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Accounting for Investments in Associates

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Defined words appear in *italics* the first time they appear in a section. The definitions are in Section 9. Standards are printed in **bold** type and commentary in light type.

MAIN FEATURES OF THE STANDARD

The Standard:

- (a) defines associates and prescribes the circumstances in which investors must use the equity method of accounting for investments in associates
- (b) prescribes rules for the implementation of the equity method of accounting under which:
 - (i) the carrying amount of the investment is increased or decreased to recognise the investor's share of the post-acquisition profits or losses and other changes in net assets of the associate
 - (ii) the investor's share of the post-acquisition profits or losses of the associate is included in the consolidated profit and loss or other operating statement of the investor
- (c) prescribes disclosure requirements in respect of investments in associates, including those for which the equity method of accounting is not required.

This Standard supersedes the requirements of Australian Accounting Standard AAS 14 "Equity Method of Accounting".

AUSTRALIAN ACCOUNTING STANDARD
AAS 14 "ACCOUNTING FOR INVESTMENTS IN ASSOCIATES"

1 Application

- 1.1 Subject to paragraph 1.3, this Standard applies to *general purpose financial reports* of each *reporting entity* to which Accounting Standards operative under the Corporations Law do not apply.**
- 1.2 Subject to paragraph 1.3, this Standard also applies to financial reports that are held out to be general purpose financial reports by an *entity* which is not a reporting entity, and to which Accounting Standards operative under the Corporations Law do not apply.**
- 1.2.1 Accounting Standards operative under the Corporations Law apply to companies and to other entities required by legislation, ministerial directive or other government authority to apply such Standards. Reporting entities which are not required to apply Accounting Standards operative under the Corporations Law are required to apply this Standard.
- 1.2.2 The standards specified in this Standard apply to the financial report where information resulting from their application is material. This requirement is set out in Australian Accounting Standard AAS 5 "Materiality", which provides guidance on the role of materiality in making judgements in the preparation and presentation of financial reports.
- 1.3 Except for the requirements of paragraph 6.1, this Standard does not apply where, in accordance with another Australian Accounting Standard, investments are measured at *net market value* and changes in net market value are *recognised as revenues or expenses in the profit and loss or other operating statement in the reporting period in which the changes occur.***
- 1.3.1 Paragraph 6.1 of this Standard requires certain disclosures to be made about all *associates*, whether the *investor* applies the equity method or the net market value method of accounting for investments.

- 1.3.2 The other requirements of this Standard do not apply where the net market value method of accounting for investments is required by or adopted in accordance with another Australian Accounting Standard. For example, Australian Accounting Standards AAS 25 "Financial Reporting by Superannuation Plans" requires the assets of superannuation plans to be measured at net market values and AAS 26 "Financial Reporting of General Insurance Activities" requires the net market value method of accounting to be applied for investments that are integral to general insurance activities. Another example is Australian Accounting Standard AAS 10 "Accounting for the Revaluation of Non-Current Assets", which permits public sector borrowing or financing entities to apply the net market value method of accounting for financial assets.

2 Operative Date

- 2.1 **This Standard applies to reporting periods ending on or after 30 June 1998.**
- 2.2 **This Standard may be applied to reporting periods ending before 30 June 1998.**
- 2.3 **When operative, this Standard supersedes Australian Accounting Standard AAS 14 "Equity Method of Accounting" as issued in November 1986 and amended to December 1987.**

3 Purpose of Standard

- 3.1 **The purpose of this Standard is to:**
- (a) **prescribe the circumstances in which *investors* must use the equity method of accounting ("equity method") for investments in *associates***
 - (b) **prescribe how the equity method is to be applied**
 - (c) **require certain disclosures in respect of investments in associates.**
- 3.1.1 In some cases, the relationship between an investor and its *investee* does not extend beyond an investor/investee relationship. However, in other cases, a special relationship between the investor and the investee exists which is characterised by the investor's control of, or *significant influence* over, an investee. This Standard deals with

circumstances where an investor has significant influence over an investee. In these cases, the investee is known as an associate. Australian Accounting Standard AAS 24 "Consolidated Financial Reports" deals with accounting for controlled *entities* (*subsidiaries*).

- 3.1.2 Where the investor has significant influence over the investee, it has the *capacity* to affect substantially either, or both, the investee's financial and operating policies. Consequently, the investor should be able to achieve some protection from changes in the operating and financing policies of the investee which would adversely affect it, and also achieve broad consistency, in areas of mutual interest, in the implementation of policies. In these circumstances, the investor has a measure of responsibility for the associate's performance. Since the associate's performance and the economic resources underlying the investment may have a significant effect on the investor, information about them should be reported in the financial reports of the investor.
- 3.1.3 Under the equity method, the investment is initially recorded at the *cost of acquisition* and adjusted thereafter for post-acquisition changes in the investor's share of the net assets of the investee. The profit and loss or other operating statement reflects the investor's share of the *result (profit or loss)* of the investee.
- 3.1.4 Prescribing the use of the equity method for investments in associates and the disclosures specified in this Standard should result in *general purpose financial reports* that reflect the importance of investments in associates to the activities of the investor. This information should assist users of the reports to assess the investor's performance, financial position and financing and investing activities.

4 Accounting for Investments in Associates

- 4.1 **An investor that is required to prepare a consolidated financial report must *recognise* an investment in an *associate* by applying the equity method in its consolidated financial report and by applying the cost method of accounting ("cost method") in its own financial report.**
 - 4.1.1 In this Standard, the equity method is viewed as a method of determining the *carrying amount* of an investment in an associate and the amount of revenue from the investment. The general

features of, and requirements for, the application of the equity method are set out in Section 5 of this Standard.

- 4.1.2 The general features of the cost method are:
- (a) an investment in the *equity* of another *entity* is initially recognised at its *cost of acquisition*
 - (b) revenue attributable to the investment is recognised only to the extent of dividends received or receivable out of post-acquisition profits (results) of the *investee*
 - (c) dividends received or receivable from pre-acquisition profits (results) are considered to be a recovery of part of the cost of the investment and are accounted for by reducing the carrying amount of the investment
 - (d) the carrying amount of the investment may be revalued in accordance with Australian Accounting Standard AAS 10 "Accounting for the Revaluation of Non-Current Assets".
- 4.2 **An investor that is not required to prepare a consolidated financial report must recognise an investment in an associate by applying the equity method in its own financial report.**

5 Application of the Equity Method

Initial Application

- 5.1 **When an investment in an *associate* is acquired, the investment must be *recognised* at its *cost of acquisition*.**
- 5.1.1 The *carrying amounts* of the identifiable assets and liabilities of the associate are examined as at the *acquisition date* and, where appropriate, notionally adjusted to *fair values* as at that date. Any difference between the cost of the investment in the associate and the *investor's* share of the net adjusted fair values is regarded as goodwill (or, as the case may be, discount on acquisition). Notional adjustments are made to the *result (profit or loss)* of the associate in subsequent periods to reflect revisions in depreciation of depreciable assets and any amortisation of goodwill. This Standard does not require the goodwill (discount on acquisition) relating to the associate to be disclosed separately in the consolidated financial report.
- 5.2 **When an *investee* becomes an associate subsequent to initial acquisition of an *ownership interest*:**

- (a) **the carrying amount of the investment must be adjusted to that amount, determined in accordance with paragraph 5.3, which would have been the carrying amount had it been an investment in an associate since the acquisition date**
- (b) **the share of the results (profits or losses) of the associate since the acquisition date must be *recognised* in the profit and loss or other operating statement**
- (c) **the share of movements in reserves of the associate other than retained profits (surplus) or accumulated losses (deficiency), such as asset revaluation reserves, which has not been previously recognised by the investor, must be recognised as part of reserves.**

5.2.1 The purchase of an additional ownership interest or the occurrence of other events or transactions may result in an investor obtaining *significant influence* over an investee.

5.2.2 Where an investor obtains an ownership interest in an associate in discrete steps, say in two tranches of 10 per cent and 15 per cent respectively, the carrying amount of the investment is determined by applying the equity method in respect of each separate tranche as at the acquisition date of each tranche. The amount of the adjustment to the carrying amount of the investment which is recognised in the profit and loss or other operating statement is determined by reference to the investor's share of the result (profit or loss) of the investee, determined in accordance with paragraph 5.3(a), arising subsequent to the acquisition date of each particular tranche. These adjustments are illustrated in the Appendix to this Standard.

Subsequent Application

5.3 In each reporting period that the equity method is applied, the carrying amount of the investment in the associate:

- (a) **must be increased or decreased by the amount of the investor's share of the post-acquisition result (profit or loss) of the associate in relation to the reporting period after adjustments for:**
 - (i) **distributions to preference equityholders**

- (ii) **revisions in depreciation of depreciable assets and amortisation of goodwill arising from**

notional adjustments made as at the date of acquisition (see paragraph 5.1.1)

- (iii) dissimilar accounting policies, in accordance with paragraph 5.9**
- (iv) certain inter-entity transactions, in accordance with paragraphs 5.10 and 5.11**
- (b) must be decreased by the amount of dividends received or receivable from the associate**
- (c) must be increased or decreased by the amount of the investor's share of post-acquisition increments or decrements in the associate's total reserves in relation to the reporting period, to the extent that the amounts of these movements have not been recognised previously in the profit and loss or other operating statement of the associate, or otherwise reflected in the carrying amount of the investment.**

- 5.3.1 If an associate has outstanding cumulative preference shares, the investor computes its share of the result (profit or loss) of the associate after adjusting for preference dividends, whether or not dividends have been declared.
- 5.3.2 Under the cost method, the investor recognises dividends received or receivable from an associate as revenue in its own financial report. Under the equity method, dividends received or receivable from the associate must be deducted from the carrying amount of the investment so that recognition of this portion of the share of the result (profit or loss) of the associate is not duplicated. A corresponding adjustment must be made so that the amount of revenue is not overstated.
- 5.3.3 Where the associate revalues all or some of its assets after the investor has acquired its ownership interest and that revaluation records asset values already reflected in the investor's cost of acquisition, and thus the carrying amount of the investment, the carrying amount is not adjusted to reflect the movement in the asset revaluation reserve.
- 5.4 In each reporting period that the equity method is applied:**

- (a) **the amount of the investor's share of the post-acquisition result (profit or loss) of the associate in relation to the reporting period, determined in**

accordance with paragraph 5.3(a), must be recognised in the profit and loss or other operating statement

- (b) the amount of the investor's share of the post-acquisition increments and decrements in the associate's reserves in relation to the reporting period, determined in accordance with paragraph 5.3(c), must be recognised in the investor's reserves.

5.5 The investor's share of the net assets, the result (profit or loss) and the reserves of an associate must be determined in accordance with the investor's ownership interest in the associate.

5.6 If the associate is a *parent entity*, the investor's share of the net assets, the result (profit or loss) and the reserves of that associate must be based on the net assets, the result (profit or loss) and the reserves of the *economic entity* attributable to members of the parent entity reflected in the associate's consolidated financial report.

Financial Reports of the Associate

5.7 In accounting for an associate, the investor must ensure that the most recent financial information available to the equityholders of the associate is used.

5.7.1 There may be constraints on the information which an investor may provide about an associate. For example, where an associate is a company, financial information may be limited to that provided in the most recent published financial report of the company. This information is readily available to all shareholders of the associate.

5.8 Where a difference exists between the *reporting date* of the associate and that of the investor, and it is not possible to bring the reporting dates into line, the difference must be consistent from reporting period to reporting period.

5.8.1 Where the financial reports of the associate are prepared at a date earlier than that of the investor, it may be necessary to include additional information in the financial statements by way of note. This note would disclose significant events or transactions which have occurred since the date of the associate's previous financial report where these events or transactions could materially affect the performance or financial position of the associate for the subsequent reporting period.

Dissimilar Accounting Policies

- 5.9** Where the accounting policies adopted by an associate are dissimilar and are not required to be adopted by another Accounting Standard, and this dissimilarity would materially affect the amounts determined as the investor's share of the net assets, the result (profit or loss) and the reserves of the associate, adjustments must be made, where possible, to achieve consistency with the accounting policies of the investor.

Inter-Entity Transactions

- 5.10** Adjustments must be made, where possible, to eliminate unrealised profits and unrealised losses on transactions between the associate and:
- (a) the investor and its controlled *entities* (the economic entity);
 - (b) another associate of the investor.
- 5.11** Where a transaction is between an entity within the economic entity and an associate, the amount of the unrealised profits or unrealised losses eliminated must be determined in accordance with the investor's ownership interest in the associate. Where a transaction is between associates of the investor, the amount of the unrealised profits or unrealised losses eliminated must be determined in accordance with the product of the investor's ownership interest in each of the associates.
- 5.11.1** Where, for example, an associate in which a 25% ownership interest is held transacts with an associate in which a 40% ownership interest is held, 10% (0.25×0.4) of the unrealised profit or unrealised loss is eliminated.

Discontinuation of the Equity Method

- 5.12** The equity method must not be applied when an investee ceases to qualify as an associate because the investor's influence over the investee has been reduced. Thereafter, where the investment is retained, it must be accounted for in accordance with the cost method. In these circumstances, the carrying amount of the investment determined by the equity method remains the carrying amount of the investment, and thereafter dividends from the investee must be recognised as revenue to the extent

that they are not already reflected in the carrying amount of the investment.

- 5.12.1 The investee ceases to qualify as an associate when the investor no longer has significant influence. This may occur for a number of reasons, including the sale of part of the investment and changes in the ownership structure of the investee. In the event that the investor acquires control of the investee, the requirements of Australian Accounting Standard AAS 24 "Consolidated Financial Reports" apply.
- 5.13 The amount of an investor's share of the deficits (losses) and reserve decrements of an associate must be recognised in their entirety. However, where the investor's share of deficits (losses) and reserve decrements reduces the carrying amount of the investment below zero, application of the equity method must be discontinued and the investment recorded at zero.**
- 5.14 When an investor resumes application of the equity method after having discontinued its use, the investor must not recognise its share of the results (profits) and reserve increments of the associate until such share offsets its share of deficits (losses) and reserve decrements not recognised during the reporting periods in which the equity method was not applied.**

Carrying Amount of the Investment

- 5.15 The carrying amount of an investment in an associate must not exceed its *recoverable amount*. Where the recoverable amount of an investment has declined below its carrying amount, the carrying amount must be written down to that recoverable amount. The amount of the reduction must be recognised in the profit and loss or other operating statement in the reporting period in which the reduction occurs.**
- 5.15.1 Where equity instruments are traded in an active and liquid market, the quoted market price is normally regarded as a reliable indicator of the recoverable amount. Where there is infrequent activity in a market, or the market is not well established, or small volumes are traded relative to the size of the investor's holding in the investee, quoted market prices may not be a reliable indicator of the recoverable amount of the investment in the associate. In these circumstances, as well as when a quoted market price is not available, estimation techniques, which include discounted cash flow techniques, may need to be used to estimate the recoverable

amount. In applying discounted cash flow techniques, a current market-determined risk-adjusted discount rate which reflects such

factors as the expected rate of return prevailing in the market for an investment having a similar exposure to business, credit and market risk should be used.

- 5.16** Where an investment in an associate has been written down to recoverable amount as at a previous reporting date in accordance with paragraph 5.15, the write-down must be reversed to the extent that the recoverable amount as at the current reporting date exceeds the written-down carrying amount. The amount of the reversal must be recognised in the profit and loss or other operating statement in the reporting period in which the reversal occurs.
- 5.17** Where the equity method is applied, the maximum amount at which an investment in an associate can be recognised in the financial report is the carrying amount determined by applying the equity method.
- 5.17.1 The application of the equity method precludes the recognition of increases in the carrying amount of the investment through revaluations made in accordance with Australian Accounting Standard AAS 10 "Accounting for the Revaluation of Non-Current Assets".

Reciprocal Equity Holdings Between Investor and Associate

- 5.18** Where an associate holds *equity* in the investor, the carrying amount of the investment in the associate must be reduced by an amount representing the investor's indirect holding in its own equity because of the cross-holding. An equivalent adjustment must be made to the equity of the investor.
- 5.19** Where an associate holds equity in the investor and uses the cost method to account for its investment, the amount of the investor's share of the associate's result (profit or loss) must be determined after eliminating from the associate's result (profit or loss) dividends received or receivable by the associate from the investor included therein.
- 5.20** Where an associate holds equity in the investor and uses the equity method to account for its investment, the amount of the investor's share of the associate's result (profit or loss) must be determined after eliminating the effect of the associate having applied the equity method to determine the carrying amount of its investment in the investor.

- 5.20.1 The purpose of the adjustments in paragraphs 5.19 and 5.20 is to eliminate, from the investor's share of the result (profit or loss) of an associate, the investor's proportionate share of that part of its own result (profit or loss) which has been included in the associate's result (profit or loss).

Changes in Investor's Ownership Interest

- 5.21 **The carrying amount of an investment in an associate must be adjusted where the investor's ownership interest in the associate is reduced by sale of part of that interest, or in consequence of a post-acquisition change in the equity of the associate.**
- 5.22 **Where the transactions or events referred to in paragraph 5.21 result in a change in the share of retained profits (surplus) or accumulated losses (deficiency) of an associate, the carrying amount of the investment must be adjusted and the amount of the change must be recognised in the profit and loss or other operating statement.**
- 5.23 **Where the transactions or events referred to in paragraph 5.21 result in a change in the share of reserves other than retained profits (surplus) or accumulated losses (deficiency) of an associate, the amount of the change must be recognised as part of reserves and must not be recognised in the profit and loss or other operating statement.**
- 5.24 **A change in ownership interest resulting from further acquisition of equity in an associate must be recognised at the cost of the acquisition to the investor in accordance with paragraph 5.1.**

6 Disclosures

- 6.1 **The following information must be disclosed:**
- (a) **in respect of each *associate*:**
 - (i) **its name and principal activities**
 - (ii) **the *investor's ownership interest* as at the *associate's reporting date* and, if different, at the investor's reporting date**

- (iii) the proportion of *voting power* held in the associate where different from the proportion of ownership interest held
 - (iv) the *carrying amount* of the investment
 - (v) its reporting date, if different from that of the investor
- (b) the amount of the investor's share of associates':
- (i) contingent liabilities
 - (ii) capital commitments contracted for
 - (iii) other expenditure commitments contracted for, other than for the supply of inventories
- (c) the amount of the investor's contingent liabilities that arise because the investor is severally liable for all the liabilities of an associate
- (d) where an associate holds *equity* in the investor, the percentage of equity held by the associate
- (e) where investments in associates, either individually or in aggregate, are material to an evaluation of the operating performance and financial position of the investor, a summarised presentation of the *recognised* amounts of assets, liabilities, and the *result (profit or loss)* of associates, either individually or in aggregate, as appropriate.

6.2 Where the equity method is applied to investments in associates, the following information must be disclosed:

- (a) the amount of the investor's share of associates':
- (i) operating results (profits or losses) before income tax
 - (ii) income tax expense attributable to operating results (profits or losses)
 - (iii) extraordinary items (net of income tax)

- (b) **the amounts of retained profits (surplus) or accumulated losses (deficiency) as at the beginning and end of the reporting period which are attributable to associates**
- (c) **the amounts of other reserves as at the beginning and end of the reporting period which are attributable to associates**
- (d) **a schedule setting out the movements in the carrying amount of investments in associates, separately identifying the carrying amount as at the beginning and end of the reporting period, and the amounts of new investments, disposals, share of the result (profit or loss), dividends and other movements**
- (e) **the financial effects of events or transactions which have occurred after the reporting date of an associate and which could materially affect the financial position or operating performance of that associate for the next reporting period**
- (f) **where adjustments to eliminate the effect of dissimilar accounting policies cannot be made, the nature of the dissimilarities.**

7 Comparative Information

7.1 Information for the preceding corresponding reporting period which corresponds to the disclosures specified for the current reporting period in this Standard must be disclosed, except where, in respect of the reporting period to which this Standard is first applied, the superseded Standard did not require corresponding information.

7.1.1 Disclosure of comparative information for the reporting period to which this Standard is first applied is encouraged where the superseded Standard did not require corresponding information.

8 Transitional Provisions

8.1 The accounting policies required by this Standard must be applied as at the beginning of the reporting period to which this

**Standard is first applied. The *carrying amount* of investments
in**

associates must be adjusted, as at the beginning of the reporting period to which this Standard is first applied, to that amount which would have been the carrying amount had the requirements of this Standard been applicable from the acquisition date of the investment in the associate. The amount of this adjustment which relates to:

- (a) the accumulated share of the results (profits or losses) of associates since the acquisition date must be adjusted against retained profits (surplus) or accumulated losses (deficiency)**
- (b) increments and decrements in reserves of associates, other than retained profits (surplus) or accumulated losses (deficiency), must be adjusted against the reserves of the investor.**

8.2 Where an investment in an associate is recognised at a revalued amount, the asset revaluation reserve and the carrying amount of the investment must be adjusted to remove the effects of the revaluation prior to implementing the requirements of paragraph 8.1.

8.2.1 The purpose of these adjustments is to ensure that amounts attributable to the investor's share of the post-acquisition results (profits or losses) recognised by the associate are included in retained profits (surplus) or accumulated losses (deficiency) of the investor and not included in other reserves. Adjustments to achieve this outcome are necessary irrespective of the method of accounting previously applied in respect of the investment in an associate.

8.3 Where an investment in an associate is recognised at a revalued amount and the asset revaluation reserve attributable to the investment has been used, the amount of the adjustment must be made against retained profits (surplus) or accumulated losses (deficiency) as at the beginning of the reporting period to which this Standard is first applied.

8.4 Where the retrospective application of the requirements of this Standard is not practicable, the amounts attributed to the carrying amount of investments in associates shall be deemed to have been determined in accordance with this Standard.

9 Definitions

9.1 In this Standard:

acquisition date means the date on which an *investor* acquires an *ownership interest* in the *equity* of an *investee* (The terms pre-acquisition and post-acquisition must be read as deriving from this definition.)

associate means an investee, not being:

- (a) a *subsidiary* of the investor; or
- (b) a partnership the investor; or
- (c) an investment acquired and held exclusively with a view to its disposal in the near future (see paragraphs 9.1.1 and 9.1.2),

over which the investor has *significant influence*

capacity means ability or power, whether direct or indirect, and includes ability or power that is presently exercisable as a result of, by means of, in breach of, or by revocation of, any of or any combination of the following:

- (a) trusts
- (b) relevant agreements
- (c) practices,

whether or not enforceable

carrying amount means, in relation to an asset, the amount at which the asset is *recognised* in the statement of financial position as at the *reporting date* net of any provisions for depreciation, amortisation or diminution in value

cost of acquisition means purchase consideration plus any costs incidental to the acquisition

economic entity means a group of *entities* comprising the *parent entity* and each of its subsidiaries

entity means any legal, administrative, or fiduciary arrangement, organisational structure or other party (including a person) having the *capacity* to deploy scarce resources in order to achieve objectives

equity means the residual interest in the assets of the entity after deduction of its liabilities

fair value means the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's-length transaction

general purpose financial report means a financial report intended to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs

investee means an entity in which an investor has an ownership interest

investor means an entity that has an ownership interest in the equity of another entity

net market value means, in relation to an asset, the amount which could be expected to be received from the disposal of the asset in an orderly market after deducting costs expected to be incurred in realising the proceeds of such a disposal

ownership interest means the percentage of equity interest held in an *associate* by an investor, whether such interests are held directly or indirectly through subsidiaries or associates, or through their respective nominees. The percentage of equity interest excludes interests which carry no right to participate beyond a specified amount in the distribution of the entity's profits (surplus) or in the ultimate distribution of its assets

parent entity means an entity which controls another entity

recognised means reported on, or incorporated in amounts reported on, the face of the profit and loss or other operating statement or of the statement of financial position (whether or not further disclosure of the item is made in notes)

recoverable amount means, in relation to an asset, the net amount that is expected to be recovered through the cash inflows and outflows arising from its continued use and subsequent disposal

reporting date means the end of the reporting period to which the financial report relates

reporting entity means an entity (including an *economic entity*) in respect of which it is reasonable to expect the existence of users dependent on *general purpose financial reports* for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources

result (profit or loss) means, in relation to:

- (a) an entity - the operating result (profit or loss) and extraordinary items of the entity after applicable income tax expense
- (b) an economic entity - the operating result (profit or loss) and extraordinary items attributable to members of the parent entity of the economic entity after applicable income tax expense

significant influence means the capacity of an entity to affect substantially (but not control) either, or both, of the financial and operating policies of another entity (see paragraphs 9.1.3 to 9.1.8)

subsidiary means an entity which is controlled by a parent entity

voting power means the voting rights attaching to equity interests of an associate but excludes voting rights which apply only in special or contingent circumstances.

Associate

- 9.1.1 As defined in this Standard, the term associate includes joint ventures, other than partnerships, which involve the establishment of an entity, that is, a joint venture entity in which the investor has an ownership interest. Joint venture entities which are not established as entities separate from the venturers do not qualify as associates. Accordingly, unincorporated joint ventures which involve the shared use of assets and other resources of the venturer

are not associates. The method of accounting for participation in these joint

ventures, is set out in Australian Accounting Standard AAS 19 "Accounting for Interests in Joint Ventures".

- 9.1.2 An investment which has been acquired and continues to be held exclusively with a view to disposal in the near future is not an associate under this Standard. Such an investment is held exclusively for sale if a purchaser has been identified, or is being actively sought, and disposal is reasonably expected to occur within one year of its *acquisition date*.

Significant Influence

- 9.1.3 Whether an investor has significant influence over an investee will need to be decided in the light of the prevailing circumstances. The existence of significant influence depends upon substance and not merely form.
- 9.1.4 Significant influence will normally stem from the investor's *voting power* in the investee which is linked to the investor's ownership interest. In some cases this will be conclusive, while in other cases this will need to be supported by satisfying other conditions. In deciding whether the investor's voting power gives rise to significant influence over the investee, it may be necessary to consider the distribution of the balance of the voting power. For example, in the case of a company, whether the balance of the voting power is held in a few large equityholdings or distributed over a large number of small equityholdings needs to be considered in determining the capacity of the investor to exercise significant influence.
- 9.1.5 Where an investor holds 20 per cent or more of the voting power in an investee, this could lead to a presumption that the investor has significant influence over the investee in the absence of evidence to the contrary. However, this percentage is not an absolute cut-off point. In certain cases, an investee will qualify as an associate, notwithstanding that the investor's voting power in the investee is less than or has fallen below 20 per cent. The converse also applies.
- 9.1.6 Some of the factors which, singly or in combination, may indicate the existence of significant influence are:
- (a) the investor's voting power in the investee
 - (b) representation on the investee's board of directors or equivalent governing body

(c) dependence on technical information

- (d) economic dependency, including material transactions between investor and investee
- (e) interchange of managerial personnel
- (f) participation in decisions on the distribution or retention of the investee's results (profits)
- (g) participation, in other ways, in policy-making decisions of the investee.

9.1.7 It is unlikely that significant influence would exist or would continue to exist where an investee operates under severe long-term restrictions which impair significantly its ability to make distributions to the investor, for example, restrictions on the repatriation of dividends.

9.1.8 The investor's voting power in an associate needs to be distinguished from the investor's ownership interest in the equity of that associate. Voting power is important in determining whether significant influence exists. The investor's ownership interest in the equity of the associate is relevant when measuring the *carrying amount* of the investment based on the investor's share of the associate's *result (profit or loss)* and net assets.

CONFORMITY WITH INTERNATIONAL AND NEW ZEALAND ACCOUNTING STANDARDS

Conformity with International Accounting Standards

As at the date of issue of this Standard, compliance with this Standard will ensure conformity with International Accounting Standard IAS 28 "Accounting for Investments in Associates", with the following exceptions:

- (a) IAS 28 requires the equity method to be applied in the investor's financial reports where the equity method is applied in the consolidated financial reports. This Standard requires the cost method to be applied in the investor's own financial reports except where consolidated financial reports are not required to be prepared. Consolidated financial reports prepared in accordance with this Standard will, except as noted in (b) below, comply with the requirements of IAS 28.
- (b) IAS 28 requires the carrying amount of an investment to be written down to recognise a decline, other than temporary, in the value of the investment. This Standard requires that the carrying amount of the investment must not exceed its recoverable amount. The International Accounting Standards Committee and the Australian Accounting Standards Board and the Public Sector Accounting Standards Board of the Australian Accounting Research Foundation have current projects on impairment of assets which will address issues such as the permanent diminution test in IAS 28. This difference will be addressed in the context of those projects.

Conformity with New Zealand Accounting Standards

As at the date of issue of this Standard, compliance with this Standard will ensure conformity with Statement of Standard Accounting Practice SSAP-8 "Accounting for Business Combinations", to the extent that it addresses accounting for associates, with the following exceptions:

- (a) SSAP-8 precludes the equity method from being applied in the investor's own financial reports. This Standard requires the equity method of accounting to be applied in the investor's own financial reports when consolidated financial reports are not required to be prepared. In this latter circumstance, SSAP-8 requires the investor

to adapt its own financial reports to incorporate the information required or to present an additional profit and loss or other operating statement and statement of financial position incorporating this information.

- (b) SSAP-8 requires that where an investor has less than a 20 per cent of an investee, the associate must concur in writing that the investor is in a position to exert significant influence, before the equity method may be applied by the investor. This Standard does not contain a similar requirement.
- (c) SSAP 8 requires goodwill to be separately recognised and reported in the consolidated statement of financial position. This Standard requires goodwill to be identified and notional adjustments to be made for the amortisation of goodwill to determine the result (profit or loss) recognised by the investor under the equity method.
- (d) SSAP-8 requires an investment in an associate to be written down to fair value if its fair value is less than the carrying amount for other than a temporary period. This Standard provides that the carrying amount of an investment in an associate should not exceed its recoverable amount.

APPENDIX

INVESTEES BECOMING AN ASSOCIATE SUBSEQUENT TO INITIAL ACQUISITION

This Appendix forms part of the commentary and is provided for illustrative purposes only. The example in this Appendix illustrates the accounting treatment outlined in paragraph 5.2.2 of this Standard concerning an investee becoming an associate subsequent to the initial acquisition of an ownership interest by the investor.

Example: An investor acquired a ten per cent interest in an investee on 1 January 19X1 for \$76,000. As at this date the fair value of the net assets of the investee were \$700,000 and comprised paid-up capital \$500,000, asset revaluation reserve of \$100,000 and retained profits of \$100,000. A further fifteen per cent interest was acquired on 31 December 19X3 for \$168,000. Significant influence is achieved on 31 December 19X3. At this date the fair value of the net assets of the investee were \$920,000 and comprised paid-up capital \$500,000, asset revaluation reserve \$200,000 and retained profits \$220,000. The investor had applied the cost method to account for its investment made on 1 January 19X1.

The investee, which had revalued its non-current assets as at 31 December 19X2, reported profits of \$80,000, \$60,000, and \$100,000 in the years ended December 19X1, 19X2 and 19X3 respectively. Dividends from post-acquisition profits received by the investor were \$4,000 in each year.

The amount of the adjustment made at 31 December 19X3 would be determined as follows:

- (a) Acquisition of 10% interest: 1 January 19X1

Consideration paid	\$76,000
Share of net assets acquired	<u>70,000</u>
Goodwill	<u>\$ 6,000</u>

The investor's accounting policy is to amortise goodwill over three years.

- (b) Acquisition of 15% interest: 31 December 19X3

Consideration paid	\$168,000
Share of net assets acquired	<u>138,000</u>

Goodwill

\$ 30,000

At 31 December 19X3 the carrying amount of the investment in the books of the investor would be \$244,000 (\$76,000 + \$168,000) under the cost method. For the consolidated financial reports, or the investor's own financial reports if it is not a parent, the carrying amount would be adjusted as follows:

	Debit \$	Credit \$
Investment	16,000	
Profit and Loss		6,000
Asset Revaluation Reserve		10,000

The change in the carrying amount of the investment arises from:

(i)	restating recognised revenues as an adjustment to investments in associates	
	Dividends received or receivable	\$(12,000)
(ii)	recognition of the share of profits post-acquisition of tranche 1, now to be equity accounted	
	\$240,000 x 10%	24,000
	Less: adjustments to reflect amortisation of goodwill since acquisition \$2,000 per year for 3 years	<u>(6,000)</u>
	Net adjustment to the result (profit and loss)	\$6,000
(iii)	recognition of the share of the movement in asset revaluation reserve occurring post-acquisition of tranche 1 and now to be equity accounted	
	\$100,000 x 10%	<u>10,000</u>
	Total increase in the equity-accounted carrying amount of the investment	<u>\$16,000</u>

DEVELOPMENT OF THE STANDARD

This section does not form part of the Standard. It is a summary of the development of the Standard and the Public Sector Accounting Standards Board's and Australian Accounting Standards Board's consideration of the key issues dealt with in the Standard.

- 1 The issue of the Standard follows consideration of the responses received on Exposure Draft ED 71 "Accounting for Investments in Associates by the Equity Method" which was prepared by the Australian Accounting Standards Board and by the Public Sector Accounting Standards Board of the Australian Accounting Research Foundation and released in December 1995.
- 2 The intention of ED 71 was to revise Australian Accounting Standard AAS 14 "Equity Method of Accounting" to require investments in associates to be recognised in the financial report at amounts determined in accordance with the equity method. AAS 14 required disclosure of information, determined in accordance with the equity method, in notes or supplementary financial statements.

Noteworthy Differences from ED 71

- 3 ED 71 proposed a broad definition of "associates" and that the equity method be applied in respect of all associates. The Standard clarifies that the equity method is not required to be applied where, in accordance with another Australian Accounting Standard, or as permitted by another Australian Accounting Standard, the net market value method of accounting is used to account for an investment in an associate. In addition, the definition of an associate was amended to exclude:
 - (a) an investment acquired and held exclusively with a view to disposal in the near future
 - (b) partnerships.

International Accounting Standard IAS 31 "Financial Reporting of Interests in Joint Ventures", which deals with accounting for joint venture entities, contains a benchmark treatment and an allowed alternative treatment. The benchmark treatment requires the proportionate consolidation method to be applied in accounting for interests in joint venture entities. The allowed alternative treatment permits the use of the equity method of accounting for interests in joint venture entities. This Standard requires the equity method of

accounting to be applied where a joint venture entity is an associate of the investor.

This Standard does not prevent the equity method of accounting from being applied in accounting for interests in partnerships in the investor's own financial report. The Board will address accounting for interests in partnerships when it considers International Accounting Standard IAS 31 as part of the international harmonisation program.

- 4 ED 71 did not specify how to account for the adjustment arising when an investee becomes an associate subsequent to the initial acquisition of an ownership interest by the investor. Respondents sought clarification of the treatment of the adjustment. The Boards considered requiring that the adjustment be:
- (a) made to retained profits (surplus) as at the beginning of the reporting period; or
 - (b) recognised in the profit and loss or other operating statement in the reporting period in which the investee became an associate.

Australian Accounting Standard AAS 1 "Profit and Loss or other Operating Statements" precludes making an adjustment to retained profits (surplus) as at the beginning of the reporting period in these circumstances. As a result, the Standard requires that the adjustment relating to the accumulated share of post-acquisition profits or losses be recognised in the consolidated profit and loss or other operating statement.

- 5 ED 71 proposed that the carrying amount of an investment in an associate should not exceed its net market value. However, the Boards concurred with the views of most respondents that the reference point for assessing the carrying amount of an equity-accounted investment should be consistent with that used for assessing other non-current assets. Accordingly, the Standard specifies that the carrying amount should not exceed the recoverable amount of the investment. The Standard also clarifies that where the equity method is applied the investment cannot be revalued upwards in accordance with Australian Accounting Standard AAS 10 "Accounting for the Revaluation of Non-Current Assets".
- 6 Some respondents commented that the transitional provisions in ED 71 did not deal specifically with circumstances where the

carrying amount of an investment in an associate had previously been determined at a revalued amount and sought clarification of the accounting adjustments required on adopting the equity method. In response to these comments, the Standard now requires that the amount of an investment in an associate included in the consolidated financial reports of the investor be adjusted to the amount which would have been the carrying amount of the investment in the associate had the requirements of the Standard been applicable from the date of the investment in the associate. The effects of previous revaluations of the investment in the associate are required to be reversed prior to implementing the equity method. Where the asset revaluation reserve has been used, for example for making an issue of bonus shares, the transitional adjustment should be made against retained profits (surplus) or accumulated losses (deficiency).

Principal Features of ED 71 Retained in the Standard

- 7 The Standard retains the basic structure and content of the proposals in ED 71 relating to the recognition and measurement of investments in associates and the matters required to be disclosed.
- 8 Some respondents to ED 71 expressed the view that the equity method is a consolidation technique for reporting information about an investor, its subsidiaries and its associates as an economic entity. Those respondents to ED 71 noted that their view is consistent with the rationale underlying some overseas pronouncements that deal with the equity method. This view is inconsistent with the concept of an economic entity as applied in Australia and the application of the criterion of control for determining the entities which should be consolidated as part of a reporting entity, as set out in Statement of Accounting Concepts SAC 1 "Definition of the Reporting Entity". The Boards concurred with the views of respondents that implementation of the equity method is necessary to enable Australian reporting entities to report in a manner consistent with foreign national and international requirements and practice.
- 9 The treatment of reciprocal equityholdings between the investor and the associate on the carrying amount of the investment and the aggregate equity of the investor was implicit in ED 71. This Standard clarifies that the effect of the investor's indirect ownership in itself is to be eliminated.