UNIT 6:

IND AS 28: INVESTMENTS IN ASSOCIATES AND JOINT VENTURES

6.1 OBJECTIVE OF IND AS 28

Ind AS 28 prescribes following:

- guidance on accounting of investments in associates and
- the requirements for the application of the equity method when accounting for investments in associates and joint ventures.

6.2 SCOPE OF IND AS 28

Ind AS 28 shall be applied by all entities that are

- investors with **joint control** of an investee (i.e. the investee is a joint venture of the investor), or
- **significant influence** over an investee (i.e. the investee is an associate of the investor).

6.3 SIGNIFICANT INFLUENCE

An associate is an entity over which the investor has significant influence. Hence, to assess whether an investee is an associate or not, an entity needs to understand the term 'significant influence'.

Significant influence is the power to **participate in the financial and operating policy decisions** of the investee but is not control or joint control of those policies.

In this section, we will discuss following concepts related to assessment of significant influence:

- Presumption of significant influence
- Judgement required in assessment of significant influence
- Consideration of potential voting rights when assessing significant influence
- Loss of significant influence

Each of the above concepts are discussed in detail below.

6.3.1 Presumption of significant influence

Presumption of significant influence:

- If an entity holds (directly or indirectly through a subsidiary) **20% or more of the voting rights** of an investee then it is **presumed that the entity has significant influence**, unless it can be clearly demonstrated that it is not the case.
- Conversely, if the entity holds, (directly or indirectly through a subsidiary), less **than 20% of the voting power** of the investee, it is **presumed that the entity does not have significant influence**, unless such influence can be clearly demonstrated.

It should be noted that a substantial or majority ownership by another investor does not necessarily preclude an entity from having significant influence.

Illustration 1: Significant influence

E Ltd. holds 25% of the voting power of an investee. The balance 75% of the voting power is held by three other investors each holding 25%.

The decisions about the financing and operating policies of the investee are taken by investors holding majority of the voting power. Since, the other three investors together hold majority voting power, they generally take the decisions without taking the consent of E Ltd. Even if E Ltd. proposes any changes to the financing and operating policies of the investee, the other three investors do not vote in favour of those changes. So, in effect the suggestions of E Ltd. are not considered while taking decisions related to financing and operating policies.

Determine whether E Ltd. has significant influence over the investee?

Solution:

Since E Ltd. is holding more than 20% of the voting power of the investee, it indicates that E Ltd. might have significant over the investee. However, the other investors in the investee prevent E Ltd. from participating in the financing and operating policy decisions of the investee. Hence, in this case, E Ltd. is not in a position to have significant influence over the investee.

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6.3.2 Judgement required in assessment of significant influence

The assessment of whether the investor has significant influence over the investee requires application of judgement. In making such judgement, the investor shall consider following factors which generally demonstrate the existence of significant influence:

a) representation on the board of directors or equivalent governing body of the investee

Illustration 2: Representation on board

Kuku Ltd. holds 12% of the voting shares in Boho Ltd. Boho Ltd.'s board comprise of eight members and two of these members are appointed by Kuku Ltd. Each board member has one vote at meeting. is Boho Ltd an associate of Kuku Ltd?

Solution:

Boho Ltd is an associate of Kuku Ltd as significant influence is demonstrated by the presence of directors on the board and the relative voting rights at meetings.

It is presumed that entity has significant influence where it holds 20% or more of the voting power of the investee, but it is not necessary to have 20% representation on the board to demonstrate significant influence, as this will depend on all the facts and circumstances. One board member may represent significant influence even if that board member has less than 20% of the voting power. But for significant influence to exist it would be necessary to show based on specific facts and circumstances that this is the case, as significant influence would not be presumed.

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b) participation in policy-making processes, including participation in decisions about dividends or other distributions

Illustration 3: Participation in policy-making processes

M Ltd. holds 10% of the voting power an investee. The balance 90% voting power is held by nine other investors each holding 10%.

The decisions about the relevant activities (except decision about taking borrowings) of the investee are taken by the members holding majority of the voting power. The decisions about taking borrowings are required to be taken by unanimous consent of all the investors. Further, decisions about taking borrowing are not the decisions that most significantly affect the returns of the investee.

Determine whether M Ltd. has significant influence over the investee?

Solution:

In this case, though M Ltd. is holding less than 20% of the voting power of the investee, M Ltd.'s consent is required to take decisions about taking borrowings which is one of the relevant activities. Further, since the decisions about taking borrowing are not the decisions that most significantly affect the returns of the investee, it cannot be said that all the investors have joint control over the investee.

Hence, it can be said that M Ltd. has significant influence over the investee.

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c) material transactions between the entity and its investee

Illustration 4: Material transactions between the entity and its investee

RS Ltd. is an entity engaged in the business of pharmaceuticals. It has invested in the share capital of an investee XY Ltd. and is holding 15% of XY Ltd.'s total voting power.

XY Ltd. is engaged in the business of producing packing materials for pharmaceutical entities. One of the incentives for RS Ltd. to invest in XY Ltd. was the fact that XY Ltd. is engaged in the business of producing packing materials which is also useful for RS Ltd. Since last many years, XY Ltd.'s almost 90% of the output is procured by RS Ltd.

Determine whether RS Ltd. has significant influence over XY Ltd.?

Solution:

Since 90% of the output of XY Ltd. is procured by RS Ltd., XY Ltd. would be dependent on RS Ltd. for the continuation of its business. Hence, even though RS Ltd. is holding only 15% of the voting power of XY Ltd. it has significant influence over XY Ltd.

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d) interchange of managerial personnel

Illustration 5: Interchange of managerial personnel

Entity X and entity Y operate in the same industry, but in different geographical regions. Entity X acquires a 10% shareholding in entity Y as a part of a strategic agreement. A new production process is key to serve a fundamental change in the strategic direction of entity Y. The terms of agreement provide for entity Y to start a new production process under the supervision of two managers from entity X. The managers seconded from entity X, one of whom is on entity X's board, will oversee the selection and recruitment of new staff, the purchase of new equipment, the training of the workforce and the negotiation of new purchase contracts for raw materials. The two managers will report directly to entity Y's board and as well as to entity X. Analyse.

Solution:

The secondment of the board member and a senior manager from entity X to entity Y gives entity X a range of power over a new production process and may evidence that entity X has significant influence over entity Y. This assessment takes into the account what are the key financial and operating policies of entity Y and the influence this gives entity X over those policies.

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e) provision of essential technical information

Illustration 6: Provision of essential technical information

R Ltd. is a tyre manufacturing entity. The entity has entered into a technology transfer agreement with another entity Y Ltd. which is also involved in the business of tyre manufacturing. R Ltd. is an established entity in this business whereas Y Ltd. is a relatively new entity.

As per the agreement, R Ltd. has granted to Y Ltd. a license to use its technical information and know-how which are related to the processes for the manufacture of tyres. Y Ltd. is dependent on the technical information and know-how supplied by R Ltd. because of its lack of expertise and experience in this business. Further, R Ltd. has also invested in 10% of the equity share capital of Y Ltd.

Determine whether R Ltd. has significant influence over Y Ltd.?

Solution:

Y Ltd. obtains essential technical information for the running of its business from R Ltd. Hence R Ltd. has significant influence over Y Ltd. despite of holding only 10% of the equity share capital of Y Ltd.

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6.3.3 Consideration of potential voting rights when assessing significant influence

An entity may own potential voting rights such as share warrants, share call options, convertible instruments, or other similar instruments that can give the entity additional voting power or reduce another party's voting power over the investee.

Potential voting rights that are **currently exercisable are considered** when assessing whether an entity has significant influence. Potential voting rights that are currently not exercisable are not considered for the assessment. This can be the case when the rights cannot be exercised until a future date or until the occurrence of a future event.

In assessing whether potential voting rights contribute to significant influence, the entity examines all facts and circumstances except (a) the intentions of management and (b) the financial ability to exercise those potential rights.

Illustration 7: Potential voting rights

An entity which is currently holding 10% of the voting power of an entity has an option of purchase additional 15% voting power of the investee from other investors. However, the entity currently does not have financial ability to purchase additional 15% voting power of the investee. Determine whether the entity has significant influence over the investee?

Solution:

Considering the potential voting rights, the entity can have more than 20% of the voting power of the investee and hence it is presumed that the entity has significant influence over the investee. The fact that the entity does not have financial ability to purchase such additional voting power is not considered in such assessment (It should be noted that under Ind AS 110, potential voting rights which an entity cannot exercise because of its financial ability are not considered as substantive and hence not factored in the assessment. However, under Ind AS 28, there is no such requirement given. Hence the potential voting rights, even if they are not substantive as per Ind AS 110, are included in the assessment of significant influence.)

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6.3.4 Loss of significant influence

An entity loses significant influence over an investee **when it loses the power to participate in the financial and operating policy decisions** of that investee.

The loss of significant influence can occur with or without a change in ownership levels. For example, loss of significant influence can occur when an associate becomes subject to the control of a government, court, administrator or regulator. It could also occur as a result of a contractual arrangement.

6.4 EQUITY METHOD

The **equity method** is a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets. The investor's profit or loss includes its share of the investee's profit or loss and the investor's other comprehensive income includes its share of the investee's other comprehensive income. In this section, we will discuss following principles related to equity method of accounting:

- Application of the equity method

- Exemptions from applying the equity method
- Equity method procedure

The above principles are explained below.

6.4.1 Application of the equity method

An investor is required to account its investments in associates and joint ventures as per equity method.

It should be noted that equity method is **not applied** for accounting of investments in associates and joint ventures **in the separate financial statements** of the investor. In separate financial statements, an investor shall apply the guidance given in Ind AS 27 which is discussed in detail in unit 7.

Under the equity method of accounting, an investor shall pass following entries at various stages of investment:

1) Initial entry to record investment done in associate or joint venture at cost

2) Recording of investor's share in the profit / loss of the associate or joint venture after the date of acquisition

3) Recording of investor's share in the other comprehensive income of the associate or joint venture after the date of acquisition

4) Distributions received from an investee

Above entries are explained by way of an illustration below:

Illustration 8: Accounting entries related investment in associate / joint venture

On the first day of a financial year, A Ltd. invested in the equity share capital of B Ltd. at a cost of ₹ 1,00,000 to acquire 25% share in the voting power of B Ltd. A Ltd. has concluded that B Ltd. is an associate of A Ltd. At the end of the year, B Ltd. earned profit of ₹ 10,000 and other comprehensive income of ₹ 2,000. In that year, B Ltd. also declared dividend to the extent of ₹ 4,000. Pass necessary entries in the books of A Ltd. to account for the investment in associate.

Solution:

Following entries would be passed in the books of A Ltd.:

1) Initial entry to record investment done in associate

Investment in B Ltd. A/c	Dr.	1,00,000	
To Bank A/c			1,00,000

2) Recording of share in the profit of the associate

Investment in B Ltd. A/c	Dr.	2,500	
To Share in profit of investee (P&L)			2,500

[A Ltd. share in profit would be ₹ 2,500 (₹ 10,000 x 25%)]

3) Recording of share in the other comprehensive income (OCI) of the associate

Investment in B Ltd. A/c	Dr.	500	
To Share in OCI of investee (OCI)			500

[A Ltd. share in OCI would be ₹ 500 (₹ 2,000 x 25%)]

4) Recording of dividend distributed by associate

Dividend Receivable A/c	Dr.	1,000	
To Investment in B Ltd. A/c			1,000

[A Ltd. share in dividend would be ₹ 1,000 (₹ 4,000 x 25%)]

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It should be noted that Ind AS 28 not only requires to record the income distributed by the associate or joint venture but it also requires an investor to record its share in the profit / loss of the associate or joint venture (which may not be yet distributed). This provides more informative reporting of the investor's net assets and profit or loss.

Potential voting rights

Generally, an entity accounts for its interest in an associate or joint venture on the basis of existing ownership interests and the possible effect of exercise or conversion of any **potential voting rights are not considered for applying equity method**. Instruments with such potential voting rights are accounted for as per Ind AS 109.

For example, if potential voting rights are contained in Compulsorily Convertible Preference Shares (CCPS) of the investee and such CCPS do not give present access to returns associated with ownership interests (refer below), then such CCPS shall be accounted for as per Ind AS 109 (refer chapter 12) i.e. either at fair value through profit or loss or at fair value through other comprehensive income.

However, there can be some cases where the potential voting rights in substance currently give access to the returns associated with an ownership interest in an associate or a joint venture. In such cases, the investor shall account for instruments with such potential voting rights as per equity method and not as per Ind AS 109. This can be the situation where, **for example**, an investor has a purchase option to acquire additional voting power in an investee and the terms of the contract provides that the investor will also get the share in the profit / loss of the investee even for the period prior to the date of actual exercise of the option.

6.4.2 Exemptions from applying the equity method

An entity need not apply the equity method to its investment in an associate or a joint venture in following cases:

Exemption 1

As per paragraph 17 of Ind AS 28, an entity need not apply equity method if the entity is a parent that is **exempt from preparing consolidated financial statements** by the scope exception in paragraph 4(a) of Ind AS 110 **or if all the following** apply:

Owners of the entity	
The entity is a wholly owned or partly owned subsidiary of another entity and all the owners of the entity are informed and they do not object to the entity not applying the equity method.	The entity's ultimate or any intermediate parent produces financial statements that are available for public use and comply with Ind ASs, in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with Ind AS 110.
Public trading of instruments of the entity	
The debt or equity instruments of the entity are not traded in a public market (whether domestic or foreign stock exchange or an over-the-counter market, including local and regional markets).	The entity has not filed nor is it in the process of filing its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market.

The above conditions are similar to the conditions given in paragraph 4(a) of Ind AS 110. To see illustration of above conditions, refer to the scope exemption illustrations give in unit 3 on Ind AS 110.

Exemption 2

When an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a **venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds**, the entity may elect to measure investments in those associates and joint ventures at **fair value through profit or loss** in accordance with

Ind AS 109. ***An example of an investment-linked insurance fund is a fund held by an entity as the underlying items for a group of insurance contracts with direct participation features. For the purposes of this election, insurance contracts include investment contracts with discretionary participation features***. Such election shall be made separately for each associate or joint venture at time of its initial recognition.

Example 1

A mutual fund has invested in the equity share capital of certain companies in excess of 20% of the total equity share of those entities. Hence, those investees are presumed to be an associate of the mutual fund. In this case, the mutual fund can decide not to apply equity method to account for those investments and instead measure them at fair value through profit or loss as per Ind AS 109.

Exemption 3

When an entity has an investment in an associate, a portion of which is held indirectly through a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure that portion of the investment in the associate at fair value through profit or loss in accordance with Ind AS 109.

This is regardless of whether the venture capital organisation has significant influence over that portion of the investment.

If the entity makes that election, the entity shall apply the equity method to any remaining portion of its investment in an associate that is not held through a venture capital organisation.

This exemption is explained in below illustration:

Illustration 9: Exemption from applying equity method

MNO Ltd. holds 15% of the voting power of DEF Ltd. PQR Mutual Fund (which is a subsidiary of MNO Ltd.) also holds 10% voting power of DEF Ltd. Hence, MNO Ltd. holds total 25% voting power of DEF Ltd. (15% held by own and 10% held by subsidiary) and accordingly has significant influence over DEF Ltd. How should MNO Ltd. account for investment in DEF Ltd. in its consolidated financial statements?

Solution:

The 15% interest which is held directly by MNO Ltd. should be measured as per equity method of accounting. However, with respect to the 10% interest which is held through a mutual fund, MNO Ltd. can avail the exemption from applying the equity method to that 10% interest and instead measure that investment at fair value through profit or loss. To summarise, the total interest of 25% in DEF Ltd. should be measured as follows:

- 15% interest held directly by MNO Ltd.: Measure as per equity method of accounting
- 10% interest held indirectly through a mutual fund: Measure as per equity method of accounting or at fair value thorough profit or loss as per Ind AS 109

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6.4.3 Equity method procedure

Many of the concepts used in applying the equity method of accounting are similar to the concepts used for consolidation procedure for subsidiaries. Following is the summary of various concepts used in applying the equity method of accounting:

- Calculation of goodwill / capital reserve on acquisition of investment in associate or joint venture and calculation of share in profit / loss of associate or joint venture
- Determination group's share in an associate or a joint venture
- Accounting of upstream and downstream transactions between the entity and its associate or joint venture
- Accounting of contribution of non-monetary asset by an entity to its associate or joint venture
- How to deal with different reporting periods of the entity and its associate or joint venture?
- Requirement to have uniform accounting policies
- What are the long-term interests in associate or joint venture apart from equity investment?
- How to account for share in losses of loss making associate or joint venture in excess of value interest in the associate or joint venture?

Each of the above concepts are explained below.

6.4.3.1 Calculation of goodwill / capital reserve and calculation of share in profit / loss of associate or joint venture

An investment is accounted for using the equity method from the date on which it becomes an associate or a joint venture.

On acquisition of the investment, an entity shall identify the goodwill or capital reserve.

Goodwill

Any excess of the cost of the investment over the entity's share of the net fair value of the investee's identifiable assets and liabilities is treated as goodwill. Goodwill is included in the carrying amount of the investment. Amortisation of that goodwill is not permitted.

Capital reserve

Any excess of the entity's share of the net fair value of the investee's identifiable assets and liabilities over the cost of the investment is treated as capital reserve. It is recorded directly in equity.

While recording the entity's share in the profit / loss of the investee, the entity needs to make certain adjustment to that share of profit / loss. For example, adjustment shall be made for:

- depreciation of the depreciable assets based on their fair values at the acquisition date.
- impairment losses such as for goodwill or property, plant and equipment.

Illustration 10: Acquisition of interest in an associate

Blue Ltd. acquired 25% of the equity share capital of Green Ltd. on the first day of the financial year for ₹ 1,25,000. As of that date, the carrying value of the net assets of Green Ltd. was ₹ 3,00,000 and the fair value was ₹ 4,00,000. The excess of fair value over the carrying value was attributable to one of the buildings owned by Green Ltd. having a remaining useful life of 20 years. Green Ltd. earned profit of ₹ 40,000 and other comprehensive income of ₹ 10,000 during the year. Calculate the goodwill / capital reserve on the date of acquisition, Blue Ltd.'s share in the profit and other comprehensive income for the year and closing balance of investment at the end of the year.

Solution:

(1) Goodwill / capital reserve on the date of acquisition

The cost of the investment is higher than the net fair value of the investee's identifiable assets and liabilities. Hence there is goodwill. Amount of goodwill is calculated as follows

	₹
Cost of acquisition of investment	1,25,000
Blue Ltd.'s share in fair value of net assets of Green Ltd. on the date of acquisition (4,00,000 x 25%)	(1,00,000)
Goodwill	**25,000**

Above goodwill will be recorded as part of carrying amount of the investment.

(2) Share in profit and other comprehensive income of Green Ltd.

	₹
Share in profit of Green Ltd. (40,000 x 25%)	10,000
Adjustment for depreciation based on fair value (1,00,000 ÷ 20) x 25%	(1,250)
Share in profit after adjustment	**8,750**
Share in other comprehensive income (10,000 x 25%)	**2,500**

(3) Closing balance of investment at the end of the year

	₹
Cost of acquisition of investment (including goodwill of ₹ 25,000)	1,25,000
Share in profit after adjustments	8,750
Share in other comprehensive income	2,500
Closing balance of investment	**1,36,250**

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Illustration 11: Cumulative preference shares issued by associate or joint venture

KL Ltd. has invested in 50% voting power of a joint venture MN Ltd. MN Ltd. has also issued 10% cumulative preference shares, classified as equity, to other investors worth ₹ 10,00,000. During the year, MN Ltd. earned profit of ₹ 4,00,000. Also, MN Ltd. has not declared any dividend on the preference shares for current year. Calculate KL Ltd.'s share in the net profit of MN Ltd. for the year.

Solution:

If an associate or a joint venture has outstanding cumulative preference shares that are held by parties other than the entity and are classified as equity, the entity should compute its share of profit or loss after adjusting for dividend on such shares, whether or not the dividends have been declared.

In current case, KL Ltd.'s share in net profit of MN Ltd. would be as follows.

	₹
Profit of MN Ltd. for the year	4,00,000
Dividend on cumulative preference shares (10,00,000 x 10%)	(1,00,000)
Net profit attributable to the holders of equity share	3,00,000
KL Ltd.'s 50% share in net profit of MN Ltd.	1,50,000

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6.4.3.2 Group's share in an associate or a joint venture

For applying the equity method, an entity shall consider the share held by it **directly or indirectly (through a subsidiary)** in an associate or a joint venture. The holding by the entity's associate or joint venture in another associate or joint venture of the entity is ignored for this purpose.

Example 2

A Ltd., its subsidiary B Ltd. and its joint venture C Ltd. holds 15%, 10% and 10% respectively of the share capital of an associate X Ltd. Hence, to apply equity method, A Ltd. shall consider the interest held by it and by its subsidiary B Ltd. i.e. total interest of 25%. It shall not consider the interest held by C Ltd. which is a joint venture.

When an **associate or a joint venture has subsidiaries, associates or joint ventures**, the profit or loss, other comprehensive income and net assets taken into account in applying the equity method are those recognised in the associate's or joint venture's **financial statements which include** the associate's or joint venture's share of the profit or loss, other comprehensive income and net assets of its associates and joint ventures.

Example 3

X Ltd. has an associate P Ltd. P Ltd. has further invested in a subsidiary Q Ltd. and a joint venture R Ltd. Hence, for the purpose of applying the equity method, X Ltd. shall consider the consolidated financial statements of P Ltd.

Illustration 12: Share in the consolidated financial statements of associate

Entity A holds a 20% equity interest in Entity B (as associate) that in turn has a 100% equity interest in Entity C. Entity B recognised net assets relating to Entity C of ₹1,000 in its consolidated financial statements. Entity B sells 20% of its interest in Entity C to a third party (a non-controlling shareholder) for ₹300 and recognises this transaction as an equity transaction in accordance with paragraph 23 of Ind AS 110, resulting in a credit in Entity B's equity of ₹100.

The financial statements of Entity A and Entity B are summarised as follows before and after the transaction:

Before

A's consolidated financial statements

Assets	₹	Liabilities	₹
Investment in B	200	Equity	200
Total	200	Total	200

B's consolidated financial statements

Assets	₹	Liabilities	₹
Assets (from C)	1,000	Equity	1,000
Total	1,000	Total	1,000

The financial statements of B after the transaction are summarised below:

<u>After</u>

B's consolidated financial statements

Assets	₹	Liabilities		₹
Assets (from C)	1,000	Equity	1,000	
Cash	300	Equity transaction with non-controlling interest	100	
		Equity attributable to owners		1,100
		Non-controlling interest		200
Total	1,300	Total		1,300

Although Entity A did not participate in the transaction, Entity A's share of net assets in Entity B increased as a result of the sale of B's 20% interest in C. Effectively, A's share in B's net assets is now ₹ 220 (20% of ₹ 1,100) i.e. ₹ 20 in addition to its previous share.

How is an equity transaction that is recognised in the financial statements of Entity B reflected in the consolidated financial statements of Entity A that uses the equity method to account for its investment in Entity B?

Solution:

The change of interest in the net assets / equity of the associate as a result of the investee's equity transaction is reflected in the investor's financial statements as 'share of other changes in equity of investee' (in the statement of changes in equity) instead of gain in Statement of profit and loss, since it reflects the post-acquisition change in the net assets of the investee and also faithfully reflects the investor's share of the associate's transaction as presented in the associate's consolidated financial statements.

Thus, in the given case, Entity A recognises ₹ 20 as change in other equity instead of in statement of profit and loss and maintains the same classification as of its associate, Entity B, i.e., a direct credit to equity as in its consolidated financial statements.

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6.4.3.3 Upstream and downstream transactions between the entity and its associate or joint venture

An entity (or a subsidiary of the entity) may enter into upstream or downstream transactions with its associate or joint venture.

- 'Upstream' transactions are, for example, sales of assets from an associate or a joint venture to the investor.
- 'Downstream' transactions are, for example, sales or contributions of assets from the investor to its associate or its joint venture.

There may be some gain / loss resulting from such transactions. The entity shall record such gain / loss in its financial statements only to the extent of the unrelated investors' interests in the associate or joint venture.

Illustration 13: Upstream and downstream transaction between an entity and its associate

Scenario A

M Ltd. has invested in 40% share capital of N Ltd. and hence N Ltd. is an associate of M Ltd. During the year, N Ltd. sold inventory to M Ltd. for a value of ₹ 10,00,000. This included profit of 10% on the transaction price i.e. profit of ₹ 1,00,000. Out the above inventory, M Ltd. sold inventory of ₹ 6,00,000 to outside customers. Hence, the inventory of ₹ 4,00,000 purchased from N Ltd. is still lying with M Ltd. Determine the unrealised profit to be eliminated on above transaction.

Scenario B

Assume the same facts as per Scenario A except that the inventory is sold by M Ltd. to N Ltd. instead of N Ltd. selling to M Ltd. Determine the unrealised profit to be eliminated on above transaction.

Solution:

Scenario A

Firstly, as part of its equity method accounting for investment in N Ltd., M Ltd. will pass this journal entry:

Investment in N Ltd.	Dr.	40,000	
To Share in profit of N Ltd.			40,000

Out of the inventory of ₹ 10,00,000, M Ltd. has sold inventory worth ₹ 6,00,000 to outside customers. Hence, the profit of ₹ 60,000 (6,00,000 x 10% profit margin) on such inventory is realised. However, the inventory worth ₹ 4,00,000 is still held by M Ltd. which consists profit of ₹ 40,000 (4,00,000 x 10%). Hence, M Ltd.'s share in such profit i.e. ₹ 16,000 (40,000 x 40%) is considered as unrealised.

Accordingly, after recording of share in total profit of N Ltd., M Ltd. should pass following adjustment entry to reverse the unrealised profit margin:

Share in profit of N Ltd.	Dr.	16,000	
To Inventory / Investment in N Ltd.			16,000

In subsequent period, when this inventory of ₹ 4,00,000 is sold by N Ltd. to an outside customer then the above profit margin of ₹ 16,000 will be treated as realised and hence the above entry will be reversed in that period.

[**Note**: in the separate financial statements of M Ltd., inventory is carried at ₹ 4,00,000 whereas in its consolidated financial statements, inventory is carried at ₹ 3,84,000 (due to elimination entry above in respect of unrealized profit). In the subsequent period, when the inventory is sold, Inventory Account is credited by ₹ 4,00,000 whereas for the purpose of consolidated financial statements, it should have been credited by only ₹ 3,84,000. The difference is adjusted by debiting back ₹ 16,000 to the Inventory Account and a corresponding recognition of share in profit of associate.]

Scenario B

Out of the inventory of ₹ 10,00,000, N Ltd. has sold inventory worth ₹ 6,00,000 to outside customers. Hence, the profit of ₹ 60,000 (6,00,000 x 10% profit margin) on such inventory is realised. However, the inventory worth ₹ 4,00,000 is still held by N Ltd. which consists profit of ₹ 40,000 (4,00,000 x 10%). Out of this profit of ₹ 40,000, profit to the extent of other investor's interest in the investee is treated as realised profit i.e. ₹ 24,000 (40,000 x 60%) is treated as realised profit. Balance profit of ₹ 16,000 (40,000 x 40%) is considered as unrealised. Hence, M Ltd. should pass following adjustment entry to reverse the unrealised profit:

Sales	Dr.	160,000	
To Cost of material consumed			144,000
To Investment in N Ltd.			16,000

In subsequent period, when this inventory of ₹ 4,00,000 is sold by N Ltd. to an outside customer then the above profit margin of ₹ 16,000 will be treated as realised and hence the above entry will be reversed in that period.

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When downstream transactions provide evidence of a **reduction in the net realisable value** of the assets to be sold or contributed, or of an **impairment loss** of those assets, those losses shall be **recognised in full** by the investor.

When upstream transactions provide evidence of a reduction in the **net realisable value** of the assets to be purchased or of an **impairment loss** of those assets, the investor shall **recognise its share** in those losses.

Illustration 14: Impairment loss on downstream and upstream transaction between an entity and its joint venture

Scenario A

X Ltd. has invested in a joint venture Y Ltd. by holding 50% of its equity share capital. During the year, X Ltd. sold an asset to Y Ltd. at its market value of ₹ 8,00,000. The asset's carrying value in X Ltd.'s books was ₹ 10,00,000. Determine how should X Ltd. account for the sale transaction in its books.

Scenario B

Assume the same facts as per Scenario A except that the asset is sold by Y Ltd. to X Ltd. instead of X Ltd. selling to Y Ltd. Determine how should X Ltd. account for the above transaction in its books.

Solution:

Scenario A

X Ltd. should record full loss of ₹ 2,00,000 (10,00,000 – 8,00,000) in its books as that would represent the impairment loss because the market value has actually declined. This loss would have been recorded even if X Ltd. had first impaired the asset and then sold to Y Ltd. at zero profit / loss. Following entry should be passed in the books of X Ltd.

Bank A/c	Dr.	8,00,000	
Loss on sale of asset	Dr.	2,00,000	
To Asset			10,00,000

Scenario B

X Ltd. should record loss to the extent of its share in Y Ltd. Hence, X Ltd.'s share in loss i.e. ₹ 1,00,000 [(10,00,000 – 8,00,000) x 50%] should be recorded by X Ltd. in its books. The loss should be recorded since the market value of the asset has actually declined and this would represent impairment. This loss would have been recorded even if Y Ltd. would have first recorded an impairment loss of ₹ 2,00,000 and then sold to X Ltd. at zero profit / loss. Following entry should be passed in the books of X Ltd.

Asset	Dr.	8,00,000	
Share in loss of Y Ltd.	Dr.	1,00,000	
To Bank			8,00,000
To Investment in Y Ltd.			1,00,000

*****

6.4.3.4 Contribution of non-monetary asset by an entity to its associate or joint venture

An entity might contribute a non-monetary asset to an associate or a joint venture in exchange of an equity interest in that associate or joint venture. Such contribution of asset shall be accounted in accordance with the **guidance for downstream transactions** discussed above.

However, if such contribution of cnon-monetary asset **lacks commercial substance**, then the gain / loss involved in such transaction is treated as unrealised and such **gain / loss is eliminated against the investment value**. In other words, the carrying amount of the investment in associate or joint venture in such a situation will be equal to the carrying amount of non-monetary asset contributed in exchange. The term 'commercial substance' has the same meaning as defined in Ind AS 16 *'Property, Plant and Equipment'* and discussed in unit 2 of chapter 7.

If, in addition to receiving an equity interest in an associate or a joint venture, an entity receives monetary or non-monetary assets, the entity **recognises in full** in profit or loss the portion of the **gain or loss** on the non-monetary contribution **relating to the monetary or non-monetary assets received**.

6.4.3.5 Different reporting periods of the entity and its associate or joint venture

To apply equity method of accounting, an entity shall use the **most recent** available financial statements of the associate or joint venture.

When the end date of the reporting period of the entity and that of the associate or joint venture is different (e.g. entity's financial year ends on 31 March 20X1 but the associate's financial year ends on 31 December 20X0) then associate or joint venture shall prepare financial statements as of the period end date of the entity **for the purpose of doing equity method accounting** by the entity.

In above situation, if it is impracticable for the associate or joint venture to prepare financial statements as of the period end date of the entity then the entity can use the financial statements of associate or joint venture ending on different date subject to **giving effect of significant transactions or events** occurring between the end date of the associate's or joint venture's financial statements and end date of the entity's financial statements.

In no case, the difference between the end date of the reporting period of associate or joint venture and end date of reporting period of the entity **can exceed 3 months**.

The length of the reporting periods and any difference between the ends of the reporting periods shall be the same from period to period. This means that if the financial statements of an associate or a joint venture used for equity accounting in previous periods were ending on different dates than that of the entity whereas the financial statements used for current period end on the same date as that of the entity then the comparatives for previous period should be restated to have comparison of equivalent periods.

6.4.3.6 Uniform accounting policies

When using the financial statements of an associate or joint venture for doing equity method accounting, the **accounting policies** (for like transaction and events in similar circumstances) as used by associate or joint venture in preparing their financial statements **should be same as the policies used by the entity** in preparing its financial statements.

If the accounting policies are not same then **adjustments should be made to align** the accounting policies of associate or joint venture to those of the entity.

Example 4

A Ltd. (a company incorporated and registered in India) holds 25% voting power of B Inc. (a company incorporated and registered in United States). B Inc. is an associate for A Ltd. A Ltd. Follows Ind AS for the preparation of its financial statements. However, B Inc. follows generally accepted accounting principles in United States (US GAAP). Hence, while using B Inc.'s financial statements for the purpose of doing equity method accounting, A Ltd. Shall do necessary adjustment to covert US GAAP financial statements to Ind AS financial statements and then do equity method accounting.

There are two exceptions to above rule:

Exception 1

In case of an **associate**, the adjustment for uniformity of accounting policies with those of the entity will not be done **if it is impracticable to do so**.

It is to be noted that this exemption is available in case of an associate only and not available for joint venture. This is because for an investor with just significant influence over an investee, it may be difficult to obtain necessary information to do adjustment for aligning accounting policies. However, in case of a joint venture, it would be relatively easy to obtain such information as the investor has joint control over the joint venture.

Exception 2

An entity may have interest in **an associate or a joint venture that is an investment entity**. Such an associate or a joint venture may also have interest in one or more subsidiaries. When this is the case, such associate or joint venture, being an investment entity, would **account for its interest in subsidiaries at fair value**. Hence, in such case, the **entity can elect to retain** the fair value measurement used by the associate or joint venture.

Such election can be made by the entity **separately for each associate or joint venture** at the later of the date on which:

a) the associate or joint venture is initially recognised

b) the associate or joint venture becomes an investment entity

c) the associate or joint venture first becomes a parent

6.4.3.7 Long-term interests in associate or joint venture apart from equity investment

An entity might hold financial instruments in an associate or joint venture other than the investments accounted for using the equity method. These includes long-term interests that, in substance, form part of the entity's net investment in the associate or joint venture.

For example, an item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, an extension of the entity's investment in that associate or joint venture.

- Such items may include
  - preference shares and
  - long-term receivables or loans,
- but do not include
  - trade receivables,
  - trade payables or

- any long-term receivables for which adequate collateral exists, such as secured loans.

An entity shall account such long-term interest in accordance with Ind AS 109. It is to be noted that certain requirements of Ind AS 28 also apply to such long-term interests (like allocating share in loss of associate or joint venture to such interests and testing for impairment and recording of impairment loss on the net investment in associate or joint venture – these are explained in subsequent paragraphs). However, an entity should first apply Ind AS 109 to those interests and then apply Ind AS 28 to the balance remaining after applying Ind AS 109.

6.4.3.8 Loss making associate or joint venture

In case of a loss making associate or joint venture, an entity's share of losses of such associate or joint venture may equal or exceed its **interest in the associate or joint venture**. In such case, the entity discontinues recognized its share of further losses.

It should be noted that the interest in the associate or joint venture not only includes the carrying amount of the investment in the associate or joint venture determined using the equity method but also includes any **long-term interests that, in substance, form part of the entity's net investment in the associate or joint venture**. The examples of such long-term interests are discussed in 6.4.2.8 above. It should be noted that an entity should **first apply Ind AS 109** to such long-term interests and then apply the above requirement of allocating to such long-term interest any share in loss of associate or joint venture. Further, while applying Ind AS 109, an entity shall not take account of any adjustments to the carrying value of long-term interests that arise from applying Ind AS 28.

Losses recognized using the equity method in excess of the entity's investment in ordinary shares are applied to the other components of the entity's interest in an associate or a joint venture in the reverse order of their seniority (i.e. priority in liquidation).

After the entity's interest is reduced to zero, additional losses are provided for, and a liability is recognized, only to the extent that the entity has incurred **legal or constructive obligations or made payments** on behalf of the associate or joint venture.

If the associate or joint venture **subsequently reports profits**, the entity resumes recognized its share of those profits **only after** its share of the profits equals the share of losses not recognized.

Illustration 15: Loss making associate and long-term interests

An entity has following three type interests in an associate:

- *Equity shares: 25% of the equity shares to which equity method of accounting is applied*
- *Preference shares: Non-cumulative preference shares that form part of net investment in the associate. Such preference shares are measured at fair value as per Ind AS 109.*
- *Long-term loan: The loan carrying interest of 10% p.a. The interest income is received at the end of each year. The long-term loan is accounted as per amortised cost as per Ind AS 109. This loan also forms part of net investment in the associate.*

At the start of year 1, the carrying value of each of the above interests is as follows:

- *Equity shares – ₹ 10,00,000*
- *Preference shares – ₹ 5,00,000*
- *Long-term loan – ₹ 3,00,000*

Following table summarises the changes in the fair value of preference shares as per Ind AS 109, impairment loss on long-term loan as per Ind AS 109 and entity's share in profit / loss of associate for year 1-5.

₹

End of Year	Increase / (Decrease) in fair value of preference shares as per Ind AS 109	Impairment loss / (reversal) on long-term loan as per Ind AS 109	Entity's share in profit / (loss) of associate
1	(50,000)	(50,000)	(16,00,000)
2	(50,000)	-	(2,00,000)
3	1,00,000	50,000	-
4	50,000	-	10,00,000
5	30,000	-	10,00,000

Throughout year 1 to 5, there has been no objective evidence of impairment in the net investment in the associate. The entity does not have any legal or constructive obligation to share the losses of the associate beyond its interest in the associate.

Based on above, determine the closing balance of each of the above interests at the end of each year.

Solution:

Year 1

Below table summarises the closing balance of each of the interest at the end of year 1: ₹

Type of interest	Opening balance at the start of the year	Adjustment as per Ind AS 109	Balance after applying Ind AS 109	Share in profit / (loss) of associate	Closing balance at the end of the year
	(A)	(B)	I = (A+B)	(D)	I = (C+D)
Equity shares	10,00,000	NA	10,00,000	(10,00,000)	-
Preference shares	5,00,000	(50,000)	4,50,000	(4,50,000)	-
Long-term loan	3,00,000	(50,000)	2,50,000	(1,50,000)	1,00,000
Total	**18,00,000**	**(1,00,000)**	**17,00,000**	**(16,00,000)**	**1,00,000**

The entire loss of ₹ 16,00,000 is recognised. Hence, there is no unrecognised loss at the end of year 1.

Year 2

Below table summarises the closing balance of each of the interest at the end of year 2: ₹

Type of interest	Opening balance at the start of the year	Adjustment as per Ind AS 109	Balance after applying Ind AS 109	Share in profit / (loss) of associate	Closing balance at the end of the year
	(A)	(B)	I = (A+B)	(D)	I = (C+D)
Equity shares	-	NA	-	-	-
Preference shares	-	(50,000)	(50,000)	50,000 *	-
Long-term loan	1,00,000	-	1,00,000	(1,00,000)	-
Total	**1,00,000**	**(50,000)**	**50,000**	**(50,000)**	**-**

* Recognition of changes in fair value as per Ind AS 109 has resulted in the carrying amount of Preference shares being negative ₹ 50,000. Consequently, the entity shall reverse a portion of the associate's losses previously allocated to Preference shares.

Out of the total loss of ₹ 2,00,000 for the year, loss of only ₹ 50,000 is recognized. Hence, there is unrecognized loss to the extent of ₹ 1,50,000 at the end of year 2.

Year 3

Below table summarises the closing balance of each of the interest at the end of year 3: ₹

Type of interest	Opening balance at the start of the year	Adjustment as per Ind AS 109	Balance after applying Ind AS 109	Share in profit / (loss) of associate	Closing balance at the end of the year
	(A)	(B)	I = (A+B)	(D)	I = (C+D)
Equity shares	-	NA	-	-	-
Preference shares	-	1,00,000	1,00,000	(1,00,000)	-
Long-term loan	-	50,000	50,000	(50,000)	-
Total	**-**	**1,50,000**	**1,50,000**	**(1,50,000)**	**-**

The share in profit / loss for the year is nil. However, there was previously unrecognised loss of ₹ 1,50,000 which is allocated in current year. After recognising the above loss, there is no unrecognised loss at the end of year 3.

Year 4

Below table summarises the closing balance of each of the interest at the end of year 4: ₹

Type of interest	Opening balance at the start of the year	Adjustment as per Ind AS 109	Balance after applying Ind AS 109	Share in profit / (loss) of associate	Closing balance at the end of the year
	(A)	(B)	I = (A+B)	(D)	I = (C+D)
Equity shares	-	NA	-	2,00,000	2,00,000
Preference shares	-	50,000	50,000	5,00,000	5,50,000
Long-term loan	-	-	-	3,00,000	3,00,000
Total	**-**	**50,000**	**50,000**	**10,00,000**	**10,50,000**

The entity's share in profit of associate for the year is ₹ 10,00,000. The entity shall allocate such profit to each of the instruments in order of their seniority in liquidation. The entity should limit the amount of profit to be allocated to preference shares and long-term loan to the extent of losses previously allocated to them. Hence, the entity has allocated ₹ 5,00,000 to preference shares and ₹ 3,00,000 to long-term debt.

There is no unrecognised loss at the end of year 4.

Year 5

Below table summarises the closing balance of each of the interest at the end of year 5:

₹

Type of interest	Opening balance at the start of the year	Adjustment as per Ind AS 109	Balance after applying Ind AS 109	Share in profit / (loss) of associate	Closing balance at the end of the year
	(A)	(B)	I = (A+B)	(D)	I = (C+D)
Equity shares	2,00,000	NA	2,00,000	10,00,000	12,00,000
Preference shares	5,50,000	30,000	5,80,000	-	5,80,000
Long-term loan	3,00,000	-	3,00,000	-	3,00,000
Total	**10,50,000**	**30,000**	**10,80,000**	**10,00,000**	**20,80,000**

The entity's share in profit of associate for the year is ₹ 10,00,000. The entire profit is allocated to equity shares since there is no loss previously allocated to either preference shares or long-term loan.

There is no recognized loss at the end of year 5.

Year 1 to 5

The interest accrual on long-term loan would be done in each year at 10% p.a. This will be done without taking into account any adjustment done in the carrying value of long-term loan as per Ind AS 28. Hence, the entity will accrue interest of ₹ 30,000 (3,00,000 x 10%) in each year.

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6.5 IMPAIRMENT LOSSES

After doing accounting as per equity method explained above, an entity shall determine whether there is **an objective evidence** that the entity's net investment in an associate or a joint venture is impaired.

The objective evidence of impairment can arise as a result of:

- one or more events that occurred after the initial recognition of the net investment (a **'loss event'**) and

- that loss event (or events) has an **impact on the estimated future cash flows** from the net investment that can be reliably estimated.

It is not necessary to identify a single event that caused impairment. Rather, impairment can be a combined effect of several individual events.

Losses expected as a result of future events, no matter how likely, are not recognized.

Objective evidence that the net investment is impaired includes **observable data** about the following loss events:

Significant **financial difficulty** of the associate or joint venture

Breach of contract, such as a default in payments by the associate or joint venture

The entity **granting a concession** to associate or joint venture (because of its financial difficulties)

It becoming probable that the associate or joint venture will enter **bankruptcy or other financial reorganisation**

Disappearance of an active market for the net investment because of financial difficulties of the associate or joint venture

Adverse effect in the environment (technological, market, economic or legal) in which associate or joint venture operates

Significant or prolonged decline in the fair value of an investment in an equity instrument below its cost

It should be noted that the disappearance of an active market because the associate's or joint venture's equity or financial instruments are **no longer publicly traded is not evidence of impairment**.

A downgrade of an associate's or joint venture's credit rating or a decline in the fair value of the associate or joint venture, is not of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information.

Impairment of goodwill included in carrying value of associate or joint venture

As discussed earlier in this unit, the goodwill on acquisition of associate or joint venture is recognized as part of the carrying amount of the net investment in associate or joint venture. Such goodwill is **not tested separately** for impairment, rather the entire carrying amount of the investment is **tested for impairment as a single asset** when there is objective evidence of impairment as mentioned above.

Any impairment loss recognized is **not allocated** to any asset, including goodwill, that forms part of the carrying amount of the net investment in the associate or joint venture.

Reversal of impairment loss

Any reversal of impairment loss is recognized in accordance with Ind AS 36 *'Impairment of Assets'* to the extent that the recoverable amount of the net investment subsequently increases.

Determining value in use

Impairment loss is provided by comparing the recoverable amount (higher of value in use and fair value less ***costs of disposal***) with the carrying amount of the investment.

For above purpose, an entity can determine the value in use in **either** of the following ways:

a) Method 1: Values in use shall include entity's share in the present value of estimated future cash flows expected to be generated by the associate or joint venture, including:

   i. cash flows from the operations of the associate or joint venture and

   ii. proceeds from the ultimate disposal of the investment

b) Method 2: Value in use shall include the present value of estimated future cash flows expected to arise from:

   i. dividends to be received and

   ii. proceeds from the ultimate disposal of the investment.

If appropriate assumptions are used then both the above methods will give the same results.

The recoverable amount of an investment in an associate or a joint venture shall be assessed for each associate or joint venture separately, unless the associate or joint venture does not generate cash inflows from continuing use that are largely independent of those from other assets of the entity.

6.6 DISCONTINUING THE USE OF THE EQUITY METHOD

An entity shall discontinue the use of the equity method from the date when its investment ceases to be an associate or a joint venture

The accounting consequences when an investment ceases to be an associate or a joint venture are explained below.

Investment becomes a subsidiary

If the investment becomes a subsidiary, the entity shall account for its investment in accordance with Ind AS 103 and Ind AS 110. Ind AS 103 requires revaluation of the previously held interest in the equity accounted investment at its acquisition date fair value, with recognition of any gain or loss in profit or loss.

Retained interest in the former associate or joint venture is a financial asset

Retained interest in the former associate or joint venture that is a financial asset shall be measured at fair value. The entity shall recognise in profit or loss any difference between:

- the fair value of any retained interest and any proceeds from disposing of a part interest in the associate or joint venture; and
- the carrying amount of the investment at the date the equity method was discontinued.

Following illustration explains how an entity shall record in profit or loss any gain / loss on discontinuation of equity method in such case.

Illustration 16: Recording in profit or loss of the gain / loss on discontinuation of equity method

CD Ltd. held 50% of the voting power of RS Ltd. which is a joint venture of CD Ltd. The carrying value of the investment in RS Ltd. is ₹ 1,00,000. Now out of the 50% stake, CD Ltd. has sold 20% stake in RS Ltd. to a third party for a consideration of ₹ 80,000. The fair value of the retained 30% interest is ₹ 1,20,000. Determine how much gain / loss should be recorded in profit or loss of CD Ltd.

Solution:

CD Ltd. Shall record in profit or loss difference between below:

- the fair value of any retained interest (i.e. ₹ 1,20,000) and any proceeds from disposing of a part interest in the joint venture (i.e. ₹ 80,000); and
- the carrying amount of the investment at the date the equity method was discontinued (i.e. ₹ 1,00,000).

Hence, CD Ltd. Shall record gain of ₹ 1,00,000 in profit or loss.

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Reclassification of items recorded in other comprehensive income

On discontinuation of equity method, any share in the other comprehensive income of associate or joint venture that was previously recognized by the entity shall be reclassified to profit or loss on the same basis as would have been required if the investee had directly disposed of the related assets or liabilities.

Example 5

An investor has recognised in past in its other comprehensive income its share of ₹ 10,000 in the cumulative exchange differences relating to a foreign operation of its associate. Now, the investment in that associate is sold and equity method of accounting is stopped. So, the investor shall reclassify the cumulative exchange differences of ₹ 10,000 recorded in its other comprehensive income to profit or loss.

The above principle also applies in case there is a reduction in the ownership interest in an associate or joint venture but the investee still continues to be an associate or joint venture. In that case, the reclassification should be done in proportion to the reduction in the ownership interest.

It may be noted that while it is not explicitly stated in Ind AS 28, it can be inferred that in case there is a reduction in the ownership interest in an associate or joint venture but the investee still continues to be an associate or joint venture, the entity should recognize gain or loss. This accounting treatment is different from the accounting for changes in ownership interest interests in a subsidiary, without losing control.

An associate becomes a joint venture and vice versa

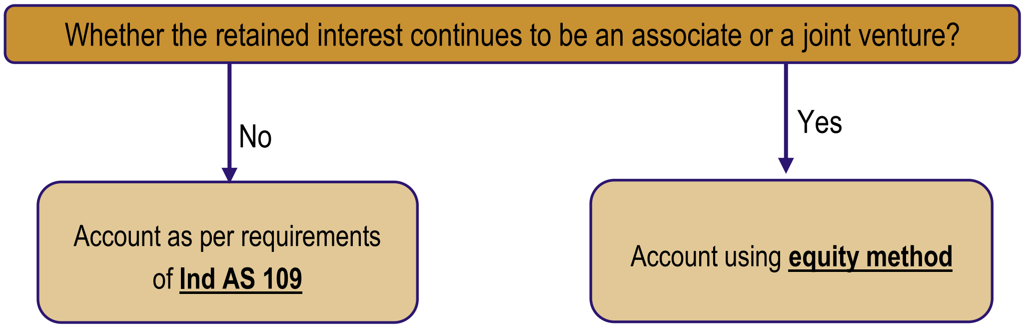
If an investment in an associate becomes an investment in a joint venture or an investment in a joint venture becomes an investment in an associate, the entity continues to apply the equity method and does not remeasure the retained interest.

6.7 CLASSIFICATION OF INVESTMENT IN ASSOCIATE OR JOINT VENTURE AS HELD FOR SALE

An entity shall apply Ind AS 105 *'Non-current Assets Held for Sale and Discontinued Operations'* to an investment, or a portion of an investment, in an associate or a joint venture that meets the criteria to be classified as held for sale.

Any **retained portion of an investment** in an associate or a joint venture that has not been classified as held for sale shall be accounted as follows:

- Till the time disposal of the portion that is classified as held for sale takes place:
    - Accounted using equity method
- After the disposal of the portion that is classified as held for sale takes place
    - Accounted as follows:



The above requirements are explained in below illustration:

Illustration 17: Investment in joint venture held for sale

Ram Ltd. holds 50% of the equity share capital of Shyam Ltd. The balance 50% equity share capital is held by another investor. Ram Ltd. has joint control over Shyam Ltd. and it is a joint venture of Ram Ltd., accounted using equity method. Now Ram Ltd. is planning to sell 10% of the equity share capital of Shyam Ltd. to a third party. Such 10% investment meets the criteria of an asset held for sale and has been measured and disclosed accordingly. Now determine how should Ram Ltd. account 40% interest retained in Shyam Ltd.

Solution:

Till the time 10% stake is sold, Ram Ltd. shall account for the retained interest of 40% as per equity method. After the sale of 10% investment, if Ram Ltd. still has joint control over Shyam Ltd. (e.g. through contractual arrangement) then it shall continue to measure that investment using equity method. However, if Ram Ltd. is not going to have joint control over Shyam Ltd. post the disposal of 10% investment then retained investment of 40% shall be accounted as per Ind AS 109.

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When an investment, or a portion of investment, in associate or a joint venture previously classified as held for sale **no longer meets the criteria** to be so classified, it shall be accounted for using the **equity method retrospectively** as from the date of its classification as held for sale. Financial statements for the prior periods shall be amended accordingly.

6.8 SIGNIFICANT CHANGES IN IND AS 28 FROM IAS 28 RESULTING INTO CARVE OUT

As per IFRS

IAS 28 (paragraph 35) requires that for the purpose of applying equity method of accounting in the preparation of investor's financial statements, uniform accounting policies should be used. In other words, if the associate's accounting policies are different from those of the investor, the investor should change the financial statements of the associate by using same accounting policies.

Carve out

In Ind AS 28 (paragraph 35), the phrase, 'unless impracticable to do so' has been added in the relevant requirements.

Reason

Certain associates, e.g., regional rural banks (RRBs), being associates of nationalized banks, may not be in a position to use the Ind AS as these may be too advanced for the RRBs. Accordingly, the above-stated words have been included to exempt such associates.

6.9 SIGNIFICANT DIFFERENCES BETWEEN IND AS 28 AND AS 23

S. No.	Topic	Ind AS 28	AS 23
1.	Significant Influence	In Ind AS 28, 'Significant Influence' has been defined as 'power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies'. Ind AS 28 defines joint control also.	In AS 23, 'Significant Influence' has been defined as 'power to participate in the financial and/or operating policy decisions of the investee but is not control over those policies'.
2.	Consideration for significant influence	As per Ind AS 28, existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether an entity has significant influence or not.	For considering share ownership for the purpose of significant influence, potential equity shares of the investee held by investor are not taken into account as per AS 23.
3.	Application of equity method	No exemption for applying equity method is provided in Ind AS 28.	One of the exemptions from applying equity method in AS 23 is where the associate operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investee.

4.	Measurement of the investment in the associate at fair value through profit or loss as per Ind AS 109	Ind AS 28 permits an entity that has an investment in an associate, a portion of which is held indirectly through venture capital organisations, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, to elect to measure that portion of the investment in the associate at fair value through profit or loss in accordance with Ind AS 109 regardless of whether these entities have significant influence over that portion of the investment.	AS 23 does not provide for the same.
5.	Held for sale	Ind AS 28 requires a portion of an investment in an associate or a joint venture to be classified as held for sale if the disposal of that portion of the interest would fulfil the criteria to be classified as held for sale in accordance with Ind AS 105.	AS 23 does not specifically deal with this aspect.
6.	Accounting of investment in an associate in separate financial statements	As per Ind AS 28, in separate financial statements, investment in an associate is to be accounted for at cost or in accordance with Ind AS 109, Financial Instruments.	As per AS 23, in separate financial statements, investment in an associate is not accounted for as per the equity method, the same is accounted for in accordance with AS 13, Accounting for Investments.
7.	Difference in reporting dates	There is no limit on the length of difference in the reporting dates of the investor and the associate. As per Ind AS 28, length of difference in the reporting dates of the associate or joint venture should not be more than three months.	AS 23 permits the use of financial statements of the associate drawn upto a date different from the date of financial statements of the investor when it is impracticable to draw the financial statements of the

			associate upto the date of the financial statements of the investor.
8.	Accounting Policies	Both AS 23 and Ind AS 28 require that similar accounting policies should be used for preparation of investor's financial statements and in case an associate uses different accounting policies for like transactions, appropriate adjustments shall be made to the accounting policies of the associate. Ind AS 28 provides that the entity's financial statements shall be prepared using uniform accounting policies for like transactions and events in similar circumstances unless, in case of an associate, it is impracticable to do so.	AS 23 provide exemption to this that if it is not possible to make adjustments to the accounting policies of the associate, the fact shall be disclosed along with a brief description of the differences between the accounting policies.
9.	Share of losses in the associate	As per Ind AS 28, carrying amount of investment in the associate or joint venture determined using the equity method together with any long-term interests that, in substance, form part of the entity's net investment in the associate or joint venture shall be considered for recognising entity's share of losses in the associate or joint venture.	As per AS 23, investor's share of losses in the associate is recognised to the extent of carrying amount of investment in the associate.
10.	Recognition of impairment loss on investment	Ind AS 28 requires that after application of equity method, including recognising the associate's or joint venture's losses, the requirements of Ind AS 109 shall be applied to determine whether it is necessary	With regard to impairment, AS 23 requires that the carrying amount of investment in an associate should be reduced to recognise a decline, other than temporary, in the value of the investment.

		to recognise any additional impairment loss.	
11.	When investment ceases to be an associate	Ind AS 28 provides that use of equity method will be discontinued from the date when investment ceases to be an associate and in case such associates become the subsidiary, it will be accounted in accordance with Business Combination (Ind AS 103) and if the retained interest becomes a financial asset, it will measure the retained interest at fair value.	AS 23 does not deal with the situation as to associate becoming a subsidiary. However, in other case (there is some retained interest), the investment will be accounted for in accordance with AS 13-Investments and retained interest will not be fair valued under AS 23.