Comments due by 30 November 2016

ACCOUNTING STANDARDS BOARD

EXPOSURE DRAFT OF A PROPOSED STANDARD OF GENERALLY RECOGNISED ACCOUNTING PRACTICE ON

INVESTMENTS IN ASSOCIATES AND JOINT VENTURES

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Introduction

Standards of Generally Recognised Accounting Practice (GRAP)

The Accounting Standards Board (the Board) is required in terms of the Public Finance Management Act, Act No. 1 of 1999, as amended (PFMA), to determine generally recognised accounting practice referred to as Standards of Generally Recognised Accounting Practice (GRAP).

The Board must determine GRAP for:

(a) departments (including national, provincial and government components);

(b) public entities;

(c) trading entities (as defined in the PFMA);

(d) constitutional institutions;

(e) municipalities and boards, commissions, companies, corporations, funds or other entities under the ownership control of a municipality; and

(f) Parliament and the provincial legislatures.

The above are collectively referred to as "entities".

The Board has approved the application of International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board for:

(a) public entities that meet the criteria outlined in Directive 12 on *The Selection of an Appropriate Reporting Framework by Public Entities;* and

(b) entities under the ownership control of any of these entities.

Financial statements should be described as complying with Standards of GRAP only if they comply with all the requirements of each applicable Standard of GRAP and any related Interpretations of the Standards of GRAP.

Any limitation of the applicability of specific Standards or Interpretations is made clear in those Standards or Interpretations of the Standards of GRAP.

The Standard of GRAP on *Investments in Associates and Joint Ventures* is set out in paragraphs .01 to .50. All paragraphs in this Standard of GRAP have equal authority. The status and authority of appendices are dealt with in the preamble to each appendix. This Standard should be read in the context of its objective, its basis for conclusions if applicable, the *Preface to Standards of GRAP,* the *Preface to the Interpretations of the Standards of GRAP* and the *Framework for the Preparation and Presentation of Financial Statements*.

Standards of GRAP and Interpretations of the Standards of GRAP should also be read in conjunction with any directives issued by the Board prescribing transitional provisions, as well as any regulations issued by the Minister of Finance regarding the effective dates of the Standards of GRAP, published in the Government Gazette.

Reference may be made here to a Standard of GRAP that has not been issued at the time of issue of this Standard. This is done to avoid having to change the Standards already issued when a later Standard is subsequently issued. Paragraph .11 of the Standard of GRAP on *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

.01 The objective of this Standard is to prescribe the accounting for investments in associates and joint ventures and to set out the requirements for the application of the equity method when accounting for investments in associates and joint ventures.

Scope

.02 An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for investments in associates and joint ventures.

.03 This Standard shall be applied by all entities that are investors with significant influence over, or joint control of, an investee where the investment leads to the holding of a quantifiable ownership interest.

.04 This Standard provides the basis for accounting for ownership interests in associates and joint ventures. That is, the investment in the other entity confers on the entity the risks and rewards incidental to an ownership interest. This Standard applies only to quantifiable ownership interests. This includes ownership interests arising from investments in the formal equity structure of another entity. A formal equity structure means share capital or an equivalent form of capital. Quantifiable ownership interests may also include ownership interests arising from other investments in which the entity's ownership interest can be measured reliably (for example, interests in a partnership). Where the equity structure of the other entity is poorly defined, it may not be possible to obtain a reliable measure of the ownership interest.

.05 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, an entity may make a substantial investment in the development of a hospital that is owned and operated by a charity. While such contributions are non-exchange in nature, they allow the entity to participate in the operation of the hospital, and the charity is accountable to the entity for its use of public monies. However, the contributions made by the entity do not constitute an ownership interest, as the charity could seek alternative funding and thereby prevent the entity from participating in the operation of the hospital. Accordingly, the entity is not exposed to the risks, nor does it enjoy the rewards, that are incidental to an ownership interest.

Definitions

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

An associate is an entity over which the investor has significant influence.

Binding arrangement is an arrangement that confers enforceable rights and obligations on the parties to the arrangement as if it were in the form of a contract. It includes rights from contracts or other legal rights.

Consolidated financial statements are the financial statements of an economic entity in which assets, liabilities, net assets, revenue, expenses and cash flows of the controlling entity and its controlled entities are presented as those of a single economic entity.

The equity method is a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets. The investor's surplus or deficit includes its share of the investee's surplus or deficit and the investor's net assets includes its share of changes in the investee's net assets that have not been recognised in the investee's surplus or deficit.

A joint arrangement is an arrangement of which two or more parties have joint control.

Joint control is the agreed sharing of control by way of a binding arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

A joint venturer is a party to a joint venture that has joint control of that joint venture.

Significant influence is the power to participate in the financial and operating policy decisions of another entity but is not control or joint control of those policies.

Terms defined in other Standards of GRAP are used in this Standard with the same meaning as in those Standards of GRAP.

Binding arrangement

.07 Binding arrangements can be evidenced in several ways:

(a) a contract concluded between the parties;

(b) legislation, supporting regulations or similar means including, but not limited to, laws, regulation, policies, decisions concluded by authorities such as cabinet, executive committees, boards, municipal councils and ministerial orders; or

(c) through the operation of law, including common law.

A binding arrangement is often, but not always, in writing, in the form of a contract or documented discussions between the parties.

Significant influence

.08 Whether an investor has significant influence over the investee is a matter of judgement 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 a quantifiable ownership interest either in the form of a shareholding or other formal equity structure or in another form in which the entity’s interest can be measured reliably.

.09 If an entity holds a quantifiable ownership interest and it holds, directly or indirectly (e.g., through controlled entities), 20 percent or more of the voting power of the investee, it is presumed that the entity has significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the entity holds, directly or indirectly (e.g., through controlled entities), less than 20 percent of the voting power of the investee, it is presumed that the entity 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 entity from having significant influence.

.10 The existence of significant influence by an entity 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, including participation in decisions about dividends or similar distributions;

(c) material transactions between the entity and its investee;

(d) interchange of managerial personnel; or

(e) provision of essential technical information.

.11 An entity 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 entity additional voting power or to reduce another party's voting power over the financial and operating policies of another entity (i.e., potential voting rights). The existence and effect of potential voting rights that are currently exercisable or convertible, including potential voting rights held by other entities, are considered when assessing whether an entity has significant influence. Potential voting rights are not currently exercisable or convertible when, for example, they cannot be exercised or converted until a future date or until the occurrence of a future event.

.12 In assessing whether potential voting rights contribute to significant influence, the entity examines all facts and circumstances (including the terms of exercise of the potential voting rights and any other binding arrangements whether considered individually or in combination) that affect potential rights, except the intentions of management and the financial ability to exercise or convert those potential rights.

.13 An entity loses significant influence over an investee when it loses the power to participate in the financial and operating policy decisions of that investee. The loss of significant influence can occur with or without a change in absolute or relative ownership levels. It could occur, for example, when an associate becomes subject to the control of another government, a court or an administrator. It could also occur as a result of a binding arrangement.

Equity method

.14 Under the equity method, on initial recognition the investment in an associate or a joint venture is recognised at cost and the carrying amount is increased or decreased to recognise the investor's share of the surplus or deficit of the investee after the date of acquisition. The investor's share of the investee's surplus or deficit is recognised in the investor's surplus or deficit. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's equity that have not been recognised in the investee's surplus or deficit. Such changes include those arising from the revaluation of property, plant and equipment and from foreign exchange translation differences. The investor's share of those changes is recognised in net assets of the investor.

.15 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 or a joint venture because the distributions received may bear little relation to the performance of the associate or joint venture. Because the investor has joint control of, or significant influence over, the investee, the investor has an interest in the associate's or joint venture's performance and, as a result, the return on its investment. The investor accounts for this interest by extending the scope of its financial statements to include its share of the surplus or deficit of such an investee. As a result, application of the equity method provides more informative reporting of the investor's net assets and surplus or deficit.

.16 When potential voting rights or other derivatives containing potential voting rights exist, an entity's interest in an associate or a joint venture is determined solely on the basis of existing ownership interests and does not reflect the possible exercise or conversion of potential voting rights and other derivative instruments, unless paragraph .17 applies.

.17 In some circumstances, an entity has, in substance, an existing ownership interest as a result of a transaction that currently gives it access to the benefits associated with an ownership interest. In such circumstances, the proportion allocated to the entity is determined by taking into account the eventual exercise of those potential voting rights and other derivative instruments that currently give the entity access to the benefits.

.18 The Standard of GRAP on *Financial Instruments* does not apply to interests in associates and joint ventures that are accounted for using the equity method. When instruments containing potential voting rights in substance currently give access to the benefits associated with an ownership interest in an associate or a joint venture, the instruments are not subject to the Standard of GRAP on *Financial Instruments*. In all other cases, instruments containing potential voting rights in an associate or a joint venture are accounted for in accordance with the Standard of GRAP on *Financial Instruments*.

.19 An investment in an associate or a joint venture accounted for using the equity method shall be classified as a non-current asset.

Application of the equity method

.20 An entity with joint control of, or significant influence over, an investee shall account for its investment in an associate or a joint venture using the equity method except when that investment qualifies for exemption in accordance with paragraphs .21 to .23.

Exemptions from applying the equity method

.21 An entity need not apply the equity method to its investment in an associate or a joint venture if the entity is a controlling entity that is exempt from preparing consolidated financial statements by the scope exception in paragraph .05 of the Standard of GRAP on *Consolidated Financial Statements* or if all of the following apply:

(a) The entity itself is a controlled entity and the information needs of users are met by its controlling entity's consolidated financial statements, and, in the case of a partially owned entity, all its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the entity not applying the equity method.

(b) The entity's debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets).

(c) The entity did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation, for the purpose of issuing any class of instruments in a public market.

(d) The ultimate or any intermediate controlling entity of the entity produces financial statements available for public use that comply with the Standards of GRAP , in which controlled entities are consolidated or are measured at fair value in accordance with the Standard of GRAP on *Consolidated Financial Statements*.

.22 When an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure investments in those associates and joint ventures at fair value in accordance with the Standard of GRAP on *Financial Instruments*. An investment entity will, by definition, have made this election.

.23 When an entity has an investment in an associate, a portion of which is held indirectly through a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure that portion of the investment in the associate at fair value in accordance with the Standard of GRAP on *Financial Instruments* regardless of whether the venture capital organisation, or the mutual fund, unit trust and similar entities including investment-linked insurance funds, has significant influence over that portion of the investment. If the entity makes that election, the entity shall apply the equity method to any remaining portion of its investment in an associate that is not held through a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds. When an entity has an investment in an associate, a portion of which is held indirectly through an investment entity, the entity shall measure that portion of the investment at fair value in accordance with the Standard of GRAP on *Financial Instruments*.

Discontinuing the use of the equity method

.24 An entity shall discontinue the use of the equity method from the date when its investment ceases to be an associate or a joint venture as follows:

(a) If the investment becomes a controlled entity, the entity shall account for its investment in accordance with the Standards of GRAP on Transfer of Functions Between Entities Under Common Control, Transfer of Functions Between Entities Not Under Common Control, Mergers and Consolidated Financial Statements and the Standard of GRAP on Consolidated Financial Statements.

(b) If the retained interest in the former associate or joint venture is a financial asset, the entity shall measure the retained interest at fair value. The fair value of the retained interest shall be regarded as its fair value on initial recognition as a financial asset in accordance with the Standard of GRAP on Financial Instruments. If an entity is precluded by the Standard of GRAP on Financial Instruments from measuring the retained interest at fair value, the entity shall measure the retained interest at the carrying amount of the investment at the date that it ceases to be an associate or joint venture and that carrying amount shall be regarded as its cost on initial recognition as a

financial asset in accordance with the Standard of GRAP on Financial Instruments. The entity shall recognise in surplus or deficit any difference between:

(i) the fair value (or, where relevant, the carrying amount) of any retained interest and any proceeds from disposing of a part interest in the associate or joint venture; and

(ii) the carrying amount of the investment at the date the equity method was discontinued.

(c) When an entity discontinues the use of the equity method, the entity shall account for all amounts previously recognised directly in the entity's net assets 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.

.25 If an investment in an associate becomes an investment in a joint venture or an investment in a joint venture becomes an investment in an associate, the entity continues to apply the equity method and does not remeasure the retained interest.

Change in ownership interest

.26 If an entity's ownership interest in an associate or a joint venture is reduced, but the investment continues to be classified either as an associate or a joint venture respectively, the entity shall transfer directly to accumulated surpluses or deficits the proportion of the gain or loss that had previously been recognised in net assets relating to that reduction in ownership interest if that gain or loss would be required to be transferred directly to accumulated surpluses or deficits on the disposal of the related assets or liabilities.

Equity method procedures

.27 Many of the procedures that are appropriate for the application of the equity method are similar to the consolidation procedures described in the Standard of GRAP on *Consolidated Financial Statements*. Furthermore, the concepts underlying the procedures used in accounting for the acquisition of a controlled entity are also adopted in accounting for the acquisition of an investment in an associate or a joint venture.

.28 An economic entity's share in an associate or a joint venture is the aggregate of the holdings in that associate or joint venture by the controlling entity and its controlled entities. The holdings of the economic entity's other associates or joint ventures are ignored for this purpose. When an associate or a joint venture has controlled entities, associates or joint ventures, the surplus or deficit and net assets taken into account in applying the equity method are those recognised in the associate's or joint venture's financial statements (including the associate's or joint venture's share of the surpluses or deficits and net assets of its associates and joint ventures), after any adjustments necessary to give effect to uniform accounting policies (see paragraphs .35 to .37).

.29 Gains and losses resulting from "upstream" and "downstream" transactions between an entity (including its consolidated controlled entities) and its associate or joint venture are recognised in the entity's financial statements only to the extent of unrelated investors' interests in the associate or joint venture. "Upstream" transactions are, for example, sales of assets from an associate or a joint venture to the investor. "Downstream" transactions are, for example, sales or contributions of assets from the investor to its associate or its joint venture. The investor's share in the associate's or joint venture's surpluses or deficits resulting from these transactions is eliminated.

.30 When downstream transactions provide evidence of a reduction in the net realisable value of the assets to be sold or contributed, or of an impairment loss of those assets, those losses shall be recognised in full by the investor. When upstream transactions provide evidence of a reduction in the net realisable value of the assets to be purchased or of an impairment loss of those assets, the investor shall recognise its share in those losses.

.31 The contribution of a non-monetary asset to an associate or a joint venture in exchange for an equity interest in the associate or joint venture shall be accounted for in accordance with paragraph .29.

.32 If, in addition to receiving an equity interest in an associate or a joint venture, an entity receives monetary or non-monetary assets, the entity recognises in full in surplus or deficit the portion of the gain or loss on the contribution relating to the monetary or non-monetary assets received.

.33 An investment is accounted for using the equity method from the date on which it becomes an associate or a joint venture. On acquisition of the investment, any difference between the cost of the investment and the entity's share of the net fair value of the investee's identifiable assets and liabilities is accounted for in terms of the Standards of GRAP on *Transfer of Functions Between Entities Under Common Control* or *Transfer of Functions Between Entities Not Under Common Control* (as appropriate).

Appropriate adjustments to the entity's share of the associate's or joint venture's surplus or deficit after acquisition are made in order to account, for example, for depreciation of the depreciable assets based on their fair values at the acquisition date. Similarly, appropriate adjustments to the entity's share of the associate's or joint venture's surplus or deficit after acquisition are made for impairment losses such as for property, plant and equipment.

.34 The most recent available financial statements of the associate or joint venture are used by the entity in applying the equity method. When the end of the reporting period of the entity is different from that of an associate or a joint venture the entity either:

(a) obtains, for the purpose of applying the equity method, additional financial information as of the same date as the financial statements of the entity; or

(b) uses the most recent financial statements of the associate or joint venture adjusted for the effects of significant transactions or events that occur between the date of those financial statements and the date of the entity's financial statements.

.35 The entity's financial statements shall be prepared using uniform accounting policies for like transactions and events in similar circumstances.

.36 Except as described in paragraph .37, if an associate or a joint venture uses accounting policies other than those of the entity for like transactions and events in similar circumstances, adjustments shall be made to make the associate's or joint venture's accounting policies conform to those of the entity when the associate's or joint venture's financial statements are used by the entity in applying the equity method.

.37 Notwithstanding the requirements in paragraph .36, if an entity has an interest in an associate or a joint venture that is an investment entity, the entity shall, when applying the equity method, retain the fair value measurement applied by that investment entity associate or joint venture to its interest in controlled entities.

.38 If an associate or a joint venture has outstanding cumulative preference shares that are held by parties other than the entity and are classified as equity, the entity computes its share of surplus or deficit after adjusting for the dividends or similar distributions on such shares, whether or not the dividends or similar distributions have been declared.

.39 If an entity's share of the deficit of an associate or a joint venture equals or exceeds its interest in the associate or joint venture, the entity discontinues recognising its share of further deficits. The interest in an associate or a joint venture is the carrying amount of the investment in the associate or joint venture determined using the equity method together with any long-term interests that, in substance, form part of the entity's net investment in the associate or joint venture. For example, an item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, an extension of the entity's investment in that associate or joint venture. Such items may include preference shares and long-term receivables or loans, but do not include trade receivables, trade payables or any long-term receivables for which adequate collateral exists, such as secured loans. Deficits recognised using the equity method in excess of the entity's investment in ordinary shares are applied to the other components of the entity's interest in an associate or a joint venture in the reverse order of their seniority (i.e. priority in liquidation).

.40 After the entity's interest is reduced to zero, additional deficits are provided for, and a liability is recognised, only to the extent that the entity has incurred legal or constructive obligations or made payments on behalf of the associate or joint venture. If the associate or joint venture subsequently reports surpluses, the entity resumes recognising its share of those surpluses only after its share of the surpluses equals the share of deficits not recognised.

Impairment losses

.41 After application of the equity method, including recognising the associate's or joint venture's deficits in accordance with paragraph .39 the entity applies the Standard of GRAP on *Financial Instruments* to determine whether it is necessary to recognise any additional impairment loss with respect to its net investment in the associate or joint venture.

.42 The entity also applies the Standard of GRAP on *Financial Instruments* to determine whether any additional impairment loss is recognised with respect to its interest in the associate or joint venture that does not constitute part of the net investment and the amount of that impairment loss.

.43 Whenever application of the Standard of GRAP on *Financial Instruments* indicates that the investment in an associate or a joint venture may be impaired, an entity applies the Standard of GRAP on *Impairment of Cash-Generating Assets,* and possibly, the Standard of GRAP on *Impairment of Non-Cash-Generating Assets.*

.44 The Standard of GRAP on *Impairment of Cash-generating Assets* directs an entity to determine the value in use of the cash-generating investment. In determining the value in use of the cash-generating investment in accordance with the Standard of GRAP on *Impairment of Cash-generating Assets*, an entity estimates:

(a) its share of the present value of the estimated future cash flows expected to be generated by the associate or joint venture, including the cash flows from the operations of the associate or joint venture and the proceeds from the ultimate disposal of the investment; or

(b) the present value of the estimated future cash flows expected to arise from dividends or similar distributions to be received from the investment, and from its ultimate disposal.

Using appropriate assumptions, both methods give the same result.

.45 The Standard of GRAP on *Impairment of Non-cash-generating Assets* requires that, if the recoverable service amount of an asset is less than its carrying amount, the carrying amount shall be reduced to its recoverable service amount. Recoverable service amount is the higher of an asset’s fair value, less costs to sell and its value in use. Value in use of a non-cash-generating asset is defined as the present value of the asset’s remaining service potential. The present value of the remaining service potential may be assessed using the depreciated replacement cost approach, the restoration cost approach or the service units approach, as appropriate.

.46 The recoverable amount of an investment in an associate or a joint venture shall be assessed for each associate or joint venture, unless the associate or joint venture does not generate cash inflows from continuing use that are largely independent of those from other assets of the entity.

Separate financial statements

.47 An investment in an associate or a joint venture shall be accounted for in the entity's separate financial statements in accordance with paragraph .12 of the Standard of GRAP on Separate Financial Statements.

Transitional provisions

.48 The transitional provisions to be applied by entities on the initial adoption of this Standard are prescribed in a directive(s). The provisions of this Standard should be read in conjunction with each applicable directive.

Effective date

.49 An entity shall apply this Standard of GRAP for annual financial statements covering periods beginning on or after a date to be determined by the Minister of Finance in a regulation to be published in accordance with section 91(1)(b) of the Public Finance Management Act, Act No. 1 of 1999, as amended.

Withdrawal of the Standard of GRAP on *Investments in Associates*

.50 This Standard supersedes the previous Standard of GRAP on *Investments in Associates* issued in November 2005.

Comparison with the International Public Sector Accounting Standard on *Investments in Associates and Joint Ventures* (January 2015)

The Exposure Draft on *Investments in Associates and Joint Ventures* is drawn primarily from the International Public Sector Accounting Standard on *Investments in Associates and Joint Ventures* (IPSAS 36). The main differences between GRAP 36 and IPSAS 36 are as follows:

- IPSAS 36 describes the residual of total assets after deducting total liabilities as “net assets/equity” whereas this Standard refers to “net assets”.
- Additional explanatory text has been included in this Standard to explain “binding arrangement”. This guidance is not included in IPSAS 36.
- Guidance on the treatment of goodwill related to the acquisition of an associate differs from the guidance prescribed in IPSAS 36. The guidance on the treatment of goodwill has been aligned with the principles in the Standards of GRAP on *Transfer of Functions Between Entities Under Control*, *Transfer of Functions Between Entities Not Under Control* and *Mergers.*
- Guidance on transactions that lack commercial substance has been deleted from this Standard as this guidance has been deleted from the Standards of GRAP.
- Transitional provisions to this Standard of GRAP are dealt with differently than in IPSAS 36.