

Assets		
Non-Current Assets		
Property, Plant and Equipment		
Goodwill		
Investment in Associate		
Current assets		
Total assets		
Equity		
Stated Capital		
Retained earnings		

Equity attributable to Parent company shareholders		
Non-Controlling Interest		
Total equity		
Liabilities		
Total equity and liabilities		

Working 1 - Acquisition information summary

Working 2 – Consolidation

(In Rs'………..)

Description	Goodwill calculation	NCI	Group Retained earnings	Investment in Associate
Investment				
+ NCI				
(-) Net Assets				
Goodwill on acquisition date				
Retained Earnings of Subsidiary - Post acquisition				
Retained Earnings of Parent - Year end amount				
Investment in Associate				
Share of profits				
Dividends of Associate				
Balance at year end				

Ex 02 – Dividend receivable From Associate

Statements of Financial Position as at 31.3.2012

Non current assets	P Ltd	S Ltd	A Ltd
PPE	14,300	5,000	4,000
Investment in S Ltd	2,500	-	-
Investment in A Ltd	1,200	-	-
Current assets	5,000	2,500	2,000
Total Assets	**23,000**	**7,500**	**6,000**
Equity and Liabilities			
Stated Capital	12,000	3,000	4,000
Retained Earnings	5,000	2,500	1,000
Liabilities	6,000	2,000	1,000
Total Equity and liabilities	**23,000**	**7,500**	**6,000**

- On 1-4-2009 P acquired 75% of S when S Ltd.'s retained earnings stood at 1000.
- On 1-4-2011 P acquired 30% in A when A Ltd.'s retained earnings stood at 600.
- During the year ended 31-3-2012 A Ltd made a profit of 900 of which 500 was declared as dividend.
- P Ltd has not yet accounted for the dividends receivable

Prepare the Consolidated Statement of Financial Position of P Ltd Group.

……………. Ltd
Statement of Financial Position
As at …………….   (in Rs'………)

Assets		
Non-Current Assets		
Property, Plant and Equipment		
Goodwill		
Investment in Associate		
Current assets		
Total assets		
Equity		
Stated Capital		
Retained earnings		
Equity attributable to Parent company shareholders		
Non-Controlling Interest		
Total equity		
Liabilities		
Total equity and liabilities		

Working 1 - Acquisition information summary

Working 2 – Consolidation

(In Rs'………..)

Description	Goodwill calculation	NCI	Group Retained earnings	Investment in Associate
Investment				
+ NCI				
(-) Net Assets				
Goodwill on acquisition date				
Retained Earnings of Subsidiary Post acquisition				
Retained Earnings of Parent - Year end amount				
Investment in Associate				
Share of profits				
Dividends of Associate				
Balance at year end				

Transaction between the Group and the Associate

Tutorial Note

Trading transactions and/or loans may be made between member companies of the group (i.e. parent and subsidiaries) and the associate. As the associate is not consolidated, these transactions are not cancelled out.

For example, a loan made by the parent to an associate will remain as a loan on the consolidated Statement of Financial Position (as an asset). The liability recorded in the associate's Statement of Financial Position will merely reduce the net assets (which are recorded as one figure-share of net assets- on the consolidated Statement of Financial Position).

Trading between group and associate

An adjustment will only be required if there is unrealized profit at the Statement of Financial Position date, i.e. inventories exist as a result of the trading.

The elimination should be taken in the consolidated income statement against either the group or the associate according to which of them recorded the profit on the transaction. The adjustment in the Statement of Financial Position should be made against:

- consolidated inventory (if the unrealized profit is in respect of part of this inventory)
- Investment is associate (if the inventory is in the associate).

Steps in eliminating the unrealized profits

Step 1
Calculate the Unrealized Profit only to the extent of the investors holding percentage
Based on the markup basis the URP should be calculated and multiplied by the investors holding percentage

Step 2
Determine who has made the sale and where the profit is recorded then eliminate the URP

Investor ⟶ Associate

When the Investor has sold goods to the Associate then the profit is realized in the parent's books and thus the URP should be removed from the consolidated P&L and,

As the carrying amount in the investment in associate represent the investor's portion of the Net Assets of the associate the URP of inventories is included in it. Therefore it should be removed from there as well.

Consolidated P&L Dr
    Investment in associate Cr

Associate ⟶ Investor

When the Associate has sold the goods to the parent the entries are as follows

Consolidated P&L Dr
    Consolidated Inventories Cr

Receivables and payables in the Statement of Financial Position from trading

Any receivables and payables arising from trading between the associate and the investor should be kept in the consolidated Statement of Financial Position and is not eliminated.

Ex 03 URP on transactions with Associate

Statements of Financial Position as at 31.3.2012

Non-current assets	P Ltd	S Ltd	A Ltd
PPE	12,000	6,500	5,200
Investment in S Ltd	6,000	-	-
Investment in A Ltd	2,000	-	-
Inventories	5,000	2,500	2,000
Total Assets	**25,000**	**9,000**	**7,200**
Equity and Liabilities			
Stated Capital	12,000	3,000	4,000
Retained Earnings	5,000	2,500	1,000
Revaluation Reserve	2,000	1,500	1,200
Liabilities	6,000	2,000	1,000
Total Equity and liabilities	**25,000**	**9,000**	**7,200**

- On 1-4-2009 P acquired 75% of S when S Ltd's retained earnings stood at 1000 and the revaluation reserve stood at 300. On this date the fair value of the net assets exceeded the book value by 800. These assets were estimated to have a useful life of 8 years.
- The groups policy is to measure NCI at proportion of net assets.
- On 1-4-2011 P acquired 30% in A when A Ltd's retained earnings stood at 600 and the revaluation reserve stood at 200.
- During the year S sold goods to P amounting to 2000 and 30% of these goods were with P at the year end. S sets the selling price at a markup of 25% on cost.
- During the year ended 31-3-2012 A Ltd made 1000 sales to P Ltd at a margin of 20% on selling price. At the year-end P Ltd had 30% of these goods with them.
- During the year P sold goods to A amounting to 1000 and 40% of these goods were with A at the year end. P sets the selling price at a margin of 20% on selling price.
- During the year S sold goods to A amounting to 500 and 50% of these goods were with A at the year end. S sets the selling price at a markup of 25% on cost
- At the year end the goodwill was impaired by 200 and the investment in A was impaired by 300.

Prepare the Consolidated Statement of Financial Position of P Ltd Group.

……………. Ltd

Statement of Financial Position

As at …………….   (in Rs'………)

Assets		
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Goodwill		
Investment in Associate		
Current assets		
Total assets		
Equity		
Stated Capital		
Retained earnings		
Equity attributable to Parent company shareholders		
Non-Controlling Interest		
Total equity		
Liabilities		
Total equity and liabilities		

Working 1 - Acquisition information summary

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(In Rs'………..)

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+ NCI				
(-) Net Assets				
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Share of profits				
Dividends of Associate				
Balance at year end				