PBE IPSAS 7: INVESTMENTS IN ASSOCIATES

Version 1: 2014

Effective Periods Beginning
1 April 2015

PBE IPSAS 7 applies to all investments in associates except those held by:

- Venture capital organisations; or
- Mutual funds, unit trusts or similar entities.
  - These investments are accounted for as designated at fair value or classified as held-for-trading with changes in fair value recognised in surplus or deficit in accordance with PBE IPSAS 29.

An associate is:

- An entity, including an unincorporated entity such as a partnership;
- Over which the investor has significant influence; and
- That is neither a controlled entity nor an interest in a joint venture.

Significant influence is:

- Power to participate in financial & operating policy decisions of the investee.
- But is not control or joint control over those policies.

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 net assets of the investee.
- The profit or loss of the investor includes the investor's share of the profit or loss of the investee.

APPLICATION

SIGNIFICANT INFLUENCE

- Rebuttable presumption that between 20% - 50% shareholding = significant influence.
- Significant influence is usually evidenced in one or more of the following ways:
  - Representation on the board of directors or equivalent governing body of the investee;
  - Participation in policy-making processes, including participation in decisions about dividends or other distributions;
  - Material transactions between the investor and the investee;
  - Interchange of managerial personnel; or
  - Provision of essential technical information.

EXEMPTION FROM EQUITY METHOD

- The investor is a wholly owned controlled entity and the users of the financial statements prepared by the equity method are unlikely to exist; or is partially owned controlled entity of another entity and all owners have been informed of and do not object to the decision.
- The investor 's debt or equity instruments are not publicly traded.
- The investor did not file its financial statements with a securities commission or other regulator for the purposes of issuing its shares to the public; AND
- The ultimate or intermediate controlling entity of the investor produces consolidated financial statements available for public use that comply with PBE Standards.*

* RDR Reporters do not have to meet the requirements of this last bullet point but must meet all other criteria above in order to qualify for the exemption.

EQUITY METHOD

- The investment in an associate is initially recognised at cost; and
- Subsequently, 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 surplus or deficit of the investee 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 arise from changes in the investee's other comprehensive revenue and expense , for example the revaluation of property, plant and equipment and foreign exchange translation differences. The investor's share of those changes is recognised directly in other comprehensive revenue and expense of the investor.
  - An investment in an associate that meets the definition of a "non-current asset held for sale" should be recognised in accordance with PBE IFRS 5 - *Non-current Assets Held for Sale and Discontinued Operations*.
- The investor uses the equity method to account for its investment in the associate from the date significant influence arises, to the date significant influence ceases.

SEPARATE FINANCIAL STATEMENTS

Investments in associates are carried at either:

- Cost less impairment losses; or fair value in terms of PBE IPSAS 29 – *Financial Instruments: Recognition and Measurement*.
- Non-current asset Held for Sale (PBE IFRS 5) if it meets the definition of "Held for sale".

ISSUES TO NOTE

- Potential voting rights are taken in into account to determine whether significant influence exists, but equity account based on present ownership interest.
- Financial statements of the investor and investee used for equity accounting must not differ by more than 3 months in terms of the reporting date, except when reporting dates are fixed by statute and no reliable interim information is available.
- The investors' share in the associate's surpluses and deficits resulting from transactions with the associate are eliminated in the equity accounted financial statements of the parent.
- Use uniform accounting policies for like transactions and other events in similar circumstances.
- If an investor's share of deficits of an associate exceeds its interest in the associate, the investor discontinues recognising its share of further deficits. The interest in an associate is the carrying amount of the investment in the associate under the equity method together with any long-term interests that, in substance, form part of the investor's net investment in the associate. 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.

TIER 2 RDR REPORTERS

RDR Reporters are granted certain disclosure exemptions within the standard.