7.1 INTRODUCTION

Ind AS 28, Investments in Associates and Joint Ventures,

a) prescribes the accounting for investments in associates and

b) sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures.

It is important to note here that Ind AS 111, describes joint arrangements including joint ventures and prescribes equity method for joint ventures. But here, in Ind AS 28, the equity method is described for both Associate and Joint Ventures.

7.2 SCOPE

This Standard shall be applied by all entities that are investors with joint control of, or significant influence over, an investee.

7.3 SIGNIFICANT INFLUENCE

The concept of 'significant influence' signifies the close relationship between two entities where one has the power to influence the decision making in the other entity. In today's business world, many companies do not have actual control over other companies but hold significant ownership to influence the decision making in such companies. Many such investments are in the form of joint ventures in which two or more companies form a new entity to carry out a specified operating purpose.

For example, Microsoft and NBC formed MSNBC, a cable channel and online site to go with NBC's broadcast network. Each partner owns 50 percent of the joint venture. For each of these investments, the investors do not possess absolute control because they hold less than a majority of the voting stock. Thus, the preparation of consolidated financial statements is inappropriate. However, the large percentage of ownership indicates that each investor possesses some ability to affect the investee's decision-making process.

Definition

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.
Analysis

- **HOLDING 20% OR MORE OF THE VOTING RIGHTS**: If an entity holds, directly or indirectly (e.g., through subsidiaries), 20 per cent or more of the voting power of the investee, it is presumed that the entity has significant influence, unless it can be clearly demonstrated that this is not the case.

- **HOLDING LESS THAN 20% OF VOTING RIGHTS**: Also, in cases where the entity holds, directly or indirectly (e.g., through subsidiaries), less than 20 per cent 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.

**Illustration 1**

*X Ltd. owns 20% of the voting rights in Y Ltd. and is entitled to appoint one director to the board, which consists of five members. The remaining 80% of the voting rights are held by two entities, each of which is entitled to appoint two directors.*

A quorum of four directors and a majority of those present are required to make decisions. The other shareholders frequently call board meetings at short notice and make decisions in the absence of X Ltd.’s representative. X Ltd has requested financial information from Y Ltd, but this information has not been provided. X Ltd.’s representative has attended board meetings, but suggestions for items to be included on the agenda have been ignored and the other directors oppose any suggestions made by X Ltd. Is Y Ltd an associate of X Ltd.?

**Solution**

Despite the fact that the X Ltd owns 20% of the voting rights and has representations on the board, the existence of other shareholders holding a significant proportion of the voting rights prevent X Ltd. from exerting significant influence. Whilst it appears that X Ltd should have the power to participate in the financial and operating policy decision, the other shareholders prevent X Ltd.’s efforts and stop X Ltd from actually having any influence.

Since, significant influence requires participation in decision making process which X Ltd. has. Therefore, X Ltd. has significant influence over Y Ltd. Hence, Y Ltd would be an associate of X Ltd. Y Ltd. is jointly controlled by the other two entities.

Whether an investor has significant influence over the investee is a matter of judgment based on the nature of the relationship between the investor and the investee. Existence of significant influence may be judged by the following factors:

a) **Representation on the board of directors or equivalent governing body of the investee**;

**Illustration 2**

*Kuku Ltd. holds 12% of the voting shares in Boho Ltd. Boho Ltd.’s board comprises 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.

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

Example:

X Ltd creates a separate legal entity in which it holds less than 20% of the voting interests but however controls that entity through contracts that ensures that decision-making power and the distribution of profits and losses lies with X ltd. In such cases the investor is able to exercise significant influence over its investee.

Example:

Info Ltd owns 9% equity in Sync Ltd. However, it has the approval or veto rights over critical decisions of compensation, hiring, termination, and other operating and capital spending decisions of Sync Ltd. The non-controlling rights are so restrictive that it is appropriate to infer that control rests with the Info Ltd for all major decisions.

c) Material transactions between the entity and its investee;

Illustration 3

Q Ltd manufactures shoes for a leading retailer P Ltd. P Ltd provides all designs for the shoes and participates in scheduling, timing and quantity of the production. The majority (i.e. 90%) of Q Ltd’s sales are made to the retailer, P Ltd. P Ltd. has 10% shareholding in the Q Ltd. It acquired this interest many years ago at the start of their relationship. Does significant influence exist?

Solution

Q Ltd is highly dependent on the retailer for the continued existence of the business. Despite having only a 10% interest in Q Ltd, P Ltd has significant influence
Illustration 4

X Ltd owns 15% of the voting rights of Y Ltd, and the remainder are widely dispersed among the public.

X Ltd also is the only supplier of crucial raw materials to Y Ltd, further it provides certain expertise guidance regarding the maintenance of Y Ltd’s factory.

Discuss the relationship between X Ltd and Y Ltd.

Solution

Y Ltd is effectively functioning because of the participation of X Ltd in the Y Ltd’s factory despite having 15% interest in Y Ltd, X Ltd has significant influence.

d) Interchange of managerial personnel; or

Illustration 5

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 provides 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 as well as to entity X’s. 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 take into the account what are the key financial and operating policies of entity Y and the influence this gives entity X over those policies.

e) Provision of essential technical information.

Illustration 6

Soul Ltd has 18% interest in God Ltd. Soul Ltd manufacture mobile telephone handsets using technology developed by God Ltd. God Ltd licenses the technology to Soul Ltd and updates the licence agreement for new technology on a regular basis. The handsets are sold by Soul Ltd and represent substantially Soul Ltd’s entire sale. Analyse.
Solution

Soul Ltd is dependent on the technology that God Ltd supplies since a high proportion of Soul Ltd’s sales are based on that technology. Therefore, Soul Ltd is likely to be an associate of God Ltd because of the provision of essential technical informational.

7.4 POTENTIAL VOTING RIGHTS

An investor may hold any instrument (such as share warrants, share call options, debt or equity instruments) issued by an associate and terms of the instrument is that a holder will get an equity rights on the expiry of the term i.e. they are convertible into ordinary shares, to give the entity additional voting power or to reduce another party’s voting power over the financial and operating policies of another entity (i.e. potential voting rights). Only an existing right will be considered for determining the Significant influence. Any potential voting rights that will arise in future will not be considered while determining Significant influence.

It is worth nothing that a substantial or majority ownership by another investor does not necessarily preclude an entity from having significant influence

7.5 EQUITY METHOD

a) **On the date of acquisition:**

Under the equity method, on initial recognition the investment in an associate or a joint venture is recognised at cost.
b) Recognizing the share in Profit or loss:

Since the investor has the significant influence over the investee, the investor has an interest in the performance of the investee. It can influence the dividend to be distributed irrespective of the actual profits made by the investee. Here the recognition of income based on profit distributed may not be a true measure of the income earned by an investor on an investment in an associate or a joint venture. The distributions made may bear little relation to the actual performance of the associate or joint venture. Hence recognizing actual profit or loss (irrespective of the amount of dividend distributed) is more reflective of the actual value of the investment.

(i) If Associate or joint venture makes profit

<table>
<thead>
<tr>
<th>Investment in Associate A/c</th>
<th>Dr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Share in Profit from Associate A/c</td>
<td></td>
</tr>
</tbody>
</table>

(ii) If Associate or joint venture makes losses

<table>
<thead>
<tr>
<th>Share in Losses from Associate A/c</th>
<th>Dr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Investment in Associate A/c</td>
<td></td>
</tr>
</tbody>
</table>

(iii) Cash dividend received: Any distribution of dividend in the form of cash received from the associate reduces the carrying amount of the investment.

<table>
<thead>
<tr>
<th>Cash A/c</th>
<th>Dr.</th>
</tr>
</thead>
<tbody>
<tr>
<td>To Investment in Associate A/c</td>
<td></td>
</tr>
</tbody>
</table>

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**Application of Equity Method**

<table>
<thead>
<tr>
<th>Investee Event</th>
<th>Books of Investor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income is earned</td>
<td>Proportionate share of income is recognized by investor</td>
</tr>
<tr>
<td>Dividends distributed</td>
<td>Investor’s share in dividends reduces the investment account</td>
</tr>
</tbody>
</table>

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**Illustration 7**

Amar Ltd. acquires 40% shares of Ram Ltd. On 1 April, 20X1, the price paid is ₹10,00,000. Ram Ltd has reported a profit of ₹2,00,000 and paid dividend of ₹1,00,000. Make necessary journal entries in the books of Amar Ltd.
**CONSOLIDATED FINANCIAL STATEMENTS**

Solution

<table>
<thead>
<tr>
<th>Amount</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>₹</td>
<td>₹</td>
</tr>
<tr>
<td>Investmen in Associate A/c</td>
<td>Dr. 10,00,000</td>
</tr>
<tr>
<td>Investment in Associate A/c</td>
<td>Dr. 80,000</td>
</tr>
<tr>
<td>Cash A/c</td>
<td>Dr. 40,000</td>
</tr>
</tbody>
</table>

Adjustments to the carrying amount may also be necessary for a change in the investor’s proportionate interest in the investee arising from changes in the investee’s other comprehensive income. Such changes include those arising from the revaluation of property, plant and equipment and from foreign exchange translation differences. The investor’s share of those changes is recognised in other comprehensive income of the investor.

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**7.6 APPLICATION OF EQUITY METHOD**

The investor needs to apply equity method of accounting when it has joint control or significant influence over the investee.

The rationale behind the application of the equity method is that in case of an associate or a joint venture, an investor commences to gain the ability to influence the decision-making process of an investee as the level of ownership rises. The investor, hence, has the ability to exercise significant influence over operating and financial policies of an investee even though the investor holds 50 percent or less of the voting rights. Clearly, this is a subject of judgments and interpretations in practice. Also, it is important to note that ‘significant influence’ is required to be present but there is no requirement that any actual influence must have ever been applied.

However, the investor is exempt from the application of Equity Method under certain circumstances.

**7.6.1 Exemptions from applying the equity method**

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

(a) The entity is a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the entity not applying the equity method.

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(b) The entity’s debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets).

(c) The entity did not file, 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.

(d) The ultimate or any intermediate parent of the entity produces consolidated financial statements available for public use that comply with Ind AS.

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.

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 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.

### 7.6.2 Discontinuing of Equity Method

The investor should discontinue the use of Equity Method from the date the significant influence or joint control ceases.

### 7.6.3 Equity Method Procedures

While preparing the consolidated financial statements, an investor applies equity method of accounting for investments in associates and joint ventures. It includes the aggregate of the holdings in that associate or joint venture by the parent and its subsidiaries taken together. The holdings of the group’s other associates or joint ventures are ignored for this purpose.

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 (including 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), after any adjustments necessary to give effect to uniform accounting policies.

In accounting, transactions between related companies are identified as either downstream or upstream. Downstream transfers include investor’s sale of an item to investee. Conversely, a downstream transfer means sales made by investee to investor. These two types of intra entity transactions are examined separately.
Gains and losses resulting from ‘upstream’ and ‘downstream’ transactions between an entity (including its consolidated subsidiaries) and its associate or joint venture are recognised in the entity’s financial statements only to the extent of unrelated investors’ interests in the associate or joint venture. The investor’s share in the associate’s or joint venture’s gains or losses resulting from these transactions is eliminated.

Example:

Assume that Babu Ltd owns a 40% share of Sahu Ltd and accounts for this investment through the equity method. In 20X1, Babu Ltd sells inventory to Sahu Ltd at a price of 50,000. This figure includes a gross profit of 30%.

By the end of 20X1, Sahu Ltd has sold 40,000 of these goods to outside parties while retaining 10,000 in inventory for sale during the subsequent year.

The investor has made downstream sales to the investee. In applying the equity method, recognition of the related profit must be delayed until the buyer disposes of these goods.

Although total intra-entity transfers amounted to 50,000, only 40,000 of this merchandise has already been resold to outsiders, thereby justifying the normal reporting of profits.

For the 10,000 still in the investee’s inventory, the earning process is not finished. In computing equity income, this portion of the intra-entity profit must be deferred until Sahu Ltd disposes of the goods.

The gross profit on the original sale was 30% of the transfer price; therefore, Sahu Ltd’s profit associated with these remaining items is 3,000 (10,000 * 30%). However, because only 40% of the investee’s stock is held by Babu Ltd, just 1,200 (3,000 * 40%) of this profit is unearned. Babu Ltd’s ownership percentage reflects the intra-entity portion of the profit. The total 3,000 gross profit within the ending inventory balance is not the amount deferred. Rather, 40% of that gross profit is viewed as the currently unrealized figure.

After calculating the appropriate deferral, the investor decreases current equity income by 1,200 to reflect the unearned portion of the intra-entity profit. This procedure temporarily removes this portion of the profit from the investor’s books in 20X1 until the investee disposes of the inventory in 20X2.

In the subsequent year, when this inventory is eventually consumed by Sahu Ltd. or sold to unrelated parties, the deferral is no longer needed. The earning process is complete, and Babu Ltd. should recognize the 1,200.

Example: Equity method accounting

B Ltd acquired a 30% interest in D Ltd and achieved significant influence. The cost of the investment was ₹ 2,50,000. The associate has net assets of ₹ 5,00,000 at the date of acquisition. The fair value of those net assets is ₹ 6,00,000 as a fair value of property, plant...
& equipment is ₹1,00,000 higher than its book value. This property, plant & equipment has a remaining useful life of 10 years.

After acquisition D Ltd recognize profit after tax of ₹1,00,000 and paid a dividend out of these profits of ₹9,000. D Ltd has also recognized exchange losses of ₹20,000 directly in other comprehensive income.

B Ltd’s interest in D Ltd at the end the year is calculated as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance on requisition under the equity method (including goodwill of ₹70,000)</td>
<td>₹4,25,000 - (30% x ₹6,00,000)</td>
</tr>
<tr>
<td>B Ltd’s share of D Ltd’s after tax profit (30% x ₹1,00,000)</td>
<td>30,000</td>
</tr>
<tr>
<td>Elimination of dividend received by B Ltd from D Ltd (30% x ₹9,000)</td>
<td>(2,700)</td>
</tr>
<tr>
<td>B Ltd’s share of D Ltd’s exchange differences (30% x ₹20,000)</td>
<td>(6,000)</td>
</tr>
<tr>
<td>B Ltd’s share of amortisation of fair value uplift (30% x ₹10,000)</td>
<td>(3,000)</td>
</tr>
<tr>
<td>B Ltd’s interest in D Ltd at the end of the year under the equity method</td>
<td>2,68,300</td>
</tr>
<tr>
<td>(including goodwill)</td>
<td></td>
</tr>
</tbody>
</table>

D Ltd has net assets at the end of the year of ₹5,71,000 (that is, net assets at the start of the year of ₹5,00,000, plus profit during the year of ₹1,00,000, less dividend of ₹9,000, less foreign exchange losses of ₹20,000).

B Ltd’s interest in D Ltd at the end of the year is made up of:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>B Ltd’s share of D Ltd.’s net assets (30% x ₹5,71,000)</td>
<td>1,71,300</td>
</tr>
<tr>
<td>Goodwill</td>
<td>70,000</td>
</tr>
<tr>
<td>B Ltd’s share of D Ltd’s fair value adjustments (the initial fair value difference of ₹1,00,000 has been reduced by ₹10,000 due to depreciation in the year) (30% x ₹90,000)</td>
<td>27,000</td>
</tr>
<tr>
<td>B Ltd’s interest in D Ltd</td>
<td>2,68,300</td>
</tr>
</tbody>
</table>

### 7.6.4 Impairment losses

After application of the equity method, it is necessary to recognise any additional impairment loss with respect to Investor’s net investment in the associate or joint venture. There has to be substantial objective evidence of impairment 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. There may be combined multiple events that may result in impairment. It is important to note that any losses expected from future events, no matter how likely, are not recognized. Objective
evidences may include

(a) significant financial difficulty of the associate or joint venture;

(b) a breach of contract, such as a default or delinquency in payments by the associate or joint venture;

(c) the entity, for economic or legal reasons relating to its associate’s or joint venture’s financial difficulty, granting to the associate or joint venture a concession that the entity would not otherwise consider;

(d) it becoming probable that the associate or joint venture will enter bankruptcy or other financial reorganisation; or

(e) the disappearance of an active market for the net investment because of financial difficulties of the associate or joint venture.

Example:

X Ltd, an associate of Y Ltd, disappears from the active market as its financial instruments are no longer publicly traded. However, this is not evidence of impairment. It has to supported by other evidences.

Example:

There is a downgrade of an associate’s or joint venture’s credit rating. This, however, is not an evidence of impairment, although it may be evidence of impairment when considered with other available information.

Example:

There are significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the associate or joint venture operates, and indicates that the cost of the investment in the equity instrument may not be recovered. A significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is also objective evidence of impairment.

Goodwill that forms part of the carrying amount of the net investment in an associate or a joint venture is not separately recognized. Therefore, it is not tested for impairment separately by applying the requirements for impairment testing goodwill in Ind AS 36, Impairment of Assets. Instead, the entire carrying amount of the investment is tested for impairment in accordance with Ind AS 36 as a single asset, by comparing its recoverable amount (higher of value in use and fair value less costs to sell) with its carrying amount. Accordingly, any reversal of that impairment loss is recognised in accordance with Ind AS 36 to the extent that the recoverable amount of the net investment subsequently increases.
In determining the value in use of the net investment, an entity estimates:

(a) its share of the present value of the estimated future cash flows expected to be generated by the associate or joint venture, including the cash flows from the operations of the associate or joint venture and the proceeds from the ultimate disposal of the investment;

or

(b) the present value of the estimated future cash flows expected to arise from dividends to be received from the investment and from its ultimate disposal.

Using appropriate assumptions, both methods give the same result.