PROCESSING INVESTMENTS IN ASSOCIATES USING ORACLE E-BUSINESS SUITE

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Abstract

International Accounting Standard (IAS) 28 requires organizations to follow the equity accounting method for investments in associates. This paper explains how some of these key requirements can be met in Oracle E-Business Suite.

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Audience

This document is intended for the following audience:

- Oracle E-Business Suite application owners
- Consultants and support providers in Oracle E-Business Suite ecosystem
- Accountants

Background

When an investor entity exerts significant influence over an investee entity, the latter is called an 'associate' of the former. When the investor has the right to participate in the financial and operating policy decisions of the investee, it is treated as a 'significant influence.' However, the term 'significant influence' does not include 'controlling influence,' in which case, the investee would be called a 'subsidiary' of the investor entity.

The investor may acquire this 'significant influence' by holding a 20–50 percent stake in the equity capital of the investee, or through terms and conditions of its investment that provide the entity such rights.

IAS 28 prescribes the use of the equity accounting method for treatment of investments in associates.

Key concepts in the equity accounting method

As per the equity method, the initial investment in an associate is recognized at cost.

The carrying amount is adjusted to incorporate the investor's share in the profit or loss of the investee. The other side of this adjustment is reflected in the profit and loss of the investor.

Dividend received from an investee decreases the carrying amount of the investment.

The carrying amount is also adjusted to reflect any change in the investor's interest in the investee. For example, an upward revaluation of the investee's fixed assets would increase the value of the investor's investment. The other side of this adjustment is reflected in the other comprehensive income of the investor.

Example scenario

Let us assume that company 'A' buys 40 percent equity shares of company 'X', for US$48 million. The following table illustrates some of the key transactions that company 'A' would account for in its books.

Scenario	Accounting entries
Investment made Company A buys 400,000 shares of Company X, which is 40% of the equity capital of Company X	Dr Investment US$48 million Cr Cash / cash clearing US$48 million
Incorporation of year-end profit and loss Let us say company X's net profit is US$1 million at the end of the fiscal year	Dr Investment US$0.4 million Cr Share in profit and loss of associate US$0.4 million
Dividend Company X distributes US$0.1 million dividend to company A	Dr Cash / cash clearing US$0.1 million Cr Investment US$0.1 million
Liquidation of investment Company A liquidates 25% of its investment in company X, for US$13 million	Dr Cash / cash clearing US$13 million Cr Investment US$12.075 million Cr Profit on sale of investment US$0.925 million

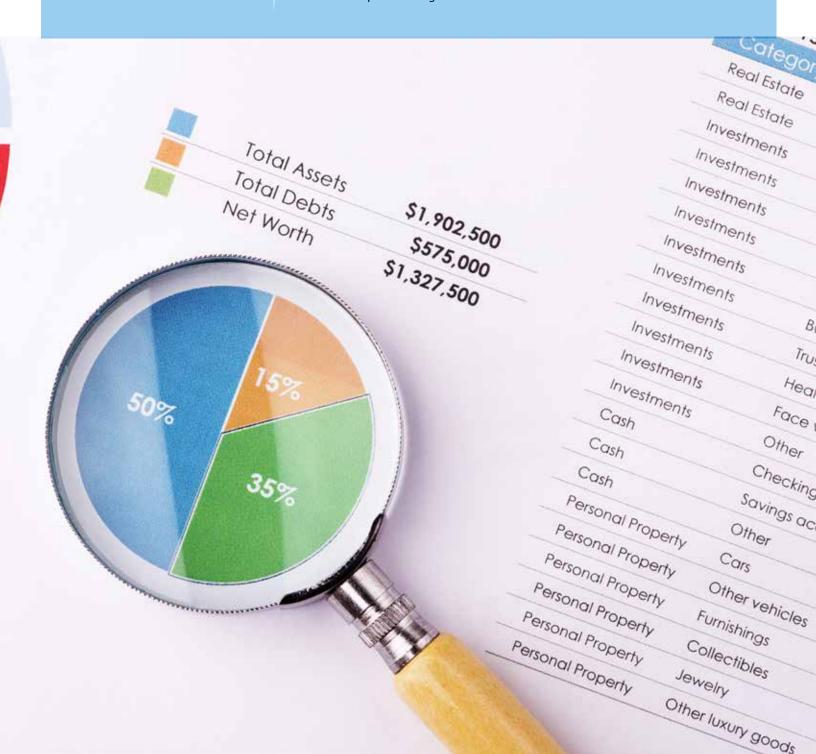# Key configuration prerequisites

The following additional configuration will be required, assuming that the basic configurations of the fixed assets and general ledger modules are already in place in Oracle E-Business Suite.

Investment asset book

A separate corporate asset book should be created. Access for an asset book can be controlled in the fixed assets module. Creating a separate asset book will help ensure segregation of accesses for managing fixed assets and for managing investments in associates. It will also facilitate an investment-specific configuration.

Asset category

A new asset category that is not subject to depreciation should be configured. Ensure that a suspense / clearing account is used in the 'revaluation reserve account' field.

Processing of example scenarios in Oracle E-Business Suite

This section explains how the example scenario transactions can be modeled / processed in Oracle E-Business Suite by leveraging the features of the fixed assets and general ledger modules.

Note: Most organizations manage such investments through spreadsheets. The cumulative accounting impact is booked directly as a journal in the general ledger. However, if the volume of such investment transactions is high, maintaining it in spreadsheets can be risky and inefficient.

Business event	Solution description
Recording of investment	• When an investment is made, add an asset through 'asset workbench' in the 'assets' module • Ensure that the number of equity shares purchased is recorded in the 'unit' field. The assets module will then track the carrying cost per share throughout the investment's transaction life cycle. This helps in calculation of gain / loss on partial sale of investment, later on • The 'create accounting' process would generate the following entry: **Dr Investment US$48 million** **Cr Asset Clearing US$48 million**
Payment for investment	• When the payment is made out of the bank, book a journal in the general ledger (GL) to debit the asset clearing account (A/C) and credit the cash A/C **Dr Asset Clearing US$48 million** **Cr Cash US$48 million**
Period end depreciation run in the assets module	Since the asset category is configured as non-depreciable, the investment asset will not be considered in the depreciation process
Incorporation of year-end profit and loss	• To incorporate the 40% share of the US$1 million profit of company X, calculate the return on investment. It is 400,000 / 48,000,000 x 100 = 0.83333333% • Use the assets 'mass revaluation' functionality to revalue the investment asset by 0.83333333%. In case of loss, the revaluation percentage would be negative • The 'create accounting' process would then generate the following entry in the revaluation transaction **Dr Investment US$0.4 million** **Cr Investment in Associate Suspense US$0.4 million** • The 'investment in associate' suspense account is used in the revaluation reserve account set up in the asset category • After this, a journal needs to be booked in the GL to reallocate the amount from the suspense account to 'share in revenue of associate company' (a P&L account) **Dr Investment in Associate Suspense US$0.4 million** **Cr Share in Revenue of Associate Company US$0.4 million**

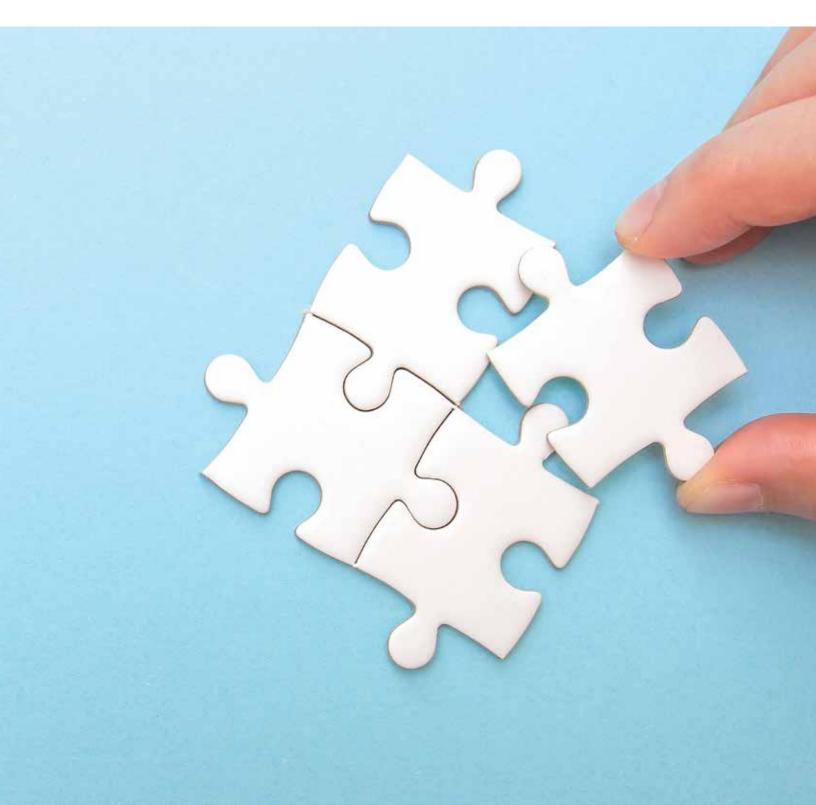|	
Dividend booking	• When the company X announces a dividend amount to its shareholders, company A needs to adjust its investment carrying amount by the dividend amount (that is, US$0.1 million) • The first step is to calculate the dividend amount as a percentage of the investment carrying amount, that is, 100,000 / 48,400,000 x 100 = 0.2066115702% • Next, create a `negative' revaluation transaction to recognize this dividend amount • The `create accounting' process would then generate the following entry for the retirement transaction **Dr Investment in Associate Suspense US$0.1 million** **Cr Investment US$0.1 million**
Receipt of dividend money	• When the dividend money is received, book the following journal in the GL: **Dr Cash US$0.1 million** **Cr Investment in Associate Suspense US$0.1 million**
Liquidation of investment	• When company A liquidates its investment, partially or completely, the retirement process in the fixed asset module is followed • Mention the count of shares sold and proceeds of the sale in the retirement workbench. The `calculate gain and losses' standard program will calculate the gain / loss on the sale • The `create accounting' process would then generate the following entry for the retirement transaction: **Dr Proceeds of Sale Clearing US$13 million** **Cr Investment US$12.075 million** **Cr Gain / loss on sale US$0.925 million**
Receipt of sale proceeds	• When the sale proceeds is received, book the following journal in the GL: **Dr Cash US$13 million** **Cr Proceeds of Sale Clearing US$13 million**

Solution benefits

The following are the key benefits of the solution:

- A complete transaction history and audit trail is maintained — which is not possible in spreadsheets

- Oracle EBS Assets module tracks the cost of each stock throughout the transaction life cycle. It helps in accurate calculations of the gain / loss on the sale of an investment

- The same solution can be leveraged to a great extent, when significant influence is lost and the investor does not need to follow the equity accounting method anymore

- Out-of-box reports can be leveraged for reporting purposes (e.g. asset register)

- The fixed assets module supports impairment functionality, which can be used to process any impairment in investments

About the Author

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Pravin is a Chartered Accountant. He has over 11 years of work experience in implementing finance and accounting processes and solutions on Oracle E-Business Suite and Fusion Applications ERP platforms.

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