

Investments in Associates and Joint Ventures (IAS 28)

Table of Contents

1. Objective and scope of IAS 28
2. Key definitions
3. Initial recognition and measurement
4. Subsequent measurement — mechanics of the equity method
5. Detailed issues under the equity method
6. Exemptions and special cases
7. Discontinuing the equity method
8. Disclosure requirements
9. Integrated exam-style example
10. Summary — key exam points
11. Multiple Choice Questions (MCQs)
12. Comprehensive Question Bank (with Solutions)

1. Objective and scope of IAS 28

IAS 28 prescribes how an investor accounts for investments in:

- **Associates:** entities over which the investor has significant influence but not control.
- **Joint ventures:** joint arrangements where parties have joint control and rights to the net assets of the arrangement.

The standard requires the **equity method** to be applied to these investments in consolidated financial statements, except in specific cases (e.g. certain venture capital organisations that elect fair value through profit or loss).

IAS 28 interacts closely with:

- **IFRS 10:** control and consolidation of subsidiaries.
- **IFRS 11:** classification of joint arrangements (joint operations vs joint ventures).

2. Key definitions

2.1 Associate

Associate: An entity over which the investor has **significant influence** but neither control nor joint control.

2.2 Significant influence

Significant influence: The power to participate in the financial and operating policy decisions of the investee, but not control or joint control over those policies.

IAS 28 includes a **rebuttable presumption**:

- **20% or more** of voting power → presumed significant influence.
- **Less than 20%** → presumed no significant influence.
- Either presumption can be rebutted by clear evidence.

Qualitative indicators of significant influence include:

- **Representation on the board** or equivalent governing body.
- **Participation in policymaking**, including dividend decisions.
- **Material transactions** between investor and investee.
- **Interchange of managerial personnel.**
- **Provision of essential technical information.**

2.3 Joint venture

Joint venture: A joint arrangement in which the parties that have joint control have **rights to the net assets** of the arrangement (not to specific assets and liabilities).

Joint control: Contractually agreed sharing of control, where decisions about relevant activities require **unanimous consent** of the parties sharing control.

Joint ventures are **not fully consolidated**; instead, they are accounted for using the **equity method** under IAS 28.

2.4 Equity method

Equity method: A method of accounting whereby the investment is:

- Initially recognised at **cost**.
- Subsequently adjusted for the investor's **share of the investee's profit or loss** and **other comprehensive income (OCI)**.
- Reduced by **distributions (dividends)** received.

This is often described as a “**one-line consolidation**”: the investor presents a single line item for the investment, rather than consolidating the investee's individual assets and liabilities.

3. Initial recognition and measurement

3.1 Initial recognition

On acquisition date, the investment in an associate or joint venture is recognised **at cost**. Cost includes:

- **Purchase consideration** (cash, other assets, equity instruments, or liabilities assumed).
- **Directly attributable transaction costs** (unless measured at fair value through profit or loss under an exemption).

3.2 Allocation of cost — goodwill and bargain purchase

At acquisition, the investor compares:

- **Cost of the investment**, and
- **Investor's share of the net fair value of identifiable assets and liabilities** of the associate/joint venture.

If **cost > share of net fair value**, the difference is treated as **goodwill**, included in the carrying amount of the investment (not recognised separately).

If **cost < share of net fair value**, the difference is a **bargain purchase gain**, recognised in profit or loss at acquisition.

4. Subsequent measurement — mechanics of the equity method

4.1 Basic mechanics

After initial recognition, the carrying amount of the investment is adjusted as follows:

1. **Share of profit or loss**
 - Investor recognises its share of the associate/joint venture's **post-acquisition profit or loss** in its own profit or loss.
 - The carrying amount of the investment is **increased** (for profit) or **decreased** (for loss).
2. **Share of other comprehensive income (OCI)**
 - Investor recognises its share of the investee's OCI in its own OCI.
 - The carrying amount of the investment is adjusted accordingly.
3. **Dividends received**
 - Dividends are treated as a **reduction of the carrying amount** of the investment (a return of investment), not as separate income.
4. **Other changes in net assets**
 - Investor's share of other changes in the investee's net assets (e.g. equity-settled share-based payments, revaluation reserves) may also adjust the carrying amount.

4.2 Numerical example — equity method

Example 1: Basic equity method

- On 1 Jan 20X1, Investor Co acquires **30%** of Associate Co for **R300 000**.
- On that date, Associate Co's net assets at fair value are **R800 000**.
- Investor Co's share of net assets:

$$30\% \times R800\,000 = R240\,000$$

- Difference between cost and share of net assets:

$$R300\,000 - R240\,000 = R60\,000 \text{ (goodwill)}$$

Year 20X1:

- Associate Co reports **profit for the year (after tax)** of **R100 000**.
- Associate Co declares and pays **dividends** of **R20 000**.

Investor Co's share of profit:

$$30\% \times R100\,000 = R30\,000$$

Investor Co's share of dividends:

$$30\% \times R20\,000 = R6\,000$$

Carrying amount at 31 Dec 20X1:

- Opening carrying amount: R300 000
- Plus share of profit: +R30 000
- Less dividends received: –R6 000

$$\text{Closing carrying amount} = R300\,000 + R30\,000 - R6\,000 = R324\,000$$

Journal entries:

- Recognise share of profit:
 - Dr Investment in Associate R30 000
 - Cr Share of profit of associate (P/L) R30 000
- Recognise dividends received:
 - Dr Bank R6 000
 - Cr Investment in Associate R6 000

5. Detailed issues under the equity method

5.1 Losses and carrying amount

If the investor's share of losses of an associate or joint venture **equals or exceeds** the carrying amount of the investment (including any long-term interests that, in substance, form part of the net investment), the investor:

- **Discontinues recognising further losses**, unless it has incurred legal or constructive obligations or made payments on behalf of the investee.
- Any such obligations are recognised as **liabilities**.

Once the investor's share of profits resumes, it only resumes recognising its share of profits **after** previously unrecognised losses have been recovered.

5.2 Impairment of the investment

The entire carrying amount of the investment (including goodwill) is tested for **impairment** when there is objective evidence of impairment.

- Impairment is assessed under **IAS 36** principles.
- Any impairment loss is recognised in profit or loss.
- Reversals of impairment are recognised when the recoverable amount increases, subject to IAS 36.

5.3 Upstream and downstream transactions

Upstream transactions:

- From associate/joint venture to investor (e.g. sale of goods by associate to investor).

Downstream transactions:

- From investor to associate/joint venture (e.g. sale of goods by investor to associate).

Profits and losses from such transactions are **eliminated to the extent of the investor's interest** in the associate or joint venture:

- If the transaction results in **unrealised profit** (e.g. inventory still on hand), the investor eliminates its share of that profit.
- The elimination is made against the investor's share of the associate/joint venture's profit.

Example 2: Downstream transaction

- Investor Co sells goods to Associate Co for **R50 000**, cost **R35 000**.
- Profit on sale:

$$R50\,000 - R35\,000 = R15\,000$$

- At year-end, Associate Co still holds **40%** of these goods in inventory.
- Unrealised profit:

$$40\% \times R15\,000 = R6\,000$$

- Investor Co's interest in Associate Co: **30%**.

Investor Co eliminates its share of unrealised profit:

$$30\% \times R6\,000 = R1\,800$$

Journal:

- | | | |
|-----------------------------------|--------|--------|
| • Dr Share of profit of associate | R1 800 | |
| • Cr Investment in Associate | | R1 800 |

5.4 Different reporting dates

If the reporting date of the associate/joint venture differs from that of the investor by more than a short period, the associate/joint venture prepares additional financial information as of the investor's reporting date, or adjustments are made for significant transactions/events between the two dates.

5.5 Different accounting policies

The investor uses **uniform accounting policies** for like transactions and events. If the associate/joint venture uses different policies, adjustments are made to align with the investor's policies, where practicable.

6. Exemptions and special cases

6.1 Venture capital organisations and similar entities

Venture capital organisations, mutual funds, unit trusts, and similar entities may elect to measure investments in associates and joint ventures at **fair value through profit or loss** under IFRS 9, instead of using the equity method.

6.2 Separate financial statements

In **separate financial statements** (under IAS 27), investments in associates and joint ventures are accounted for using **one of the following**:

- **Cost**; or
- **Fair value through profit or loss** (IFRS 9); or
- **Fair value through OCI** (if applicable under IFRS 9).

The equity method is generally applied in **consolidated financial statements**, not in separate financial statements.

7. Discontinuing the equity method

The investor **discontinues** applying the equity method from the date when:

- It **ceases to have significant influence** over an associate; or
- It **ceases to have joint control** over a joint venture.

From that date, the investment is accounted for under **IFRS 9** (or other relevant standards), usually at:

- **Fair value**, with any difference between carrying amount and fair value recognised in profit or loss.

If the investor retains an interest but no longer has significant influence or joint control, the retained interest is treated as a **financial asset**.

8. Disclosure requirements

IAS 28 requires extensive disclosures to help users understand:

- **Nature and extent** of interests in associates and joint ventures.
- **Financial effects** of those interests on the investor's financial position and performance.

Key disclosures include:

- **Name, nature, and principal place of business** of each material associate/joint venture.
- **Proportion of ownership interest** and, if different, proportion of voting rights.
- **Method of accounting** (equity method or fair value).
- **Summarised financial information** for material associates and joint ventures (assets, liabilities, revenue, profit or loss).
- **Unrecognised share of losses**, if any.
- **Restrictions** on the ability of associates/joint ventures to transfer funds to the investor.

9. Integrated exam-style example

Scenario:

Parent Co (P) acquires **25%** of Associate Co (A) on 1 Jan 20X1 for **R500 000**. On that date, A's net assets at fair value are **R1 800 000**.

During 20X1:

- A reports **profit for the year (after tax)** of **R200 000**.
- A reports **OCI (revaluation gain)** of **R40 000**.
- A declares and pays **dividends** of **R80 000**.

Step 1: Determine goodwill

P's share of A's net assets at acquisition:

$$25\% \times R1\,800\,000 = R450\,000$$

Goodwill:

$$R500\,000 - R450\,000 = R50\,000$$

Total initial carrying amount (including goodwill): **R500 000**.

Step 2: Share of profit and OCI

Share of profit:

$$25\% \times R200\,000 = R50\,000$$

Share of OCI:

$$25\% \times R40\,000 = R10\,000$$

Step 3: Share of dividends

Share of dividends:

$$25\% \times R80\,000 = R20\,000$$

Step 4: Closing carrying amount

Opening carrying amount: R500 000

- Share of profit: +R50 000
- Share of OCI: +R10 000
- Dividends received: –R20 000

$$\text{Closing carrying amount} = R500\,000 + R50\,000 + R10\,000 - R20\,000 = R540\,000$$

Step 5: Presentation

Statement of financial position (extract):

- Non-current assets:
 - Investment in associate (equity method) — R540 000

Statement of profit or loss (extract):

- Share of profit of associate — R50 000

Statement of other comprehensive income (extract):

- Share of OCI of associate — R10 000

10. Summary — key exam points

- **Identify significant influence** using both the 20% presumption and qualitative indicators.
- **Apply the equity method:** cost, plus share of profit and OCI, minus dividends.
- **Include goodwill** within the carrying amount; test the entire investment for impairment.
- **Eliminate unrealised profits** on upstream/downstream transactions to the extent of the investor's interest.
- **Stop recognising losses** when the carrying amount (including long-term interests) is reduced to zero, unless obligations exist.
- **Discontinue equity method** when significant influence or joint control ceases; remeasure retained interest under IFRS 9.

- **Provide clear disclosures** on nature, extent, and financial impact of associates and joint ventures.

11. Multiple-Choice Questions (MCQs)

Set of 20 Questions with Answers

1. Significant influence is presumed when an investor holds:

- A. More than 10% of voting power
- B. Exactly 50% of voting power
- C. 20% or more of voting power
- D. Control over the investee

➤ **Answer: C**

2. The equity method requires the investment to be initially recognised at:

- A. Fair value
- B. Cost
- C. Net asset value
- D. Share of profits

➤ **Answer: B**

3. Under the equity method, the investor's share of the associate's profit:

- A. Is ignored
- B. Increases the carrying amount of the investment
- C. Is recognised only when dividends are declared
- D. Is recognised as revenue only in OCI

➤ **Answer: B**

4. Dividends received from an associate are:

- A. Recognised as revenue
- B. Added to the carrying amount
- C. Deducted from the carrying amount
- D. Ignored

➤ **Answer: C**

5. Goodwill relating to an associate under IAS 28 is:

- A. Recognised separately as an intangible asset
- B. Included in the carrying amount of the investment
- C. Amortised over 10 years
- D. Measured at fair value through OCI

➤ **Answer: B**

6. A joint venture is characterised by:

- A. Rights to net assets
- B. Rights to specific assets
- C. No joint control
- D. Full consolidation

➤ **Answer: A**

7. Unrealised profits on downstream transactions are eliminated:

- A. Fully
- B. Only if material
- C. To the extent of the investor's interest
- D. Never

➤ **Answer: C**

8. When an investor's share of losses equals the carrying amount of the investment:

- A. Losses continue to be recognised
- B. Loss recognition stops unless obligations exist
- C. The investment becomes a liability
- D. The investment must be derecognised

➤ **Answer: B**

9. If the reporting dates of investor and associate differ significantly:

- A. No adjustments are allowed
- B. The associate must change its year-end
- C. Adjustments for significant transactions are required
- D. The investor must adopt the associate's reporting date

➤ **Answer: C**

10. In separate financial statements, investments in associates may be measured at:

- A. Only cost
- B. Only equity method
- C. Cost, fair value through P/L, or fair value through OCI
- D. Only fair value

➤ **Answer: C**

11. Venture capital organisations may account for associates using:

- A. Equity method only
- B. Cost method only
- C. Fair value through profit or loss
- D. Consolidation

➤ **Answer: C**

12. When significant influence is lost, the investment is:

- A. Derecognised and replaced with a liability
- B. Measured under IFRS 9
- C. Continued under equity method
- D. Consolidated

➤ **Answer: B**

13. Upstream transactions refer to:

- A. Investor selling to associate
- B. Transactions between joint venturers only
- C. Transactions between subsidiaries
- D. Associate selling to investor

➤ **Answer: D**

14. Impairment of an investment in an associate is assessed under:

- A. IFRS 9
- B. IAS 36
- C. IFRS 10
- D. IAS 12

➤ **Answer: B**

15. The investor's share of an associate's OCI:

- A. Is ignored
- B. Is recognised in the investor's OCI
- C. Is recognised in profit or loss
- D. Is recognised only when dividends are paid

➤ **Answer: B**

16. The equity method is often described as:

- A. Full consolidation
- B. Proportionate consolidation
- C. One-line consolidation
- D. Fair value accounting

➤ **Answer: C**

17. A key indicator of significant influence is:

- A. Ability to veto decisions
- B. Representation on the board
- C. Control over dividends
- D. Holding preference shares

➤ **Answer: B**

18. If an investor sells goods to an associate at a profit and inventory remains unsold:

- A. No adjustment is required
- B. Full profit is eliminated
- C. Profit is eliminated to the extent of the investor's interest
- D. Profit is recognised immediately

➤ **Answer: C**

19. The carrying amount of an investment under the equity method is increased by:

- A. Dividends received
- B. Share of losses
- C. Share of profits
- D. Impairment losses

➤ **Answer: C**

20. Joint control requires decisions about relevant activities to be made:

- A. By majority vote
- B. By any one venturer
- C. Unilaterally by the investor
- D. Unanimously by the parties sharing control

➤ **Answer: D**

12. Comprehensive Question Bank (with Solutions)

Question 1 — Definition and Indicators of Significant Influence

Required: Explain the meaning of *significant influence* under IAS 28 and list **five indicators** that an investor has significant influence over an investee.

Solution:

Significant influence is the **power to participate** in the financial and operating policy decisions of an investee, **without having control or joint control**.

Indicators include:

1. Representation on the board of directors.
2. Participation in policy-making processes.
3. Material transactions between investor and investee.
4. Interchange of managerial personnel.
5. Provision of essential technical information.

IAS 28 also includes a **rebuttable presumption** that holding **20% or more** of voting power indicates significant influence.

Question 2 — Initial Recognition of an Associate

Investor Co acquires 30% of ABC Ltd for R600 000. The fair value of ABC's identifiable net assets is R1 800 000.

Required: Calculate the goodwill included in the investment at initial recognition.

Solution:

Investor's share of net assets: $30\% \times R1\,800\,000 = R540\,000$

Goodwill: Cost – Share of net assets = $R600\,000 - R540\,000 = \mathbf{R60\,000}$

Question 3 — Basic Equity Method Adjustments

Using the investment in Question 2, ABC Ltd reports profit for the year (after tax) of R200 000 and pays dividends of R50 000.

Required: Calculate the closing carrying amount of the investment.

Solution:

- Opening carrying amount: R600 000
- Share of profit: $30\% \times R200\ 000 = R60\ 000$
- Share of dividends: $30\% \times R50\ 000 = R15\ 000$
- Closing carrying amount: $600\ 000 + 60\ 000 - 15\ 000 = \mathbf{R645\ 000}$

Question 4 — Share of OCI

ABC Ltd reports OCI of R40 000 relating to a revaluation surplus.

Required: Calculate Investor Co's share of OCI and explain how it is recognised.

Solution:

Share of OCI: $30\% \times R40\ 000 = \mathbf{R12\ 000}$

Recognition:

- Increase investment carrying amount by R12 000
- Recognise R12 000 in the investor's **OCI**

Question 5 — Losses Exceeding Carrying Amount

An investor's share of losses in an associate totals R300 000. The carrying amount of the investment is R250 000. The investor has no obligations to fund the associate.

Required: Explain how losses are recognised.

Solution:

- Investor recognises losses **only up to the carrying amount** (R250 000).
- Remaining R50 000 losses are **not recognised**.
- Investment is reduced to **zero**.
- Future profits are recognised **only after** unrecognised losses are recovered.

Question 6 — Upstream Transaction Elimination

Associate sells goods to Investor for R100 000 at a profit of R30 000. At year-end, Investor still holds 40% of the goods. Investor owns 25% of the associate.

Required: Calculate the unrealised profit to eliminate.

Solution:

- Unrealised profit in inventory: $40\% \times R30\,000 = R12\,000$
- Investor eliminates its share: $25\% \times R12\,000 = \mathbf{R3\,000}$

Question 7 — Downstream Transaction Elimination

Investor sells goods to Associate for R80 000 at a profit of R20 000. Associate still holds 50% of the goods. Investor owns 30% of the associate.

Required: Calculate the adjustment.

Solution:

- Unrealised profit: $50\% \times R20\,000 = R10\,000$
- Investor eliminates: $30\% \times R10\,000 = \mathbf{R3\,000}$
- Decrease investment and reduce share of profit.

Question 8 — Impairment of an Associate

Explain how impairment of an investment in an associate is assessed under IAS 28.

Solution:

- Entire carrying amount (including goodwill) is tested under **IAS 36**.
- Recoverable amount = higher of value in use or fair value less costs of disposal.
- Impairment loss recognised in **profit or loss**.
- Reversal permitted if recoverable amount increases (subject to IAS 36 rules).

Question 9 — Different Reporting Dates

Investor's year-end: 31 December Associate's year-end: 30 September

Required: Explain how the investor applies the equity method.

Solution:

- Use associate's financial statements **not more than 3 months old**.
- Adjust for **significant transactions** between 30 September and 31 December.
- If necessary, obtain additional financial information.

Question 10 — Change in Ownership Without Losing Significant Influence

Investor increases its interest from 25% to 30%.

Required: Explain how the investment is adjusted.

Solution:

- Continue using equity method.
- Additional cost is added to the carrying amount.
- No remeasurement of previously held interest.
- No gain or loss recognised.

Question 11 — Loss of Significant Influence

Investor sells shares and reduces interest from 25% to 10%.

Required: Explain how the investment is accounted for after the sale.

Solution:

- Equity method is discontinued.
- Remaining 10% interest is recognised under **IFRS 9** at fair value.
- Difference between carrying amount and fair value is recognised in **profit or loss**.

Question 12 — Joint Venture vs Joint Operation

Explain the difference between a joint venture and a joint operation.

Solution:

Joint venture:

- Parties have **rights to net assets**.
- Accounted for using **equity method**.

Joint operation:

- Parties have **rights to specific assets and obligations for specific liabilities**.
- Recognise share of assets, liabilities, income, and expenses directly.

Question 13 — Fair Value Option for Venture Capital Entities

Explain when an entity may elect not to use the equity method.

Solution:

Venture capital organisations, mutual funds, and similar entities may elect to measure investments in associates and joint ventures at **fair value through profit or loss** under IFRS 9.

Question 14 — Associate with Preference Shares

Investor holds 25% of voting shares and 60% of non-voting preference shares.

Required: Explain whether significant influence exists.

Solution:

Significant influence depends on **voting power**, not economic interest. Investor holds **25% voting power**, so significant influence is presumed unless rebutted.

Question 15 — Equity Method Journal Entries

Provide the journal entries for:

1. Share of profit
2. Dividends received

Solution:

1. Share of profit:
 - Dr Investment in Associate
 - Cr Share of profit of associate (P/L)
2. Dividends received:
 - Dr Bank
 - Cr Investment in Associate

Question 16 — Associate with Negative Net Assets

Associate has negative net assets of R200 000. Investor owns 40%.

Required: Explain how the investor accounts for its share.

Solution:

- Investor recognises losses **only up to carrying amount**.
- If carrying amount becomes zero, investor stops recognising further losses unless obligations exist.
- Negative net assets do not create a negative investment balance.

Question 17 — OCI Reclassification

Associate reclassifies a cash-flow hedge reserve to profit or loss.

Required: Explain how the investor reflects this.

Solution:

Investor recognises its share of the associate's reclassification:

- Reduce OCI
- Increase profit or loss
- Adjust carrying amount accordingly

Question 18 — Associate with Different Accounting Policies

Associate uses FIFO for inventories; investor uses weighted average.

Required: Explain how the equity method is applied.

Solution:

Investor must adjust associate's results to align with **uniform accounting policies**, where practicable.

Question 19 — Disposal of Entire Associate

Investor sells its entire 30% interest.

Required: Explain how the gain or loss is calculated.

Solution:

- Gain/loss = Proceeds – Carrying amount of investment
- Recognised in **profit or loss**.

Question 20 — Comprehensive Scenario

Investor acquires 40% of Beta Ltd for R1 000 000. Beta reports:

- Profit: R300 000
- OCI: R50 000
- Dividends: R40 000

Required: Calculate the closing carrying amount.

Solution:

- Share of profit: $40\% \times 300\,000 = 120\,000$
- Share of OCI: $40\% \times 50\,000 = 20\,000$
- Share of dividends: $40\% \times 40\,000 = 16\,000$
- Closing carrying amount: $1\,000\,000 + 120\,000 + 20\,000 - 16\,000 = \mathbf{R1\,124\,000}$