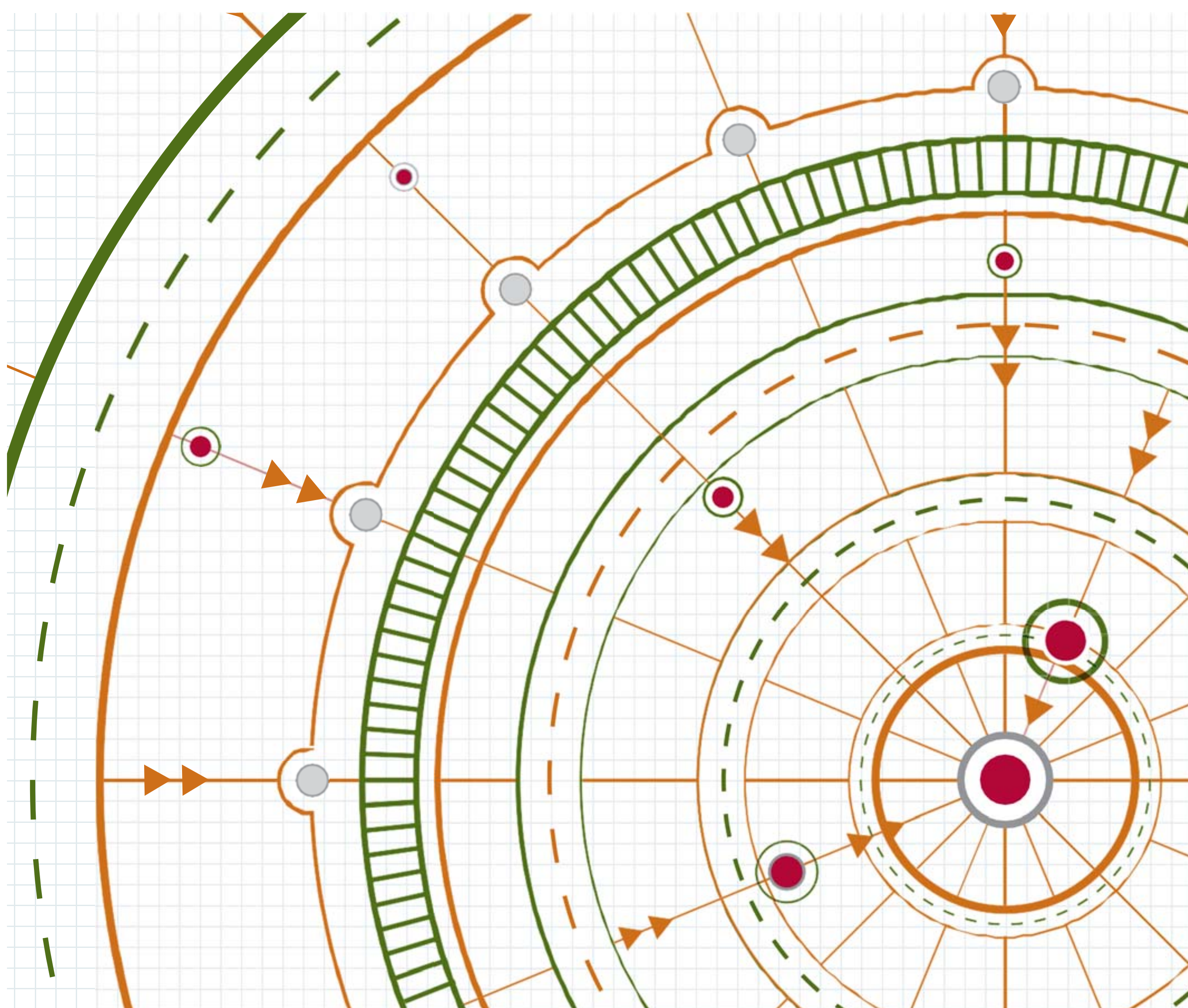
*IFRS for SMEs*® Standard (2015) + Q&As

IFRS® Foundation—Supporting Material for the *IFRS for SMEs* Standard

# Module 14—Investments in Associates



IFRS®

# IFRS® Foundation Supporting Material for the *IFRS for SMEs*® Standard

including the full text of
Section 14 *Investments in Associates*
of the *IFRS for SMEs* Standard
issued by the International Accounting Standards Board in October 2015

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

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# Module 14—Investments in Associates

The accounting requirements applicable to small and medium-sized entities (SMEs) discussed in this module are set out in the *IFRS for SMEs* Standard, issued by the International Accounting Standards Board (Board) in October 2015.
This module has been prepared by IFRS Foundation education staff.
The contents of Section 14 *Investments in Associates* of the *IFRS for SMEs* Standard are set out in this module and shaded grey. The Glossary of terms of the *IFRS for SMEs* Standard (Glossary) is also part of the requirements. Terms defined in the Glossary are reproduced in **bold type** the first time they appear in the text of Section 14. The notes and examples inserted by the education staff are not shaded. These notes and examples do not form part of the *IFRS for SMEs* Standard and have not been approved by the Board.

## INTRODUCTION

### Which version of the *IFRS for SMEs*® Standard?

When the *IFRS for SMEs* Standard was first issued in July 2009, the Board said it would undertake an initial comprehensive review of the Standard to assess entities' experience of the first two years of its application and to consider the need for any amendments. To this end, in June 2012, the Board issued a Request for Information: *Comprehensive Review of the IFRS for SMEs*. An Exposure Draft proposing amendments to the *IFRS for SMEs* Standard was subsequently published in 2013, and in May 2015 the Board issued *2015 Amendments to the International Financial Reporting Standards for Small and Medium-sized Entities (IFRS for SMEs* Standard*)*.

The document published in May 2015 only included amended text, but in October 2015, the Board issued a fully revised edition of the Standard, which incorporated additional minor editorial amendments as well as the substantive May 2015 revisions. This module is based on that version.

The *IFRS for SMEs* Standard issued in October 2015 is effective for annual periods beginning on or after 1 January 2017. Earlier application was permitted, but an entity that did so was required to disclose the fact.

Any reference in this module to the *IFRS for SMEs* Standard refers to the version issued in October 2015.

### This module

This module focuses on the general requirements for accounting for investments in associates applying Section 14 *Investments in Associates* of the *IFRS for SMEs* Standard. It introduces the subject and reproduces the official text along with explanatory notes and examples designed to enhance understanding of the requirements. The module identifies the significant judgements required in accounting for investments in associates. In addition, the module includes questions designed to test your understanding of the requirements and case studies that provides a practical opportunity to apply the requirements to account for investments in associates applying the *IFRS for SMEs* Standard.

Upon successful completion of this module, you should, within the context of the *IFRS for SMEs* Standard, be able to:

- identify when an entity has significant influence over another entity;

- measure investments in associates on initial recognition and subsequently;
- apply the cost model, equity method and fair value model;
- present and disclose investments in associates in financial statements; and
- demonstrate an understanding of the significant judgements that are required in accounting for investments in associates.

## *IFRS for SMEs* Standard

The *IFRS for SMEs* Standard 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* Standard is comprised of mandatory requirements and other non-mandatory material.

The non-mandatory material includes:

- a preface, which provides a general introduction to the *IFRS for SMEs* Standard and explains its purpose, structure and authority;
- implementation guidance, which includes illustrative financial statements and a table of presentation and disclosure requirements;
- the Basis for Conclusions, which summarises the Board's main considerations in reaching its conclusions in the *IFRS for SMEs* Standard issued in 2009 and, separately, in the 2015 Amendments; and
- the dissenting opinion of a Board member who did not agree with the issue of the *IFRS for SMEs* Standard in 2009 and the dissenting opinion of a Board member who did not agree with the 2015 Amendments.

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

The *IFRS for SMEs* Standard has been issued in two parts: Part A contains the preface, all the mandatory material and the appendices to Section 21, Section 22 and Section 23; and Part B contains the remainder of the material mentioned above.

Further, the SME Implementation Group (SMEIG), which assists the Board with supporting implementation of the *IFRS for SMEs* Standard, publishes implementation guidance as 'questions and answers' (Q&As). These Q&As provide non-mandatory, timely guidance on specific accounting questions raised with the SMEIG by entities implementing the *IFRS for SMEs* Standard and other interested parties. At the time of issue of this module (September 2018) the SMEIG has not issued any Q&As relevant to this module.

## 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. Such users include, for example, owners who are not involved in managing the business, existing and potential creditors and credit rating agencies.

# Module 14—Investments in Associates

The objective of Section 14 *Investments in Associates* is to prescribe the accounting 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.

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

(a) the cost model, investment in an associate is measured at cost 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 is available.

(b) the equity method, investment in an associate is initially recognised at the transaction price (including transaction costs) and adjusted thereafter for the investor's share of the profit or loss and other comprehensive income of the associates less any accumulated impairment losses.

(c) the fair value model, 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 uses the cost model for any investment in an associate for which fair value cannot be measured reliably without undue cost or effort.

Impairment assessments under the cost model and equity are performed in accordance with Section 27 *Impairment of Assets*.

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.

If an entity has joint ventures and subsidiaries it follows the requirements of Section 15 *Investments in Joint Ventures* and Section 9 *Consolidated and Separate Financial Statements*, respectively.

## What has changed since the 2009 *IFRS for SMEs* Standard

There are consequential changes to the disclosures in Section 14 (see paragraph 14.15) relating to changes to Section 2 *Concepts and Pervasive Principles.* The changes to Section 2 add clarifying guidance on the undue cost or effort exemption that is used in several sections of the *IFRS for SMEs* Standard—based on Q&A 2012/01 *Application of 'undue cost or effort'*[1]—as well as a new requirement within relevant sections for entities to disclose their reasoning for using such an exemption (see paragraphs 2.14A–2.14D). There are also minor editorial changes. All changes are covered in this Module.

[1] Q&As are non-mandatory guidance issued by the SME Implementation Group (SMEIG).

# Module 14—Investments in Associates

## REQUIREMENTS AND EXAMPLES

### 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 for:

- a parent that prepares consolidated financial statements; or
- an investor that is not a parent but has one or more associates.

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. Such an entity may then choose (or be required by the law in its jurisdiction) to prepare separate financial statements as a second set of financial statements where it applies the requirements in paragraph 9.26 to its associates.

If a parent is exempt from producing consolidated financial statements in accordance with paragraph 9.3, it will apply Section 11 *Basic Financial Instruments* to account for its associates in its financial statements. These financial statements are not separate 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. 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 on accounting for 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):

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

Control is not based on legal ownership and can be passive (it is the ability to control, not the exercise of control). The parent need not own shares in its subsidiary (for example, an entity might have control over a special purpose entities by some other means, such as a legal agreement when that entity is set up). 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 in detail the facts and circumstances surrounding how an entity's financial and operating policies are governed 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 (venturers). The requirements on accounting and reporting for 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:

(a) if an investor holds, directly or indirectly (for example, 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 (for example, 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; and

(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 affect something. Consequently, an entity has significant influence when it can exercise that power, regardless of whether significant influence is actively demonstrated or passive in nature.

Judgement must be exercised, in some cases, 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% or more of the voting power of the investee has no 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% of the voting power of the investee can exercise significant influence, the investment will be accounted for as an associate.

In most cases when applying the guidance in the *IFRS for SMEs* Standard it will be clear whether an entity has significant influence over another entity. However, for more complex cases an entity may, but is not required to, refer to full IFRS Standards which provides more detailed application guidance (see paragraph 10.6 of Section 10 *Accounting Policies, Estimates and Errors* of the *IFRS for SMEs* Standard). Paragraph 6 of IAS 28 *Investments in Associates and Joint Ventures* indicates that the existence of significant influence by an entity is usually evidenced in one or more of the following ways (note, this is not intended to be 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 entity and its investee;

(d) the interchange of managerial personnel; or

(e) the 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 the control of a government, court, administrator or regulator. Furthermore, it could be lost because of a contractual agreement.

Where the investor is a parent (it has one or more subsidiaries), the voting rights of the group (the parent and its subsidiaries) in the investee are aggregated to determine 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 directly or indirectly through its subsidiaries holds 20% 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% of the voting power, the investor is presumed to have control rather than significant influence (see paragraph 9.5). Unless there is joint control (see Section 15 *Investments in Joint Ventures*), ownership of 50% 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%, the substance of the 20% 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 are considered when assessing whether an entity has significant influence (see paragraph 14.8(b)).

### Examples—investment is not an associate

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

Entity A does not only have significant influence over Entity B—it controls Entity B Entity A is required to consolidate Entity B in its consolidated financial statements in accordance with Section 9 *Consolidated and Separate Financial Statements.*

Ex 2 **Entity A owns 25% of the ordinary shares that carry voting rights at a general meeting of the shareholders of Entity B. Entity C owns 30% of the ordinary shares that carry voting rights at a general meeting of the shareholders of Entity B.**

Entities A and C have contractually agreed to jointly control Entity B.
Entity A does not only 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*.

### Examples—judgement indicates that significant influence exists

Ex 3 **Entity A owns 25% of the ordinary shares that carry voting rights at a general meeting of the 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 and therefore Entity B is an associate of Entity A.

However, the determination that Entity A's 25% holding in Entity B results in significant influence is not automatic. Judgement is required—it may be that despite the 25% holding of voting rights, it can be clearly demonstrated that 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, 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 the ordinary shares in Entity B. Entity B own 25% of the ordinary shares that carry voting rights at a general meeting of the shareholders of Entity C.**
**The Entity A Group (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 Entity A has significant influence over Entity C.

However, the determination that Entity A's indirect 25% holding in Entity C results in significant influence is not automatic. Judgement is required— it may be that despite the 25% holding, Entity A (or B) does not have significant influence over Entity C.

If it is determined that neither Entity A nor Entity B has significant influence over Entity C, the investment in the ordinary shares of Entity C would be accounted for as an equity instrument in Entity B's financial statements and Entity A's consolidated financial statements 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% of the ordinary shares of Entity C and that Entity A also owns 10% of the ordinary shares of Entity C.**

If an investor holds, directly or indirectly (through subsidiaries), 20% 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% investment in Entity C, by itself, does not give Entity A significant influence over Entity C. Similarly, Entity B's 15% 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% investment in Entity C is considered together with Entity B's 15% investment in Entity C. Accordingly, in the absence of evidence to the contrary, Entity A is presumed to have significant influence over Entity C.

The determination that the combination of Entity A's 10% holding in Entity C and Entity B's 15% holding in Entity C results in significant influence is not automatic. Judgement is required, and it may be that despite the combined 25% 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% and 10%, respectively, of the ordinary shares that carry voting rights at a general meeting of the shareholders of Entity C. Entity B owns 70% of the ordinary shares that carry voting rights at a general meeting of the 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% of the voting power in Entity C. Unless it can be clearly demonstrated that this is not the case, it is presumed that Entity A has significant influence over Entity C since Entity A holds more than 20% of the voting power in Entity C. Therefore, Entity C is an associate of Entity A.

Entity B holds 40% of the voting power in Entity C (10% directly plus 30% 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 (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% (not 70%) of the ordinary shares that carry voting rights at a general meeting of the shareholders of Entity A (and Entity A is an associate, not a subsidiary, of Entity B).**

Entity A holds 30% of the voting power in Entity C. Unless it can be clearly demonstrated that this is not the case, it is presumed that Entity A has significant influence over Entity C since Entity A holds more than 20% of the voting power in Entity C. Therefore, Entity C is an associate of Entity A.

The holding of Entity B's associate (Entity A) is ignored when assessing how much voting power Entity B holds in Entity C (because Entity B does not control Entity A). Entity B holds less than 20% of the voting power in Entity C (it holds 10% 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% and 30%, respectively, of the ordinary shares that carry voting rights at a general meeting of the shareholders of Entity C.**

Entity B holds 30% of the voting power in Entity C. Unless it can be clearly demonstrated that this is not the case, it is presumed that Entity B has significant influence over Entity C.

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*.

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, 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; or

(c) the **fair value** model in paragraph 14.9.

### 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).

## 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 and other comprehensive income 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 for impairment but, instead, as part of the test for impairment of the investment as a whole.

(e) *investor's transactions with associates*. 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 Instrument 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.

## 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 value measurement 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 fair value cannot be measured reliably without undue cost or effort.

### Notes

If an entity is required or chooses to prepare separate financial statements, a second set of financial statements, the choice of accounting policy for investments in associates in the separate financial statements under paragraph 9.26 does not need to be consistent with the accounting policy chosen in accordance with 14.4.

*Cost model*

*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 such investments have any indicators of impairment (see paragraphs 27.7–27.9 and 27.29). If present, an impairment test must be performed (see paragraphs 27.10–27.20). 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 27.30-27.31).

*Published price quotation*

Investments in associates for which there is a published price quotation are accounted for using fair value model. Assuming the entity only has one investment in an associate, it cannot elect the cost model (see paragraph 14.9). An investor who has more than one investment in associates with at least one where a published price quotation is not available can elect the cost model while still measuring investments with a quoted price at fair value (see paragraph 14.7). Investments carried at fair value are not tested for impairment.

*Cost on initial recognition*

For assets, historical cost is the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire the asset at the time of its acquisition (see paragraph 2.34(a)). Therefore, the cost of an investment in an associate at initial recognition comprises its purchase price and any directly attributable expenditures necessary to obtain it such as professional fees for legal services, transfer taxes and other transaction costs. When the investment in associates have published price quotations, they are accounted for using the fair value model and therefore, transaction costs are recognised in profit or loss directly.

*Equity method*

Other than to the extent that fair value is relevant to impairment testing in accordance with Section 27, market price is not used in accounting for investments using the equity method.

*Fair value model*

*Fair value cannot be measured reliably without undue cost or effort*

Considering whether determining the fair value of an investment in an associate would involve undue cost or effort depends on the entity's specific circumstances and on management's judgement in assessing the costs and benefits. This judgement requires considering how not having that information could affect the economic decisions of expected users of financial statements. Applying a requirement would involve undue cost or effort by an SME if the incremental cost (for example, valuers' fees) or additional effort (for example, endeavours by employees) substantially exceeds the benefits that expected users of the SME's financial statements would receive from having the information (see paragraph 2.14B). If an SME already has or could easily and inexpensively acquire the information necessary to comply with a requirement, any related undue cost or effort exemption would not be applicable. The exemption would not be applicable because, if the information is easily or inexpensively acquired, the benefits of having it to the users of financial statements would be expected to exceed any further cost or effort by the SME.

Assessments as to whether initial application of a requirement would involve undue cost or effort should be based on information about the costs and benefits of applying the requirement at the time of initial application. An entity must make a new assessment of whether a requirement will involve undue cost or effort at each subsequent reporting date, based on information available at that subsequent reporting date (see paragraph 2.14C).

When an entity has selected the fair value model (see paragraph 14.4(c)) but accounts for an investment in an associate using the cost model because the fair value of that associate cannot be measured reliably without undue cost or effort, the entity shall disclose that fact, the reasons why fair value measurement would involve undue cost or effort and the carrying amount of the associate (see paragraph 14.15). At each reporting date, in accordance with Section 27, the investor must consider whether such investments have any indicators of impairment (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 (or reversal of an impairment loss) in profit or loss (see paragraphs 27.6 and 27.30).

*All other investments in associates*

An investor that has selected the fair value model (see paragraph 14.4(c)) accounts for all its investments in associates for which it can measure 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 when a reliable fair value can be determined (see paragraphs BC115–BC117 of the Basis for Conclusions accompanying the *IFRS for SMEs* Standard). 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 Section 11 *Basic Financial Instruments*).

### Examples—accounting policy

Unless otherwise stated, ignore value in use in determining the recoverable amount necessary to calculate any impairment loss (fair value less costs to sell is assumed to be the recoverable amount).

Ex 9 **On 1 January 20X1 Entity A acquired 30% of the ordinary shares that carry voting rights at a general meeting of the shareholders of Entity B for CU300,000[2]. 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 Entity A estimates that the fair value of its investment in Entity B is CU425,000. However, there is no published price quotation for Entity B.**

*Cost model*

Applying the cost model, Entity A must recognise dividend income of CU45,000 (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 (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*. Assuming costs to sell is nil, there would be no impairment loss because the fair value (CU425,000) of the investment exceeds its carrying amount (CU300,000).

[2] In this example, and in all other examples in this module, monetary amounts are denominated in 'currency units (CU)'.

*Equity method*[3]

Applying the equity method, Entity A must recognise income from its associate of CU120,000 (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 - 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*. Assuming costs to sell are nil, there would be no impairment loss because the fair value (CU425,000) less costs to sell of the investment exceeds its carrying amount (CU375,000).

*Fair value model*

Applying the fair value model, in determining profit or loss for the year ended 31 December 20X1 Entity A must:

- recognise dividend income of CU45,000 (30% × CU150,000 dividend declared by entity B);[4] and
- recognise the increase in the fair value of its investment in Entity B of CU125,000 (CU425,000 fair value at 31 December 20X1 minus 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 10** **The facts are the same as in Example 9. However in this example, on 2 January 20X1, Entity B also declared and paid a dividend of CU100,000 for the year 20X0 and at 31 December 20X1, Entity A estimates that the fair value of its investment in Entity B is CU400,000.**

*Cost model*

Applying the cost model, 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% × CU100,000 dividend declared on 2 January + 30% × CU150,000 dividend declared on 31 December).

At 31 December 20X1 Entity A must report its investment in Entity B (an associate) at CU300,000 (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. Assuming costs to sell is nil, there would be no impairment loss because the fair value (CU400,000) of the investment exceeds its carrying amount (CU300,000).

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[3] In examples 9–18 it is assumed that there is no implicit goodwill and that there are no fair value adjustments. Example 19 illustrates implicit goodwill and fair value adjustments.

[4] 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.

*Equity method*

Applying the equity method, Entity A must recognise income from its associate of CU120,000 (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 - CU30,000 dividend declared for the year 20X0 - CU45,000 dividend declared for the year 20X1). 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, triggers an impairment test at 31 December 20X1 (at 31 December 20X1 Entity A would 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). Assuming costs to sell are nil and when the impairment test is conducted, there would be no impairment because the fair value (CU400,000) less costs to sell of the investment would exceed its carrying amount (CU345,000).

*Fair value model*

Applying the fair value model, in determining profit or loss for the year ended 31 December 20X1 Entity A must:

- recognise dividend income of CU75,000 (CU30,000 from the first distribution + CU45,000 from the second distribution); and
- recognise the increase in fair value of CU100,000 (CU400,000 fair value at 31 December 20X1 minus 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 11** **The facts are the same as in Example 9. However, in this example, CU425,000 is the published price quotation for Entity B.**

*Cost model*

Applying the cost model, Entity A must recognise dividend income of CU45,000 (30% × CU150,000 dividend declared by Entity B) and the 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 (fair value).

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.

*Equity method*

Applying the equity method, Entity A must recognise income from its associate of CU120,000 (30% × CU400,000 annual profit from 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 CU375,000 (calculation: CU300,000 cost + CU120,000 share of earnings - 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. Assuming costs to sell are nil, there would be no impairment because the fair value (CU425,000) less costs to sell of the investment would exceed its carrying amount (CU375,000).

*Fair value model*

Applying the fair value model, in determining profit or loss for the year ended 31 December 20X1 Entity A must:

- recognise dividend income of CU45,000 (30% × CU150,000 dividend declared by entity B); and
- recognise the increase in the fair value of its investment in Entity B of CU125,000 (CU425,000 fair value at 31 December 20X1 minus 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 12 **On 1 March 20X1, Entity A acquired 30% of the ordinary shares that carry voting rights at a general meeting of the shareholders of Entity B for CU300,000. On 31 December 20X1, Entity B declared and paid a dividend of CU100,000 for the year 20X1. Entity B reported a profit of CU80,000 for the year ended 31 December 20X1. Assume, at 31 December 20X1, the recoverable amount of Entity A's investment in Entity B is CU290,000 (calculation: fair value CU293,000 minus costs to sell CU3,000). There is no published price quotation for Entity B.**

*Cost model*

Applying the cost model, Entity A must recognise dividend income of CU30,000 in profit or loss (30% × CU100,000 dividend declared by Entity B).

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

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

*Equity method*

Applying the equity method, assuming Entity B earned its profit evenly through the year, Entity A must recognise income from its associate of CU20,000 in profit or loss (30% × CU66,667 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 - CU30,000 dividend).

The payment of the dividend partly out of pre-acquisition profits on 1 March 20X1 is significant and so may be identified as an impairment indicator that, in accordance with Section 27, triggers an impairment test at 31 December 20X1. In this case there be no impairment because the recoverable amount (CU290,000) of the investment equals its carrying amount (CU290,000).

*Fair value model*

Applying the fair value model, in determining profit or loss for the year ended 31 December 20X1, Entity A must:

- recognise dividend income of CU30,000 (30% × CU100,000 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 (CU293,000 fair value at 31 December 20X1 minus 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.

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 ignored in determining the investment's carrying amount.

Ex 13 **On 1 January 20X1, Entity A acquired 30% of the ordinary shares that carry voting rights at a general meeting of the 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. Assume at 31 December 20X1 the recoverable amount of Entity A's investment in Entity B is CU310,000 (calculation: CU325,000 fair value minus CU15,000 estimated costs to sell). There is no published price quotation for Entity B.**

*Cost model*

Applying the cost model, at 31 December 20X1 Entity A must report its investment in Entity B (an associate) at CU300,000. The investment in Entity B has no impact in the profit or loss of Entity A for the year ended 31 December 20X1, because Entity B did not declare any dividends. Although the loss is significant and may be identified as an impairment indicator that triggers an impairment test, Entity A's investment in Entity B is not impaired at 31 December 20X1 (the carrying amount of CU300,000 is lower than the recoverable amount of CU310,000).

*Equity method*

Applying the equity method, Entity A must recognise its share of the losses of its associate of CU30,000 in profit or loss (30% × CU100,000 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 minus CU30,000 share of associate's loss).

Although the loss is significant and may be identified as an impairment indicator that triggers an impairment test, Entity A's investment in Entity B is not impaired at 31 December 20X1 (the carrying amount of CU270,000 is lower than the recoverable amount of CU310,000).

*Fair value model*

Applying the fair value model, 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 (CU325,000 fair value at 31 December 20X1 minus 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 excluded from fair value when using the fair value model).

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 minus CU10,000 estimated costs to sell).**

*Cost model*

Applying the cost model, Entity A must recognise an impairment loss of CU35,000 in profit or loss for the year ended 31 December 20X1 (CU300,000 cost minus 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*

Applying the equity method, Entity A must recognise its share of the losses of its associate of CU30,000 (30% × CU100,000 loss incurred by Entity B for the year ended 31 December 20X1) and an impairment of its investment in its associate of CU5,000 (calculation: CU300,000 cost minus CU30,000 share of associate's losses = CU270,000 carrying amount before impairment. CU270,000 minus CU265,000 recoverable amount = CU5,000 impairment loss) 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 minus CU30,000 share of associate's loss minus CU5,000 accumulated impairment loss).

*Fair value model*

Applying the fair value model, 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 (CU275,000 fair value at 31 December 20X1 minus 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.

### Examples—others: equity method

Ex 15 **The facts are the same as in Example 9. However, in this example, in 20X1 Entity A purchased goods for CU100,000 from Entity B. At 31 December 20X1 60% of the goods purchased from Entity B were in Entity A's inventories (they had not been sold by Entity A). Entity B sells goods at a 50% mark-up on cost.**

Entity A must recognise income from its associate of CU114,000 (30% × CU400,000 Entity B's profit for the year = CU120,000 minus 30% × CU20,000[5],[6] 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.[7] 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, - 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.

In this example Entity A would measure the inventories that it acquired from Entity B at CU60,000 (60% unsold × CU100,000 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 16 **The facts are the same as in Example 15. However, in this example, Entity B purchased goods for CU100,000 from Entity A. At 31 December 20X1 60% of the goods purchased from Entity A were in Entity B's inventories (they had not been sold by Entity B). Entity A sells goods at a 50% mark-up on cost.**

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

The unrealised profit of CU6,000 (CU33,333 profit recognised by Entity B × 60% unsold inventories × 30% ownership interest) may be eliminated in two ways:

- Apportioned to the revenue and related and cost of sales (using the example, CU18,000 against revenue—CU100,000 × 60% unsold inventories × 30% ownership interest, and CU12,000 against cost of sales—CU18,000 ÷ 150%–50% mark-up on cost); or
- Cost of sales

Either approach is used in practice. Regardless of the approach used, the elimination is made against the related investment in associate.

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[5] In this example the tax effects of eliminating the unrealised profit have been ignored.

[6] Calculation: 60% inventories bought from entity B unsold by entity A × CU33,333 profit recognised by Entity B (CU100,000 revenue less CU66,667 cost of goods sold (CU100,000 selling price ÷ (100% + 50% mark-up on cost))).

[7] An alternative accounting policy would be to eliminate the unrealised profit in upstream transactions against the asset transferred (in this case the inventories).

Ex 17 **On 1 January 20X1, Entity A acquired 25% of the ordinary shares that carry voting rights at a general meeting of the shareholders of Entity B for CU100,000. The purchase price is equal to 25% of the fair value of Entity B's net identifiable assets (25% of the difference between the fair value of its identifiable assets and liabilities.**

**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 (25% × CU600,000 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 minus 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 (25% × CU800,000 Entity B's profit for the year = CU200,000 share of associate's profit. CU200,000 share of associate's profit - 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 - CU100,000 share of losses recognised in 20X1 + CU150,000 share of profit recognised in 20X2).

Ex 18 **The facts are the same as in Example 9. 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% 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 (30% × CU400,000 Entity B's profit for the year = CU120,000).
- a gain on derecognition of an investment in its associate of CU45,000 (calculation: (CU212,500 proceeds from sale of shares - CU5,000 transaction costs + CU212,500 fair value of the retained interest) - 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[(a)] | |
| Dr | Financial instrument—equity investment (shares of Entity B) | CU212,500[(b)] | |
| | Cr Investment in associate (Entity B) | | CU375,000[(c)] |
| | Cr Profit or loss | | CU45,000 |

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

(a) CU212,500 proceeds from sale of shares minus CU5,000 transaction costs incurred.

(b) In the absence of other information, this is assumed to be the fair value of the retained interest in Entity B (recent market transaction (see paragraph 11.27(b))).

(c) The carrying amount of investment in associate derecognised (calculation: CU300,000 cost + CU120,000 share of earnings minus 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 (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 19** **The facts are the same as in Example 9. 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 (30% × CU400,000 Entity B's profit for the year - CU4,000[(a)] amortisation of implicit goodwill - 30% × CU10,000[(b)] depreciation adjustment).[(8)]

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 - CU45,000 dividend). Entity A must also consider whether any indicators suggest that its investment is impaired and, if so, conduct an impairment test in accordance with Section 27.

(a) CU300,000 cost of acquisition - CU280,000 share of the fair values of the net identifiable assets = CU20,000 implicit goodwill. CU20,000 implicit goodwill ÷ 5 year useful life = CU4,000 amortisation expense.

(b) CU50,000 'additional' cost of machine ÷ 5 year remaining useful life = CU10,000 depreciation.

(8) In this example the tax effects of implicit goodwill and fair value adjustments have been ignored.

### Examples—other: fair value model

Ex 20 **The facts are the same as in Example 9. However, in this example, Entity A cannot measure the fair value of the investment in Entity B reliably without undue cost or effort.**

Entity A must recognise dividend income of CU45,000 (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 (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. In this case it is unlikely that the profitable associate would be impaired.

Even though Entity A has selected 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 cannot measure the fair value of its investment in Entity B reliably without undue cost and effort. If an investor applies the undue cost or effort exemption in paragraph 14.10 for any associates, it shall disclose that fact, the reasons why fair value measurement would involve undue cost or effort and the carrying amount of investments in associates accounted for under the cost model (see paragraph 14.15).

## Financial statement presentation

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

### Example—presentation

Ex 21 **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* |
|---|---|---|---|
| **ASSETS** | | *CU* | *CU* |
| **Non-current assets** | | | |
| Investment in associates | 15 | 80,000 | 100,000 |
| … | | | |

## Disclosures

14.12 An entity 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)); and

(c) the fair value of investments in associates accounted for using the equity method for which there are published price quotations.

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 22 On 1 January 20X0, SME A acquired 25% 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 31 December 20X0 because at that date the investment showed no indication that it 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

| | *Note* | *20X1* | *20X0* |
|---|---|---|---|
| **ASSETS** | | *CU* | *CU* |
| **Non-current assets** | | | |
| Investment in associate | 15 | 80,000 | 100,000 |
| … | | | |

SME A—Statement of comprehensive income for the year ended 31 December 20X1

| | *Note* | *20X1* | *20X0* |
|---|---|---|---|
| | | *CU* | *CU* |
| … | | | |
| 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 for the period of the change.

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

**Note 15 Investment in associate**

| | *20X1* | *20X0* |
|---|---|---|
| | *CU* | *CU* |
| Cost | 100,000 | 100,000 |
| Less accumulated impairment losses | (20,000) | – |
| | 80,000 | 100,000 |

SME A owns 25% of the equity of its associate SME B.

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 23 **The facts are the same as in Example 22. However, in this example, SME A uses the equity model to account for its investment in its only associate.**

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

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

| | *20X1* | | *20X0* | |
|---|---|---|---|---|
| | *CU* | | *CU* | |
| … | | | | |
| Impairment of investment in associate | (15,000) | (a) | | |
| Share of associate's (loss)/profit for the year | (15,000) | (b) | 20,000 | (c) |
| … | | | | |

### SME A—Statement of financial position at 31 December 20X1

| | Note | 20X1 | | 20X0 | |
|---|---|---|---|---|---|
| **ASSETS** | | CU | | CU | |
| **Non-current assets** | | | | | |
| 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 an 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 indications show 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's post-acquisition reserves less accumulated impairment losses | 80,000 | 110,000 |

SME A owns 25% of the equity of its associate SME B.

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

[a] CU95,000[f] carrying amount at 31 December 20X1 before impairment minus 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[f] carrying amount at 31 December 20X1 before impairment minus CU15,000[a] accumulated impairment of investment in associate = CU80,000 carrying amount at 31 December 20X1.

[e] CU100,000 cost + CU20,000[c] profit for the year ended 31 December 20X0 minus CU10,000[g] dividend received from associate = CU110,000 carrying amount at 31 December 20X0.

[f] CU110,000 carrying amount at 31 December 20X0 minus CU15,000[b] share of associate's loss for the year ended 31 December 20X1 = CU95,000 carrying amount at 31 December 20X1 before impairment.

[g] 25% × CU40,000 dividend declared and paid by associate = CU10,000 dividend received from associate.

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. If an investor applies the undue cost or effort exemption in paragraph 14.10 for any associates it shall disclose that fact, the reasons why fair value measurement would involve undue cost or effort and the carrying amount of investments in associates accounted for under the cost model.

### Example—fair value model disclosures

Ex 24 **The facts are the same as in Example 22. However, in this example, SME A 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 two 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**

| | *Note* | *20X1* | *20X0* |
|---|---|---|---|
| **ASSETS** | | *CU* | *CU* |
| **Non-current assets** | | | |
| Investment in associate | 15 | 85,000 | 120,000 |
| ... | | | |

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

| | *Note* | *20X1* | *20X0* |
|---|---|---|---|
| | | *CU* | *CU* |
| … | | | |
| Other income—dividend from associate | | – | 10,000 |
| Change in the fair value of investment in associate | | (35,000) | 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 recognised initially at transaction price excluding transaction costs and are subsequently accounted for at fair value with changes in fair value recognised in profit or loss for the period.

Dividend income from associates is recognised when the shareholders' right to receive payment has 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% of the equity of its associate SME B.

The fair value of the investment in SME B at 31 December 20X1 was determined 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 two basis points because SME B's equity is not traded in a public market.[9]

[9] In addition, SME A would also disclose this information as required by paragraphs 11.41–11.44.

## SIGNIFICANT ESTIMATES AND OTHER JUDGEMENTS

Applying the requirements of the *IFRS for SMEs* Standard to transactions and events often requires the exercise of judgement, including making estimates. Information about significant judgements made by an entity's management and key sources of estimation uncertainty are useful when assessing an entity's financial position, performance and cash flows. Consequently, in accordance with paragraph 8.6, an entity must disclose the judgements—apart from those involving estimates—its management has made in applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

Furthermore, applying 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* Standard require disclosure of information about particular judgements and estimation uncertainties.

Some of the areas where significant estimates and other judgements applying Section 14 are set out as follows.

### Classification

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

In this context, power refers to the ability to do or affect something. Consequently, an entity has significant influence when it can exercise that power, regardless of whether significant influence is actively demonstrated or passive in nature. In cases where significant influence is not actively demonstrated, judgement may be required to assess whether it 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. If after considering all the facts and circumstances, it is unclear whether significant influence exists, the entity will be unable to demonstrate the presumptions are incorrect. However, the guidance in paragraph 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 its investee;
(d) the interchange of managerial personnel; or
(e) the 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 demonstrated that an investor holding 20% 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% 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%, the substance of the 20% investor's influence should be examined carefully to determine whether it is significant influence or more in the nature of a passive investment.

## Measurement

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 = an investment in an associate shows any indication that it may be impaired (see paragraph 27.7); and
- if the investment in an associate shows any indication that it may be impaired—estimating the recoverable amount of that investment (see paragraph 27.11).

*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:

- when estimating the fair value of the associate's identifiable assets and identifiable liabilities (see paragraph 14.8(c));
- if on acquisition there is implicit goodwill, judgement must be made about the useful life of the goodwill (see paragraph 14.8(c));
- if the entity and its associate have different reporting dates (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)); and
- if the entity and its associate use different accounting policies—judgements may need to be made about the effects of applying the entity's accounting policies to the associate (see paragraph 14.8(g)).

*Fair value model*

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

- assess 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
- decide 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 IFRS STANDARDS

When accounting for and reporting investments in associates for periods beginning on 1 January 2017, the main differences between the requirements of full IFRS Standards (see IAS 28 *Investments in Associates*) and the *IFRS for SMEs* Standard (see Section 14 *Investments in Associates*) are that:

- the *IFRS for SMEs* Standard is drafted in plain language and includes significantly less guidance on how to apply the principles.
- the *IFRS for SMEs* Standard permits an entity to account for investments in associates in its main/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 IFRS Standards require investments in associates to be accounted for using the equity method in an investor's primary financial statements.
- There are a few differences between the equity method in Section 14 and that in IAS 28, including:
    - the *IFRS for SMEs* Standard includes an impracticability exemption from the requirement that the investor makes adjustments to the associate's financial statements to reflect the investor's accounting policies. Full IFRS Standards do not have such an exemption.
    - if it is impracticable for the financial statements of the associate to be prepared as of the same date as the financial statements of the investor, both full IFRS Standards and the *IFRS for SMEs* Standard require the most recent available financial statements of the associate to be used. Full IFRS Standards further requires the difference between the end of the reporting period of the associate and that of the investor to be no more than three months. The *IFRS for SMEs* Standard doesn't include a three-month limit on the difference between the reporting dates.
    - the *IFRS for SMEs* Standard requires that implicit goodwill be systematically amortised over its expected useful life. Full IFRS Standards do not allow the amortisation of goodwill.
    - if an investor loses significant influence for reasons other than a partial disposal of its investment, the *IFRS for SMEs* Standard requires the investor to regard the carrying amount of the investment at that date as a new cost basis for accounting using Sections 11 or 12. Full IFRS Standards would require the retained investment to be remeasured to fair value.
    - when an entity discontinues use of the equity method, full IFRS Standards require the entity to account for all amounts previously recognised in other comprehensive income in relation to that investment on the same basis as would have been required if the investee had directly disposed of the related assets or liabilities. The *IFRS for SMEs* Standard does not have a similar requirement.

# Module 14—Investments in Associates

## TEST YOUR KNOWLEDGE

Test your knowledge of the requirements for accounting and reporting investments in associates applying the *IFRS for SMEs* Standard by answering the questions provided.

You should assume that all amounts mentioned are material.

Once you have completed the test, check your answers against those set out beneath it.

**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 selected 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 selected on an investment-by-investment basis).

### 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% of the ordinary shares that carry voting rights at a general meeting of the shareholders of Entity C.

Entity A, in the absence of any evidence to the contrary:

☐ (a) has no significant influence over Entity C and is accounted for as an equity instrument within the scope of Section 11 *Basic Financial Instruments*.

☐ (b) has significant influence over Entity C, provided it does not have joint control over Entity C.

☐ (c) has significant influence over Entity C, provided it does not have control over Entity C.

☐ (d) has significant influence over Entity C, provided 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% or more of the voting power of the investee

☐ (b) holding indirectly, through a subsidiary, 20% or more of the voting power of the investee

☐ (c) holding indirectly, through a joint venture, 20% or more of the voting power of the investee

☐ (d) holding directly 10% of voting power of the investee and holding indirectly, through a subsidiary, 10% of the voting power of the investee

## Question 7

On 31 December 20X1, Entity A acquired 30% 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, Entity B identified impairment indicators and so in accordance with Section 27 *Impairment of Assets*, management assessed the recoverable amount of the investment in Entity B. The fair value of Entity A's investment in Entity B was estimated as CU102,000, CU110,000 and CU90,000 respectively. Costs to sell are estimated at CU4,000 throughout. Assume value in use was assessed to be lower or equal to fair value less costs to sell on each of these dates.

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

### 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) the interchange of managerial personnel
- ☐ (e) the 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 it holds that are 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 is 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 less 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 (which in this case is fair value less transaction costs) | Impairment recognised during the year —(impairment reversal) | Carrying amount at the year-end |
|---|---|---|---|---|
| 20X1 | CU101,000 | CU98,000 (CU102,000 minus CU4,000) | CU3,000 | CU98,000 |
| 20X2 | CU98,000 | CU106,000 (CU110,000 minus CU4,000) | (CU3,000) | CU101,000 |
| 20X3 | CU101,000 | CU86,000 (CU90,000 minus 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 minus CU101,000 | CU102,000 |
| 20X2 | CU102,000 | CU8,000 = CU110,000 minus CU102,000 | CU110,000 |
| 20X3 | CU110,000 | (CU20,000) = CU90,000 minus CU110,000 | CU90,000 |

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

## APPLY YOUR KNOWLEDGE

Apply your knowledge of the requirements for accounting and reporting investments in associates using the *IFRS for SMEs* Standard by completing the case studies provided.

Once you have completed the case study, check your answers against those set out beneath it.

### Case study 1

On 1 January 20X1, SME A acquired 25% 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% 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 CU5,000 and CU18,000 respectively. 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. However, assume that SME A can determine the fair values of its investments in entities B, C and D at 31 December 20X1 as CU13,000, CU29,000 and CU15,000, respectively, using appropriate valuation techniques. Costs to sell are estimated at 5% of the fair value of the investments. Also assume that the recoverable amount of Entity D at 31 December 20X1 is equal to its fair value less costs to sell (as this is determined to be higher than value in use).

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.

## Answer to case study 1–Part A

**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 (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 (25% × CU8,000 dividend paid by Entity C).*

| | | | |
|---|---|---|---|
| Dr | Profit or loss (impairment loss) | CU14,030[(a)] | |
| | Cr Investment in associate (Entity D) | | CU14,030 |

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

(Note: an impairment test is only performed if impairment indicators are present. In this case Entity D's significant loss would likely be an impairment indicator)

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

(a) CU28,280 cost minus CU14,250[(b)] = CU14,030 impairment loss.

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

## Answer to case study 1–Part B

**1 January 20X1**

| | | Dr | Cr |
|---|---|---|---|
| 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 | Cr |
|---|---|---|---|
| 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 | Cr |
|---|---|---|---|
| Dr | Cash | CU250 | |
| | Cr Investment in associate (Entity B) | | CU250 |

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

**31 December 20X1**

| | | Dr | Cr |
|---|---|---|---|
| Dr | Receivable (Entity C) | CU2,000 | |
| | Cr Investment in associate (Entity C) | | CU2,000 |

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

| | | Dr | Cr |
|---|---|---|---|
| Dr | Investment in associate (Entity B) | CU1,250 | |
| | 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 (25% × CU5,000 profit by Entity B).*

| | | Dr | Cr |
|---|---|---|---|
| Dr | Investment in associate (Entity C) | CU4,500 | |
| | 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 (25% × CU18,000 profit by Entity C).*

| | | Dr | Cr |
|---|---|---|---|
| Dr | Profit or loss (share of associate's earnings) | CU5,000 | |
| | Cr Investment in associate (Entity D) | | CU5,000 |

*To recognise the share of Entity D's (an associate) loss for the year (25% × CU20,000 loss by Entity D).*

| | | Dr | Cr |
|---|---|---|---|
| Dr | Profit or loss (impairment loss) | CU9,030[(a)] | |
| | Cr Investment in associate (Entity D) | | CU9,030 |

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

(Note: an impairment test is only performed if impairment indicators are present. In this case Entity D's significant loss would likely be an impairment indicator)

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

(a) CU28,280 cost minus CU5,000 SME A’s share of Entity D’s loss for the year minus CU14,250[(b)] = CU9,030 impairment loss.

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

## Answer to case study 1–Part C

**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[(a)] | |
| | 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 (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 (25% × CU8,000 dividend paid by Entity C).*

| | | | |
|---|---|---|---|
| Dr | Profit or loss | CU13,000[(b)] | |
| | 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[(c)] | |
| Dr | Investment in associate (Entity C) | CU14,000[(d)] | |
| | 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 minus 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 minus 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 minus CU15,000 cost = CU14,000 increase in the fair value of the investment in Entity C for the year ended 31 December 20X1.

## Case study 2

On 1 January 20X1, SME E acquired 10% of the equity of Entity G for CU10,000.

On 2 January 20X1, Entity F (a wholly-owned subsidiary of SME E) acquired 25% 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 (CU38,500). Costs to sell are estimated at 5% 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.

## Answer to case study 2—Part A

**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 | |
| | 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 investment in associate.*

**31 December 20X1**

| | | | |
|---|---|---|---|
| Dr | Cash | CU1,400[(a)] | |
| | Cr Profit or loss (other income—dividend from associate) | | CU1,400 |

*To recognise the dividend from an associate (Entity G).*

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% × CU4,000 dividend declared = CU400 dividend received by SME E directly.

(c) 25% × 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 (CU25,000 + CU10,000).

## Answer to case study 2—Part B

**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[(a)] | |
| | 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 investment in associate.*

**31 December 20X1**

| | | | |
|---|---|---|---|
| Dr | Cash | CU1,400[(b)] | |
| | Cr Profit or loss | | CU1,400 |

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

| | | | |
|---|---|---|---|
| Dr | Investment in associate (Entity G) | CU3,500[(c)] | |
| | 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[(d)] + CU1,000[(e)] = CU1,400.

(c) CU38,500 fair value at 31 December 20X1 minus CU35,000[(f)] carrying amount before remeasuring to fair value = CU3,500.

(d) 10% × CU4,000 dividend declared = CU400 dividend received by SME E directly.

(e) 25% × CU4,000 dividend declared = CU1,000 dividend received by SME E group via Entity F.

(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.

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