Guidance document: Equity Investments

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| Acronyms | Full form |
| AASB | Australian Accounting Standards Board |
| DTF | Department of Treasury and Finance |
| FITA | *Fiscal Integrity and Transparency Act 2001* |
| FMA | *Financial Management Act 1995* |
| NT | Northern Territory |
| OCI | Other comprehensive income |

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# Introduction

## Purpose

To provide better practice guidance to assist accountable officers and agencies to meet their obligations under the Treasurer’s Direction (TD) – Equity investments, the *Financial Management Act 1995* (FMA), and other relevant legislation. Accordingly, this document should be read in conjunction with the TD – Equity investments, relevant accounting standards and other relevant legislation.

Guidance material in this document is not mandatory. If a conflict arises between this document and TD or other legislative requirements, the legislation takes precedence followed by the TD.

The TD generally designate responsibility to the accountable officer. Unless specifically excluded by the FMA or TD, accountable officers may choose to delegate certain responsibilities and functions to agency employees. This can be done through a number of mechanisms, such as accountable officer approved policies, procedures and agency delegations.

Any reference to ‘agency’ also includes ‘government business division’ unless specifically excluded.

## Statement

The objectives of the TD – Equity investments and this guidance document are to detail the requirements for Northern Territory (NT) Government agencies for the approval, recognition, measurement and reporting of equity investments.

## Legislative basis and related documents

* FMA
* Australian Accounting Standards on:
* AASB 7 Financial Instruments: Disclosures
* AASB 9 Financial instruments
* AASB 10 Consolidated Financial Statements
* AASB 11 Joint Arrangements
* AASB 13 Fair Value Measurement
* AASB 128 Investment in Associates and Joint Venture
* AASB 1058 Income of Non-for-profit entities
* Treasurer’s Direction on:
* Equity investments
* R2.1 Financial Reporting: Agency Financial Statements
* R3.1 GBD Financial Statements
* Guidance document on:
* Treasurer’s delegations
* Financial Instruments

## Background

The Territory Government may invest money determined by the Treasurer as ‘available funds for investment’ in accordance with the requirements of Section 29 of the FMA. Section 29 (2) of the FMA details the types of investments permitted by the FMA.

The TD - Equity investments and this guidance document details the requirements pertaining to equity investments only and not the other types of investments permitted by the FMA.

# Definitions

## Equity Investments

Equity investments are equity-based financial instruments that represent an ownership in an entity and are categorised as either:

1. controlled entity investments
2. equity accounted investments
3. or investments in shares (excludes investments classified as a debt instrument such as investments in unit trusts).

Classification of investments into the appropriate category is important as it determines how investments will be recognised, measured and presented in the financial statements.

Agencies must document significant judgment and assumptions made in determining the classification of investment (such as determining control, joint control or significant influence) and must disclose these assumptions in the financial statements.

Examples of scenarios an agency may include in the significant judgment and assumptions disclosure are:

* the Territory Government does not control another entity even though it holds more than half of the voting rights
* the Territory Government controls another entity even though it holds less than half of the voting rights
* the Territory Government does not have a significant influence even though it holds 20 per cent or more of the voting rights.

### Controlled entity investments

Controlled entity investments represent controlling interest by the Territory Government over an entity.

Control exists where all of the following criteria are met:

1. the Territory Government has power over the investee, such as holding majority of the voting rights, giving the ability to direct relevant activities either directly or by appointing a member of the governing body
2. the Territory Government has exposure or rights to variable returns from its involvement with the investee for example dividends, income distribution and or changes in the value of the investment
3. and the Territory Government has the ability to use its power over the investee to affect the amount of financial returns.

Refer to **Appendix A** for examples on how to determine if control exists.

### Equity accounted investments

Equity accounted investments represent an ownership interest in an entity held by the Territory Government where either criteria is met:

1. the Territory Government has significant influence over the investee
2. or the Territory Government has joint control over the investee through a joint venture arrangement.

#### Significant influence

Significant influence exists where there is power to participate in the financial and operating policy decisions of the investee but does not have control or joint control over those policy decisions.

Power to participate in the financial and operating policy decisions maybe either active or passive participation. Thus, where the Territory Government has power to participate in the financial and operating policy decisions but has not exercised such power, significant influence still exists.

**Indicators of significant influence**

One or more of the following usually evidence existence of significant influence:

1. representation on the board of directors or equivalent governing body of the investee
2. participation in policy-making processes, including participation in decisions about dividends or other distributions
3. material transactions between the investor and the investee
4. interchange of managerial personnel
5. provision of essential technical information.

Where the Territory Government has significant influence over an investee, the investee is referred to as an associate.

**Holding 20 per cent or more of voting power**

Significant influence is **presumed to exist** if the Territory Government holds, directly or indirectly **20 per cent or more of the voting power, but less than 50 per cent**, unless it can be clearly demonstrated that this is not the case.

Agencies must consider the voting rights attached to ordinary shares and voting preferred shares to determine if they have 20 per cent or more voting power.

The table below summarises an example where an entity’s voting rights are **evenly divided** between ordinary shares and voting preferred shares.

|  |  |  |  |
| --- | --- | --- | --- |
|  | Voting rights  A | Investment  B | Voting Power  (A x B) |
| Ordinary shares | 50% | 4% | 2% |
| Voting preferred shares | 50% | 36% | 18% |
| **Total** |  |  | **20%** |

An investment in four per cent of the ordinary shares and 36 per cent of the voting preferred shares, will result in a presumption that the four per cent ordinary share ownership will be accounted for under the equity method, provided that the voting preferred share investment is, with respect to voting rights, substantively the same as an investment in ordinary shares.

**Holding less than 20 per cent of voting power**

If the Territory Government holds, directly or indirectly through subsidiaries, less than 20 per cent of the voting power of the investee, it is presumed that the Territory Government does not have significant influence, unless such influence can be clearly demonstrated.

The presence of one or more of the indicators set out in the earlier paragraph may indicate that Territory Government exercises significant influence over a less than 20 per cent owned investee.

In addition to the indicators set out above, the following indicators may provide evidence of significant influence:

* the Territory Government's extent of ownership is significant relative to other shareholdings (for example, a lack of concentration of other shareholders)
* the Territory Government is a member of significant investee committees, such as the executive committee or the finance committee.

**Potential voting rights**

In assessing the total voting rights held, agencies must consider the existence of potential voting rights. Potential voting rights can arise through share warrants, share call options, debt or equity instruments that are convertible into ordinary shares, or similar instruments that have the potential, if exercised or converted, to give the holder additional voting power or reduce another party's voting power over the financial and operating policies of another entity.

The existence and effect of potential voting rights that are currently exercisable or currently convertible should be considered when assessing whether the Territory Government has significant influence over the investee. 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.

Refer to **Appendix A** for examples on how to determine if significant influence exists.

#### Joint venture arrangement

A joint arrangement is an arrangement where two or more parties have joint control of an arrangement. Joint control exists where the parties contractually agree to share control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

A joint arrangement is either a joint operation or a joint venture.

A joint operation is a joint arrangement where the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangements. This differs from a joint venture. A joint venture is an arrangement whereby the parties, that have joint control of the arrangement, have rights to the net assets of the arrangement.

Only the joint venture arrangement is referred to as an equity accounted investment and therefore accounted for using the equity method.

The contractual arrangement may be evidenced in a number of ways such as by a contract or minutes of discussions between the parties, or in the articles of other by-laws of the joint arrangement.

Refer to **Appendix A** for examples on how to determine if joint control or a joint venture arrangement exist.

### Investments in shares

Investments in shares represent ownership interest in an entity in the form of shares held by the Territory Government where there is no significant influence or control or joint control over the entity.

Equity investments outside the scope of controlled entity investments and equity accounted investments generally fall under this category.

This category excludes investments classified as a debt instrument such as investments in unit trusts. Agency must refer to the [guidance document on financial instruments](https://treasury.nt.gov.au/dtf/financial-management-group/treasurers-directions/treasurers-directions#Accounting) for requirements on how to account for investments classified as a debt instrument.

### Hybrid contracts

A hybrid contract is a financial instrument that contains both a non-derivative host contract and an embedded derivative. A common example of a hybrid contract is a loan convertible to equity shares (convertible note).

Agencies are to assess the hybrid contract as a whole for classification. If the terms of the hybrid contract meet the criteria for subsequent measurement at amortised cost or FVOCI for debt instruments then it is accounted for at amortised cost or FVOCI, respectively. Where the criteria is not met, then it is measured at FVTPL.

In most cases, convertible note is measured at FVTPL. Refer to the [guidance document on financial instruments](https://treasury.nt.gov.au/dtf/financial-management-group/treasurers-directions/treasurers-directions#Accounting) for debt instrument classification and measurement requirements.

# Risk management

A sound risk management strategy provides a framework to identify, analyse, evaluate, and respond to risks, such as those arising from investment decisions.

Risk is defined as any uncertain future situation or event, which could influence the achievement of the Territory’s or the agency’s objectives or realisation of opportunities.

The FMA requires accountable officers to establish and maintain appropriate procedures that, at all times, afford proper internal control. Use of systematic risk management methodologies can assist an agency in assessing the level and nature of its exposure to risks from equity investments, to ensure appropriate resources are allocated to mitigate or minimise significant risks and evaluate the effectiveness of its risk control measures.

To recognise the potential interdependencies between different risks, it is important that risk assessment on equity investment are considered in the broader context of agency-wide strategic planning and risk assessment.

It is better practice for an agency to develop a risk management policy and framework in accordance with the Australian standard AS/NZS ISO 31000:2018.

## Risk assessment

### Risk review

Agencies are responsible for determining the risk assessment approach most appropriate for their circumstances. To minimise the Territory Government’s exposure to risk, equity investments must not be entered unless they meet all the following criteria:

* the risks assumed by the Territory Government are acceptable given the objectives, scope and benefits of the investment, that is, the expected benefits objectively outweigh the level and cost of the risks
* and the risks do not present unacceptable risk exposure to the Territory Government.

### Risk considerations

Agencies should consider all the potential risks to the Territory Government, on deciding whether to proceed with the investment or not. Agencies should consider the following risks, at a minimum:

|  |  |
| --- | --- |
| Risk | Examples of considerations |
| Financial and economic risk | * What is the risk of financial loss to the Territory Government? * What/how much is the forgone income or financial return if the Territory Government will not invest? * How sensitive is the investment to any change in the macroeconomic conditions (for example, exchange rate fluctuations, a shift in government policy or regulations, political instability, or the introduction of economic sanctions? |
| Reputational risk | * Is the investment politically sensitive? * Is there a reputational risk if the endeavour fails, or there is a breach or negligence by the entity? |
| Operational risk | * Is there any other involvement by Territory Government (for example, a board representative is required from Territory Government) other than the financial investment? * How does this impact on the operations of the agency? * Is there an adequate resources or expertise within the agency to be involved in this type of investment? * Is there a change required in the agency structure and practises/culture as a result of the investment? |
| Social risk | * Does the investment align with Territory Government’s objectives or values? * Is there a risk of adverse public perception (for example, environmental pollution, hazards to human health, safety and security, and threats to a region’s biodiversity and cultural heritage)? |
| Legal risk | * Is there a potential loss that the Territory Government could face because of a legal issue? * Is there any contingent liability (for example, warranties, guarantees and indemnities) for the Territory Government because of the investment? |

The assessment should include the identified risks for both scenario where the investment proceeds or does not proceed.

When seeking approval to enter into an equity investment, agencies should demonstrate and document that the benefits outweighs the identified risks to the Territory Government. For all identified risks, agencies should have a plan or process in place to mitigate the risks to an acceptable level.

### Legal advice

In certain circumstances, a review of investment terms and conditions by a legal advisor may assist an agency in determining whether the equity investment would benefit the Territory Government, and whether the agency should proceed with the approval process to issue the equity investment.

Agencies must use their best judgement in determining if and when (for example, during contract negotiations and risk assessments), to engage legal advisors and or the level of legal consultation required for a particular equity investment.

## Monitoring and evaluation

Risk management is a continuous process, rather than an activity conducted at a point in time. It demands proactive action on the part of management to continually update their understanding of risk and to develop effective solutions in managing the risk.

Prudent risk management will necessitate agencies to establish and maintain appropriate risk identification, management, and mitigation strategies arising from the performance of equity investments. Each accountable officer is responsible for determining what processes are considered appropriate for monitoring and evaluating equity investments. These processes must include at a minimum:

* transparency in the evaluation and decision making process
* monitoring, evaluating and reviewing at least once every financial year:
  + the performance of the investment, recognising any impairment losses
  + the key risks to the future performance of the investment
* where applicable, considering the level of influence and control the Territory Government has over the investee, taking action to mitigate or minimise identified risks within a reasonable timeframe.

# Approval process

## Treasurer’s determination

Before an agency can make an investment, there must be a Treasurer’s determination, which permits that type of investment.

A determination can be sought for a specific equity investment or a Territory Government initiative. Where a Treasurer’s determination has been issued for a Territory Government initiative, agencies do not need to seek a separate determination each time an investment under that initiative is made.

To organise a Treasurer’s determination, agencies must contact Department of Treasury and Finance (DTF) seeking to commence the process for the draft of a determination. All requests must include relevant information to assist with processing the request.

Agencies must not make an equity investment until the Treasurer’s determination has been approved.

## Treasurer’s approval process

Treasurer’s approval is required for all equity investments unless that function or power has been delegated in accordance with section 29(1) of the FMA.

An agency must seek ministerial endorsement from the portfolio minister prior to seeking Treasurer’s approval for an investment.

While the Treasurer will form a view of the terms and conditions of the equity investments, the portfolio minister is expected to have a more comprehensive understanding of the potential benefit and risks associated with the equity investments. Accordingly, the portfolio minister’s endorsement of the equity investment is a requirement prior to the Treasurer providing approval for the investment.

Prior to seeking ministerial request, an accountable officer must conduct a comprehensive review and assessment of the investee’s business. If the equity investment is under a Territory Government initiative, an accountable officer must assess the investment against the objectives and criteria set by the initiative.

## Accountable officer approval process

The Treasurer has delegated authority to accountable officers to approve equity investments in accordance with section 29(1) of the FMA subject to certain limitations.

An accountable officer may only make an investment pursuant to a Determination where the equity investment:

* is of a type, or part of an established Territory Government initiative, consistent with a determination
* does not give the Territory Government a significant influence, joint control or controlling interest over the investee
* and is within the approved budget and accountable officer’s area of responsibility.

# Recognition and measurement

Agencies must comply with the requirements of the applicable accounting standards for the recognition, measurement and presentation and disclosure of equity investments in the financial statements.

## Controlled entity investments

The financial statements of the investee must be consolidated within the Territory’s whole-of-government financial statements at the end of the financial reporting period.

If the investee’s reporting date and accounting policies are significantly different from the Territory Government, adjustments must be made to align the financial statements of the investee with the Territory’s whole-of-government financial statements.

Where the controlling agency is required to prepare consolidated financial statements, agency must contact DTF for assistance with the consolidation process.

## Equity accounted investments

Agencies must account for investments with significant influence or a joint venture arrangement under the equity method presented as an investment asset on the balance sheet.

The table below summarises the stages of recognition and measurement of investment under the equity method.

|  |  |
| --- | --- |
| Stage | Accounting treatment |
| Initial recognition | Recognised at acquisition cost.  ***Note:***  Where the consideration for the investment is significantly less than fair value principally to enable the entity to further its objectives, investment is recognised at fair value in accordance with AASB 13 Fair Value Measurement(AASB 13)*.* AASB 1058 Income of non-for-profit entities addresses the recognition of related amounts. |
| Subsequent measurement | Carrying value of investment adjusted by:   1. a share in the adjusted profit or loss of the associate or joint venture entity 2. a share in the associate or joint venture’s changes in other comprehensive income (for example, changes arising from the revaluation of property, plant and equipment) 3. dividends received or receivable from the associate or joint venture.   ***Note:***  The adjusted profit or loss of the investee is the profit or loss of the investee adjusted for the following:   * agency’s share in the associate or joint venture’s profit or losses resulting from transactions between an agency and associate or joint venture is to be eliminated * assets and liabilities of the associate or joint venture entity not recorded at fair value at acquisition date * cumulative preference dividends, if applicable.   If an agency’s share in an associate or joint venture entities is a loss, which equals or exceeds its ownership interest, the agency must discontinue recognising its share of losses, which exceeds its ownership interest.  After an agency’s investment is reduced to zero, additional losses are to be recognised as a liability of the agency, but only to the extent that the agency:   * has incurred legal or constructive obligations * or made payments on behalf of the associate or joint venture entity.   If the associate or joint venture entity subsequently reports profits, the agency resumes recognising its share of those profits only after its share of the profits equals the share of losses not previously recognised. |
| Impairment | Agencies must assess the investment for impairment on annual basis.  The net investment in an associate or joint venture is impaired and impairment losses are incurred if, and only if:   1. there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the net investment (a ‘loss event’) 2. and that loss event (or events) has an impact on the estimated future cash flows from the net investment and can be reliably estimated. |
|  | Examples of loss events which may be an impairment indicator include:   * significant financial difficulty of the associate or joint venture * a breach of contract, such as a default or delinquency in payments by the associate or joint venture * the agency, for economic or legal reasons relating to its associate’s or joint venture’s financial difficulty, granting to the associate or joint venture a concession that the agency would not otherwise consider * it becomes probable that the associate or joint venture will become bankrupt or undertake to reorganise the structure of the entity * the disappearance of an active market for the net investment because of financial difficulties of the associate or joint venture.   **Impairment loss** = recoverable amount < carrying amount of the investment  Recoverable amount is calculated using either:   * a discounted cash flow model based on the cash flows the associate or joint venture is expected to generate from its operations, and proceeds from disposing of the investment * or a dividend discount model based on the distributions expected to be received from the associate or joint venture, and proceeds from disposing of the investment. |

Refer to **Appendix B** for an illustration on how to account for equity accounted investments.

## Investments in shares

The table below summarises the stages of recognition and measurement for investments in shares.

|  |  |
| --- | --- |
| Stage | Accounting treatment |
| Initial recognition | Recognised at fair value at the time of acquisition. |
| Subsequent measurement | Measured at fair value annually at 30 June in accordance with AASB 13 at:   1. fair value through profit and loss if investment is held for the purpose of making funds available to others with no policy intent and with the aim of earning a commercial rate of return for liquidity management purposes (held for trading) 2. or fair value through other comprehensive income (OCI) if investment is held for Territory Government policy purposes such as encouraging the development of certain industries. Under this method: 3. all fair value changes, excluding dividends (a return on investments), will be included in OCI 4. upon sale of equity investment, gain or loss on sale is recorded through OCI and not the operating profit and loss   In determining the fair value of unquoted equity instruments, agencies may find it useful to refer to an education paper issues by the International Financial Reporting Standards (IFRS) Foundation, titled IFRS 13 Fair Value Measurement – Unquoted equity instruments within the scope of IFRS 9 Financial Instruments - <http://archive.ifrs.org/Use-around-the-world/Education/FVM/Documents/Education-guidance-FVM.pdf> |
| Impairment | No requirement to assess for impairment as agencies must measure investment annually at fair value. |

Refer to **Appendix C** for an illustration on how to account for investments in shares.

# Recordkeeping

Agencies must establish and maintain policies and procedures to appropriately document and maintain records that support compliance with the TD – Equity investments.

Agencies must maintain a register of equity investments, which should include all equity investments approved by the Treasurer or a delegate. The register must include as a minimum, the details listed in **Appendix A** **of the TD – Equity investments**. A register is not required where an agency has never had any equity investments.

The register must be maintained as at each reporting date, as such may need to be replicated and updated annually.

Agencies must retain records relating to equity investments, for the specified minimum period, in accordance with the agency’s records disposal schedule.

In addition to maintaining the register, an agency may keep the following documents:

1. Governing board, for example:
2. names, addresses, dates of birth and dates of appointment of the members of the entity’s board or other governing committee (for example, directors, members, trustee)
3. names and addresses of the Chief Executive Officer, Managing Director, Company Secretary and or Public Officer.
4. Operational information, for example:
5. annual returns, where applicable
6. any government and other guarantees or indemnities
7. any charges and encumbrances (for example, mortgages over property, bills of sale)
8. details of any winding up action (such as the appointment of a liquidator) or other external administration (for example, appointment of a receiver).
9. Statutory records, for example:
10. minute book
11. register of members or shareholders.

It is also best practice for agencies to reconcile the equity investments recorded in the register and what is reported in financial records at a minimum annually for the following:

1. total acquisition cost in the register must reconcile with the total cash paid by the agency to acquire the equity investments
2. total value of equity investments as at 30 June each year must reconcile with the balance of equity investments in the financial statements
3. changes in the value of the equity investments due to changes in fair value or impairment loss must reconcile to the impact recorded in the statement of profit or loss and other comprehensive income.

An accountable officer must keep appropriate documentation of the assumptions and calculations used to determine the valuation and impairment of equity investments.

If an independent valuer is engaged to value an investment, the agency must review and assess the document provided for reasonableness prior to using it. Agencies must provide a copy of this report to DTF and or the Auditor-General on request.

# Reporting

Upon request, an accountable officer must provide DTF a copy of the register of equity investments (if applicable) and any other relevant information as necessary.

An accountable officer must ensure financial statements of controlled entities, joint controlled entities and entities where significant influence exists are:

1. prepared in accordance with Australian accounting standards
2. audited, with a copy of the audited financial statements submitted to DTF within two months after the end of the financial year.

This is because this information is incorporated in the agency and whole-of-government financial statements.

If the investee’s reporting date is different from Territory government, the investee is required to provide financial statements as at and for the period ended 30 June, if practicable.

If there are significant accounting policies adopted by the investee, which are different from the Territory Government, the agency must maintain a schedule of variations, which quantifies the differences. This will assist with adjustments required when incorporating the investee’s financial information in the agency and whole-of-government financial reports.

For equity investments categorised as investments in shares, an accountable officer shall use best judgement in determining the appropriate evidence/documentation required from the investee taking into consideration the ability to undertake the following:

1. assess the fair value of the investment as at 30 June
2. assess risk arising from the performance of the equity investments.

# Appendix A

**Examples on how to determine if a controlling interest, significant influence or joint control exists**

|  |  |  |
| --- | --- | --- |
| SCENARIO | ANALYSIS | CONCLUSION |
| Investor A holds 65 per cent of the voting rights of an investee and is entitled to dividends based on ownership.  Shareholders are involved in the following decision making:   * establishing operating and capital decisions of the investee, including budgets * appoint/remunerate/terminate key management personnel. | Investor A holds majority of the voting rights and is involved in significant decision-making process, which may affect the amount of financial returns. | Investor A has a controlling interest over investee. |
| Investor A holds 45 per cent of the voting rights of an investee.  Two other investors each hold 26 per cent of the voting rights of the investee. The remaining voting rights are held by three other shareholders, each holding 1 per cent.  There are no other arrangements that affect decision-making. Shareholders are entitled to dividends based on their ownership. | The size of the investor A’s voting interest relative to the other shareholdings is sufficient to conclude that investor A does not have power.  Only two other investors would need to co-operate to prevent investor A from directing the relevant activities of the investee. Investor A does not meet all the criteria for a controlling interest to exist. | Investor A has no control over investee. |

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| --- | --- | --- |
| SCENARIO | ANALYSIS | CONCLUSION |
| Investor A acquires 48 per cent of the voting rights of an investee. Thousands of shareholders, none individually holding more than 1 per cent of the voting rights, hold the remaining rights. Shareholders are entitled to dividends based on their ownership.  None of the shareholders has any arrangements to consult any of the others or make collective decisions. When assessing the proportion of voting rights to acquire, based on the relative size of the other shareholdings, the investor determined that a 48 per cent interest would be sufficient to give it control. | In this case, based on the absolute size of its holding and the relative size of the other shareholdings, the investor concludes that it has a sufficiently dominant voting interest to meet the power criterion without the need to consider any other evidence of power. | Investor A has controlling interest over investee. |
| Investor B holds 40 per cent of the voting rights in Company Z. Investor B has not sent any representative to the board meeting of Company Z since acquiring the shares.  The remaining 60 per cent of shares are held in equal part by four unrelated entities. | Investor B has not exercised the power to participate in board meeting, however, power to participate exist by virtue of the 40 per cent shareholding. | Investor B has significant influence over the investee. |
| Investor B holds 18 per cent of the voting rights in Company Y and has a representative on the board of Company Y. More than half of Company Y’s sales are made to Investor B. | Investor B has too small a shareholding (less than 20 per cent) in Company Y for significant influence to be presumed to exist. However, it does have a representative on the board and there are material transactions between Investor B and Company Y. | Investor B has significant influence over the investee. |

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| --- | --- | --- |
| SCENARIO | ANALYSIS | CONCLUSION |
| Three parties establish an arrangement with the following voting rights:  A 50 per cent  B 30 per cent  C 20 per cent  The contractual arrangement between A, B and C specifies that at least 75 per cent of the voting rights are required to make decisions about the relevant activities of the arrangement. | Even though A can block any decision, it does not control the arrangement because it needs the agreement of B.  The terms of their contractual arrangement requiring at least 75 per cent of the voting rights to make decisions about the relevant activities imply that A and B have joint control of the arrangement because decisions about the relevant activities of the arrangement cannot be made without both A and B agreeing. | Joint control exist between A and B. |

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| --- | --- | --- |
| SCENARIO | ANALYSIS | CONCLUSION |
| Investor A and Investor B (investors) set up Company AB for the purpose of acquiring and operating a shopping centre. The contractual arrangement between the parties establishes joint control of the activities that are conducted in Company AB.  Company AB, as a separate entity, has rights to the assets and obligations for the liabilities, relating to the arrangement. The terms of the contractual arrangement are such that:   1. Company AB owns the shopping centre. The contractual arrangement does not specify that investors have rights to the shopping centre. 2. Investors are not liable in respect of the debts, liabilities or obligations of Company AB. If Company AB is unable to pay any of its debts or other liabilities or to discharge its obligations to third parties, the liability of the investors to any third party will be limited to the unpaid amount of that investor’s capital contribution. 3. The investors have the right to sell or pledge their interests in Company AB. 4. Each investor receives a share of the income from operating the shopping centre (which is the rental income net of the operating costs) in accordance with its interest in Company AB. | The joint arrangement is carried out through a separate entity (Company AB) whose legal form has rights to the assets and obligations for the liabilities.  In addition, the terms of the contractual arrangement do not specify that the investors have rights to the assets, or obligations for the liabilities, relating to the arrangement. Instead, the terms of the contractual arrangement establish that the parties have rights to the net assets of Company AB. | Joint arrangement is a joint venture. |

# Appendix B

**Example of equity accounted investments**

**Scenario**

Agency A purchased 40 per cent of the issued capital of Investee Z for $40 000 on 1 July 20X8. The net assets of investee Z at the date of acquisition is $100 000 and was measured at fair value. The consideration paid by Agency A equalled its share of the net assets ($100 000 x 40 per cent) in Investee Z and no goodwill was acquired.

The statement of profit or loss and other comprehensive income of Investee Z for the financial year ended 30 June 20X9 revealed the following:

* a profit of $50 000
* a dividend payment of $15 000

*Analysis:*

Agency A has established it does not have control over the investee, however significant influence over Investee Z. Investment has must be accounted under equity method. Journal entry is as follows:

1. To recognise acquisition of 40 per cent of the issued capital of Investee Z on 1 July 20X8.

|  |  |  |  |
| --- | --- | --- | --- |
| DR | Equity accounted investments – Purchases1 | $40 000 |  |
| CR | Cash |  | $40 000 |

1. Torecognise 40% share in the profit of Investee Z ($50,000 x 40%).

|  |  |  |  |
| --- | --- | --- | --- |
| DR | Equity accounted investments – Share in profit or loss1 | $20 000 |  |
| CR | Share in profit/loss from investee1 |  | $20 000 |

1. To recognise 40% share in the dividends payment of Investee Z ($15,000 x 40%).

|  |  |  |  |
| --- | --- | --- | --- |
| DR | Cash | $6 000 |  |
| CR | Equity accounted investments – Dividends/distribution received1 |  | $6 000 |

1 *Contact DTF for appropriate standard classification code.*

# Appendix C

**Example of investment in shares**

**Scenario**

Agency A acquires 100 shares of Company B for $150 000 on 1 March 20X9. Total issued shares of Company B is 1 000 shares after the share acquisition.

Agency A’s ownership interest is 10 per cent (100 shares / 1 000 shares). Agency A has conducted an assessment and has concluded significant influence or control over Company B does not exist.

Journal entry at 1 March 20X9 is as follows:

1. To recognise acquisition of 100 shares in Company B.

|  |  |  |  |
| --- | --- | --- | --- |
| DR | Investments in shares – purchases (818110 / 835910) | $150 000 |  |
| CR | Cash (811110) |  | $150 000 |

At 30 June 20X9, Agency A has determined that the fair value of the investment in Company B is now $120,000, a $30 000 reduction in fair value of the investment. Journal entry at 30 June 20X9 as follows:

1. To recognise change in fair value of the equity investment in shares.

|  |  |  |  |
| --- | --- | --- | --- |
| DR | Gain/Loss (OCI) - Investments in shares (992100) | $30 000 |  |
| CR | Investments in shares – revaluation increment/decrement (818140 / 835940) |  | $30 000 |

Carrying values at 30 June 20X9 are:

**Amount**

|  |  |
| --- | --- |
| Investments in shares | $150 000 |
| Accumulated OCI – loss on investments in shares | (30 000) |
| **Carrying value** | **$120 000** |

On 31 March 20Y0, Agency A receives cash dividends of $1 000. The journal entry at   
31 March 20Y0 is as follows:

1. To record receipt of dividend from Company B:

|  |  |  |  |
| --- | --- | --- | --- |
| DR | Cash (811110) | $1 000 |  |
| CR | Dividend income (153000) |  | $1 000 |

On 30 June 20Y0, the fair value of the 100 shares in Company B is $160 000, an increase of $40 000 from the balance of investment as at 30 June 20X9 of $120 000. The journal entry at 30 June 20Y0 is as follows:

1. To recognise change in fair value of the equity investment in shares.

|  |  |  |  |
| --- | --- | --- | --- |
| DR | Equity investments in shares – revaluation increment/decrement (818140 / 835940) | $40 000 |  |
| CR | Gain/Loss (OCI) - Investments in shares (992100) |  | $40 000 |

Carrying values at 30 June 20Y0 are:

**Amount**

|  |  |
| --- | --- |
| Investments in shares | $150 000 |
| Accumulated OCI – gain/loss on investments in shares\* | 10 000 |
| **Carrying value** | **$160 000** |

*\*-$30 000 + $40 000 = $10 000*

On 31 July 20Y0, Agency A decides to dispose of the entire investment in Company B. There is no change in the market value of the investment at the time of sale. The journal entry for the disposal is as follows:

1. To recognise the sale of investment in Company B.

|  |  |  |  |
| --- | --- | --- | --- |
| DR | Cash (811110) | $160 000 |  |
| CR | Investments in shares – sales (818120 / 835920) |  | $160 000 |

The following table sets out the carrying values at 31 July 20Y0 after disposal:

**Amount**

|  |  |
| --- | --- |
| Cash | $160 000 |
| Equity investments in shares | $0 |
| *less* accumulated OCI – loss on investments in shares | $10 000 |
| **Carrying value** | **$150 000** |

Note: On disposal, the cumulative changes in fair value remains in OCI. Agency will then transfer the cumulative OCI balance to accumulated funds. Journal entry is as follows:

1. To transfer balance of cumulative OCI to accumulated funds:

|  |  |  |  |
| --- | --- | --- | --- |
| DR | Accumulated OCI – Gain/Loss – Investments in shares (992100) | $10 000 |  |
| CR | Transfers to/from reserves (993300) |  | $10 000 |