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IAS® Standard 28 Investment in Associates and Joint Ventures

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CASE STUDY - IAS 28 INVESTMENT IN ASSOCIATES AND JOINT VENTURES

Introduction

Companies generally invest in other companies to stay competitive and expand in the market. Different types of investments are explained in the International Accounting/Financial Reporting Standards. When making investments, recognition of this in the financial statements is crucial to present relevant and faithful information. IAS 28 Investment in Associates and Joint Ventures specifically focuses on associates and the equity method. To recognise an investment as an associate, significant influence and other indicators must exist.

This case illustrates how a company invests in other companies and how to recognize different investment types, including associates with which value.

The Case Information

FasText Company operates in the textile sector. FasText was founded in 1940 as a family business in a small factory. The founder of FasText, Mr. Chad Fox, greatly emphasizes quality and customer and retailer satisfaction. Even though a short time has passed since its foundation, FasText has gained a significant market share. Along with the development of digitalization and expansion in the sector, FasText has been looking for ways to expand its market share and profitability since 2012 and they decided to accomplish this aim via investments at the national and international levels.

To expand FasText's share, the first step was to invest in companies operating in the same sector. In 2012, Iron Company operated in the textile sector, and they were new in the sector. But Iron Company brought a new point of view by using automated tools and techniques in the production process with their young core. FasText saw the Iron Company as a threat to its operations and bought %65 of its share with CU900,000.

Over the years, FasText made some changes to the board of directors who are talented in the information sector, keeps up with the development in information technology and believes in the information sector's rapid growth. They saw this as an opportunity. In the board meeting, to increase profitability, it was argued that WinTech Company which operated in the software sector, was showing significant signs of development. The decision-makers of FasText decided to buy %25 of WinTech's shares with CU850,000 in 2015. When FasText acquired WinTech’s shares, WinTech's net assets' fair value was worth CU750,000. In 2018, WinTech reported CU150,000 profits and paid CU80,000 dividends.

In 2020, FasText was looking for an opportunity overseas. FasText's board of directors discussed that to expand the Company's customer portfolio and make it international, and they should invest overseas. In 2020, FasText attended the International Textile Expo. On the 3rd day of the expo, FasText's representatives visited G-Heart Company's booth area. G-Heart was located in India. At that meeting, representatives of FasText were impressed by G-Heart's management farsightedness. After detailed research, they discovered that G-Heart Company has a broad customer and retailer network. By getting in touch with G-Heart Company in detail, FasText aimed to enter the Indian market, increase its total profitability, and benefit from the Indian market's advantages. To accomplish this aim, after months of discussions, FasText and G-Heart Company agreed that, FasText bought %30 shares with CU1,000,000. Three months after the agreement, there were newsbreaks heard around the world. The National Government of India announced that from now on, the Government took control of companies' Indian shares, but they will not intervene in the shares of foreign-based companies. But the Government will be in charge of all operational and financial activities of companies in India. Along with this sudden and unexpected development, FasText had a %30 share of G-Heart Company, whereas the Government had the other %70 shares. In addition, the Government was in charge of daily activities and made the critical decisions related to G-Heart Company.

Discussion Questions

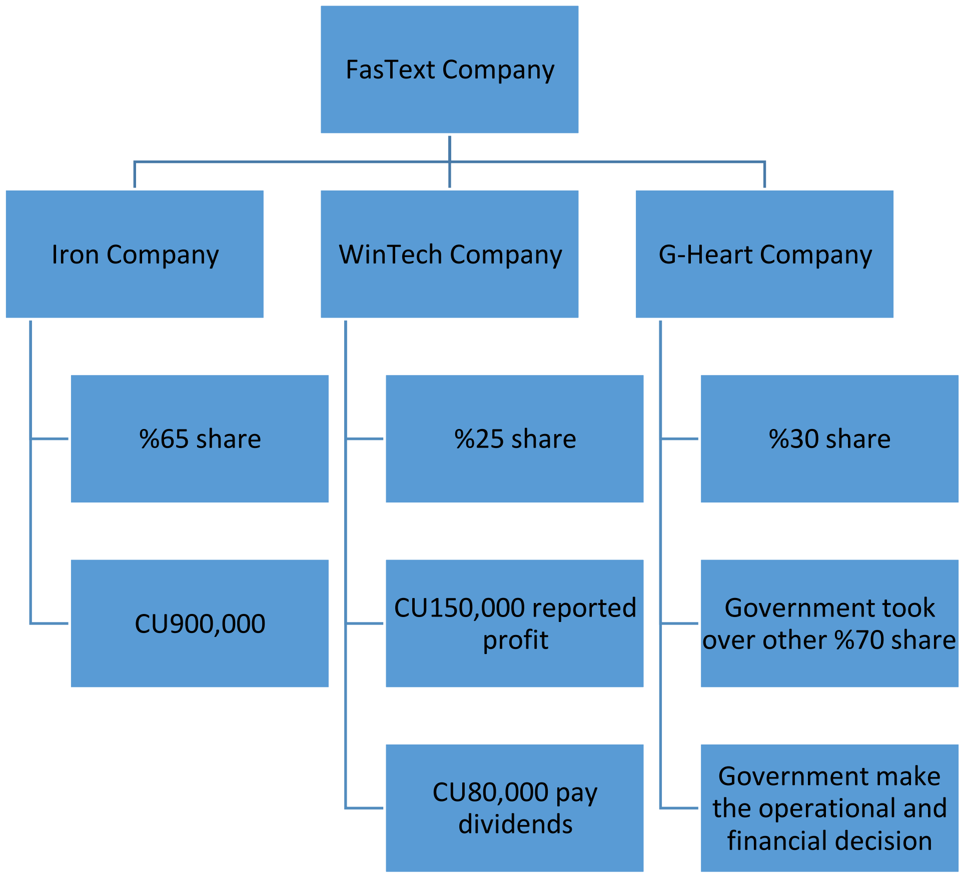
1. Interpret the FasText Company’s acquisition of Iron Company and make the journal entry.

2. Interpret the FasText Company’s acquisition of WinTech Company and make the journal entries of acquisition, profit reporting, and paying dividend process under the equity method.

3. Interpret the FasText Company’s acquisition of G-Heart Company and make the journal entry of the acquisition. In addition, interpret the development of government interference and how FasText recognizes its investment in G-Heart Company along with this development.

SOLUTION OF CASE STUDY - IAS 28 INVESTMENT IN ASSOCIATES AND JOINT VENTURES

Figure 1: Summary of the Case



1. Acquisition of Iron Company's share and interpretation of this transaction

Dr. Subsidiary CU900,000

(Investment in Iron Company)

Cr. Bank Account CU900,000

Interpretation of investment in Iron Company: IAS 28 defines four types of investments: Subsidiaries, Associates, Joint Ventures/Joint Operations, and Financial assets. To record an investment as an Associate, an investor should have shares between 20-50%, which means significant influence occurred. Other indicators should be considered if this criterion has not been met. If the investor has more than 50% shares upon the investee, then the investor has control power; therefore, the investment should be recorded as a subsidiary. In the acquisition of Iron Company, FasText has 65% shares and control power. That's why investment in Iron Company is recorded as a "Subsidiary."

2. Acquisition of WinTech Company and interpretation of this transaction

Dr. Associates CU850,000

(Investment in WinTech)

Cr. Bank Account CU850,000

Interpretation of investment in WinTech Company: According to IAS 28, if an investor has shares between 20-50% over an investee, which means significant influence, then the investee should be considered an Associate unless otherwise. At the time of acquisition, to calculate whether there is goodwill or not, the fair value of the investee's assets should be compared with the transferred amount. If the transferred amount is bigger than the fair value of assets, goodwill occurs. Goodwill does not record as a separate item in the financial statement and is included in an acquisition cost. This is why the FasText record associates with the amount of CU850,000.

Net Fair Value of WinTech Company's assets	CU750,000
Transferred Amount	CU850,000
Goodwill	CU100,000

In the case of associates, they recognized with the equity method. In the equity method, the carrying amount of the investment is increased in case an investee reports profit. If an investee pays dividends, the investor decreases the investment's carrying amount.

Dr. Associates CU37,500
(Investment in WinTech)
Cr. Profit of associates CU37,500
Measured with the equity method

Dr. Cash CU20,000

Cr. Associates CU20,000
(Investment in WinTech)

3. Acquisition of G-Heart Company and interpretation of this transaction

Dr. Associates CU1,000,000
(Investment in G-Heart)

Cr. Bank Account CU1,000,000

Interpretation of investment in G-Heart Company: According to IAS 28, if an investor has shares between 20-50% over an investee, which means significant influence, then the investee should be considered as an Associate unless otherwise. At the time of acquisition, significant influence occurred, then the investment in G-Heart should be recorded as an associate. Three months later, Government took control of share companies' Indian shares. Therefore, in G-Heart Company, Government holds the 70% of the shares and makes all the relevant operational and financial decisions. According to IAS 28, significant influence disappears when the investor loses its participation power in the associate's operating and financial decisions and, in case of a change in absolute or relative ownership levels such as Government, court, administrator, or regulator becomes the controller of an associate. In the G-Heart case, this is the situation. Even though FasText holds 30% shares, it will not be included in the financial and operational activities, therefore not ensuring significant influence. In this case, significant influence disappeared, turning this investment into a financial asset.

Dr. Financial Asset (Investment in G-Heart)	CU1,000,000	
Cr. Associates		CU1,000,000