



FRR 2H Interests in Associates and Joint Arrangements

INTRODUCTION

Policy items, indicated by **shaded bold print**, form the Minimum Reporting Requirements (MRRs).

Pursuant to sections 38(2) and 39(2) of the *Financial and Performance Management Standard 2019* (FPMS), departments and statutory bodies must prepare their financial statements in accordance with the MRRs. All of the MRRs are mandatory for departments. Statutory bodies comply with the FPMS by applying the parts of the MRRs that are considered relevant to their circumstances.

Application Guidance, indicated by plain text under the “Application Guidance” sub-headings, provides support on interpreting and applying the mandatory policy items and other matters.

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2H.1 EQUITY METHOD OF ACCOUNTING

REFERENCES

- AASB 128 *Investments in Associates and Joint Ventures*
- AASB 11 *Joint Arrangements*

POLICY

- Agencies are not to rely on paragraphs 17 – Aus17.1 of AASB 128 to avoid using the equity method when accounting for material interests in associates and joint ventures, regardless of whether consolidated financial statements are prepared by the parent entity. As such, it is mandated that these exemptions not be applied.

APPLICATION GUIDANCE

Interests in Associates

Agencies should refer to the definition and explanations of ‘associate’ and ‘significant influence’ in paragraphs 3 and 5 – 9 of AASB 128. Professional judgement is required to determine whether, all circumstances considered, significant influence over another entity exists.

Interests in Joint Arrangements – Distinguishing Between Joint Operations and Joint Ventures

For the purposes of AASB 11, ‘control’ is determined as per AASB 10. Therefore, both AASB 10 and AASB 11 need to be referred to, in making a determination about whether a joint arrangement exists. Relevant paragraphs in AASB 11 regarding joint control are paragraphs 7 – 13 and B5 – B11. Where two or more agencies have joint control (as defined by AASB 11) of an arrangement, it is a ‘joint arrangement’ that falls within the scope of AASB 11.

There are two types of joint arrangements under AASB 11, according to the rights and obligations of the parties, being ‘joint operations’ and ‘joint ventures’. Agencies should refer to the definitions contained in AASB 11. All joint arrangements require a contractual arrangement that binds the parties and establishes joint control by two or more of those parties. The contractual arrangement may be evidenced in a number of ways (e.g. by a contract or minutes of discussions between the parties, or in the articles or other by-laws of the joint arrangement). Paragraphs B2 – B5 of AASB 11 provide further guidance on this subject.

Equity Accounting only applies to Joint Ventures

The applicable accounting treatment differs according to the type of joint arrangement. The equity method of accounting only applies to 'joint ventures'. Separate measurement rules (refer to paragraphs 20-23 of AASB 11) apply for 'joint operations'. Agencies should refer to the guidance in AASB 11 in paragraphs 14 – 19 and B12 – B33 in classifying joint arrangements.

Overview of Equity Method of Accounting

The equity method is based on the investor's ownership interest in an associate or joint venture. Ownership interest is the percentage of equity held in an associate or joint venture, directly or indirectly, by the investor. Equity accounting involves the following:

- the investment in an associate/joint venture is initially recognised at cost;
- following initial recognition, the carrying amount of the investment is increased or decreased to recognise the agency's share of the associate/joint venture's operating result, with a corresponding amount recognised in the agency's operating result;
- if an agency's share of an associate/joint venture's losses equals or exceeds its ownership interest, the agency must discontinue recognising its share of further losses. After the agency's investment is reduced to zero, additional losses are to be recognised as a liability of the agency, but only to the extent that the agency has incurred legal or constructive obligations or made payments on behalf of the associate/joint venture. If the associate/joint venture subsequently reports profits, the agency resumes recognising its share of those profits only after its share of the profits equals the share of losses not previously recognised;
- distributions received from the associate/joint venture are offset against the carrying amount of the investment;
- adjustments to the carrying amount may also be necessary for changes in the agency's proportionate ownership interest in the associate/joint venture due to changes in the associate/joint venture's equity that were not recognised in the associate/joint venture's operating result (e.g. changes arising from the revaluation of property, plant and equipment). The agency's share of those changes is to be recognised directly in equity;
- profits or losses resulting from transactions between an agency and an associate/joint venture are to be recognised in the agency's financial statements only to the extent of the unrelated agency's interests in the associate/joint venture. The agency's share in the associate/joint venture's profits or losses resulting from these transactions is to be eliminated;

- an agency's investment in an associate/joint venture is to be assessed annually to determine if it is impaired as per AASB 136 *Impairment of Assets*. Refer to paragraphs 40 to 43 of AASB 128.
- If the recoverable amount of the agency's investment is less than the carrying amount, then the agency is to recognise an impairment loss. Recoverable amount can be calculated using either:
 - a *discounted cash flow model* based on the cash flows the associate/joint venture is expected to generate from its operations, and the proceeds from disposing of the investment; or
 - a *dividend discount model* based on the distributions expected to be received from the associate/joint venture.

Example

An agency has a \$100 initial investment in an associate. At year-end, the agency's share of the profits of the associate is \$60 and it receives a dividend on 29 June of \$20. The following journal entries will apply to each transaction (ignoring the impact of tax or tax equivalents):

DR Investment in associate	100	
CR Cash at bank		100
<i>(to record initial investment)</i>		
DR Investment in associate	60	
CR Profit from associate - revenue		60
<i>(to record share of profits in associate)</i>		
DR Cash at bank	20	
CR Investment in associate		20
<i>(to record dividend from associate & reduction in carrying amount of investment)</i>		