

IPSAS 7—ACCOUNTING FOR INVESTMENTS IN ASSOCIATES

Acknowledgment

This International Public Sector Accounting Standard is drawn primarily from International Accounting Standard (IAS) 28, “Accounting for Investments in Associates” published by the International Accounting Standards Committee (IASC). The International Accounting Standards Board (IASB) and the International Accounting Standards Committee Foundation (IASCF) were established in 2001 to replace IASC. The International Accounting Standards (IASs) issued by IASC remain in force until they are amended or withdrawn by IASB. Extracts from IAS 28 are reproduced in this publication of the Public Sector Committee of the International Federation of Accountants with the permission of IASB.

The approved text of the IASs is that published by IASB in the English language, and copies may be obtained directly from IASB Publications Department, 7th floor, 166 Fleet Street, London EC4A 2DY, United Kingdom.

E-mail: publications@iasb.org

Internet: <http://www.iasb.org>

IASs, exposure drafts and other publications of IASC and IASB are copyright of IASCF.

“IAS,” “IASB,” “IASC,” “IASCF” and “International Accounting Standards” are trademarks of IASCF and should not be used without the approval of IASCF.

**IPSAS 7—ACCOUNTING FOR INVESTMENTS
IN ASSOCIATES**

CONTENTS

	Paragraph
Scope.....	1–5
Definitions	6–17
Cost Method	7
Economic Entity	8–10
Equity Method.....	11
Future Economic Benefits or Service Potential	12
Government Business Enterprises	13
Net Assets/Equity	14
Significant Influence	15–17
Consolidated Financial Statements	18–22
Separate Financial Statements of the Investor	23–28
Application of the Equity Method	29–37
Impairment Losses	37
Income Taxes.....	38
Contingencies.....	39
Disclosure	40–42
Effective Date	43–44
Comparison with IAS 28	

The standards, which have been set in bold type, should be read in the context of the commentary paragraphs in this Standard, which are in plain type, and in the context of the “Preface to International Public Sector Accounting Standards.” International Public Sector Accounting Standards are not intended to apply to immaterial items.

Scope

1. **An entity which prepares and presents financial statements under the accrual basis of accounting should apply this Standard in accounting by an investor for investments in associates where the investment in the associate leads to the holding of an ownership interest in the form of a shareholding or other formal equity structure.**
2. This Standard provides the basis for accounting for ownership interests in associates. That is, the investment in the other entity confers on the investor the risks and rewards incidental to an ownership interest. The Standard applies only to investments in the formal equity structure (or its equivalent) of an investee. A formal equity structure means share capital or an equivalent form of unitized capital, such as units in a property trust, but may also include other equity structures in which the investor’s interest can be measured reliably. Where the equity structure is poorly defined it may not be possible to obtain a reliable measure of the ownership interest.
3. Some contributions made by public sector entities may be referred to as an “investment” but may not give rise to an ownership interest. For example, a public sector entity may make a substantial investment in the development of a hospital that is owned and operated by a charity. Whilst such contributions are non-reciprocal in nature, they allow the public sector entity to participate in the operation of the hospital, and the charity is accountable to the public sector entity for its use of public monies. However, the contributions made by the public sector entity do not constitute an ownership interest, as the charity could seek alternative funding and thereby prevent the public sector entity from participating in the operation of the hospital. Accordingly, the public sector entity is not exposed to the risks nor does it enjoy the rewards which are incidental to an ownership interest.
4. **This Standard applies to all public sector entities other than Government Business Enterprises.**
5. Government Business Enterprises (GBEs) are required to comply with International Accounting Standards (IASs) issued by the International Accounting Standards Committee. The Public Sector Committee’s Guideline No. 1, “Financial Reporting by Government Business Enterprises” notes that IASs are relevant to all business enterprises, regardless of whether they are in the private or public sector. Accordingly, Guideline No.1

recommends that GBEs should present financial statements that conform, in all material respects, to IASs.

Definitions

6. The following terms are used in this Standard with the meanings specified:

Accounting policies are the specific principles, bases, conventions, rules and practices adopted by an entity in preparing and presenting financial statements.

Accrual basis means a basis of accounting under which transactions and other events are recognized when they occur (and not only when cash or its equivalent is received or paid). Therefore the transactions and events are recorded in the accounting records and recognized in the financial statements of the periods to which they relate. The elements recognized under accrual accounting are assets, liabilities, net assets/equity, revenue and expenses.

Assets are resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity.

Associate is an entity in which the investor has significant influence and which is neither a controlled entity nor a joint venture of the investor.

Consolidated financial statements are the financial statements of an economic entity presented as those of a single entity.

Contributions from owners means future economic benefits or service potential that has been contributed to the entity by parties external to the entity, other than those that result in liabilities of the entity, that establish a financial interest in the net assets/equity of the entity, which:

- (a) Conveys entitlement both to distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or
- (b) Can be sold, exchanged, transferred or redeemed.

Control is the power to govern the financial and operating policies of another entity so as to benefit from its activities.

Controlled entity is an entity that is subject to the control of another entity (known as the controlling entity).

Controlling entity is an entity that has one or more controlled entities.

Cost method is a method of accounting whereby the investment is recorded at cost. The statement of financial performance reflects revenue from the investment only to the extent that the investor receives distributions from accumulated net surpluses of the investee arising subsequent to the date of acquisition.

Distributions to owners means future economic benefits or service potential distributed by the entity to all or some of its owners, either as a return on investment or as a return of investment.

Economic entity means a group of entities comprising a controlling entity and one or more controlled entities.

Equity method is a method of accounting whereby the investment is initially recorded at cost and adjusted thereafter for the post-acquisition change in the investor's share of net assets/equity of the investee. The statement of financial performance reflects the investor's share of the results of operations of the investee.

Expenses are decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrences of liabilities that result in decreases in net assets/equity, other than those relating to distributions to owners.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Government Business Enterprise means an entity that has all the following characteristics:

- (a) Is an entity with the power to contract in its own name;
- (b) Has been assigned the financial and operational authority to carry on a business;
- (c) Sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery;
- (d) Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length); and

- (e) **Is controlled by a public sector entity.**

Investor in a joint venture is a party to a joint venture and does not have joint control over that joint venture.

Joint venture is a binding arrangement whereby two or more parties are committed to undertake an activity which is subject to joint control.

Liabilities are present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.

Net assets/equity is the residual interest in the assets of the entity after deducting all its liabilities.

Net surplus/deficit comprises the following components:

- (a) Surplus or deficit from ordinary activities; and
- (b) Extraordinary items.

Reporting date means the date of the last day of the reporting period to which the financial statements relate.

Revenue is the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets/equity, other than increases relating to contributions from owners.

Significant influence (for the purpose of this Standard) is the power to participate in the financial and operating policy decisions of the investee, but is not control over those policies.

Cost Method

7. Under the cost method, an investor records its investment in the investee at cost. The investor recognizes revenue only to the extent that it is entitled to receive distributions from the accumulated net surpluses of the investee arising subsequent to the date of acquisition by the investor. Entitlements due or received in excess of such surpluses are considered a recovery of investment and are recognized as a reduction of the cost of the investment.

Economic Entity

8. The term “economic entity” is used in this Standard to define, for financial reporting purposes, a group of entities comprising the controlling entity and any controlled entities.

9. Other terms sometimes used to refer to an economic entity include “administrative entity,” “financial entity,” “consolidated entity” and “group.”
10. An economic entity may include entities with both social policy and commercial objectives. For example, a government housing department may be an economic entity which includes entities that provide housing for a nominal charge, as well as entities that provide accommodation on a commercial basis.

Equity Method

11. Under the equity method, the investment is initially recorded at cost and the carrying amount is increased or decreased to recognize the investor’s share of net surpluses or deficits of the investee after the date of acquisition. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for alterations in the investor’s proportionate interest in the investee arising from changes in the investee’s equity that have not been included in the statement of financial performance. Such changes include those arising from the revaluation of property, plant, equipment and investments, from foreign exchange translation differences and from the adjustment of differences arising from business combinations.

Future Economic Benefits or Service Potential

12. Assets provide a means for entities to achieve their objectives. Assets that are used to deliver goods and services in accordance with an entity’s objectives but which do not directly generate net cash inflows are often described as embodying “service potential.” Assets that are used to generate net cash inflows are often described as embodying “future economic benefits.” To encompass all the purposes to which assets may be put, this Standard uses the term “future economic benefits or service potential” to describe the essential characteristic of assets.

Government Business Enterprises

13. Government Business Enterprises (GBEs) include both trading enterprises, such as utilities, and financial enterprises, such as financial institutions. GBEs are, in substance, no different from entities conducting similar activities in the private sector. GBEs generally operate to make a profit, although some may have limited community service obligations under which they are required to provide some individuals and organizations in the community with goods and services at either no charge or a significantly reduced charge. International Public Sector Accounting Standard (IPSAS) 6, “Consolidated Financial Statements and Accounting for Controlled Entities” provides guidance on determining whether control exists for financial

reporting purposes, and should be referred to in determining whether a GBE is controlled by another public sector entity.

Net Assets/Equity

14. “Net assets/equity” is the term used in this Standard to refer to the residual measure in the statement of financial position (assets less liabilities). Net assets/equity may be positive or negative. Other terms may be used in place of net assets/equity, provided that their meaning is clear.

Significant Influence

15. Whether an investor has significant influence over the investee is a matter of judgment based on the nature of the relationship between the investor and the investee, and on the definition of significant influence in this Standard. This Standard applies only to those associates in which an entity holds an ownership interest.
16. The existence of significant influence by an investor is usually evidenced in one or more of the following ways:
- (a) Representation on the board of directors or equivalent governing body of the investee;
 - (b) Participation in policy-making processes;
 - (c) Material transactions between the investor and the investee;
 - (d) Interchange of managerial personnel; or
 - (e) Provision of essential technical information.
17. If the investor’s ownership interest is in the form of shares and it holds, directly or indirectly through controlled entities, 20% or more of the voting power of the investee, it is presumed that the investor does have significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investor holds, directly or indirectly through controlled entities, less than 20% of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an investor from having significant influence.

Consolidated Financial Statements

18. **An investment in an associate should be accounted for in consolidated financial statements under the equity method except when the investment is acquired and held exclusively with a view to its disposal in the near future, in which case it should be accounted for under the cost method.**

19. The recognition of revenue on the basis of distributions received may not be an adequate measure of the revenue earned by an investor on an investment in an associate because the distributions received may bear little relationship to the performance of the associate. In particular, where the associate has not-for-profit objectives, investment performance will be determined by factors such as the cost of outputs and overall service delivery. As the investor has significant influence over the associate, the investor has a measure of responsibility for the associate's performance and, as a result, the return on its investment. The investor accounts for this stewardship by extending the scope of its consolidated financial statements to include its share of net surpluses or deficits of such an associate and so provides an analysis of earnings and investment from which more useful ratios can be calculated. As a result, the application of the equity method provides more informative reporting of the net assets/equity and net surplus or deficit of the investor.
20. An investment in an associate is accounted for using the cost method when it operates under severe long-term restrictions that significantly impair its ability to transfer funds or provide other non-financial benefits to, or on behalf of, the investor. Investments in associates are also accounted for using the cost method when the investment is acquired and held exclusively with a view to its disposal in the near future.
21. **An investor should discontinue the use of the equity method from the date that:**
- (a) **It ceases to have significant influence in an associate but retains, either in whole or in part, its investment; or**
 - (b) **The use of the equity method is no longer appropriate because the associate operates under severe long-term restrictions that significantly impair its ability to transfer funds or provide other non-financial benefits to, or on behalf of, the investor.**
- The carrying amount of the investment at that date should be regarded as cost thereafter.**
22. An entity is required to discontinue the equity method where severe long-term restrictions have the effect of preventing, or substantially preventing, the investee from transferring funds or providing other non-financial benefits to the investor. Where the associate does not have a profit objective (such as a social welfare agency) the associate may not be able to transfer funds to the investor but may nonetheless be able to deliver services to beneficiaries, consistent with the objectives of the investor.

Separate Financial Statements of the Investor

23. **An investment in an associate that is included in the separate financial statements of an investor that issues consolidated financial statements should be either:**
- (a) **Accounted for using the equity method or the cost method, whichever is used for the associate in the investor's consolidated financial statements; or**
 - (b) **Accounted for as an investment.**
24. Guidance on accounting for investments can be found in international and/or national accounting standards.
25. The preparation of consolidated financial statements does not, in itself, obviate the need for separate financial statements for an investor.
26. **An investment in an associate that is included in the financial statements of an investor that does not issue consolidated financial statements should be either:**
- (a) **Accounted for using the equity method or the cost method, whichever would be appropriate for the associate if the investor issued consolidated financial statements; or**
 - (b) **Accounted for as an investment.**
27. Guidance on accounting for investments can be found in international and/or national accounting standards.
28. An investor that has investments in associates may not issue consolidated financial statements because it does not have controlled entities. It is appropriate that such an investor provides the same information about its investments in associates as those entities that issue consolidated financial statements.

Application of the Equity Method

29. Many of the procedures appropriate for the application of the equity method are similar to the consolidation procedures set out in IPSAS 6. Furthermore, the broad concepts underlying the consolidation procedures used in the acquisition of a controlled entity are adopted on the acquisition of an investment in an associate.
30. **Where an associate is accounted for using the equity method, unrealized surpluses and deficits resulting from all transactions between an investor (or its consolidated controlled entities) and**

associates should be eliminated to the extent of the investor's interest in the associate. Unrealized deficits should not be eliminated to the extent that the transaction provides evidence of an impairment of the asset transferred.

31. An investment in an associate is accounted for under the equity method from the date on which it falls within the definition of an associate. Guidance on accounting 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 can be found in International Accounting Standard (IAS) 22, "Business Combinations." Appropriate adjustments to the investor's share of the surpluses or deficits after acquisition are made to account for:
- (a) Depreciation of the depreciable assets, based on their fair values; and
 - (b) Amortization of the difference between the cost of the investment and the investor's share of the fair values of the net identifiable assets.
32. The most recent available financial statements of the associate are used by the investor in applying the equity method; they are usually drawn up to the same date as the financial statements of the investor. When the reporting dates of the investor and the associate are different, the associate often prepares, for the use of the investor, statements as at the same date as the financial statements of the investor. When it is impracticable to do this, financial statements drawn up to a different reporting date may be used. The consistency principle dictates that the length of the reporting periods, and any difference in the reporting dates, are consistent from period to period.
33. When financial statements with a different reporting date are used, adjustments are made for the effects of any significant events or transactions between the investor and the associate that occur between the date of the associate's financial statements and the date of the investor's financial statements.
34. The investor's financial statements are usually prepared using uniform accounting policies for like transactions and events in similar circumstances. In many cases, if an associate uses accounting policies other than those adopted by the investor for like transactions and events in similar circumstances, appropriate adjustments are made to the associate's financial statements when they are used by the investor in applying the equity method. If it is not practicable for such adjustments to be calculated, that fact is generally disclosed.

35. If an associate has outstanding cumulative preferred shares, held by outside interests, the investor computes its share of net surpluses or deficits after adjusting for the preferred dividends, whether or not the dividends have been declared.
36. If, under the equity method, an investor's share of deficits of an associate equals or exceeds the carrying amount of an investment, the investor ordinarily discontinues including its share of further losses. The investment is reported at nil value. Additional losses are provided for to the extent that the investor has incurred obligations or made payments on behalf of the associate to satisfy obligations of the associate that the investor has guaranteed or otherwise committed. If the associate subsequently reports surpluses, the investor resumes including its share of those surpluses only after its share of surpluses equals the share of net deficits not recognized.

Impairment Losses

37. If there is an indication that an investment in an associate may be impaired, an entity should consider the relevant international and/or national standards on accounting for such an impairment.

Income Taxes

38. Guidance on accounting for income taxes arising from investments in associates can be found in IAS 12, "Income Taxes."

Contingencies

39. In accordance with the appropriate standards that address provisions, contingent liabilities and contingent assets, the investor discloses:
- (a) Its share of the contingent liabilities of an associate for which it is also contingently liable;
 - (b) Those contingent liabilities that arise because the investor is severally liable for all the liabilities of the associate; and
 - (c) Its share of the contingent assets of an associate.

Disclosure

40. **The following disclosures should be made:**
- (a) **An appropriate listing and description of significant associates including the proportion of ownership interest and, if different, the proportion of voting power held; and**
 - (b) **The methods used to account for such investments.**
41. **Investments in associates accounted for using the equity method should be classified as non-current assets and disclosed as a separate item in**

the statement of financial position. The investor's share of the net surpluses or deficits of such investments should be disclosed as a separate item in the statement of financial performance. The investor's share of any extraordinary or prior period items should also be separately disclosed.

42. IPSAS 1, "Presentation of Financial Statements" also requires the share of net surpluses or deficits of associates accounted for using the equity method of accounting to be presented on the face of the statement of financial performance.

Effective Date

43. **This International Public Sector Accounting Standard becomes effective for annual financial statements covering periods beginning on or after July 1, 2001. Earlier application is encouraged.**
44. When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

Comparison with IAS 28

International Public Sector Accounting Standard (IPSAS) 7, “Accounting for Investments in Associates” is drawn primarily from International Accounting Standard (IAS) 28, “Accounting for Investments in Associates.” The main differences between IPSAS 7 and IAS 28 are as follows:

- Commentary additional to that in IAS 28 has been included in IPSAS 7 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 7 applies to all investments in associates where the investor holds an ownership interest in the associate in the form of a shareholding or other formal equity structure. IAS 28 does not contain similar ownership interest requirements. However, it is unlikely that equity accounting could be applied unless the associate had a formal or other reliably measurable equity structure.
- IPSAS 7 uses different terminology, in certain instances, from IAS 28. The most significant examples are the use of the terms “entity,” “revenue,” “statement of financial performance,” “statement of financial position” and “net assets/equity” in IPSAS 7. The equivalent terms in IAS 28 are “enterprise,” “income,” “income statement,” “balance sheet” and “equity.”
- IPSAS 7 contains a different set of definitions of technical terms from IAS 28 (paragraph 6).
- In common with IAS 28 this Standard allows an investment in an associate that is included in the separate financial statements of an investor that issues consolidated financial statements, to be carried at cost or accounted for using the equity method. International Accounting Standard IAS 28 also allows such investments in associates to be accounted for as an available-for-sale financial asset as described in International Accounting Standard IAS 39, “Financial Instruments: Recognition and Measurement.” By contrast this Standard allows such investments to be accounted for in the same way as other investments shown in the financial statements of the investor.