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IFRS Foundation: Training Material for the *IFRS<sup>®</sup> for SMEs*

# Module 14 – Investments in Associates



# **IFRS Foundation: Training Material for the *IFRS<sup>®</sup> for SMEs***

including the full text of  
Section 14 *Investments in Associates*  
of the International Financial Reporting Standard (IFRS)  
for Small and Medium-sized Entities (SMEs)  
issued by the International Accounting Standards Board on 9 July 2009

*with extensive explanations, self-assessment questions and case studies*

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This training material has been prepared by IFRS Foundation education staff and has not been approved by the International Accounting Standards Board (IASB). The accounting requirements applicable to small and medium-sized entities (SMEs) are set out in the *International Financial Reporting Standard (IFRS) for SMEs*, which was issued by the IASB in July 2009.

## INTRODUCTION

This module focuses on the accounting and reporting of investments in associates in accordance with Section 14 *Investments in Associates* of the *IFRS for SMEs*. It introduces the learner to the subject, guides the learner through the official text, develops the learner's understanding of the requirements through the use of examples and indicates significant judgements that are required in accounting for investments in associates. Furthermore, the module includes questions designed to test the learner's knowledge of the requirements and case studies to develop the learner's ability to account for investments in associates in accordance with the *IFRS for SMEs*.

### Learning objectives

Upon successful completion of this module you should know the financial reporting requirements for investments in associates in accordance with the *IFRS for SMEs*. Furthermore, through the completion of case studies that simulate aspects of the real world application of that knowledge, you should have enhanced your competence to account for investments in associates in accordance with the *IFRS for SMEs*. In particular you should, in the context of the *IFRS for SMEs*, be able:

- to identify when an entity has significant influence over another entity
- to measure investments in associates on initial recognition and subsequently
- to present and disclose investments in associates in financial statements
- to demonstrate an understanding of the significant judgements that are required in accounting for investments in associates.

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## **IFRS for SMEs**

The *IFRS for SMEs* is intended to apply to the general purpose financial statements of entities that do not have public accountability (see Section 1 *Small and Medium-sized Entities*).

The *IFRS for SMEs* includes mandatory requirements and other material (non-mandatory) that is published with it.

The material that is not mandatory includes:

- a preface, which provides a general introduction to the *IFRS for SMEs* and explains its purpose, structure and authority.
- implementation guidance, which includes illustrative financial statements and a disclosure checklist.
- the Basis for Conclusions, which summarises the IASB's main considerations in reaching its conclusions in the *IFRS for SMEs*.
- the dissenting opinion of an IASB member who did not agree with the publication of the *IFRS for SMEs*.

In the *IFRS for SMEs* the Glossary is part of the mandatory requirements.

In the *IFRS for SMEs* there are appendices in Section 21 *Provisions and Contingencies*, Section 22 *Liabilities and Equity* and Section 23 *Revenue*. Those appendices are non-mandatory guidance.

## **Introduction to the requirements**

The objective of general purpose financial statements of a small or medium-sized entity is to provide information about the entity's financial position, performance and cash flows that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs. The objective of Section 14 *Investments in Associates* is to prescribe the financial reporting requirements for investments in associates.

An associate is an entity over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture. The main issue that arises in relation to Section 14 is identification of when significant influence is present. The measurement of investments in associates can also require significant judgement when an entity elects to account for its investments in associates using the equity method or, if the investee's equity is not traded in an active market, an entity elects to account for its investments in associates using the fair value model.

Section 14 requires an entity to choose one of the following three models to account for its investments in associates:

- (a) the cost model, in accordance with which the investment in an associate is measured at cost (including transaction costs) less any accumulated impairment losses. However, an investor using the cost model is required to use the fair value model for any investment in an associate for which a published price quotation exists.
- (b) the equity method, in accordance with which the investment in an associate is initially recognised at the transaction price (including transaction costs) and adjusted thereafter

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for the post-acquisition change in the investor's share of profit or loss and other comprehensive income of the associates.

- (c) the fair value model, in accordance with which the investment in an associate is initially recognised at the transaction price (excluding transaction costs). After initial recognition, at each reporting date, the investment in an associate is measured at fair value. Changes in fair value are recognised in profit or loss. However, an investor using the fair value model is required to use the cost model for any investment in an associate for which it is impracticable to measure fair value reliably without undue cost or effort.

An entity that uses the fair value model measures its investments in associates by using the procedures in paragraphs 11.27–11.32 of Section 11 *Basic Financial Instruments*. Furthermore, it makes the disclosures required by Section 11.

Paragraph 9.26 establishes the requirements for accounting for associates in separate financial statements, if such financial statements are prepared.

Joint ventures and subsidiaries must follow the requirements of Section 15 *Investments in Joint Ventures* and Section 9 *Consolidated and Separate Financial Statements*, respectively.

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## REQUIREMENTS AND EXAMPLES

The contents of Section 14 *Investments in Associates* of the *IFRS for SMEs* are set out below and shaded grey. Terms defined in the Glossary for the *IFRS for SMEs* are also part of the requirements. They are in **bold type** the first time they appear in the text of Section 14. The notes and examples inserted by the IFRS Foundation education staff are not shaded. Other annotations inserted by the IFRS Foundation staff are presented within square brackets in *bold italics*. The insertions made by the staff do not form part of the *IFRS for SMEs* and have not been approved by the IASB.

### Scope of this section

- 14.1 This section applies to accounting for **associates** in **consolidated financial statements** and in the financial statements of an investor that is not a parent but that has an investment in one or more associates. Paragraph 9.26 establishes the requirements for accounting for associates in **separate financial statements**.

### Notes

The requirements of Section 14 apply to accounting for investments in associates regardless of whether an entity is required to prepare consolidated financial statements (see also paragraph 9.25).

#### *Primary financial statements*

If an entity has one or more subsidiaries, its ‘primary’ financial statements are its consolidated financial statements, unless the exemption in paragraph 9.3 applies. The primary financial statements of an entity that is not required to prepare consolidated financial statements are not separate financial statements.

When an entity has no subsidiaries (and therefore does not prepare consolidated financial statements) it must apply Section 14 to account for its investments in associates in its ‘primary’ financial statements (see paragraph 9.25). Such an entity may then choose (or be required by the law in its jurisdiction) to prepare separate financial statements in addition to its primary financial statements.

#### *Separate financial statements*

The requirements for separate financial statements in Section 9 apply to the accounting for investments in associates only when, in addition to consolidated financial statements, an entity prepares separate financial statements in accordance with paragraphs 9.24–9.27.

Separate financial statements are those financial statements prepared and presented in addition to the entity’s ‘primary’ financial statements. The *IFRS for SMEs* does not require an entity to prepare separate financial statements. However, an entity may

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choose (or be required by law) to prepare separate financial statements in addition to its 'primary' financial statements.

### Associates defined

14.2 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 **subsidiary** nor an interest in a **joint venture**.

### Notes

Significant influence is defined in paragraph 14.3. More than one entity can have significant influence over another entity at the same time. However, only one entity can control another at a point in time. A substantial or majority ownership by another investor does not preclude an investor from having significant influence.

A subsidiary is an entity, including an unincorporated entity such as a partnership, that is controlled by another entity (known as the parent). The requirements for accounting and reporting subsidiaries are set out in Section 9 *Consolidated and Separate Financial Statements*.

The definition of control can be split into two parts (see paragraph 9.4):

- (i) the power to govern the financial and operating policies of an entity
- (ii) so as to obtain benefits from its activities.

Control is not based on legal ownership and can be passive (ie it is the ability to control, not the exercise of control). The parent need not own shares in its subsidiary (eg certain special purpose entities (SPEs)). In the absence of an ownership interest, benefits might be obtained, for example, from cross-selling opportunities or cost savings.

Only one entity can control another entity at a point in time. It is necessary to analyse the facts and circumstances surrounding how a particular entity's financial and operating policies are governed in detail to establish where control lies.

A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. Joint ventures can take the form of jointly controlled operations, jointly controlled assets, or jointly controlled entities. Joint control is the contractually agreed sharing of control over an economic activity. It exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers). The requirements for accounting and reporting joint ventures are set out in Section 15 *Investments in Joint Ventures*.

14.3 Significant influence is the power to participate in the financial and operating policy decisions of the associate but is not **control** or **joint control** over those policies.

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- (a) If an investor holds, directly or indirectly (eg through subsidiaries), 20 per cent or more of the voting power of the associate, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case.
- (b) Conversely, if the investor holds, directly or indirectly (eg through subsidiaries), less than 20 per cent of the voting power of the associate, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated.
- (c) A substantial or majority ownership by another investor does not preclude an investor from having significant influence.

### Notes

Significant influence is the power to participate in the financial and operating policy decisions of the associate but is not control or joint control over those policies. In this context, power refers to the ability to do or effect something. Consequently, an entity has significant influence when it currently has the ability to exercise that power, regardless of whether significant influence is actively demonstrated or is passive in nature.

Judgement must be exercised in determining whether significant influence exists. Management examines all facts and circumstances and the substance of the relationship in each case is considered. If it can be clearly demonstrated that an investor holding 20 per cent or more of the voting power of the investee does not have the ability to exercise significant influence, the investment will not be accounted for as an associate—this is likely to be the case when, for example, the court has appointed an independent administrator to wind down the investee’s business. Conversely, if it can be clearly demonstrated that an investor holding less than 20 per cent of the voting power of the investee has the ability to exercise significant influence, the investment will be accounted for as an associate.

The *IFRS for SMEs* does not provide much application guidance on how to identify significant influence. In judging whether an entity has significant influence over another entity, management may look to the guidance of full IFRSs (see paragraph 10.6 of *IFRS for SMEs*), but is not required to do so. IAS 28 *Investments in Associates* (as issued at 9 July 2009) paragraph 7 indicates that the existence of significant influence by an investor is usually evidenced in one or more of the following ways (note, this is not an exhaustive list):

- (a) representation on the board of directors or equivalent governing body of the investee;
- (b) participation in policy-making processes, including participation in decisions about dividends or other distributions;
- (c) material transactions between the investor and the investee;
- (d) interchange of managerial personnel; or
- (e) provision of essential technical information.

Significant influence can be gained or lost without a change in absolute or relative ownership levels. It could be lost, for example, when an associate becomes subject to

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the control of a government, court, administrator or regulator. Furthermore, it could be lost as a result of a contractual agreement.

Where the investor is a parent (ie it has one or more subsidiaries), the voting rights of the group (ie the parent and its subsidiaries) in the investee are aggregated for the purpose of determining whether the parent has significant influence over the investee. The voting rights of the parent's associates and joint ventures are ignored for this purpose, as the parent does not control the voting rights held by those entities.

As noted in paragraph 14.3, if an investor holds, directly or indirectly through its subsidiaries, 20 per cent or more of the voting power of an investee, it is presumed that the investor has significant influence. However, if the investor holds more than 50 per cent of the voting power, control rather than significant influence is presumed to exist (see paragraph 9.5 of Section 9 *Consolidated and Separate Financial Statements*). And if there is the contractually agreed sharing of control over an economic activity, joint control exists (see Section 15 *Investments in Joint Ventures*). In the absence of a contractually agreed sharing of control, ownership of 50 per cent of the voting power would result in a rebuttable presumption of significant influence.

Where another investor has a controlling interest in an entity in which the reporting investor has an equity interest of say 20 per cent, the substance of the 20 per cent investor's influence should be examined carefully to determine whether it is significant influence. An investor may own share warrants, share call options, debt or equity instruments that are convertible into ordinary shares, or other similar instruments that have the potential, if exercised or converted, to give the investor additional voting power or to reduce another party's voting power over the financial and operating policies of another entity. These are known as potential voting rights. Potential voting rights held by an investor are considered when assessing whether an entity has significant influence (see paragraph 14.8(b)).

### Examples – not significant influence

- Ex 1 Entity A owns 75 per cent of the ordinary shares that carry voting rights at a general meeting of shareholders of entity B. Entity A controls entity B.**

Entity A does not have significant influence over entity B—it controls entity B. The entity A group is required to consolidate entity B in its group financial statements (see Section 9 *Consolidated and Separate Financial Statements*).

- Ex 2 Entity A owns 25 per cent of the ordinary shares that carry voting rights at a general meeting of shareholders of entity B. Entity C owns 30 per cent of the ordinary shares that carry voting rights at a general meeting of shareholders of entity B. Entities A and C have contractually agreed to jointly control entity B.**

Entity A does not have significant influence over entity B—it has joint control over entity B. Entity A is required to account for its investment in entity B in accordance with Section 15 *Investments in Joint Ventures*.

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### Examples – judgement indicates that significant influence exists

- Ex 3 Entity A owns 25 per cent of the ordinary shares that carry voting rights at a general meeting of shareholders of entity B.**

**Entity A neither controls nor jointly controls entity B.**

In the absence of evidence to the contrary, it is presumed that entity A has significant influence over entity B (ie entity B is an associate of entity A).

However, the determination that entity A's 25 per cent holding in entity B results in significant influence is not automatic. Judgement is required, and it may be that, despite the 25 per cent holding of voting rights, entity A does not have significant influence over entity B.

If it is determined that entity A does not have significant influence over entity B, then the investment in the ordinary shares of entity B would be accounted for as an equity instrument in accordance with Section 11 *Basic Financial Instruments*.

- Ex 4 Entity A owns all of the ordinary shares of entity B. Entity B own 25 per cent of the ordinary shares that carry voting rights at a general meeting of shareholders of entity C.**

**The entity A group (ie entity A and its subsidiary entity B) neither controls nor jointly controls entity C.**

In the absence of evidence to the contrary, it is presumed that the entity A has significant influence over entity C.

However, the determination that entity A's indirect 25 per cent holding in entity C results in significant influence is not automatic. Judgement is required, and it may be that despite the 25 per cent holding, entity A does not have significant influence over entity C.

If it is determined that entity A does not have significant influence over entity C, then the investment in the ordinary shares of entity C would be accounted for as an equity instrument in accordance with Section 11 *Basic Financial Instruments*.

- Ex 5 The facts are the same as in example 4. However, in this example, assume that entity B owns only 15 per cent of the ordinary shares of entity C and that entity A also owns 10 per cent of the ordinary shares of entity C.**

If an investor holds, directly or indirectly (through subsidiaries), 20 per cent or more of the voting power of the investee, it is presumed that the investor has significant influence over the investee unless it can be clearly demonstrated that this is not the case.

Entity A's 10 per cent investment in entity C, by itself, does not give entity A significant influence over entity C. Similarly, entity B's 15 per cent investment in entity C, by itself, does not give entity B significant influence over entity C.

However, because entity A controls entity B, entity A's 10 per cent investment in entity C is considered together with entity B's 15 per cent investment in entity C. Accordingly, in the absence of evidence to the contrary, entity A is presumed to have significant influence over entity C. Therefore, entity C is an associate of entity A.

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The determination that the combination of entity A's 10 per cent holding in entity C and entity B's 15 per cent holding in entity C results in significant influence is not automatic. Judgement is required, and it may be that despite the combined 25 per cent holding, the group does not have significant influence over entity C.

If it is determined that entity A does not have significant influence over entity C, then the investment in the ordinary shares of entity C would be accounted for as an equity instrument in accordance with Section 11 *Basic Financial Instruments*.

- Ex 6** **Entities A and B own 30 per cent and 10 per cent respectively of the ordinary shares that carry voting rights at a general meeting of shareholders of entity C. Entity B owns 70 per cent of the ordinary shares that carry voting rights at a general meeting of shareholders of entity A and it is determined that entity A is a subsidiary of entity B. Entities A and B neither control nor jointly control entity C.**

Entity A holds 30 per cent of the voting power in entity C. In the absence of evidence to the contrary it is presumed that entity A has significant influence over entity C—entity A holds more than 20 per cent of the voting power in entity C (ie unless it can be clearly demonstrated that this is not the case) and, therefore, entity C is an associate of entity A.

Entity B holds 40 per cent of the voting power in entity C (10 per cent directly plus 30 per cent indirectly through its control of entity A). Unless it can be clearly demonstrated that this is not the case, it is presumed that entity B has significant influence over entity C (ie entity C is an associate of entity B).

- Ex 7** **The facts are the same as in example 6. However, in this example, assume that entity B owns 30 per cent (not 70 per cent) of the ordinary shares that carry voting rights at a general meeting of shareholders of entity A (and entity A is not a subsidiary of entity B).**

Entity A holds 30 per cent of the voting power in entity C. In the absence of evidence to the contrary it is presumed that entity A has significant influence over entity C—entity A holds more than 20 per cent of the voting power in entity C (ie unless it can be clearly demonstrated that this is not the case) and, therefore, entity C is an associate of entity A.

The holding of entity B's associate (entity A) is ignored when accessing whether entity B has significant influence in entity C (because entity B does not control entity A). Entity B holds less than 20 per cent of the voting power in entity C (ie it holds 10 per cent of the voting power). It is determined that entity B does not have significant influence over entity C, unless such influence can be clearly demonstrated.

- Ex 8** **Entities A and B own 60 per cent and 30 per cent respectively of the ordinary shares that carry voting rights at a general meeting of shareholders of entity C.**

Entity B holds 30 per cent of the voting power in entity C. In the absence of evidence to the contrary, it is presumed that entity B has significant influence over entity C (ie unless it can be clearly demonstrated that this is not the case).

Entity A has control over more than half of the voting power in entity C. Consequently, in the absence of evidence to the contrary, entity A is presumed to control entity C. Entity A accounts for its subsidiary (entity C) in accordance with Section 9 *Consolidated and Separate Financial Statements*.

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A substantial or majority ownership by another investor does not preclude an investor from having significant influence (see paragraph 14.3(c)). However, it is possible that entity A's control over entity C could preclude entity B from having the power to participate in the financial and operating policy decisions of entity C. If this is the case entity B would not have significant influence over entity C.

All facts and circumstances should be considered in assessing whether entity B has significant influence over entity C. If entity B has significant influence over entity C then entity C is an associate of entity B.

### Measurement—accounting policy election

- 14.4 An investor shall account for all of its investments in associates using one of the following:
- (a) the cost model in paragraph 14.5.
  - (b) the equity method in paragraph 14.8.
  - (c) the fair value model in paragraph 14.9.

#### Notes

The accounting policy choice in paragraph 14.4 applies to accounting for investments in associates regardless of whether an entity is required to prepare consolidated financial statements (see paragraph 14.1).

An entity that chooses to account for its investments in associates using the equity method (see paragraph 14.4(b)) and is required to prepare separate financial statements (as in paragraph 9.2), or chooses to do so, must account for its investments in associates in its separate financial statements either at cost less impairment or at fair value with changes in fair value recognised in profit or loss (as in paragraph 9.26).

### Cost model

- 14.5 An investor shall measure its investments in associates, other than those for which there is a published price quotation (see paragraph 14.7) at cost less any accumulated **impairment losses** recognised in accordance with Section 27 *Impairment of Assets*.
- 14.6 The investor shall recognise dividends and other distributions received from the investment as income without regard to whether the distributions are from accumulated profits of the associate arising before or after the date of acquisition.
- 14.7 An investor shall measure its investments in associates for which there is a published price quotation using the fair value model (see paragraph 14.9).

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## Notes

### *No published price quotation*

An investor that has elected the cost model (see paragraph 14.4(a)) accounts for its investments in associates for which there is no published price quotation using the cost-impairment model. At each reporting date, in accordance with Section 27 *Impairment of Assets* the investor must consider whether there are indicators of impairment for such investments (see paragraphs 27.7–27.9 and 27.29) and, if present, must perform an impairment test (see paragraphs 27.10–27.20) and, if an investment is found to be impaired (or a prior period impairment is found to have reversed), recognise an impairment loss (or a reversal of an impairment loss) in profit or loss (see paragraphs 27.6 and 27.30).

### *Published price quotation*

An investor that has elected the cost model (see paragraph 14.4(a)) accounts for its investments in associates for which there is a published price quotation using the fair value model (see paragraph 14.7). Investments carried at fair value are not tested for impairment.

## Examples – cost model

The facts in examples 9–14 are the same as in examples 15–20 (equity method) and examples 25–31 (fair value model). However, in examples 9–14 investments in associates are accounted for using the cost model.

- Ex 9** On 1 January 20X1 entity A acquired 30 per cent of the ordinary shares that carry voting rights at a general meeting of shareholders of entity B for CU300,000<sup>(1)</sup>. For the year ended 31 December 20X1 entity B recognised a profit of CU400,000. On 30 December 20X1 entity B declared and paid a dividend of CU150,000 for the year 20X1. At 31 December 20X1 the fair value of entity A's investment in entity B is CU425,000. However, there is no published price quotation for entity B.

Entity A must recognise dividend income of CU45,000 (ie 30% × CU150,000 dividend declared by entity B) in profit or loss for the year ended 31 December 20X1.

At 31 December 20X1 entity A must report its investment in entity B (an associate) at CU300,000 (ie cost). Entity A must also consider whether there are any indicators that its investment is impaired and, if so, conduct an impairment test in accordance with Section 27 *Impairment of Assets*. In this case there would not be any impairment loss because the fair value (CU425,000) less costs to sell of the investment exceeds its carrying amount (CU300,000).

<sup>(1)</sup> In this example, and in all other examples in this module, monetary amounts are denominated in 'currency units (CU)'.

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**Ex 10 The facts are the same as in example 9. However, in this example, on 2 January 20X1 entity B also declared a dividend of CU100,000 for the year 20X0 and at 31 December 20X1 the fair value of entity A's investment in entity B is CU400,000.**

In accordance with paragraph 14.6, entity A must, without regard to whether the distributions are from B's accumulated profits arising before or after 1 January 20X1, recognise dividend income of CU75,000 in profit or loss for the year ended 31 December 20X1 (calculation:  $30\% \times \text{CU}100,000$  dividend declared on 2 January +  $30\% \times \text{CU}150,000$  dividend declared on 31 December).

At 31 December 20X1 entity A must report its investment in entity B (an associate) at CU300,000 (ie cost).

The payment of the dividend out of pre-acquisition profits on 2 January 20X1 could be an impairment indicator that, in accordance with Section 27 *Impairment of Assets*, could trigger an impairment test at 31 December 20X1. In this case there would not be any impairment loss because the fair value (CU400,000) less costs to sell of the investment exceeds its carrying amount (CU300,000).

**Ex 11 The facts are the same as in example 9. However, in this example, there is a published price quotation for entity B.**

Entity A must recognise dividend income of CU45,000 (ie  $30\% \times \text{CU}150,000$  dividend declared by entity B) and increase in the fair value of its investment in entity B of CU125,000 in profit or loss for the year ended 31 December 20X1.

At 31 December 20X1 entity A must report its investment in entity B (an associate) at CU425,000 (ie fair value).

Note: Even though entity A has elected the cost model as its accounting policy for investments in associates it accounts for its investment in entity B using the fair value model because entity B has a published price quotation.

**Ex 12 On 1 March 20X1 entity A acquired 30 per cent of the ordinary shares that carry voting rights at a general meeting of shareholders of entity B for CU300,000. On 31 December 20X1 entity B declared a dividend of CU100,000 for the year 20X1. Entity B reported a profit of CU80,000 for the year ended 31 December 20X1. At 31 December 20X1 the recoverable amount of entity A's investment in entity B is CU290,000 (calculation: fair value CU293,000 less costs to sell CU3,000). There is no published price quotation for entity B.**

Entity A must recognise dividend income of CU30,000 in profit or loss (ie  $30\% \times \text{CU}100,000$  dividend declared by entity B).

At 31 December 20X1 entity A must report its investment in entity B (an associate) at CU290,000 (ie cost less accumulated impairment).

The payment of the dividend partly out of pre-acquisition profits on 1 March 20X1 could be an impairment indicator that, in accordance with Section 27 *Impairment of Assets*, could trigger an impairment test at 31 December 20X1. At 31 December 20X1 the carrying amount is therefore reduced to CU290,000 (ie the lower of its recoverable amount and its carrying amount before impairment (CU300,000)). Entity A recognises the impairment loss of CU10,000 in profit or loss for the year ended 31 December 20X1.

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**Ex 13** On 1 January 20X1 entity A acquired 30 per cent of the ordinary shares that carry voting rights at a general meeting of shareholders of entity B for CU300,000. Entity B incurred a loss of CU100,000 for the year ended 31 December 20X1 and it did not declare a dividend. Furthermore, at 31 December 20X1 the recoverable amount of entity A's investment in entity B is CU310,000 (calculation: CU325,000 fair value less CU15,000 estimated costs to sell). There is no published price quotation for entity B.

At 31 December 20X1 entity A must report its investment in entity B (an associate) at CU300,000. Entity B has no effect on entity A's profit or loss for the year ended 31 December 20X1, because entity B did not declare any dividends and entity A's investment in entity B is not impaired at 31 December 20X1 (ie the carrying amount (CU300,000) is lower than the recoverable amount (CU310,000)).

**Ex 14** The facts are the same as in example 13. However, in this example, at 31 December 20X1 the recoverable amount of entity A's investment in entity B is CU265,000 (calculation: CU275,000 fair value less CU10,000 estimated costs to sell).

Entity A must recognise an impairment loss of CU35,000 in profit or loss for the year ended 31 December 20X1 (ie CU300,000 cost less CU265,000 recoverable amount).

At 31 December 20X1 entity A must report its investment in entity B (an associate) at CU265,000 (see Section 27).

### Equity method

14.8 Under the equity method of accounting, an equity investment is initially recognised at the transaction price (including transaction costs) and is subsequently adjusted to reflect the investor's share of the **profit or loss** and **other comprehensive income** of the associate.

- (a) *Distributions and other adjustments to carrying amount.* Distributions received from the associate reduce the carrying amount of the investment. Adjustments to the carrying amount may also be required as a consequence of changes in the associate's equity arising from items of other comprehensive income.
- (b) *Potential voting rights.* Although potential voting rights are considered in deciding whether significant influence exists, an investor shall measure its share of profit or loss of the associate and its share of changes in the associate's equity on the basis of present ownership interests. Those measurements shall not reflect the possible exercise or conversion of potential voting rights.
- (c) *Implicit goodwill and fair value adjustments.* On acquisition of the investment in an associate, an investor shall account for any difference (whether positive or negative) between the cost of acquisition and the investor's share of the fair values of the net identifiable assets of the associate in accordance with paragraphs 19.22–19.24. An investor shall adjust its share of the associate's profits or losses after acquisition to account for additional depreciation or amortisation of the associate's depreciable or amortisable assets (including goodwill) on the basis of the excess of their fair values over their carrying amounts at the time the investment was acquired.
- (d) *Impairment.* If there is an indication that an investment in an associate may be impaired, an investor shall test the entire carrying amount of the investment for impairment in accordance with Section 27 as a single asset. Any goodwill included as part of the carrying amount of the investment in the associate is not tested separately.

## Module 14 – Investments in Associates

for impairment but, rather, as part of the test for impairment of the investment as a whole.

- (e) *Investor's transactions with associates.* If an associate is accounted for using the equity method, the investor shall eliminate unrealised profits and losses resulting from upstream (associate to investor) and downstream (investor to associate) transactions to the extent of the investor's interest in the associate. Unrealised losses on such transactions may provide evidence of an impairment of the asset transferred.
- (f) *Date of associate's financial statements.* In applying the equity method, the investor shall use the financial statements of the associate as of the same date as the financial statements of the investor unless it is **impracticable** to do so. If it is impracticable, the investor shall use the most recent available financial statements of the associate, with adjustments made for the effects of any significant transactions or events occurring between the accounting period ends.
- (g) *Associate's accounting policies.* If the associate uses accounting policies that differ from those of the investor, the investor shall adjust the associate's financial statements to reflect the investor's accounting policies for the purpose of applying the equity method unless it is impracticable to do so.
- (h) *Losses in excess of investment.* If an investor's share of losses of an associate equals or exceeds the carrying amount of its investment in the associate, the investor shall discontinue recognising its share of further losses. After the investor's interest is reduced to zero, the investor shall recognise additional losses by a provision (see Section 21 *Provisions and Contingencies*) only to the extent that the investor has incurred legal or constructive obligations or has made payments on behalf of the associate. If the associate subsequently reports profits, the investor shall resume recognising its share of those profits only after its share of the profits equals the share of losses not recognised.
- (i) *Discontinuing the equity method.* An investor shall cease using the equity method from the date that significant influence ceases.
  - (i) If the associate becomes a subsidiary or joint venture, the investor shall remeasure its previously held equity interest to fair value and recognise the resulting gain or loss, if any, in profit or loss.
  - (ii) If an investor loses significant influence over an associate as a result of a full or partial disposal, it shall derecognise that associate and recognise in profit or loss the difference between, on the one hand, the sum of the proceeds received plus the fair value of any retained interest and, on the other hand, the carrying amount of the investment in the associate at the date significant influence is lost. Thereafter, the investor shall account for any retained interest using Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues*, as appropriate.
  - (iii) If an investor loses significant influence for reasons other than a partial disposal of its investment, the investor shall regard the carrying amount of the investment at that date as a new cost basis and shall account for the investment using Sections 11 and 12, as appropriate.

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### Examples – equity method

The facts in the examples 15–20 are the same as in examples 9–14 (cost model) and examples 25–31 (fair value model). However, in examples 15–20 investments in associates are accounted for using the equity method.

**Ex 15** On 1 January 20X1 entity A acquired 30 per cent of the ordinary shares that carry voting rights at a general meeting of shareholders of entity B for CU300,000.<sup>(2)</sup> For the year ended 31 December 20X1 entity B recognised a profit of CU400,000.

On 30 December 20X1 entity B declared and paid a dividend of CU150,000 for the year 20X1. At 31 December 20X1 the fair value of entity A's investment in entity B is CU425,000. However, there is no published price quotation for entity B.

Entity A must recognise income from its associate of CU120,000 (ie 30% × CU400,000 entity B's profit for the year) in profit or loss for the year ended 31 December 20X1.

At 31 December 20X1 entity A must report its investment in entity B (an associate) at CU375,000 (calculation: CU300,000 cost + CU120,000 share of earnings less CU45,000 dividend). Entity A must also consider whether there are any indicators that its investment is impaired and, if so, conduct an impairment test in accordance with Section 27 *Impairment of Assets*. In this case there would not be any impairment loss because the fair value (CU425,000) less costs to sell of the investment exceeds its carrying amount (CU375,000).

**Ex 16** The facts are the same as in example 15. However, in this example, on 2 January 20X1 entity B also declared a dividend of CU100,000 for the year 20X0 and at 31 December 20X1 the fair value of entity A's investment in entity B is CU400,000.

Entity A must recognise income from its associate of CU120,000 (ie 30% × CU400,000 entity B's profit for the year) in profit or loss for the year ended 31 December 20X1.

At 31 December 20X1 entity A must report its investment in entity B (an associate) at CU345,000 (calculation: CU300,000 cost + CU120,000 share of earnings less CU30,000 dividend less CU45,000 dividend). Entity A must also conduct an impairment test in accordance with Section 27 *Impairment of Assets*. The payment of the dividend out of pre-acquisition profits on 2 January 20X1 is an impairment indicator that, in accordance with Section 27, would trigger an impairment test at 31 December 20X1 (ie at 31 December 20X1 entity A must calculate the recoverable amount of its investment in entity B and, if the recoverable amount is lower than the carrying amount, reduce the carrying amount to the recoverable amount). In this case there would not be any impairment because the fair value (CU400,000) less costs to sell of the investment would exceed its carrying amount (CU345,000).

**Ex 17** The facts are the same as in example 15. However, in this example, there is a published price quotation for entity B.

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<sup>(2)</sup> In examples 15–23 it is assumed that there is no implicit goodwill and no fair value adjustments. Example 24 illustrates implicit goodwill and fair value adjustments.

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Entity A must recognise income from its associate of CU120,000 (ie  $30\% \times \text{CU}400,000$  entity B's profit for the year) in profit or loss for the year ended 31 December 20X1.

At 31 December 20X1 entity A must report its investment in entity B (an associate) at CU375,000 (calculation: CU300,000 cost + CU120,000 share of earnings less CU45,000 dividend). Entity A must also consider whether there are any indicators that its investment is impaired and, if so, conduct an impairment test in accordance with Section 27 *Impairment of Assets*. In this case there would not be any impairment because the fair value (CU425,000) less costs to sell of the investment would exceed its carrying amount (CU375,000).<sup>(3)</sup>

**Ex 18 On 1 March 20X1 entity A acquired 30 per cent of the ordinary shares that carry voting rights at a general meeting of shareholders of entity B for CU300,000.**

**On 31 December 20X1 entity B declared a dividend of CU100,000 for the year 20X1. Entity B reported a profit of CU80,000 for the year ended 31 December 20X1. At 31 December 20X1 the recoverable amount of entity A's investment in entity B is CU290,000 (calculation: fair value CU293,000 less costs to sell CU3,000). There is no published price quotation for entity B.**

Assuming that entity B earned its profit evenly through the year, entity A must recognise income from its associate of CU20,000 in profit or loss (ie  $30\% \times \text{CU}66,667$  profit earned by entity B for the 10-month period ended 31 December 20X1).

At 31 December 20X1 entity A must report its investment in entity B (an associate) at CU290,000 (calculation: CU300,000 cost + CU20,000 share of associate's profit less CU30,000 dividend).

The payment of the dividend out of pre-acquisition profits on 1 March 20X1 could be an impairment indicator that, in accordance with Section 27 *Impairment of Assets*, could trigger an impairment test at 31 December 20X1. In this case there would not be any impairment because the recoverable amount (CU290,000) of the investment equals its carrying amount (CU290,000).

**Ex 19 On 1 January 20X1 entity A acquired 30 per cent of the ordinary shares that carry voting rights at a general meeting of shareholders of entity B for CU300,000.**

**Entity B incurred a loss of CU100,000 for the year ended 31 December 20X1 and it did not declare a dividend. Furthermore, at 31 December 20X1 the recoverable amount of entity A's investment in entity B is CU310,000 (calculation: CU325,000 fair value less CU15,000 estimated costs to sell). There is no published price quotation for entity B.**

Entity A must recognise its share of the losses of its associate of CU30,000 in profit or loss (ie  $30\% \times \text{CU}100,000$  loss incurred by entity B for the year ended 31 December 20X1).

At 31 December 20X1 entity A must report its investment in entity B (an associate) at CU270,000 (calculation: CU300,000 cost less CU30,000 share of associate's loss).

Entity A's investment in entity B is not impaired at 31 December 20X1 (ie the carrying amount (CU270,000) is lower than the recoverable amount (CU310,000)).

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<sup>(3)</sup> Note: Other than to the extent that fair value is relevant to impairment testing in accordance with Section 27 *Impairment of Assets* market price is not used in accounting for investments using the equity method.

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**Ex 20** The facts are the same as in example 19. However, in this example, at 31 December 20X1 the recoverable amount of entity A's investment in entity B is CU265,000 (calculation: CU275,000 fair value less CU10,000 estimated costs to sell).

Entity A must recognise its share of the losses of its associate of CU30,000 (ie  $30\% \times \text{CU}100,000$  loss incurred by entity B for the year ended 31 December 20X1) and an impairment of its investment in associate of CU5,000 (calculation: CU300,000 cost less CU30,000 share of associate's losses = CU270,000 carrying amount before impairment. CU270,000 less CU265,000 recoverable amount = CU5,000 impairment loss) respectively in profit or loss.

At 31 December 20X1 entity A reports its investment in entity B (an associate) at CU265,000 (calculation: CU300,000 cost less CU30,000 share of associate's loss less CU5,000 accumulated impairment loss).

**Ex 21** The facts are the same as in example 15. However, in this example, in 20X1 entity A purchased goods for CU100,000 from entity B. At 31 December 20X1 60 per cent of the goods purchased from entity B were in entity A's inventories (ie they had not been sold by entity A). Entity B sells goods at a 50 per cent mark-up on cost.

Entity A must recognise income from its associate of CU114,000 (ie  $30\% \times \text{CU}400,000$  entity B's profit for the year = CU120,000. CU120,000 less  $30\% \times \text{CU}20,000^{(4), (5)}$  unrealised profit = CU114,000) in profit or loss for the year ended 31 December 20X1.

In this example it is assumed that entity A follows an accounting policy of eliminating the unrealised profits from upstream transactions with its associate against the carrying amount of the associate.<sup>(6)</sup> At 31 December 20X1 entity A would report its investment in entity B (an associate) at CU369,000 (calculation: CU300,000 cost + CU114,000 share of earnings (after adjusting for the elimination of the unrealised profit) less CU45,000 dividend). Entity A must also consider whether there are any indicators that its investment is impaired and, if so, conduct an impairment test in accordance with Section 27 *Impairment of Assets*.

Note: in this example entity A would measure the inventories that it acquired from entity B at CU60,000 (ie  $60\% \text{ unsold} \times \text{CU}100,000$  purchased) because the unrealised profit, to the extent of its interest in entity B, was eliminated from the carrying amount of its investment in entity B.

**Ex 22** On 1 January 20X1 entity A acquired 25 per cent of the ordinary shares that carry voting rights at a general meeting of shareholders of entity B for CU100,000. The purchase price is equal to the fair value of 25 per cent of the fair value of entity B's identifiable assets less 25 per cent of its identifiable liabilities.

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<sup>(4)</sup> In this example the tax effects of eliminating the unrealised profit have been ignored.

<sup>(5)</sup> Calculation:  $60\% \text{ inventories bought from entity B unsold by entity A} \times \text{CU}33,333 \text{ profit recognised by entity B (ie CU}100,000 \text{ revenue less CU}66,667 \text{ cost of goods sold (ie CU}100,000 \text{ selling price} \div (100\% + 50\% \text{ mark-up on cost))}$ .

<sup>(6)</sup> An alternative accounting policy would be to eliminate the unrealised profit in upstream transactions against the asset transferred (in this case the inventories)

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For the year ended 31 December 20X1 entity B recognised a loss of CU600,000. Entity A has no constructive or legal obligation in respect of its associate and has made no payments on its behalf.

Entity B recognised profit for the year ended 31 December 20X2 of CU800,000.

There is no published price quotation for entity B.

20X1

Entity A must recognise CU100,000 loss from its associate in profit or loss for the year ended 31 December 20X1 (ie  $25\% \times \text{CU}600,000$  entity B’s loss for the year = CU150,000. However, the entity limits the loss recognised to its CU100,000 investment in the associate).

At 31 December 20X1 entity A must measure its investment in its associate (entity B) at CU0 (calculation: CU100,000 cost less CU100,000 share of losses).

20X2

Entity A must recognise CU150,000 as its share of associate’s earnings in profit or loss for the year ended 20X2 (ie  $25\% \times \text{CU}800,000$  entity B’s profit for the year = CU200,000 share of associate’s profit. CU200,000 share of associate’s profit less CU50,000 loss not recognised in 20X1).

At 31 December 20X2 entity A must measure its investment in its associate (entity B) at CU150,000 (calculation: CU100,000 cost less CU100,000 share of losses recognised in 20X1 + CU150,000 share of profit recognised in 20X2).

**Ex 23 The facts are the same as in example 15. However, in this example, on 31 December 20X1 entity A lost significant influence over entity B when it reduced its shareholding in entity B to 15 per cent by selling half of its shares in entity B to an independent third party for CU212,500. Transaction costs of CU5,000 were incurred in selling the shares.**

Entity A must recognise in profit or loss for the year ended 31 December 20X1:

- income from its associate of CU120,000 in profit or loss for the year ended 31 December 20X1 (ie  $30\% \times \text{CU}400,000$  entity B’s profit for the year = CU120,000).
- a gain on derecognition of an investment in associate of CU45,000 (calculation: (CU212,500 proceeds from sale of shares less CU5,000 transaction costs + CU212,500 fair value of the retained interest) less CU375,000 carrying amount of investment in entity B when significant influence was lost). To account for this transaction, entity A recognises the following journal entry:

Dr Cash	CU207,500 <sup>(a)</sup>	
Dr Financial instrument—equity investment (shares of entity B)	CU212,500 <sup>(b)</sup>	
Cr Investment in associate (entity B)		CU375,000 <sup>(c)</sup>
Cr Profit or loss		CU45,000

To recognise the gain on derecognition of investment in associate (entity B).

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- (a) CU212,500 proceeds from sale of shares less CU5,000 transaction costs incurred.
- (b) The fair value of the retained interest in entity B.
- (c) The carrying amount of investment in associate derecognised (calculation: CU300,000 cost + CU120,000 share of earnings less CU45,000 dividend).

At 31 December 20X1, in accordance with Section 11 *Basic Financial Instruments*, entity A must classify its investment in entity B as a financial asset and in accordance with paragraph 14.8(i)(ii) measure its investment in entity B at CU212,500 (ie fair value on the date that significant influence was lost). Thereafter, entity A would account for its investment in entity B in accordance with paragraph 11.14(c)).

**Ex 24** The facts are the same as in example 15. However, in this example, on 1 January 20X1 entity A's share of the fair values of the net identifiable assets of entity B is CU280,000 and the fair value of one of entity B's assets (a machine) exceeded its carrying amount (in entity B's statement of financial position) by CU50,000. That machine is depreciated on the straight-line method to a nil residual value over its remaining five-year useful life.

**Entity A estimated the useful life of the implicit goodwill to be five years.**

Entity A must recognise income from its associate of CU113,000 in profit or loss for the year ended 31 December 20X1 (ie  $30\% \times \text{CU}400,000$  entity B's profit for the year less  $\text{CU}4,000^{(a)}$  amortisation of implicit goodwill less  $30\% \times \text{CU}10,000^{(b)}$  depreciation adjustment)).<sup>(7)</sup>

At 31 December 20X1 entity A must report its investment in entity B (an associate) at CU368,000 (calculation: CU300,000 cost + CU113,000 share of earnings less CU45,000 dividend). Entity A must also consider whether there are any indicators that its investment is impaired and, if so, conduct an impairment test in accordance with Section 27 *Impairment of Assets*.

- (a)  $\text{CU}300,000$  cost of acquisition less  $\text{CU}280,000$  share of the fair values of the net identifiable assets =  $\text{CU}20,000$  implicit goodwill.  $\text{CU}20,000$  implicit goodwill  $\div$  5-year useful life =  $\text{CU}4,000$  amortisation expense.
- (b)  $\text{CU}50,000$  'additional' cost of machine  $\div$  5-year useful life =  $\text{CU}10,000$  depreciation.

### Fair value model

14.9 When an investment in an associate is recognised initially, an investor shall measure it at the transaction price. Transaction price excludes transaction costs.

14.10 At each **reporting date**, an investor shall measure its investments in associates at fair value, with changes in fair value recognised in profit or loss, using the fair valuation guidance in paragraphs 11.27–11.32. An investor using the fair value model shall use the cost model for any investment in an associate for which it is impracticable to measure fair value reliably without undue cost or effort.

<sup>(7)</sup> In this example the tax effects of implicit goodwill and fair value adjustments have been ignored.

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## Notes

*Impracticable to measure fair value reliably without undue cost or effort*

It is impracticable to apply a requirement if the entity cannot apply it after making every reasonable effort to do so. 'Impracticable' is a high hurdle. What constitutes undue cost or effort is a matter of judgement.

An investor that has elected the fair value model (see paragraph 14.4(c)) accounts for its investments in associates for which it is impracticable to measure fair value reliably without undue cost or effort using the cost-impairment model. At each reporting date, in accordance with Section 27 *Impairment of Assets* the investor must consider whether there are indicators of impairment for such investments (see paragraphs 27.7–27.9 and 27.29) and, if present, must perform an impairment test (see paragraphs 27.10–27.20). If an investment is found to be impaired (or a prior period impairment is found to have reversed), the investor recognises an impairment loss in profit or loss (see paragraphs 27.6 and 27.30).

*All other investments in associates*

An investor that has elected the fair value model (see paragraph 14.4(c)) accounts for all of its investments in associates for which it is not impracticable to determine fair value reliably without undue cost or effort using the fair value model. These investments are not tested for impairment.

The fair value model is considered to provide more relevant information to lenders than the other methods. An entity choosing to apply the fair value model refers to paragraphs 11.27–11.32 for guidance on the measurement of fair value (see Module 11 *Basic Financial Instruments*).

## Examples – fair value model

The facts in examples 25–31 are the same as in examples 9–14 (cost model) and examples 15–20 (equity method). However, in examples 25–31 investments in associates are accounted for using the fair value model.

**Ex 25** On 1 January 20X1 entity A acquired 30 per cent of the ordinary shares that carry voting rights at a general meeting of shareholders of entity B for CU300,000. For the year ended 31 December 20X1 entity B recognised a profit of CU400,000.

On 30 December 20X1 entity B declared and paid a dividend of CU150,000 for the year 20X1. At 31 December 20X1 the fair value of entity A's investment in entity B is CU425,000. However, there is no published price quotation for entity B.

In determining profit or loss for the year ended 31 December 20X1 entity A must:

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- recognise dividend income of CU45,000 (ie  $30\% \times \text{CU}150,000$  dividend declared by entity B);<sup>(8)</sup> and
- recognise the increase in the fair value of its investment in entity B of CU125,000 (ie CU425,000 fair value at 31 December 20X1 less CU300,000 carrying amount on 1 January 20X1).

At 31 December 20X1 entity A must report its investment in entity B (an associate) at its fair value of CU425,000.

**Ex 26 The facts are the same as in example 25. However, in this example, on 2 January 20X1 entity B also declared a dividend of CU100,000 for the year 20X0 and at 31 December 20X1 the fair value of entity A's investment in entity B is CU400,000.**

In determining profit or loss for the year ended 31 December 20X1 entity A must:

- recognise dividend income of CU75,000 (ie CU30,000 from the first distribution + CU45,000 from the second distribution); and
- recognise the increase in fair value of CU100,000 (ie CU400,000 fair value at 31 December 20X1 less CU300,000 carrying amount on 1 January 20X1).

At 31 December 20X1 entity A must report its investment in entity B (an associate) at its fair value of CU400,000.

**Ex 27 The facts are the same as in example 25. However, in this example there is a published price quotation for entity B.**

In determining profit or loss for the year ended 31 December 20X1 entity A must:

- recognise dividend income of CU45,000 (ie  $30\% \times \text{CU}150,000$  dividend declared by entity B); and
- recognise in the increase in the fair value of its investment in entity B of CU125,000 (ie CU425,000 fair value at 31 December 20X1 less CU300,000 carrying amount on 1 January 20X1).

At 31 December 20X1 entity A must report its investment in entity B (an associate) at its fair value of CU425,000.

**Ex 28 On 1 March 20X1 entity A acquired 30 per cent of the ordinary shares that carry voting rights at a general meeting of shareholders of entity B for CU300,000.**

**On 31 December 20X1 entity B declared a dividend of CU100,000 for the year 20X1. Entity B reported a profit of CU80,000 for the year ended 31 December 20X1. At 31 December 20X1 the recoverable amount of entity A's investment in entity B is CU290,000 (calculation: fair value CU293,000 less costs to sell CU3,000). There is no published price quotation for entity B.**

In determining profit or loss for the year ended 31 December 20X1 entity A must:

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<sup>(8)</sup> In this example, and in all other examples in this module in which an investor accounts for its interests in associates using the fair value model, the investor recognises a dividend from its associate in profit or loss when its right to receive the dividend is established.

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- recognise dividend income of CU30,000 (ie  $30\% \times \text{CU}100,000$  dividend declared by entity B); and
- recognise the decrease in the fair value of its investment in entity B as an expense of CU7,000 in profit or loss (ie CU293,000 fair value at 31 December 20X1 less CU300,000 carrying amount on 1 January 20X1).

At 31 December 20X1 entity A must report its investment in entity B (an associate) at its fair value of CU293,000.

Note: Investments in associates that are carried using the fair value model are not tested for impairment. Accordingly the CU3,000 estimated costs to sell are not deducted in determining the investment's fair value.

**Ex 29 On 1 January 20X1 entity A acquired 30 per cent of the ordinary shares that carry voting rights at a general meeting of shareholders of entity B for CU300,000.**

**Entity B incurred a loss of CU100,000 for the year ended 31 December 20X1 and it did not declare a dividend. Furthermore, at 31 December 20X1 the recoverable amount of entity A's investment in entity B is CU310,000 (calculation: CU325,000 fair value less CU15,000 estimated costs to sell). There is no published price quotation for entity B.**

In determining profit or loss for the year ended 31 December 20X1 entity A must recognise income of CU25,000 for the increase in the fair value of its investment in entity B (ie CU325,000 fair value at 31 December 20X1 less CU300,000 initially recognised on 1 January 20X1).

At 31 December 20X1 entity A must report its investment in entity B (an associate) at its fair value of CU325,000 (note: unlike when determining recoverable amount, costs to sell are not deducted from fair value when using the fair value model).

**Ex 30 The facts are the same as in example 29. However, in this example, at 31 December 20X1 the recoverable amount of entity A's investment in entity B is CU265,000 (calculation: CU275,000 fair value less CU10,000 estimated costs to sell).**

In determining profit or loss for the year ended 31 December 20X1 entity A must recognise an expense of CU25,000 for the decrease in the fair value of its investment in entity B (ie CU275,000 fair value at 31 December 20X1 less CU300,000 initially recognised on 1 January 20X1).

At 31 December 20X1 entity A must report its investment in entity B (an associate) at its fair value of CU275,000.

**Ex 31 The facts are the same as in example 25. However, in this example, it was impracticable to determine the fair value of the investment in entity B without undue cost or effort.**

Entity A must recognise dividend income of CU45,000 (ie  $30\% \times \text{CU}150,000$  dividend declared by entity B) in profit or loss for the year ended 31 December 20X1.

At 31 December 20X1 entity A must report its investment in entity B (an associate) at CU300,000 (ie cost). Entity A must also consider whether there are any indicators that its investment is impaired and, if so, conduct an impairment test in accordance with

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Section 27 *Impairment of Assets*. In this case it is unlikely that the profitable associate would be impaired.

Note: Even though entity A has elected the fair value model as its accounting policy for investments in associates it accounts for its investment in entity B using the cost model because it is impracticable to determine the fair value of its investment in entity B without undue cost and effort.

## Financial statement presentation

14.11 An investor shall classify investments in associates as non-current assets.

### Example – presentation

Ex 32 An entity presenting its current assets separately from its non-current assets could present its investments in associates in its statement of financial position as follows:

SME A statement of financial position at 31 December 20X1

	Note	20X1	20X0
<b>ASSETS</b>		CU	CU
<b>Non-current assets</b>			
Investment in associates	15	80,000	100,000
...			

## Disclosures

14.12 An investor in an associate shall disclose the following:

- (a) its **accounting policy** for investments in associates.
- (b) the **carrying amount** of investments in associates (see paragraph 4.2(j)).
- (c) the fair value of investments in associates accounted for using the equity method for which there are published price quotations.

*[Refer: Section 33 for related party disclosures]*  
*[Refer: paragraph 9.27 for disclosures in separate financial statements, if prepared]*

14.13 For investments in associates accounted for by the cost model, an investor shall disclose the amount of dividends and other distributions recognised as income.

### Example – cost model disclosures

Ex 33 On 1 January 20X0 SME A acquired 25 per cent of the equity of SME B for CU100,000. SME A has significant influence over SME B. SME A uses the cost model to account for its investment in its only associate.

At 31 December 20X1 the recoverable amount of SME A’s investment in SME B is CU80,000. The recoverable amount of the investment was not determined at

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31 December 20X0 because there were no indications that the investment might be impaired.

SME B’s loss for the year ended 31 December 20X1 is CU60,000 (20X0: profit of CU80,000).

On 31 December 20X0 SME B declared and paid a dividend of CU40,000. It did not declare a dividend in 20X1.

SME A could present its investment in SME B in its financial statements as follows:

**SME A statement of financial position at 31 December 20X1**

	<i>Note</i>	<i>20X1</i>	<i>20X0</i>
<b>ASSETS</b>		<i>CU</i>	<i>CU</i>
<b>Non-current assets</b>			
Investments in associates	15	80,000	100,000
...			

**SME A statement of comprehensive income for the year ended 31 December 20X1**

	<i>Note</i>	<i>20X1</i>	<i>20X0</i>
		<i>CU</i>	<i>CU</i>
...			
Other income—dividend from associate		–	10,000
Other expenses—impairment of associate		(20,000)	–
...			

**SME A notes to the financial statements for the year ended 31 December 20X1**

**Note 2 Accounting policies**

*Investments in associates*

Investments in associates are accounted for at cost less any accumulated impairment losses. However, investments for which a published price quotation exists are accounted for at fair value with changes in fair value recognised in profit or loss of the period of the change.

Dividend income from associates is recognised when the shareholder’s right to receive payment have been established and is shown as other income.

**Note 15 Investments in associate**

	<i>20X1</i>	<i>20X0</i>
	<i>CU</i>	<i>CU</i>
Cost less accumulated impairment losses	80,000	100,000

SME A owns 25 per cent of the equity of its associate SME B.

# Module 14 – Investments in Associates

14.14 For investments in associates accounted for by the equity method, an investor shall disclose separately its share of the profit or loss of such associates and its share of any **discontinued operations** of such associates.

### Example – equity method disclosures

Ex 34 The facts are the same as in example 33.

An entity that uses the equity method could present its investments in associates in its financial statements as follows:

#### SME A statement of comprehensive income for the year ended 31 December 20X1

	20X1		20X0
	CU		CU
...			
Other expenses—impairment of investment in associate	(15,000)	(a)	
Share of associate’s profit (loss) for the year	(15,000)	(b)	20,000 (c)
...			

#### SME A statement of financial position at 31 December 20X1

	Note	20X1		20X0
<b>ASSETS</b>		CU		CU
<b>Non-current assets</b>				
Investment in associate	15	80,000 (d)		110,000 (e)
...				

#### SME A notes to the financial statements for the year ended 31 December 20X1

##### Note 2 Accounting policies

###### Investments in associates

Investments in associates are accounted for using the equity method. The carrying amount of the investment in associate is calculated at cost plus the entity’s subsequent share of the associate’s comprehensive income. If at the end of a reporting period there is an indication that an investment in an associate may be impaired, the entire carrying amount of the investment is tested for impairment. If the carrying amount of the investment is found to be less than its recoverable amount, the carrying amount is reduced to its recoverable amount and an impairment loss is immediately recognised in profit or loss.

##### Note 15 Investment in associate

	20X1	20X0
	CU	CU
Cost plus share of associate post-acquisition reserves	80,000	110,000
less accumulated impairment losses		

SME A owns 25 per cent of the equity of its associate SME B.

# Module 14 – Investments in Associates

**The calculations and explanatory notes below do not form part of the disclosures:**

- (a) CU95,000<sup>(g)</sup> carrying amount at 31 December 20X1 before impairment less CU80,000 recoverable amount = CU15,000 impairment.
- (b) 25% × CU60,000 loss for the year = CU15,000 share of associate’s loss for the year ended 31 December 20X1.
- (c) 25% × CU80,000 profit for the year = CU20,000 share of associate’s profit for the year ended 31 December 20X0.
- (d) CU95,000<sup>(g)</sup> carrying amount at 31 December 20X1 before impairment less CU15,000<sup>(a)</sup> accumulated impairment of investment in associate = CU80,000 carrying amount at 31 December 20X1.
- (e) CU100,000 cost + CU20,000<sup>(c)</sup> profit for the year ended 31 December 20X0 less CU10,000<sup>(f)</sup> dividend received from associate = CU110,000 carrying amount at 31 December 20X0.
- (f) 25% × CU40,000 dividend declared and paid by associate = CU10,000 dividend received from associate.
- (g) CU110,000 carrying amount at 31 December 20X0 less CU15,000<sup>(b)</sup> share of associate’s loss for the year ended 31 December 20X1 = CU95,000 carrying amount at 31 December 20X1 before impairment.

14.15 For investments in associates accounted for by the fair value model, an investor shall make the disclosures required by paragraphs 11.41–11.44.

**Example – fair value model disclosures**

Ex 35 **The facts are the same as in example 33. However, in this example, the entity uses the fair value model to account for its investments in associates. The fair value of the investment in SME B at 31 December 20X1 was determined to be CU85,000 (20X0: CU120,000) by multiplying the entity’s earnings by the adjusted price earnings ratio of a similar entity for which a published price quotation exists. The market price earnings ratio was reduced by 2 basis points because SME B’s equity is not traded in a public market.**

SME A could present its investment in SME B in its financial statements as follows:

**SME A statement of financial position at 31 December 20X1**

	<i>Note</i>	<i>20X1</i>	<i>20X0</i>
<b>ASSETS</b>		<i>CU</i>	<i>CU</i>
<b>Non-current assets</b>			
Investment in associate	15	85,000	120,000
...			

**SME A statement of comprehensive income for the year ended 31 December 20X1**

	<i>Note</i>	<i>20X1</i>	<i>20X0</i>
		<i>CU</i>	<i>CU</i>
...			
Other income—dividend from associate		–	10,000
Change in the fair value of investment in associate		(35,000)	20,000
...			

# Module 14 – Investments in Associates

## SME A notes to the financial statements for the year ended 31 December 20X1

### Note 2 Accounting policies

#### *Investments in associates*

Investments in associates are accounted for at fair value with changes in fair value recognised in profit or loss of the period.

Dividend income from associates is recognised when the shareholder’s right to receive payment have been established and is shown as other income.

### Note 15 Investment in associate

	20X1	20X0
	CU	CU
Fair value	85,000	120,000

SME A owns 25 per cent of the equity of its associate SME B.<sup>(9)</sup>

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<sup>(9)</sup> In addition, SME A would also disclose the information required by paragraphs 11.41–11.44.

# Module 14 – Investments in Associates

## SIGNIFICANT ESTIMATES AND OTHER JUDGEMENTS

Applying the requirements of the *IFRS for SMEs* to transactions and events often requires judgement. Information about significant judgements and key sources of estimation uncertainty are useful in assessing the financial position, performance and cash flows of an entity. Consequently, in accordance with paragraph 8.6, an entity must disclose the judgements that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements. Furthermore, in accordance with paragraph 8.7, an entity must disclose information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Other sections of the *IFRS for SMEs* require disclosure of information about particular judgements and estimation uncertainties. Some of the most significant judgements that may be required in classifying and accounting for investments in associates are set out below.

### Classification

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In evaluating whether an entity has significant influence over another entity it must first be ascertained whether the first entity has the power to participate in the financial and operating policy decisions of the second entity. If the first entity does have that power, then the entity must establish that its power constitutes neither control nor joint control over those policies, before concluding that the second entity is an associate of the first entity.

In this context, power refers to the ability to do or affect something. Consequently, an entity has significant influence when it currently has the ability to exercise that power, regardless of whether significant influence is actively demonstrated or is passive in nature. In cases where significant influence is not actively demonstrated, judgement may be required to assess whether it actually exists.

The presumptions provided in paragraph 14.3(a) and (b) are useful to clarify whether an entity should be considered to have significant influence over another. When, after considering all the facts and circumstances, it is unclear if significant influence exists the entity would be unable to demonstrate the presumption is incorrect. However, the guidance in 14.3 does not eliminate the need for judgement to be applied.

The existence of significant influence by an investor is usually evidenced in one or more of the following ways (note, this is not an exhaustive list):

- (a) representation on the board of directors or equivalent governing body of the investee;
- (b) participation in policy-making processes, including participation in decisions about dividends or other distributions;
- (c) material transactions between the investor and the investee;
- (d) interchange of managerial personnel; or
- (e) provision of essential technical information.

Judgement must be exercised in determining whether significant influence exists. The substance of the relationship in each case will need to be considered. If it can be clearly

## Module 14 – Investments in Associates

demonstrated that an investor holding 20 per cent or more of the voting power of the investee does not exercise significant influence, the investment will not be accounted for as an associate—this is likely to be the case where the court has appointed an independent administrator to wind down the investee’s business. Conversely, if it can be clearly demonstrated that an investor holding less than 20 per cent of the voting power of the investee exercises significant influence, the investment will be accounted for as an associate.

Where another investor has a controlling interest in an entity in which the reporting investor has an equity interest of say 20 per cent, the substance of the 20 per cent investor’s influence should be examined carefully to determine whether it is significant influence or more in the nature of a passive investment.

An investor may own share warrants, share call options, debt or equity instruments that are convertible into ordinary shares, or other similar instruments that have the potential, if exercised or converted, to give the investor additional voting power or to reduce another party’s voting power over the financial and operating policies of another entity. These are known as potential voting rights. The *IFRS for SMEs* does not specify how to take account of potential voting rights in assessing significant influence. In these circumstances an entity may (but is not required to) look to the requirements of full IFRSs (see paragraph 10.6).

Paragraph 8 of IAS 28 *Investments in Associates* of full IFRSs specifies that the existence and effect of potential voting rights that are currently exercisable or convertible, including potential voting rights held by other entities, are considered when assessing whether an entity has significant influence. Potential voting rights are not currently exercisable or convertible when, for example, they cannot be exercised or converted until a future date or until the occurrence of a future event. In assessing whether potential voting rights contribute to significant influence, the entity examines all facts and circumstances (including the terms of exercise of the potential voting rights and any other contractual arrangements whether considered individually or in combination) that affect potential rights, except the intention of management and the financial ability to exercise or convert (see paragraph 9 of IAS 28).

An entity may initially conclude that it has significant influence over another entity after considering the potential voting rights that it can currently exercise or convert. However, the entity may not have significant influence over the other entity when potential voting rights held by other parties are also currently exercisable or convertible. Consequently, an entity considers all potential voting rights held by it and by other parties that are currently exercisable or convertible when determining whether it has significant influence over another entity.

### Measurement

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After initial recognition an entity must measure all investments in associates using the cost model, the equity method or the fair value model.

#### *Cost model and equity method*

When the cost model or the equity method is used, significant judgements relating to accounting for any impairment of investments in associates include:

- assessing whether there is any indication that an investment in an associate may be impaired (see paragraph 27.7); and
- if there is any indication that the investment in an associate may be impaired—estimating the recoverable amount of that investment (see paragraph 27.11).

# Module 14 – Investments in Associates

## *Equity method*

When the equity method is used, significant judgements might be necessary to estimate the fair value of the associate's identifiable assets and identifiable liabilities at the date of attaining significant influence.

Many judgements are necessary to apply the equity method. For example:

- If the fair value of the associate's identifiable assets and identifiable liabilities were different from their carrying amounts (as recorded by the associate) at the date of attaining significant influence—judgements must be made about the extent of the valuation adjustments and the timing of the realisation in profit or loss (see paragraph 14.8(c)).
- If on acquisition there is a difference (positive or negative) between the cost of acquisition and the investor's share of the fair values of the net identifiable assets of associate (eg implicit goodwill)—judgements must be made about the timing of the realisation of the difference in profit or loss (see paragraph 14.8(c)).
- If upstream transactions (associate to investor) have taken place between the entity and its associate—judgements about the pricing of assets purchased from the associate and the timing of the sale of the assets by the investor are necessary to eliminate the unrealised profit to the extent of the investor's interest (see paragraph 14.8(e)).
- If downstream transactions (investor to associate) have taken place between the entity and its associate—judgements about the timing of the sale of assets by the associate are necessary to eliminate the unrealised profit to the extent of the investor's interest (see paragraph 14.8(e)).
- If the entity and its associate have different reporting dates (ie different accounting period ends) and it is impracticable for the associate to prepare financial statements with the same reporting period as the investor—judgements must be made about the effects of any significant transactions or events occurring between the accounting period ends (see paragraph 14.8(f)).
- If the entity and its associate use different accounting policies—judgements must be made about the effects of applying the different accounting policies (see paragraph 14.8(g)).

## *Fair value model*

When the fair value model is adopted for measurement subsequent to initial recognition, significant judgements might be necessary in:

- assessing whether the fair value of an investment in a particular associate can be measured with sufficient reliability without undue cost or effort for the fair value model to be applied to particular associates (see the notes below paragraph 14.10 and also paragraphs 11.27–11.32); and
- deciding which valuation model to use and determining the inputs for that model in the case when the associate's shares are not quoted in an active market (for application guidance on fair value measurement see paragraphs 11.27–11.32).

# Module 14 – Investments in Associates

## COMPARISON WITH FULL IFRSs

A high level overview of differences between the requirements as issued at 9 July 2009 for accounting and reporting investments in associates in accordance with full IFRSs (see IAS 28 *Investments in Associates*) and the *IFRS for SMEs* (see Section 14 *Investments in Associates*) includes:

- *IFRS for SMEs* is drafted in plain language and includes significantly less guidance on how to apply the principles.
- The *IFRS for SMEs* permits an entity to account for investment in associates in its primary financial statements using three different models—the equity method, the cost model and the fair value model. The chosen model is applied to all investments in associates. Full IFRSs require investments in associates to be accounted for using the equity method in an investor’s primary financial statements.
- Under the equity method, the *IFRS for SMEs* requires that implicit goodwill be systematically amortisation throughout its expected useful life (see paragraph 14.8(c)). Full IFRSs does not allow the amortisation of goodwill (see IAS 28, paragraph 23(a)).

# Module 14 – Investments in Associates

## TEST YOUR KNOWLEDGE

Test your knowledge of the requirements for accounting and reporting investments in associates in accordance with the *IFRS for SMEs* by answering the questions below.

Once you have completed the test check your answers against those set out below this test.

Assume all amounts are material.

**Mark the box next to the most correct statement.**

### Question 1

An associate is:

- (a) an entity over which the investor has significant influence.
- (b) an entity over which the investor has joint control.
- (c) an entity over which the investor has significant influence or joint control and that is not a subsidiary.
- (d) an entity over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture.

### Question 2

Significant influence is:

- (a) the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.
- (b) active participation in the financial and operating policy decisions of the investee but is not control or joint control over those policies.
- (c) the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.
- (d) the contractually agreed sharing of control over an economic activity.

### Question 3

An entity must account for its investments in associates after initial recognition using:

- (a) either the cost model or the fair value model (using the same accounting policy for all investments in associates).
- (b) either the cost model or the fair value model (model can be elected on an investment-by-investment basis).
- (c) either the cost model, the equity method or the fair value model (using the same accounting policy for all investments in associates).
- (d) either the cost model, the equity method or the fair value model (model can be elected on an investment-by-investment basis).

## Module 14 – Investments in Associates

### Question 4

Investments in associates must be tested for impairment in accordance with Section 27 *Impairment of Assets*, if the entity uses:

- (a) the cost model, equity method or fair value model.
- (b) the cost model or the equity method.
- (c) the cost model or the fair value model.
- (d) the equity method or the fair value model.

### Question 5

Entity A owns 30 per cent of the ordinary shares that carry voting rights at a general meeting of shareholders of entity C.

In the absence of evidence to the contrary, entity A:

- (a) has significant influence over entity C.
- (b) has significant influence over entity C, provided that it does not have joint control over entity C.
- (c) has significant influence over entity C, provided that it does not have control over entity C.
- (d) has significant influence over entity C, provided that it does not have control or joint control over entity C.

### Question 6

Which, if any, of the scenarios below would not lead to the presumption that an entity exerts significant influence over another entity?

- (a) holding directly 20 per cent or more of the voting power of the investee.
- (b) holding indirectly, through a subsidiary, 20 per cent or more of the voting power of the investee.
- (c) holding indirectly, through a joint venture, 20 per cent or more of the voting power of the investee.
- (d) holding directly 10 per cent of voting power of the investee and holding indirectly, through a subsidiary, 10 per cent of the voting power of the investee.

## Module 14 – Investments in Associates

### Question 7

On 31 December 20X1 entity A acquired 30 per cent of the ordinary shares that carry voting rights of entity B for CU100,000. Entity A incurred transaction costs of CU1,000 in acquiring these shares.

Entity A has significant influence over entity B. Entity A uses the cost model to account for its investments in associates.

In January 20X2 entity B declared and paid a dividend of CU20,000 out of profits earned in 20X1. No further dividends were paid in 20X2, 20X3 or 20X4.

A published price quotation does not exist for entity B. At 31 December 20X1, 20X2 and 20X3, in accordance with Section 27 *Impairment of Assets*, management assessed the fair values of its investment in entity B as CU102,000, CU110,000 and CU90,000 respectively. Costs to sell are estimated at CU4,000 throughout.

Entity A measures its investment in entity B on 31 December 20X1, 20X2 and 20X3 respectively at:

- (a) CU100,000, CU100,000, CU100,000.
- (b) CU95,000, CU95,000, CU86,000.
- (c) CU98,000, CU106,000, CU86,000.
- (d) CU98,000, CU101,000, CU86,000.
- (e) CU102,000, CU110,000, CU90,000.
- (f) CU101,000, CU101,000, CU101,000.

### Question 8

The facts are the same as in Question 7. However, in this example, a published price quotation exists for entity B.

Entity A measures its investment in entity B on 31 December 20X1, 20X2 and 20X3 respectively at:

- (a) CU100,000, CU100,000, CU100,000.
- (b) CU95,000, CU95,000, CU86,000.
- (c) CU98,000, CU106,000, CU86,000.
- (d) CU98,000, CU101,000, CU86,000.
- (e) CU102,000, CU110,000, CU90,000.
- (f) CU101,000, CU101,000, CU101,000.

## Module 14 – Investments in Associates

### Question 9

Which of the following indicators could provide evidence to support the existence of significant influence by an investor?

- (a) representation on the board of directors or equivalent governing body of the investee.
- (b) participation in policy-making processes, including participation in decisions about dividends or other distributions.
- (c) material transactions between the investor and the investee.
- (d) interchange of managerial personnel.
- (e) provision of essential technical information.
- (f) (a) and (b) above.
- (g) all of the above.

### Question 10

Which of the following statements is false?

- (a) Significant influence can be gained or lost without a change in absolute or relative ownership levels.
- (b) In determining whether an entity has significant influence over another entity, the existence and effect of potential voting rights that it holds that are currently exercisable or convertible are considered.
- (c) An entity considers the existence and effect of potential voting rights held by other parties that are currently exercisable or convertible when determining whether it has significant influence over another entity.
- (d) In determining whether an entity has significant influence over another entity, only present ownership interests are considered. The possible exercise or conversion of potential voting rights are not considered.

# Module 14 – Investments in Associates

## Answers

- Q1 (d) see paragraph 14.2
- Q2 (a) see paragraph 14.3
- Q3 (c) see paragraph 14.4
- Q4 (b) see paragraphs 14.5 and 14.8(d)
- Q5 (d) see paragraph 14.3
- Q6 (c) see paragraph 14.3
- Q7 (d)

20X1: CU98,000 because recoverable amount—fair value less costs to sell—(CU98,000) is less than cost (CU101,000).

20X2: CU101,000 because cost is more than recoverable amount.

20X3: CU86,000 because recoverable amount (CU86,000) is less than cost (CU101,000).

Year	Carrying amount at the beginning of the year	Recoverable amount at the end of the year (fair value less transaction cost)	Impairment recognised during the year – (impairment) reversal	Carrying amount at the year-end
20X1	CU101,000	CU98,000 (ie CU102,000 less CU4,000)	(CU3,000)	CU98,000
20X2	CU98,000	CU106,000 (ie CU110,000 less CU4,000)	CU3,000	CU101,000
20X3	CU101,000	CU86,000 (ie CU90,000 less CU4,000)	(CU15,000)	CU86,000

- Q8 (e) see paragraph 14.7

Year	Carrying amount (fair value) at the beginning of the year	Fair value adjustment – positive (negative)	Carrying amount (fair value) at the year-end
20X1	CU101,000	CU1,000 = CU102,000 less CU101,000	CU102,000
20X2	CU102,000	CU8,000 = CU110,000 less CU102,000	CU110,000
20X3	CU110,000	(CU20,000) = CU90,000 less CU110,000	CU90,000

- Q9 (g) see paragraph 14.3
- Q10 (d) see paragraphs 14.3 and 14.8(b)

# Module 14 – Investments in Associates

## APPLY YOUR KNOWLEDGE

Apply your knowledge of the requirements for accounting and reporting investments in associates in accordance with the *IFRS for SMEs* by solving the case studies below.

Once you have completed the case studies check your answers against those set out below this test.

### Case study 1

---

On 1 January 20X1 SME A acquired 25 per cent of the equity of each of entities B, C and D for CU10,000, CU15,000 and CU28,000 respectively. SME A has significant influence over entities B, C and D. Transaction costs of 1 per cent of the purchase price of the shares were incurred by SME A.

On 2 January 20X1 entity B declared and paid dividends of CU1,000 for the year ended 20X0. On 31 December 20X1 entity C declared a dividend of CU8,000 for the year ended 20X1. The dividend declared by entity C was paid in 20X2.

For the year ended 31 December 20X1, entities B and C recognised profit of respectively CU5,000 and CU18,000. However, entity D recognised a loss of CU20,000 for that year.

Published price quotations do not exist for the shares of entities B, C and D. Using appropriate valuation techniques SME A determined the fair value of its investments in entities B, C and D at 31 December 20X1 as CU13,000, CU29,000 and CU15,000 respectively. Costs to sell are estimated at 5 per cent of the fair value of the investments.

SME A has no subsidiaries and therefore does not produce consolidated financial statements.

#### Part A:

Assume SME A measures its investments in associates using the cost model.

**Prepare accounting entries to record the investments in associates in the accounting records of SME A for the year ended 31 December 20X1.**

#### Part B:

Assume instead that SME A measures all its investments in associates using the equity method.

Assume that there is neither implicit goodwill nor fair value adjustments.

**Prepare accounting entries to record the investments in associates in the accounting records of SME A for the year ended 31 December 20X1.**

#### Part C:

Assume instead that SME A measures all its investments in associates after initial recognition using the fair value model.

**Prepare accounting entries to record the investments in associates in the accounting records of SME A for the year ended 31 December 20X1.**

# Module 14 – Investments in Associates

## Answer to case study 1 – Part A

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### 1 January 20X1

Dr	Investment in associate (entity B)	CU10,000	
Dr	Investment in associate (entity C)	CU15,000	
Dr	Investment in associate (entity D)	CU28,000	
	Cr Cash		CU53,000

*To recognise the acquisition of investments in associates.*

Dr	Investment in associate (entity B)	CU100	
Dr	Investment in associate (entity C)	CU150	
Dr	Investment in associate (entity D)	CU280	
	Cr Cash		CU530

*To recognise the transaction costs incurred to acquire the investments in associates.*

### 2 January 20X1

Dr	Cash	CU250	
	Cr Profit or loss (other income, dividend received)		CU250

*To recognise dividends received from entity B (ie 25% × CU1,000 dividend paid by entity B).*

### 31 December 20X1

Dr	Receivable (entity C)	CU2,000	
	Cr Profit or loss (other income, dividend received)		CU2,000

*To recognise the dividend receivable from entity C (ie 25% × CU8,000 dividend paid by entity C).*

Dr	Profit or loss (impairment loss)	CU14,030 <sup>(a)</sup>	
	Cr Investment in associate (entity D)		CU14,030

*To recognise the impairment of the investment in entity D.*

The calculations and explanatory notes below do not form part of the answer to this case study:

(a) CU28,280 cost less CU14,250<sup>(b)</sup> = CU14,030 impairment loss.

(b) CU15,000 fair value at 31 December 20X1 less estimated costs to sell of CU750 (5% × CU15,000) = CU14,250 fair value less costs to sell of SME A's investment in entity D at 31 December 20X1.

# Module 14 – Investments in Associates

## Answer to case study 1 – Part B

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### 1 January 20X1

Dr	Investment in associate (entity B)	CU10,000	
Dr	Investment in associate (entity C)	CU15,000	
Dr	Investment in associate (entity D)	CU28,000	
	Cr Cash		CU53,000

*To recognise the acquisition of investments in associates.*

Dr	Investment in associate (entity B)	CU100	
Dr	Investment in associate (entity C)	CU150	
Dr	Investment in associate (entity D)	CU280	
	Cr Cash		CU530

*To recognise the transaction costs incurred to acquire the investments in associates.*

### 2 January 20X1

Dr	Cash	CU250	
	Cr Investment in associate (entity B)		CU250

*To recognise dividends received from entity B (ie 25% × CU1,000 dividend paid by entity B).*

### 31 December 20X1

Dr	Receivable (entity C)	CU2,000	
	Cr Investment in associate (entity C)		CU2,000

*To recognise the dividend receivable from entity C (ie 25% × CU8,000 dividend paid by entity C).*

Dr	Investment in associate (entity B)	CU1,250 <sup>(a)</sup>	
	Cr Profit or loss (share of associate's earnings)		CU1,250

*To recognise the share of entity B's (an associate) profit for the year.*

Dr	Investment in associate (entity C)	CU4,500 <sup>(b)</sup>	
	Cr Profit or loss (share of associate's earnings)		CU4,500

*To recognise the share of entity C's (an associate) profit for the year.*

Dr	Profit or loss (share of associate's earnings)	CU5,000 <sup>(c)</sup>	
	Cr Investment in associate (entity D)		CU5,000

*To recognise the share of entity D's (an associate) loss for the year.*

Dr	Profit or loss (impairment loss)	CU9,030 <sup>(d)</sup>	
	Cr Investment in associate (entity D)		CU9,030

*To recognise the impairment of the investment in entity D.*

## Module 14 – Investments in Associates

The calculations and explanatory notes below do not form part of the answer to this case study:

- (a)  $25\% \times \text{CU}5,000$  profit for the year (entity B) = CU1,250 SME A's share of entity B's profit for the year.
- (b)  $25\% \times \text{CU}18,000$  profit for the year (entity C) = CU4,500 SME A's share of entity C's profit for the year.
- (c)  $25\% \times \text{CU}20,000$  loss for the year (entity D) = CU5,000 SME A's share of entity D's loss for the year.
- (d)  $\text{CU}28,280$  cost less  $\text{CU}5,000^{(c)}$  SME A's share of entity D's loss for the year less  $\text{CU}14,250^{(e)}$  = CU9,030 impairment loss.
- (e)  $\text{CU}15,000$  fair value at 31 December 20X1 less estimated costs to sell of CU750 ( $5\% \times \text{CU}15,000$ ) = CU14,250 fair value less costs to sell of SME A's investment in entity D at 31 December 20X1.

# Module 14 – Investments in Associates

## Answer to case study 1 – Part C

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### 1 January 20X1

Dr	Investment in associate (entity B)	CU10,000	
Dr	Investment in associate (entity C)	CU15,000	
Dr	Investment in associate (entity D)	CU28,000	
	Cr Cash		CU53,000

*To recognise the acquisition of investments in associates.*

Dr	Profit or loss	CU530 <sup>(a)</sup>	
	Cr Cash		CU530

*To recognise the transaction costs incurred to acquire the investments in associates.*

### 2 January 20X1

Dr	Cash	CU250	
	Cr Profit or loss		CU250

*To recognise dividends received from entity B (ie 25% × CU1,000 dividend paid by entity B).*

### 31 December 20X1

Dr	Receivable (entity C)	CU2,000	
	Cr Profit or loss		CU2,000

*To recognise the dividend receivable from entity C (ie 25% × CU8,000 dividend paid by entity C).*

Dr	Profit or loss	CU13,000 <sup>(b)</sup>	
	Cr Investment in associate (entity D)		CU13,000

*To recognise the decrease in fair value of investment in entity D, an associate, in the year.*

Dr	Investment in associate (entity B)	CU3,000 <sup>(c)</sup>	
Dr	Investment in associate (entity C)	CU14,000 <sup>(d)</sup>	
	Cr Profit or loss		CU17,000

*To recognise increase in fair value of investments in associates (entities B and C), in the year.*

The calculations and explanatory notes below do not form part of the answer to this case study:

- (a) 1% (CU10,000 entity B + CU15,000 entity C + CU28,000 entity D) = CU530 transaction costs.
- (b) CU28,000 cost less CU15,000 fair value at 31 December 20X1 = CU13,000 decrease in the fair value of the investment in entity D for the year ended 31 December 20X1.
- (c) CU13,000 fair value at 31 December 20X1 less CU10,000 cost = CU3,000 increase in the fair value of the investment in entity B for the year ended 31 December 20X1.
- (d) CU29,000 fair value at 31 December 20X1 less CU15,000 cost = CU14,000 increase in the fair value of the investment in entity C for the year ended 31 December 20X1.

# Module 14 – Investments in Associates

## Case study 2

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On 1 January 20X1 SME E acquired 10 per cent of the equity of entity G for CU10,000.

On 2 January 20X1 entity F (a wholly-owned subsidiary of SME E) acquired 25 per cent of the equity of entity G for CU25,000.

SME E controls entity F and from 2 January 20X1 SME E has significant influence over entity G.

For the year ended 31 December 20X1 entity G recognised profit of CU12,000.

On 31 December 20X1 entity G declared (and paid) a dividend of CU4,000.

At 31 December 20X1 the fair value of SME E's and entity F's direct investments in entity G are respectively CU11,000 and CU27,500. The fair value of SME E group's investment in entity G is determined to be the sum of the fair value of the two direct holdings (ie CU38,500). Costs to sell are estimated at 5 per cent of the fair value of the investment.

SME E group measures investments in all associates in the consolidated financial statements subsequent to initial recognition using the cost model.

### Part A:

Assume that a published price quotation does not exist for entity G.

**Prepare accounting entries to record the investment in associates in the consolidated accounting records of the SME E group for the year ended 31 December 20X1.**

### Part B:

Assume that a published price quotation exists for entity G.

**Prepare accounting entries to record the investment in associates in the consolidated accounting records of SME E group for the year ended 31 December 20X1.**

# Module 14 – Investments in Associates

## Answer to case study 2 – Part A

### 1 January 20X1

Dr	Financial asset (investment in entity G shares)	CU10,000	
	Cr Cash		CU10,000
<i>To recognise the acquisition of entity G shares.</i>			

### 2 January 20X1

Dr	Investment in associate (entity G)	CU25,000	
	Cr Cash		CU25,000
<i>To recognise the further acquisition of an investment in entity G (now an associate) through entity F.</i>			

Dr	Investment in associate (entity G)	CU10,000	
	Cr Financial asset (investment in entity G shares)		CU10,000
<i>To recognise the reclassification of entity G shares acquired on 1 January 20X1 as an investments in associate.</i>			

### 31 December 20X1

Dr	Cash	CU1,400 <sup>(a)</sup>	
	Cr Profit or loss (other income—dividend from associate)		CU1,400
<i>To recognise the dividend from an associate (entity G).</i>			

The calculations and explanatory notes below do not form part of the answer to this case study:

- (a)  $CU400^{(b)} + CU1,000^{(c)} = CU1,400$ .
- (b)  $10\% \times CU4,000$  dividend declared = CU400 dividend received by SME E directly.
- (c)  $25\% \times CU4,000$  dividend declared = CU1,000 dividend received by SME E group via entity F.

Note: At 31 December 20X1 SME E group must report its investment in entity G (an associate) at its cost of CU35,000 (ie CU25,000 + CU10,000).

# Module 14 – Investments in Associates

## Answer to case study 2 – Part B

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### 1 January 20X1

Dr	Financial asset (investment in entity G shares)	CU10,000	
	Cr Cash		CU10,000

*To recognise the acquisition of entity G shares.*

### 2 January 20X1

Dr	Investment in associate (entity G)	CU25,000	
	Cr Cash		CU25,000

*To recognise the further acquisition of an investment in entity G (now an associate) through entity F.*

Dr	Investment in associate (entity G)	CU10,000 <sup>(a)</sup>	
	Cr Financial asset (investment in entity G shares)		CU10,000

*To recognise the reclassification of entity G shares acquired on 1 January 20X1 as an investments in associate.*

### 31 December 20X1

Dr	Cash	CU1,400 <sup>(b)</sup>	
	Cr Profit or loss		CU1,400

*To recognise the dividend from entity G, an associate.*

Dr	Investment in associate (entity G)	CU3,500 <sup>(e)</sup>	
	Cr Profit or loss		CU3,500

*To recognise the increase in the fair value of the SME E group's investments in entity G, an associate.*

The calculations and explanatory notes below do not form part of the answer to this case study:

(a) Assuming there is no change in fair value from 1 January to 2 January 20X1.

(b)  $CU400^{(c)} + CU1,000^{(d)} = CU1,400$ .

(c)  $10\% \times CU4,000$  dividend declared = CU400 dividend received by SME E directly.

(d)  $25\% \times CU4,000$  dividend declared = CU1,000 dividend received by SME E group via entity F.

(e)  $CU38,500$  fair value at 31 December 20X1 less  $CU35,000^{(f)}$  carrying amount before remeasuring to fair value = CU3,500.

(f)  $CU10,000$  cost of SME E's direct investment in entity G +  $CU25,000$  cost of SME E's indirect investment in entity G via entity F =  $CU35,000$  carrying amount of the SME E group's investment in entity G at the beginning of 20X1.

Note: At 31 December 20X1 SME E group must report its investment in entity G (an associate) at its fair value of CU38,500.