



# **FINANCIAL ACCOUNTING AND REPORTING**

**FAR10**

**INVESTMENTS IN ASSOCIATES**

**HANDOUT**

## MODULE 10 – Problems

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### Significant Influence

1. ABC Co. owns 30% of the voting shares of Alpha Co. the other 60% is held by XYZ and all seats on the board of directors are appointed by XYZ.
2. ABC Co. owns 15% of the voting shares of Alpha Co. all other shares are held in very small blocks and therefore ABC Co. has many seats on the board of directors.

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### Determining Percentage of Ownership

3. On January 1 20x1, Abet Co. acquired 30,000 shares of XYZ's 100,000 outstanding shares at P10 per share. Compute for the percentage of ownership acquired?
4. On January 1, 20x1, Abet Co acquired 30,000 newly issued shares of XYZ at P10 per share. Before the acquisition, XYZ had 100,000 ordinary shares outstanding. Compute the percentage of ownership acquired?

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### Purchase cost equal to fair value of interest acquired

5. On January 1, 20x1, Abet Co purchased 20,000 shares of the 100,000 total outstanding shares of XYZ for P1,000,000. XYZ's assets and liabilities approximate their fair values. In 20x1, XYZ reported profit of P3,000,000 and declared and paid cash dividends of P200,000.

In 20x2, XYZ reported loss of P2,000,000, declared and issued 10% stock dividends, and reported gain on property revaluation of P500,000 and loss on exchange difference on translation of foreign operations of P100,000.

- a. Compute for the share in profit or loss of associate in 20x1 and 20x2.
- b. Compute for the carrying amount of investment on 31 December 20x1 & 20x2.

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### Potential voting rights

6. ABC Co owns 15,000 shares out of the 100,000 outstanding shares of XYZ, Inc. As of year-end, ABC holds 20,000 stock rights which enable ABC to acquire additional shares from XYZ on a "2 rights for 1 share" basis. The stock rights are exercisable immediately. However, management does not intend to exercise the stock rights. XYZ does not have any other rights outstanding aside from those held by ABC.

XYZ reports year-end profit of P1M and declares cash dividends of P100,000. The investment has a carrying amount of P300,000 before any year-end adjustment.

- a. How much is ABC's share in profit of associate for the year?
- b. How much is the carrying amount of the investment as of year-end?

### Cumulative preference shares

7. ABC owns 20% of XYZ Inc.'s ordinary shares. XYZ also has an outstanding cumulative 6% preference shares of P2,000,000. None of those preference shares is held by ABC. Cumulative preference share dividends are in arrears for 3 years. XYZ reported year-end profits of P1,000,000 and declared no dividends.
- How much is ABC's Co share in profit or loss of associate?
  - What if XYZ declared dividends that pay all of the dividends in arrears on preference shares, how much is the share in profit or loss in prior years?
  - What if the preference shares are non-cumulative, how much is the share in profit or loss of associate?
  - What if the shares are redeemable preference shares and XYZ declared P150,000 cash dividends on the redeemable preference shares during the year, how much is the share in profit or loss of associate?

### Relationship between investment in associate and associate's equity

8. On January 1, 20x1, ABC Co acquired 20% interest in XYZ for P1,000,000 at a price that did not resulted to goodwill. The carrying amounts of identifiable assets and liabilities of XYZ approximate their fair values. Information on XYZ's financial position as of January 1, 20x1 is shown below:

Asset	12,000,000
Liabilities	5,000,000
6% Cumulative PS	2,000,000
Ordinary Shares	4,000,000
Retained Earnings	1,000,000
Total Equity	7,000,000

ABC holds none of the cumulative preference shares of XYZ. No dividends were in arrears as of January 1, 20x1.

In 20x1, XYZ reported profit of P1,000,000 and paid no dividends. In 20x2, XYZ reported profit of P1,000,000, paid 2-year dividends on the cumulative preference shares and paid P200,000 dividends on ordinary shares.

- What is the carrying amount of investment in associate on 01 January 20x1?
- What is investor's interest in residual equity of associate on 01 January 20x1?
- Compute for the share in associate's profit in 20x1
- What is the carrying amount of investment in associate on 31 December 20x1?
- What is the investor's interest in residual equity of associate on 31 December 20x1?
- What is the share in associate's profit in 20x2?
- What is the carrying amount of investment on 31 December 20x2?
- What is the investor's interest in residual equity of associate on 31 Dec 20x2?

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**Loss on significant influence**

9. On January 1, 20x1, ABC Co. acquired 30,000 ordinary shares for P3,000,000 which represents 30% interest in XYZ's net assets. At the time of acquisition, XYZ's net assets are fairly revalued at P10,000,000. Prior to revaluation, the net assets had a book value of P8,000,000. The difference between the revalued amount and carrying amount is attributable to a building which was credited to revaluation surplus. The building has a remaining useful life of 10 years with no residual value. It is XYZ's policy to depreciate all tangible assets using the straight line method.

At the end of 20x1, XYZ reported a profit of P1,000,000 and paid cash dividends of P600,000. At December 31, 20x1, the shares are selling at P100 per share.

On July 1, 20x2, ABC sold 60% of its investment in XYZ at the prevailing market price of P120 per share. XYZ reported interim profit of P500,000 for the six months ended June 30, 20x2. On December 31, 20x2, XYZ reported total profit of P1,200,000 for the year and declared P1,000,000 cash dividend. The shares are quoted at P135 per share at year-end.

- a. Compute for the carrying amount of investment on July 1, 20x2?
- b. How much is the gain on sale of investment?
- c. How much is the gain on remeasurement or reclassification?
- d. What is the total income to be recognized in profit or loss in 20x2?

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**Change from FVPL to equity method**

10. On January 1, 20x1, ABC Co. acquired 10,000 shares representing a 10% interest in XYZ's 100,000 outstanding shares for P800,000. In 20x1, XYZ reported profit of P5,000,000 and declared and paid dividends of P1,000,000. The investment was initially classified as investment held for trading securities measured at FVPL. The fair value of the shares on December 31, 20x1 is P85 per share.

As of December 31, 20x1, the investment held for trading securities has a carrying amount of P850,000 equal to fair value.

On July 1, 20x2, ABC Co. acquired additional 15,000 shares at P70 per share resulting to an increase in ownership interest over XYZ from the previous 10% to 25%. The transaction did not give rise to goodwill.

In 20x2, XYZ reported profit of P6,000,000, of which P4,000,000 were earned in the second half of the year. In addition, XYZ declared and paid dividends of P1,000,000 on December 31, 20x2. The XYZ shares have quoted price of P90 per share on December 31, 20x2.

- a. Compute of the carrying amount of investment in July 1, 20x2?
- b. Compute for the carrying amount of investment 31 Dec 20x2?

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**Change from FVOCI to equity method**

- 11.** On January 1, 20x1, ABC Co. acquired 10,000 shares representing a 10% interest in XYZ's 100,000 outstanding shares for P800,000. In 20x1, XYZ reported profit of P5,000,000 and declared and paid dividends of P1,000,000. The investment was initially classified as investment held for trading securities measured at FVPL. The fair value of the shares on December 31, 20x1 is P85 per share.

As of December 31, 20x1, the investment has a carrying amount of P850,000 equal to fair value and the net cumulative unrealized gains recognized in equity amounted to P50,000.

On July 1, 20x2, ABC Co. acquired additional 15,000 shares at P70 per share resulting to an increase in ownership interest over XYZ from the previous 10% to 25%. The fair value of the net assets of XYZ as of July 1, 20x2 is P6,00,000.

- a. How much is the total carrying amount of investment on July 1, 20x2?
- b. How much is the goodwill arising from investment in associate on July 1, 20x2?

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**Downstream sale of inventory**

- 12.** ABC owns 20% of XYZ Inc. and uses the equity method because it has significant influence. In 20x1, ABC sells inventory to XYZ for P100,000 with a 60% gross profit on the transaction. The inventory remains unsold during 20x1 and was sold by XYZ to external parties only in 20x2. ABC's income tax rate is 30%.

XYZ reported profit of P1,000,000 & P1,200,000 on 31 December 20x1 and 31 December 20x2, respectively.

Compute for the share in profit or loss of associate in 20x1 and 20x2.

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**Upstream sale of inventory**

- 13.** ABC owns 20% of XYZ Inc. and uses the equity method because it has significant influence. In 20x1, XYZ sells inventory to ABC for P100,000 with a 60% gross profit on the transaction. The inventory remains unsold during 20x1 and was sold by XYZ to external parties only in 20x2. ABC's income tax rate is 30%.

XYZ reported profit of P1,000,000 & P1,200,000 on 31 December 20x1 and 31 December 20x2, respectively.

Compute for the share in profit or loss of associate in 20x1 and 20x2.

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**Downstream sale of depreciable asset**

- 14.** ABC Co. owns 20% of XYZ, Inc. outstanding shares. On January 1, 20x1, ABC sold equipment with a carrying amount of P100,000 and a remaining useful life of 10 years to XYZ for P120,000. Gain of P20,000 was recorded by ABC. Both ABC and XYZ use the straight line method of depreciation.

XYZ reported profit of P1,000,000 & P1,200,000 on 31 December 20x1 and 31 December 20x2, respectively.

Compute for the share in profit or loss of associate in 20x1 and 20x2.

#### **Upstream sale of depreciable asset**

- 15.** ABC Co. owns 20% of XYZ, Inc. outstanding shares. On January 1, 20x1, XYZ sold equipment with a carrying amount of P100,000 and a remaining useful life of 10 years to ABC for P120,000. Gain of P20,000 was recorded by ABC. Both ABC and XYZ use the straight line method of depreciation.

XYZ reported profit of P1,000,000 & P1,200,000 on 31 December 20x1 and 31 December 20x2, respectively.

Compute for the share in profit or loss of associate in 20x1 and 20x2.

#### **Downstream sale of non-depreciable asset**

- 16.** ABC Co. owns 20% of XYZ, Inc. outstanding shares. On January 1, 20x1, ABC sold land with a carrying amount of P100,000. Gain of P20,000 was recorded by XY.

XYZ reported profit of P1,000,000 & P1,200,000 on 31 December 20x1 and 31 December 20x2, respectively.

Compute for the share in profit or loss of associate in 20x1 and 20x2.

#### **Upstream sale of non-depreciable asset**

- 17.** ABC Co. owns 20% of XYZ, Inc. outstanding shares. On January 1, 20x1, XYZ sold land with a carrying amount of P100,000. Gain of P20,000 was recorded by ABC.

XYZ reported profit of P1,000,000 & P1,200,000 on 31 December 20x1 and 31 December 20x2, respectively.

Compute for the share in profit or loss of associate in 20x1 and 20x2.

#### **Share in losses of associate**

- 18.** On January 1, 2012, Bart Company acquired as a long term investment for P7,000,000, a 40% interest in Hall Company when the fair value of Hall's net assets was P17,500,000. Hall Company reported the following net losses:

2012	5,000,000
2013	7,000,000
2014	8,000,000
2015	4,000,000

On January 1, 2014, Bart Company made cash advances of P2,000,000 to Hall Company. On December 31, 2015, it is not expected that Bart Company will provide further financial support for Hall Company.

What amount should be reported as loss from investment for 2015?

