Chapter 11

ACCOUNTING FOR INVESTMENTS IN ASSOCIATES (IFRS3 REVISED)

Definition of associate

- per IAS 28 (revised) an **associate** is an entity in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor.

- **significant influence**
  - significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control over those policies. Representation on the board of directors is indicative of such participation, but will neither necessarily be conclusive evidence of it nor be the only method by which the investing entity may participate in policy decisions.
  - for examination purposes the significant influence test will centre on the percentage shareholding of one entity in another.

- **IAS 28 (revised) provides that:**
  - if an investor holds directly or indirectly ≥ 20% but ≤ 50% of the voting power it is presumed the investor has the ability to exercise significant influence; therefore associate status will be presumed unless it can be demonstrated otherwise.
  - if an investor holds directly or indirectly < 20% of the voting power it is presumed the investor has no significant influence; therefore no associate status, again unless demonstrated otherwise.

- **IAS 28 (revised) states significant influence can be shown by:**
  - representation on the board of directors
  - participation in policy making processes
  - material transactions between the investor and investee
  - interchange of managerial personnel
  - provision of essential technical information

Accounting for associates in the investor's individual books

- **the investment can be**
  - carried at cost (recognising dividend income in the Statement of Profit or Loss and Other Comprehensive Income)
  - accounted for as an asset held for sale as described in IFRS 5
  - an asset held for sale in this case represents an investment in shares in another entity held for short-term profit-making by trading those shares. It should initially be recognised at cost and from then on at its fair value.

Consolidated financial statements

- an investment in an associate should be accounted for in consolidated financial statements using the equity method unless it can be shown that the investment is held to be disposed of in the near future or there are severe long-term restrictions on the ability to transfer funds to the investor in which case the cost method should be used.

Equity method: IFRS3 (revised) specifies the following treatment:

- **Statement of Financial Position**
  - the investment should initially be recorded at cost as a non-current asset investment. The carrying amount is increased/decreased as follows:

Initial cost	X
Add/less: share of post acquisition retained earnings	X/(X)
Less: amounts impaired since acquisition	(X)
Carrying value	X

- **Statement of Profit or Loss and Other Comprehensive Income**
  - the group's share of the associate's results (profit **after** tax) should be included immediately before total profit **before** tax (IAS 1).
  - the group's share of any associate prior period items should also be disclosed separately.

- ***Note***
  - an associate is not a group entity, therefore there is no cancellation of 'inter-entity' transactions. However, IFRIC 3 (International Financial Reporting Interpretations Committee) states that unrealised profits and losses on transactions between investor and associate should be eliminated (unless the unrealised loss represents an impairment) in the same way as for group accounts.
  - this elimination is best achieved by accounting for any unrealised profit ALWAYS in the associate's Statement of Profit or Loss and Other Comprehensive Income. It does not matter whether the goods were bought from, or sold to, the associate. ALWAYS in the associate's records.
  - uniform accounting policies should be used, or relevant adjustments must be made.
  - impairment losses should be accounted for in accordance with the principles of IAS 36

Example 1 Statement of Financial Position

Laura has a number of wholly owned subsidiaries and 35% holding of the issued share capital of Gunta which she acquired many years ago when retained earnings in Gunta were $3,000
At 31 December, 2009 the Consolidated Statement of Financial Position of Laura and its subsidiaries and the Statement of Financial Position of Gunta were as follows:

	Laura Group	*Gunta*
	$'000	*$'000*
Investment in Gunta	4	
Other assets	180	23
	184	23
$1 Equity shares	70	2
Retained earnings	99	18
	169	20
Liabilities	15	3
	184	23

Prepare the Consolidated Statement of Financial Position of the Laura Group as at 31 December, 2009, incorporating Gunta under the equity method of accounting.

Example 2 Statement of Profit or Loss and Other Comprehensive Income

Maris has a number of wholly owned subsidiaries and 28% holding of the issued share capital of Girts. The shares were acquired years ago. The Consolidated Statement of Profit or Loss and Other Comprehensive Income of Maris Group and the Statement of Profit or Loss and Other Comprehensive Income of Girts for the year ended 31 December, 2009 were:

	Maris	*Girts*
	$	*$*
Revenue	18,000	7,000
Cost of sales	(9,500)	(2,000)
Gross profit	8,500	5,000
Expenses	(2,900)	(1,400)
Profit from operations	5,600	3,600
Finance income	1,010	-
Finance costs	(700)	(300)
Profit before tax	5,910	3,300
Income tax	(2,000)	(1,000)
Profit after tax	3,910	2,300

Dividends of $1,500 and $400 respectively have been proposed.

Maris has not accounted for the dividend from Girts which was proposed prior to the year end.

Prepare the Consolidated Statement of Profit or Loss and Other Comprehensive Income for the Maris Group incorporating the results of Girts according to IFRS 3 (revised). (Ignore any goodwill).