

EXPOSURE DRAFT

Accounting Standard for Local Bodies (ASLB) 36

Investments in Associates and Joint Ventures

(Based on corresponding IPSAS 36)

(Last date of comments: November 25, 2019)



Issued by

The Committee on Public and Government Financial Management

The Institute of Chartered Accountants of India

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Exposure Draft ASLB 36- Investments in Associates and Joint Ventures

CONTENTS

	Paragraphs
Objective.....	1
Scope	2-7
Definitions	8-9
Binding Arrangement.....	9
Significant Influence	10-15
Equity Method	16-21
Application of the Equity Method	22-48
Exemptions from Applying the Equity Method	23-25
Discontinuing the Use of the Equity Method	26-27
Changes in Ownership Interest	28
Equity Method Procedures	29-42
Impairment Losses	43-48
Separate Financial Statements	49
Appendix A Illustrative Examples	
Appendix 1 Comparison with IPSAS 36, ‘ <i>Investment in Associates and Joint Ventures</i> ’	
Appendix 2 Comparison with existing AS 23, ‘ <i>Accounting for Investment in Associates in Consolidated Financial Statements</i> ’	

Exposure Draft
Accounting Standard for Local Bodies (ASLB) 36
Investment in Associates and Joint Ventures

Invitation to Comment

The Committee on Public and Government Financial Management of the Institute of Chartered Accountants of India invites comments on any aspect of this Exposure Draft of Accounting Standard for Local Bodies (ASLB) 36, 'Investment in Associates and Joint Ventures'. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Comments should be submitted in writing to the Secretary, Committee on Public and Government Financial Management, The Institute of Chartered Accountants of India, ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi – 110 002, so as to be received not later than November 25, 2019. Comments can also be sent by e-mail at caslb@icai.in and cpf.aslb@icai.in

Draft
Accounting Standard for Local Bodies (ASLB) 36
Investment in Associates and Joint Ventures

*(This Accounting Standard includes paragraphs set in **bold italic** type and plain type, which have equal authority. Paragraphs in bold italic type indicate the main principles. This Accounting Standard should be read in the context of its objective and the 'Preface to Accounting Standards for Local Bodies'¹.)*

The Accounting Standards for Local Bodies (ASLB) 36, 'Investment in Associates and Joint Ventures', issued by the Council of the Institute of the Chartered Accountants of India, will be recommendatory in nature in the initial years for use by the Local Bodies. This Standard will be mandatory for local bodies in a State from the date specified in this regard by the State Government concerned².

The following is the text of the Accounting Standards for Local Bodies:

¹ Attention is specifically drawn to paragraph 4.2 of the 'Preface to Accounting Standards for Local Bodies', according to which Accounting Standards are intended to apply only to items which are material.

² Reference may be made to the paragraph 7.1 of the 'Preface to Accounting Standards for Local Bodies' providing the discussion on the compliance with the Accounting Standards for Local Bodies.

Objective

1. The objective of this Standard is to prescribe the accounting for investments in associates and joint ventures and to set out the requirements for the application of the equity method when accounting for investments in associates and joint ventures.

Scope

2. *An entity that prepares and presents financial statements under the accrual basis of accounting should apply this Standard in accounting for investments in associates and joint ventures.*
- 2A. *This Standard applies to all entities described as Local Bodies in the 'Preface to the Accounting Standards for Local Bodies'³.*
3. *This Standard should be applied by all entities that are investors with significant influence over, or joint control of, an investee where the investment leads to the holding of a quantifiable ownership interest.*
4. This Standard provides the basis for accounting for ownership interests in associates and joint ventures. That is, the investment in the other entity confers on the entity the risks and rewards incidental to an ownership interest. This Standard applies only to quantifiable ownership interests. This includes ownership interests arising from investments in the formal equity structure of another entity. A formal equity structure means share capital or an equivalent form of capital, such as units in a property trust. Quantifiable ownership interests may also include ownership interests arising from other investments in which the entity's ownership interest can be measured reliably⁴ (for example, interests in a partnership). Where the equity structure of the other entity is poorly defined, it may not be possible to obtain a reliable measure of the ownership interest.
5. Some contributions made by local bodies may be referred to as an "investment," but may not give rise to an ownership interest. For example, a local body may make a substantial investment in the development of a hospital that is owned and operated by the other entity. While such contributions are non-exchange in nature, they allow the local body to participate in the operation of the hospital, and the other entity owning the hospital is accountable to the local body for its use of public monies. However, the contributions made by the local body do not constitute an ownership interest, as the other entity could seek alternative funding and thereby prevent local body from participating in the operation of the hospital. Accordingly, the local body is not exposed to the risks, nor does it enjoy the rewards, that are incidental to an ownership interest.
6. [Deleted]
7. [Deleted]

³ Refer paragraph 1.3 of the 'Preface to the Accounting Standards for Local Bodies'.

⁴ Information that is reliable is free from material error and bias, and can be depended on by users to faithfully represent that which it purports to represent or could reasonably be expected to represent

Definitions

8. *The following terms are used in this Standard with the meanings specified:*

An associate is an entity over which the investor has significant influence.

***Binding arrangement:** For the purposes of this Standard, a binding arrangement is an arrangement that confers enforceable rights and obligations on the parties to it as if it were in the form of a contract. It includes rights from contracts or other legal rights.*

***Consolidated financial statements** are the financial statements of an economic entity in which assets, liabilities, net assets/equity, revenue, expenses and cash flows of the controlling entity and its controlled entities are presented as those of a single economic entity.*

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/equity of the associate or joint venture. The investor's surplus or deficit includes its share of the investee's surplus or deficit and the investor's net assets/equity includes its share of changes in the investee's net assets/equity that have not been recognised in the investee's surplus or deficit.

A joint arrangement is an arrangement of which two or more parties have joint control.

***Joint control** is the agreed sharing of control of an arrangement by way of a binding arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.*

A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

A joint venturer is a party to a joint venture that has joint control of that joint venture.

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

Terms defined in other ASLBs are used in this Standard with the same meaning as in those Standards. The following terms are defined in either ASLB 34⁵, 'Separate Financial Statements', ASLB 35, 'Consolidated Financial Statements', or ASLB 37, 'Joint Arrangements': benefits, control, controlled entity, controlling entity, economic entity, investment entity, joint operation, power and separate financial statements.

⁵ The standard makes a reference to the various ASLBs that are yet to be formulated/ issued. The Guidance in regard to those may be obtained from other corresponding pronouncements as per the hierarchy prescribed in paragraph 15 of the ASLB 3, 'Accounting Policies, Changes in Accounting Estimates, and Errors'.

Binding Arrangement

9. Binding arrangement can be evidenced in several ways. A binding arrangement is often, but not always, in writing, in the form of a contract or documented discussions between the parties. Statutory mechanisms such as legislative or executive authority can also create enforceable arrangements, similar to contractual arrangements, either on their own, or in conjunction with contracts between the parties.

Significant Influence

10. 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, and on the definition of significant influence in this Standard. This Standard applies only to those associates in which an entity holds a quantifiable ownership interest either in the form of a shareholding or other formal equity structure or in another form in which the entity's interest can be measured reliably.
11. If an entity holds a quantifiable ownership interest and it holds, directly or indirectly (e.g., through controlled entities), 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. Conversely, if the entity holds, directly or indirectly (e.g., through controlled entities), 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. A substantial or majority ownership by another investor does not necessarily preclude an entity from having significant influence.
12. The existence of significant influence by an entity is usually evidenced in one or more of the following ways:
 - (a) Representation on the board of directors or equivalent governing body of the investee;
 - (b) Participation in policy-making processes, including participation in decisions about dividends or similar distributions;
 - (c) Material transactions between the entity and its investee;
 - (d) Interchange of managerial personnel; or
 - (e) Provision of essential technical information.
13. [Refer Appendix-1]
14. 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 absolute or relative ownership levels. It could occur, for example, when an associate becomes subject to

the control of another government, a court or an administrator. It could also occur as a result of a binding arrangement.

Equity Method

15. Under the equity method, on initial recognition the investment in an associate or a joint venture is recognised at cost and the carrying amount is increased or decreased to recognise the investor's share of the surplus or deficit of the investee after the date of acquisition. The investor's share of the investee's surplus or deficit is recognised in the investor's surplus or deficit. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's equity that have not been recognised in the investee's surplus or deficit. 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 net assets/equity of the investor.
16. The recognition of revenue on the basis of distributions received may not be an adequate measure of the revenue earned by an investor on an investment in an associate or a joint venture because the distributions received may bear little relation to the performance of the associate or joint venture. Because the investor has joint control of, or significant influence over, the investee, the investor has an interest in the associate's or joint venture's performance and, as a result, the return on its investment. The investor accounts for this interest by extending the scope of its financial statements to include its share of the surplus or deficit of such an investee. As a result, application of the equity method provides more informative reporting of the investor's net assets/equity and surplus or deficit.
17. [Refer Appendix 1]
18. [Refer Appendix 1]
19. [Refer Appendix 1]
20. *An investment in an associate or a joint venture accounted for using the equity method should be classified as a non-current asset.*

Application of the Equity Method

21. *An entity with joint control of, or significant influence over, an investee should account for its investment in associate or a joint venture using the equity method except when that investment qualifies for exemption in accordance with paragraphs 23-25.*

Exemptions from Applying the Equity Method

22. An entity need not apply the equity method to its investment in an associate or a joint venture if the entity is a controlling entity that is exempt from preparing consolidated

financial statements by the scope exception in paragraph 5 of ASLB 35 or if all of the following apply⁶:

- (a) The entity itself is a controlled entity and the information needs of users are met by its controlling entity's consolidated financial statements, and, in the case of a partially owned entity, all 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.
 - (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 organization, for the purpose of issuing any class of instruments in a public market.
 - (d) The ultimate or any intermediate controlling entity of the entity produces financial statements available for public use that comply with ASLBs, in which controlled entities are consolidated or are measured at fair value in accordance with ASLB 35.
23. 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 organization, 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 surplus or deficit in accordance with guidance on “*Financial Instruments*”⁷. An investment entity will, by definition, have made this election.
24. When an entity has an investment in an associate, a portion of which is held indirectly through a venture capital organization, 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 in accordance with paragraph 24, regardless of whether the venture capital organization, or the mutual fund, unit trust and similar entities including investment-linked insurance funds, has significant influence over that portion of the investment. If the entity makes that election, the entity should apply the equity method to any remaining portion of its investment in an associate that is not held through a venture capital organization, or a mutual fund, unit trust and similar entities including investment-linked insurance funds. When an entity has an investment in an associate, a portion of which is held indirectly through an investment entity, the entity should measure that portion of the investment at fair value through surplus or deficit in accordance with paragraph 24.

⁶ Normally, the conditions mentioned here may not be applicable to the local bodies in India. However, any entity controlled by a local body (for example corporate municipal entity as referred in SEBI regulations for issuance of Municipal Bonds) may have such structure that these exemptions may apply.

⁷ The Guidance with regard to “Financial Instruments” may be obtained from other corresponding pronouncements as per the hierarchy prescribed in paragraph 15 of the ASLB 3, ‘*Accounting Policies, Changes in Accounting Estimates, and Errors*’

Discontinuing the Use of the Equity Method

25. *An entity should discontinue the use of the equity method from the date when its investment ceases to be an associate or a joint venture as follows:*
- (a) *If the investment becomes a controlled entity, the entity should account for its investment in accordance with ASLB 40, 'Entity Combinations' and ASLB 35.*
 - (b) *If the retained interest in the former associate or joint venture is a financial asset, the entity should measure the retained interest at fair value. The entity should measure the retained interest at the carrying amount of the investment at the date that it ceases to be an associate or joint venture and that carrying amount, if it is impracticable to determine the fair value. The entity should recognise in surplus or deficit any difference between:*
 - (i) *The fair value (or, where relevant, the carrying amount) of any retained interest and any proceeds from disposing of a part interest in the associate or joint venture; and*
 - (ii) *The carrying amount of the investment at the date the equity method was discontinued.*
 - (c) *When an entity discontinues the use of the equity method, the entity should account for all amounts previously recognised directly in the entity's net assets/equity in relation to that investment on the same basis as would have been required if the investee had directly disposed of the related assets or liabilities.*
26. *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.*

Changes in Ownership Interest

27. If an entity's ownership interest in an associate or a joint venture is reduced, but the investment continues to be classified either as an associate or a joint venture respectively, the entity should transfer directly to accumulated surpluses or deficits the proportion of the gain or loss that had previously been recognised in net assets/equity relating to that reduction in ownership interest if that gain or loss would be required to be transferred directly to accumulated surpluses or deficits on the disposal of the related assets or liabilities.

Equity Method Procedures

28. Many of the procedures that are appropriate for the application of the equity method are similar to the consolidation procedures described in ASLB 35. Furthermore, the concepts underlying the procedures used in accounting for the acquisition of a controlled entity are also adopted in accounting for the acquisition of an investment in an associate or a joint venture.

29. An economic entity's share in an associate or a joint venture is the aggregate of the holdings in that associate or joint venture by the controlling entity and its controlled entities. The holdings of the economic entity's other associates or joint ventures are ignored for this purpose. When an associate or a joint venture has controlled entities, associates or joint ventures, the surplus or deficit 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 surpluses or deficits and net assets of its associates and joint ventures), after any adjustments necessary to give effect to uniform accounting policies (see paragraphs 37-39).
30. Gains and losses resulting from "upstream" and "downstream" transactions involving assets that do not constitute an operation, as defined in ASLB 40, between an entity (including its consolidated controlled entities) 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. "Upstream" transactions are, for example, sales of assets from an associate or a joint venture to the investor. The entity's share in the associate's or the joint venture's gains or losses resulting from these transactions is eliminated. "Downstream" transactions are, for example, sales or contributions of assets from the investor to its associate or its joint venture.
31. When downstream transactions provide evidence of a reduction in the net realizable value of the assets to be sold or contributed, or of an impairment loss of those assets, those losses should be recognised in full by the investor. When upstream transactions provide evidence of a reduction in the net realizable value of the assets to be purchased or of an impairment loss of those assets, the investor should recognise its share in those losses.
32. The gain or loss resulting from the contribution of non-monetary assets that do not constitute an operation, as defined in ASLB 40, to an associate or a joint venture in exchange for an equity interest in that associate or joint venture should be accounted for in accordance with paragraph 31, except when the contribution lacks commercial substance, as that term is described in ASLB 17, '*Property, Plant and Equipment*'. If such a contribution lacks commercial substance, the gain or loss is regarded as unrealised and is not recognised unless paragraph 34 also applies. Such unrealised gains and losses should be eliminated against the investment accounted for using the equity method and should not be presented as deferred gains or losses in the entity's consolidated statement of financial position or in the entity's statement of financial position in which investments are accounted for using the equity method.
33. 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 surplus or deficit the portion of the gain or loss on the contribution relating to the monetary or non-monetary assets received.
- 33A. The gain or loss resulting from a downstream transaction involving assets that constitute an operation, as defined in ASLB 40, between an entity (including its consolidated controlled entities) and its associate or joint venture is recognised in full in the investor's financial statements.

- 33B. An entity might sell or contribute assets in two or more arrangements (transactions). When determining whether assets that are sold or contributed constitute an operation, as defined in ASLB 40, an entity should consider whether the sale or contribution of those assets is part of multiple arrangements that should be accounted for as a single transaction in accordance with the requirements of ASLB 35.
34. 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, any difference between the cost of the investment the entity's share of the net fair value of the investee's identifiable assets and liabilities is accounted for as follows:
- (a) When an entity has included goodwill relating to an associate or a joint venture in the carrying amount of the investment, amortisation of that goodwill is not permitted.
 - (b) 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 included as revenue in the determination of the entity's share of the associate or joint venture's surplus or deficit in the period in which the investment is acquired.

Appropriate adjustments to the entity's share of the associate's or joint venture's surplus or deficit after acquisition are made in order to account, for example, for depreciation of the depreciable assets based on their fair values at the acquisition date. Similarly, appropriate adjustments to the entity's share of the associate's or joint venture's surplus or deficit after acquisition are made for impairment losses such as for property, plant and equipment or, where relevant, goodwill.

35. *The most recent available financial statements of the associate or joint venture are used by the entity in applying the equity method. When the end of the reporting period of the entity is different from that of an associate or a joint venture the entity either:*
- (a) *Obtains, for the purpose of applying the equity method, additional financial information as of the same date as the financial statements of the entity; or*
 - (b) *Uses the most recent financial statements of the associate or joint venture adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the entity's financial statements.*
36. *The entity usually prepares consolidated financial statements using uniform accounting policies for the like transactions and events in similar circumstances. In case an associate uses accounting policies other than those adopted for the consolidated financial statements for like transactions and events in similar*

circumstances, appropriate adjustments are made to the associate's financial statements when they are used by the investor in applying the equity method. If it is not practicable to do so, that fact is disclosed along with a brief description of the differences between the accounting policies.

37. Except as described in paragraph 39, if an associate or a joint venture uses accounting policies other than those of the entity for like transactions and events in similar circumstances, adjustments should be made to make the associate's or joint venture's accounting policies confirm to those of the entity when the associate's or joint venture's financial statements are used the entity in applying the equity method.
38. ***Notwithstanding the requirements in paragraph 38, if an entity has an interest in an associate or a joint venture that is an investment entity, the entity should, when applying the equity method, retain the fair value measurement applied by that investment entity associate or joint venture to its interest in controlled entities.***
39. 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 computes its share of surplus or deficit after adjusting for the dividends on such shares, whether or not the dividends have been declared.
40. If an entity's share of the deficit of an associate or a joint venture equals or exceeds its interest in the associate or joint venture, the entity discontinues recognizing its share of further deficits. The interest in an associate or a joint venture is the carrying amount of the 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. 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. Deficits recognised 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).
41. If, under the equity method, an investor's share of losses of an associate equals or exceeds the carrying amount of the investment, the investor ordinarily discontinues recognising its share of further losses and the investment is reported at nil value. Additional losses are provided for to the extent that the investor has incurred obligations or made payments on behalf of the associate to satisfy obligations of the associate that the investor has guaranteed or to which the investor is otherwise committed. If the associate subsequently reports profits, the investor resumes including its share of those profits only after its share of the profits equals the share of net losses that have not been recognised.

Impairment Losses

42. After application of the equity method, including recognizing the associate's or joint venture's deficits in accordance with Guidance on "*Financial Instruments*" to

determine whether it is necessary to recognise any additional impairment loss with respect to its net investment in the associate or joint venture.

43. The entity also refers to the Guidance on “*Financial Instruments*” to determine whether any additional impairment loss is recognised with respect to its interest in the associate or joint venture that does not constitute part of the net investment and the amount of that impairment loss.
44. Whenever application of Guidance on “*Financial Instruments*” indicates that the investment in an associate or a joint venture may be impaired, an entity applies ASLB 26, ‘*Impairment of Cash-Generating Assets*’, and, possibly, ASLB 21, ‘*Impairment of Non-Cash-Generating Assets*’.
45. ASLB 26 directs an entity to determine the value in use of the cash-generating investment. In determining the value in use of the cash-generating investment in accordance with ASLB 26, 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 or similar distributions to be received from the investment, and from its ultimate disposal.

Using appropriate assumptions, both methods give the same result.

46. ASLB 21 requires that, if the recoverable service amount of an asset is less than its carrying amount, the carrying amount should be reduced to its recoverable service amount. Recoverable service amount is the higher of an asset's fair value, less costs to sell and its value in use. Value in use of a non-cash-generating asset is defined as the present value of the asset's remaining service potential. The present value of the remaining service potential may be assessed using the depreciated replacement cost approach, the restoration cost approach or the service units approach, as appropriate.
47. ***The recoverable amount of an investment in an associate or a joint venture should be assessed for each associate or joint venture, 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.***

Separate Financial Statements

48. ***An investment in an associate or a joint venture should be accounted for in the entity's separate financial statements in accordance with ASLB 34, ‘Separate Financial Statements’.***

Illustrative Examples

These examples accompany, but are not part of, ASLB 36.

Illustration 1:

Set out below are the draft accounts of ABC Municipal Corporation and its subsidiaries (Group) and of Associate Co. Group has acquired 40% of the equity capital of Associate Co three years ago when the latter's reserves stood at Rs.10,000.

In 000's

Particular	Local Bodies (Consolidated)	Associates
Non-Current Assets		
Property Plant and Equipment	250	170
Investment in Associate	60	
Loan to Associate	30	
Current Assets	120	50
Total	460	220
Capital	250	
Share Capital		100
Retained Earnings	130	70
Current Liabilities		
Trade Payables	80	30
Loan from Local body		20
Total	460	220

Particular	Local Bodies (Consolidated)	Associate
Surplus Before Tax	95	80
Income tax expense	-35	-30
Surplus for the year	60	50

Prepare financial statements of the group after accounting for the associate under Equity accounting.

Solution

Condensed Statement of Income and Expenditure

Particular	Local Bodies (Consolidated)
Surplus	95
Share of profits of associated company (50 x 40%)	20
Surplus before tax	115
Income tax expense	-35
Surplus attributable to the members of Local Bodies	80

Balance Sheet

Asset	Local Bodies (Consolidated)
Non-Current Assets	
Property Plant and Equipment	250
Investment in Associates	84
Loan to Associates	30
Current Assets	120
Total	484
Capital	250
Retained Earnings	154
Current Liabilities	
Trade Payables	80
Total	484

Retained Earnings	Amount
Reserves of Associates	70
Pre-Acquisition	10
Post-acquisition	60
Group Share in associate	40%
Group share in Retained earnings	24

Investment in Associates	Amount
Cost of investment	60
Share of post-acquisition retained earnings (W)	24
Total	84

Illustration 2:

Whether voting rights on shares held by nominee or in a fiduciary capacity are considered while evaluating the significant influence of beneficiary shareholder over the investee?

Response

Paragraph 11 of ASLB 36, inter alia, provides that, “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”.

Voting rights on shares held by nominee should be considered while evaluating the significant influence of beneficiary shareholder over the investee but not for the evaluation of significant influence by the nominee shareholder over the investee as such voting rights are exercised by the nominee as per the directions and in interest of the beneficiary. Further, the Ministry of Corporate Affairs vide general circular no. 24/2014, dated 25.06.2014 clarified that the shares held by a company in another company in a 'fiduciary capacity' should not be counted for the purpose of determining the relationship of 'associate company' under section 2(6) of the Companies Act, 2013.

Therefore, a corollary is drawn between company's act requirement and ASLB 36. Beneficiary shareholder should not consider the voting rights on shares held by its nominee or in a fiduciary capacity while evaluating the significant influence over the investee.

Illustration 3:

ABC Municipal Corporation owns 20% of the voting rights in Y Ltd. and is not entitled to appoint director to the board which consist of five members. The remaining 80% of the voting rights are held by two entities each of which is entitled to appoint the directors.

A quorum of four directors and a majority of those present are required to make decisions. ABC Municipal corporation representative can attend board meetings but without an vote. Is Y Ltd an associate of ABC Municipal corporation.

Solution

Despite the fact that the ABC Municipal Corporation 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 ABC Municipal Corporation from exerting significant influence. In this situation, Y Ltd would not be an associate of ABC Municipal Corporation.

Illustration 4:

ABC Municipal Corporation 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 ABC Municipal Corporation. Each board member has one vote at meeting. Is Boho Ltd an associate of Kuku Ltd?

Solution

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

Illustration 5:

ABC Municipal Corporation creates a separate legal entity Y Limited 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 ABC Municipal Corporation. In such cases the investor is able to exercise significant influence over its investee.

Illustration 6:

ABC Municipal Corporation 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. In this case, it would be a subsidiary on account of control.

Illustration 7:

Q Ltd manufactures equipment for electric transmission utility of ABC Municipal Corporation. ABC Municipal Corporation provides all designs for the equipment and participates in scheduling, timing and quantity of the production. The majority (i.e. 90%) of Q Ltd.'s sales are made to the ABC Municipal Corporation. ABC Municipal Corporation 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 ABC Municipal Corporation for the continued existence of the business. Despite having only a 10% interest in Q Ltd, P Ltd has significant influence.

Illustration 8:

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

Solution

Y limited is effectively functioning because of the participation of ABC Municipal Corporation, in the Y Limited's factory despite having 15% interest in Y Limited. ABC Municipal Corporation has significant influence.

Appendix 1

Note: This Appendix is not a part of the Accounting Standard for Local Bodies. The purpose of this Appendix is only to bring out the major differences, if any, between Accounting Standard for Local Bodies (ASLB) 42 and the corresponding International Public Sector Accounting Standard (IPAS) 36, 'Investments in Associates and Joint Ventures'.

Comparison with IPSAS 36, 'Investments in Associates and Joint Ventures'

- a. Draft ASLB 36 uses different terminology, in certain instances, from IPSAS 36 such as *., the terms 'statement of income and expenditure', 'balance sheet' and 'entities' have been used in place of 'statement of financial performance', 'statement of financial position' and 'public sector entities'.*
- b. The following paragraphs of IPSAS 36 have been deleted. In order to maintain consistency with the corresponding IPSAS 36, the paragraph numbers have been retained:
 - For considering share ownership for the purpose of significant influence, potential voting rights of the investee held by investor are not taken into account as per ASLB 36. As per IPSAS 36, 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. Paragraph 13-14 and 18-20 have been deleted in this regard.
 - Paragraph 50 pertaining to transitional provisions have been deleted as a separate ASLB corresponding to IPSAS 33, *'First-time Adoption of IPSASs'* is being formulated which would contain all transitional provisions at one place.
 - Paragraphs 51-52 pertaining to effective date have been deleted as ASLB 36 would become mandatory for Local Bodies in a State from the date specified by the State Government concerned.
- c. Paragraph 2A pertaining to applicability of ASLBs has been inserted in ASLB 36 in line with other issued ASLBs.
- d. The draft ASLB 36 makes a reference to the various ASLBs that are yet to be formulated/ issued. Clarification on obtaining guidance in regard to those ASLBs has been incorporated in the ASLB.
- e. Additional commentary has been provided in the draft ASLB 36 with regard to the provisions that may not be applicable to the local bodies but may be applicable to corporate municipal entity or any entity controlled by a local body having a structure of corporate or equivalent.

- f. Both draft ASLB 36 and IPSAS 36 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. ASLB 36 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. IPSAS 36 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.
- g. As per draft ASLB 36, investor's share of losses in the associate is recognised to the extent of carrying amount of investment in the associates. As per IPSAS 36 carrying amount of investment in the associates 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 associates or joint venture shall be considered for recognising entity's share of losses in the associates or joint venture.
- h. Where an entity is precluded by IPSAS 29 from measuring the retained interest in a former associate or joint venture at fair value, IPSAS 36 permits an entity to use carrying amount as the cost on initial recognition of the financial asset whereas ASLB 36 prescribes that where it is impracticable to determine the fair value of retained interest in a former associate or joint venture, the measurement may be done at carrying value.

Appendix 2

Note: This Appendix is not a part of the Accounting Standard for Local Bodies. The purpose of this Appendix is only to bring out the major differences, if any, between Accounting Standard for Local Bodies (ASLB) 36 and the Existing Accounting Standard (AS) 23, 'Accounting for Investment in Associates in Consolidated Financial Statements'.

Comparison with Existing AS 23, 'Accounting for Investment in Associates in Consolidated Financial Statements'

- ASLB 36 uses different terminology, in certain instances, from existing AS 23. The most significant examples are the use of the terms "net assets/equity," "economic entity," "controlling entity," and "controlled entity" in ASLB 36. The equivalent terms in existing AS 23 are "equity," "group," "parent," and "subsidiary".
- Draft ASLB 36 requires that after application of equity method, including recognising the associate's or joint venture's losses, the requirements of "guidance on financial Instruments" should be applied to determine whether it is necessary to recognise any additional impairment loss. With regard to impairment, Existing AS 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
- In draft ASLB 36, the '*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'. ASLB 36 defines joint control also. In existing 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'.
- ASLB 36 requires application of equity method in financial statements other than separate financial statements even if the investor does not have any subsidiary whereas AS 23 requires application of the equity method only when the entity has subsidiaries and prepares consolidated financial Statements.
- One of the exemptions from applying equity method in existing AS 23 is where the associate operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investee. No such exemption is provided in ASLB 36.