Accounting for investment in associates (Part 1)

As with the classification of any investment, the substance of the arrangements in each case will need to be considered. If it can be clearly demonstrated that an investor holding 20 per cent or more of the voting power of the investee does not have significant influence, the investment will not be accounted for as an associate.

Indicators of significant influence

When an investor exercises significant influence over the investee, one or more of the following indicators is usually present:

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

Holding 20 per cent or more of voting power

As a general rule, significant influence is presumed to exist when an investor holds, directly or indirectly through subsidiaries, 20 per cent or more of the voting power of the investee.

This presumption relates to voting rights, which can arise not just in relation to an ordinary shareholding. For example, when 50 per cent of the voting rights in an entity are held by the ordinary shareholders, and the other 50 per cent of the voting rights are attached to voting preferred shares, an investment in four per cent of the ordinary shares and thirty-six 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, substantially the same as an investment in ordinary shares.

As with the classification of any investment, the substance of the arrangements in each case will need to be considered. If it can be clearly demonstrated that an investor holding 20 per cent or more of the voting power of the investee does not have significant influence, the investment will not be accounted for as an associate. In addition to the indicators set out above, the following indicators could provide evidence of significant influence:

- the investor’s extent of ownership is significant relative to other shareholdings (i.e. a lack of concentration of other shareholdings);
- the investor’s significant majority ownership, its parent, fellow subsidiaries, or officers of the investee, hold additional investment in the investee; and
- the investor is a member of significant investee committees, such as the executive committee or the finance committee.

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. When an investor owns such instruments, the existence and effect of potential voting rights that are currently exercisable or currently convertible are considered when assessing whether the investor has significant influence over that other entity. 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.

Investment in preferred shares that is substantively the same as an investment in ordinary shares

When an investment in preferred shares is determined to be substantially the same as an investment in ordinary shares, the investment may give the investor significant influence, in which case the investment should be accounted for using the equity method. Factors that either individually or collectively may indicate that a preferred share investment is substantively the same as an ordinary share investment include:

- the investor has little or no significant ordinary shares or other equity on a fair value basis that is subordinate to the preferred shares;
- the investor, regardless of ownership percentage, has demonstrated the power to exercise significant influence over the investee’s operating and financial decisions. The power to participate actively is an important factor in determining whether an equity interest exists by virtue of preferred shareholdings;
- the investor’s preferred shares have essentially the same rights and characteristics as the investee’s ordinary shares as regards voting rights, board representation, and participation in, or rate of return approximating, the ordinary share dividend; and
- the preferred shares have a conversion feature (with significant value in relation to the total value of the shares) to convert the preferred shares to ordinary shares.

Long-term interests that in substance form part of the investor’s net investment in an associate

An investor may have a variety of interests in an associate both long-term and short-term, including ordinary or preferred shares, loans, advances, debt securities, options to acquire ordinary shares, and trade receivables. For the purposes of IAS 28(2011)39 which considers the extent to which losses of an associate should be recognised, the investor’s interest in the associate is the carrying amount of the investment in the associate together with any long-term interests that, in substance, form part of the investor’s net investment in the associate.

As a general rule, significant influence is presumed to exist when an investor holds, directly or indirectly through subsidiaries, 20 per cent or more of the voting power of the investee.
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- Accounts preparation and reporting
- Bookkeeping
- Accounts reconciliation and reconstruction
- Consolidation of group accounts
- Internal control over financial reporting

**Outsourcing/Co-sourcing Services**
- Basic bookkeeping
- Treasury management
- Fixed asset accounting
- Filling temporary gaps for staff on leave, vacation, maternity

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- Budget preparation
- Cost benefit analysis
- Cash flow planning
- Management reporting
- Cost price analysis

**IFRS/IPSAS**
- IFRS conversion and restatement
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- IFRS help desk
- Financial instrument advisory

**Audit Readiness Assessment and Assistance**
- Audit readiness assessment and assistance

**Actuarial Services**
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