

# 9

ASSOCIATES AND  
JOINT VENTURES



ACCOUNTING  
STANDARDS  
BOARD

FINANCIAL REPORTING  
STANDARD

*Financial Reporting Standard 9  
'Associates and Joint Ventures' is  
issued by the Accounting Standards Board  
in respect of its application in the United  
Kingdom and by the Institute of Chartered  
Accountants in Ireland in respect of its  
application in the Republic of Ireland.*

**FINANCIAL REPORTING  
STANDARD**

# 9

**ASSOCIATES AND  
JOINT VENTURES**



**ACCOUNTING  
STANDARDS  
BOARD**

*Financial Reporting Standard 9 is set out in paragraphs 1-61.*

*The Statement of Standard Accounting Practice, which comprises the paragraphs set in bold type, should be read in the context of the Objective as stated in paragraph 1 and the definitions set out in paragraphs 4 and 5 and also of the Foreword to Accounting Standards and the Statement of Principles for Financial Reporting currently in issue.*

*The explanatory paragraphs contained in the FRS shall be regarded as part of the Statement of Standard Accounting Practice insofar as they assist in interpreting that statement.*

*Appendix III 'The development of the FRS' reviews considerations and arguments that were thought significant by members of the Board in reaching the conclusions on the FRS.*

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## **SUMMARY**

- a Financial Reporting Standard 9 ‘Associates and Joint Ventures’ sets out the definitions and accounting treatments for associates and joint ventures, two types of interests that a reporting entity may have in other entities. The FRS also deals with joint arrangements that are not entities. The definitions and treatments prescribed have been developed to be consistent with the Accounting Standards Board’s approach to accounting for subsidiaries (dealt with in FRS 2 ‘Accounting for Subsidiary Undertakings’). The requirements are consistent with companies legislation.\*
- b The table below describes the different sorts of interests that a reporting entity may have in other entities or arrangements—the shaded sections indicate those covered by the FRS. The defining relationships described in the table form the basis for the definitions used in the FRS.

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\* *The relationship between companies legislation and the standard is discussed in Appendix I.*

<b>Entity/ arrangement</b>	<b>Nature of relationship</b>	<b>Description of the defining relationship—the full definitions are given in paragraph 4 of the FRS</b>
<b>Subsidiary</b>	Investor controls its investee.	Control is the ability of an entity to direct the operating and financial policies of another entity with a view to gaining economic benefits from its activities. To have control an entity must have both: <ul style="list-style-type: none"> <li>(i) the ability to deploy the economic resources of the investee or to direct it; and</li> <li>(ii) the ability to ensure that any resulting benefits accrue to itself (with corresponding exposure to losses) and to restrict the access of others to those benefits.</li> </ul>
<b>Joint arrangement that is not an entity</b>	Entities participate in an arrangement to carry on part of their own trades or businesses.	A joint arrangement, whether or not subject to joint control, does not constitute an entity unless it carries on a trade or business of its own.
<b>Joint venture</b>	Investor holds a long-term interest and shares control under a contractual arrangement.	The joint venture agreement can override the rights normally conferred by ownership interests with the effect that: <ul style="list-style-type: none"> <li>• acting together, the venturers can control the venture and there are procedures for such joint action</li> <li>• each venturer has (implicitly or explicitly) a veto over strategic policy decisions.</li> </ul> There is usually a procedure for settling disputes between venturers and, possibly, for terminating the joint venture.



<b>Entity/ arrangement</b>	<b>Nature of relationship</b>	<b>Description of the defining relationship—the full definitions are given in paragraph 4 of the FRS</b>
<b>Associate</b>	Investor holds a participating interest and exercises significant influence.	The investor has a long-term interest and is actively involved, and influential, in the direction of its investee through its participation in policy decisions covering the aspects of policy relevant to the investor, including decisions on strategic issues such as: (i) the expansion or contraction of the business, participation in other entities or changes in products, markets and activities of its investee; and (ii) determining the balance between dividend and reinvestment.
<b>Simple investment</b>		The investor's interest does not qualify the investee as an associate, a joint venture or a subsidiary because the investor has limited influence or its interest is not long-term.

***The investor's consolidated financial statements***

- c The table below sets out the treatments in consolidated financial statements for the different interests that a reporting entity may have in other entities and for joint arrangements that are not entities—the shaded sections indicate the treatments covered by the FRS.

<b>Type of investment</b>	<b>Treatment in consolidated financial statements</b>
<b>Subsidiaries</b>	The investor should consolidate the assets, liabilities, results and cash flows of its subsidiaries.
<b>Joint arrangements that are not entities</b>	Each party should account for its own share of the assets, liabilities and cash flows in the joint arrangement, measured according to the terms of that arrangement, for example pro rata to their respective interests.
<b>Joint ventures</b>	The venturer should use the gross equity method showing in addition to the amounts included under the equity method,* on the face of the balance sheet, the venturer's share of the gross assets and liabilities of its joint ventures, and, in the profit and loss account, the venturer's share of their turnover distinguished from that of the group. Where the venturer conducts a major part of its business through joint ventures, it may show fuller information provided all amounts are distinguished from those of the group. Appendix IV sets out an optional columnar presentation.

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\* The treatment under the equity method required by the FRS is set out in paragraph 4 and summarised under Associates in this table.

<b>Type of investment</b>	<b>Treatment in consolidated financial statements</b>
<b>Associates</b>	<p>The investor should include its associates in its consolidated financial statements using the equity method. In the investor's consolidated profit and loss account the investor's share of its associates' operating result should be included immediately after group operating result. From the level of profit before tax, the investor's share of the relevant amounts for associates should be included within the amounts for the group. In the consolidated statement of total recognised gains and losses the investor's share of the total recognised gains and losses of its associates should be included, shown separately under each heading, if material. In the balance sheet the investor's share of the net assets of its associates should be included and separately disclosed. The cash flow statement should include the cash flows between the investor and its associates. Goodwill arising on the investor's acquisition of its associates, less any amortisation or write-down, should be included in the carrying amount for the associates but should be disclosed separately. In the profit and loss account the amortisation or write-down of such goodwill should be separately disclosed as part of the investor's share of its associates' results.</p>
<b>Simple investments</b>	<p>The investor includes its interests as investments at either cost or valuation.</p>

***The investor's own financial statements***

- d In the investor's own financial statements associates and joint ventures should be treated as fixed asset investments, at cost less any amounts written off, or at a valuation.

***Disclosures***

- e The FRS requires the following disclosures separately for associates and joint ventures that exceed certain thresholds.
- (i) Where an investor's aggregate share in its associates exceeds 15 per cent of any of the gross assets, gross liabilities, turnover or, on a three-year average, operating result of the investing group, the investor's aggregate share of each of the following should be shown:
- turnover (unless it is already included as a memorandum item)
  - fixed assets, current assets, liabilities due within one year and liabilities due after one year or more.
- (ii) Where an investor's aggregate share in its joint ventures exceeds 15 per cent of any of the gross assets, gross liabilities, turnover or, on a three-year average, operating result of the investing group, the investor's aggregate share of each of the following should be shown:
- fixed assets, current assets, liabilities due within one year and liabilities due after one year or more.

(iii) For any associate or joint venture where the investor's share of that individual entity exceeds 25 per cent of any of the gross assets, gross liabilities, turnover or, on a three-year average, operating result of the investing group, the investor's share of the following items for that entity should be shown:

- turnover
- profit before tax
- taxation
- profit after tax
- fixed assets
- current assets
- liabilities due within one year
- liabilities due after one year or more.

## **FINANCIAL REPORTING STANDARD 9**

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### *Objective*

- 1 The objective of this FRS is to reflect the effect on an investor's financial position and performance of its interests in two special kinds of investments—associates and joint ventures—for whose activities it is partly accountable because of the closeness of its involvement:
  - in associates, as a result of its participating interest and significant influence
  - in joint ventures, as a result of its long-term interest and joint control.

The FRS also deals with joint arrangements that do not qualify as associates or joint ventures because they are not entities.

### *Scope*

- 2 **Subject to the provisions of paragraph 3, the FRS applies to all financial statements that are intended to give a true and fair view of a reporting entity's financial position and profit or loss (or income and expenditure) for a period.**
- 3 **Reporting entities applying the Financial Reporting Standard for Smaller Entities (FRSSE) are exempt from the FRS unless preparing consolidated financial statements, in which case they should apply the FRS to such statements as required by the FRSSE currently in issue.\***

### *Definitions*

- 4 The following definitions shall apply in the FRS and in particular in the Statement of Standard Accounting Practice set out **in bold type**.

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\* *At the time of publication of the FRS, the FRSSE currently in issue requires smaller entities adopting it and preparing consolidated financial statements to apply SSAP 1 'Accounting for associated companies' rather than the FRS. It is envisaged that a future revision to the FRSSE will require such entities to apply the FRS and will withdraw SSAP 1 for those entities.*

*Associate:-\**

An entity (other than a subsidiary) in which another entity (the investor) has a PARTICIPATING INTEREST and over whose operating and financial policies the investor EXERCISES A SIGNIFICANT INFLUENCE.

## PARTICIPATING INTEREST:-

An interest held in the shares<sup>†</sup> of another entity on a long-term basis for the purpose of securing a contribution to the investor's activities by the exercise of control or influence arising from or related to that interest. The investor's interest must, therefore, be a beneficial one and the benefits expected to arise<sup>o</sup> must be linked to the exercise of its significant influence over the investee's operating and financial policies. An interest in the shares of another entity includes an interest convertible into an interest in shares or an option to acquire shares.

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\* This definition is consistent with the definition of an associated undertaking in companies legislation:

- (a) in Great Britain, paragraph 20 of Schedule 4A to the Companies Act 1985;
- (b) in Northern Ireland, paragraph 20 of Schedule 4A to the Companies (Northern Ireland) Order 1986; and
- (c) in the Republic of Ireland, Regulation 34 of the European Communities (Companies: Group Accounts) Regulations 1992.

The statutory definitions in Great Britain and Northern Ireland specifically exclude non-corporate joint ventures that are proportionally consolidated. The full definitions are given in Appendix I.

† The reference to shares is to allotted shares in an entity with a share capital, to rights to share in the capital in an entity with capital but no share capital, and to interests conferring any right to share in the profits, or imposing a liability to contribute to the losses or giving an obligation to contribute to debts or expenses in a winding up for an entity without capital.

o Dividends are not the only way a beneficial interest can be enjoyed: there are other ways of extracting benefit, for example, through a management contract with a fee based on performance (making the receiver of the fee more than just a manager).



Companies legislation provides that a holding of 20 per cent or more of the shares of an entity is to be presumed to be a participating interest unless the contrary is shown.\* The presumption is rebutted if the interest is either not long-term or not beneficial.

**EXERCISE OF SIGNIFICANT INFLUENCE:-**

The investor is actively involved and is influential in the direction of its investee through its participation in policy decisions covering aspects of policy relevant to the investor, including decisions on strategic issues such as:

- (a) the expansion or contraction of the business, participation in other entities or changes in products, markets and activities of its investee; and
- (b) determining the balance between dividend and reinvestment.

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\* In Great Britain, section 260 of the Companies Act 1985.  
In Northern Ireland, Article 268 of the Companies (Northern Ireland) Order 1986.  
In the Republic of Ireland, Regulation 35 of the European Communities (Companies: Group Accounts) Regulations 1992.

Companies legislation provides that an entity holding 20 per cent or more of the voting rights in another entity should be presumed to exercise a significant influence over that other entity unless the contrary is shown.\* For the purpose of applying this presumption, the shares held by the parent and its subsidiaries in that entity should be aggregated.† The presumption is rebutted if the investor does not fulfil the criteria for the exercise of significant influence set out above.

Further guidance on how to apply the definition of an 'associate' in practice is given in paragraphs 13-17 with 'participating interest' considered in paragraph 13 and 'exercise of significant influence' in paragraphs 14-17.

*Control:-*

See definition under *subsidiary*.

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\* In Great Britain, paragraph 20 of Schedule 4A to the Companies Act 1985.  
 In Northern Ireland, paragraph 20 of Schedule 4A to the Companies (Northern Ireland) Order 1986.  
 In the Republic of Ireland, Regulation 34 of the European Communities (Companies: Group Accounts) Regulations 1992.

† The provisions in companies legislation that deal with the voting rights to be taken into account in applying the rebuttable presumption are:

- (a) in Great Britain, paragraphs 5-11 of Schedule 10A to the Companies Act 1985;
- (b) in Northern Ireland, paragraphs 5-11 of Schedule 10A to the Companies (Northern Ireland) Order 1986; and
- (c) in the Republic of Ireland, Regulation 4 of the European Communities (Companies: Group Accounts) Regulations 1992.

*Entity:-\**

A body corporate, partnership, or unincorporated association carrying on a trade or business with or without a view to profit. The reference to carrying on a trade or business means a trade or business of its own and not just part of the trades or businesses of entities that have interests in it.

*Equity method:-*

A method of accounting that brings an investment into its investor's financial statements initially at its cost, identifying any goodwill arising. The carrying amount of the investment is adjusted in each period by the investor's share of the results of its investee less any amortisation or write-off for goodwill, the investor's share of any relevant gains or losses, and any other changes in the investee's net assets including distributions to its owners, for example by dividend. The investor's share of its investee's results is recognised in its profit and loss account. The investor's cash flow statement includes the cash flows between the investor and its investee, for example relating to dividends and loans.

*Gross equity method:-*

A form of equity method under which the investor's share of the aggregate gross assets and liabilities underlying the net amount included for the investment is shown on the face of the balance sheet and, in the profit and loss account, the investor's share of the investee's turnover is noted.

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\* *The first sentence of this definition is the same as the definition of 'undertaking' in companies legislation:*

- (a) *in Great Britain, section 259 of the Companies Act 1985;*
- (b) *in Northern Ireland, Article 267 of the Companies (Northern Ireland) Order 1986; and*
- (c) *in the Republic of Ireland, Regulation 3 of the European Communities (Companies: Group Accounts) Regulations 1992.*

*Interest held on a long-term basis:-*

An interest that is held other than exclusively with a view to subsequent resale. An interest held exclusively with a view to subsequent resale is:

- (a) an interest for which a purchaser has been identified or is being sought, and which is reasonably expected to be disposed of within approximately one year of its date of acquisition; or
- (b) an interest that was acquired as a result of the enforcement of a security,\* unless the interest has become part of the continuing activities of the group or the holder acts as if it intends the interest to become so.

*Investee:-*

An entity in which the investor has invested.

*Joint arrangement that is not an entity:-*

A contractual arrangement under which the participants engage in joint activities that do not create an entity because it would not be carrying on a trade or business of its own. A contractual arrangement where all significant matters of operating and financial policy are predetermined does not create an entity because the policies are those of its participants, not of a separate entity.†

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\* "Enforcement of a security" should be interpreted to include any other arrangement that has in substance the same effect.

† Under FRS 5 'Reporting the Substance of Transactions', where all significant matters of operating and financial policy are predetermined in a contractual arrangement, if one party gains the benefits arising from the net assets of that arrangement and is exposed to the risks inherent in them, then that party possesses control and the arrangement is that party's quasi-subsidiary.

Further guidance on how to apply this definition in practice is given in paragraphs 8 and 9.

*Joint venture:-*

An entity in which the reporting entity holds an interest on a long-term basis and is JOINTLY CONTROLLED by the reporting entity and one or more other venturers under a contractual arrangement.

JOINT CONTROL:-

A reporting entity jointly controls a venture with one or more other entities if none of the entities alone can control that entity but all together can do so and decisions on financial and operating policy essential to the activities, economic performance and financial position of that venture require each venturer's consent.

Further guidance on how to apply this definition in practice is given in paragraphs 10-12 with 'joint control' considered in paragraphs 11 and 12.

*Subsidiary:-*

A subsidiary undertaking as defined by paragraph 14 of FRS 2 'Accounting for Subsidiary Undertakings', which is consistent with companies legislation.\* In principle, a subsidiary is an entity over which another entity (the investor) has CONTROL.

CONTROL:-

The ability of an entity to direct the operating and financial policies of another entity with a view to gaining economic benefits from its activities.

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\* Paragraph 14 of FRS 2 is based on the following:

- (a) in Great Britain, section 258 of and Schedule 10A to the Companies Act 1985;
- (b) in Northern Ireland, Article 266 of and Schedule 10A to the Companies (Northern Ireland) Order 1986; and
- (c) in the Republic of Ireland, Regulation 4 of the European Communities (Companies: Group Accounts) Regulations 1992.

- 5 References to companies legislation mean:
- (a) in Great Britain, the Companies Act 1985;
  - (b) in Northern Ireland, the Companies (Northern Ireland) Order 1986; and
  - (c) in the Republic of Ireland, the Companies Acts 1963-90 and the European Communities (Companies: Group Accounts) Regulations 1992.

***Applying the key definitions in practice***

- 6 The definitions set out in paragraph 4 identify five ways in which entities further their economic activities through investments or joint arrangements. Four of those involve interests in other entities—subsidiaries, joint ventures, associates and other investments. The basis for the classification of the interests in other entities is the relationship in practice between the investor and its investee. The fifth way involves joint arrangements that do not amount to entities. Subsidiaries are dealt with in FRS 2 and are not specifically addressed in this FRS. The FRS does not provide any guidance on the treatment of investments that are not associates or joint ventures. The paragraphs below deal with joint arrangements that are not entities, and with joint ventures and associates, in that order, because it reflects the decreasing degree of the reporting entity's direct involvement.
- 7 Both associates (through the holding of a participating interest) and joint ventures are defined by reference to long-term interests. Whether any investee qualifies as an associate or joint venture should therefore be judged on long-term factors and, once an investee has qualified as an associate or joint venture, minor or temporary changes in the relationship between investor and investee should not affect its status. In particular, the status of an entity as an associate or

joint venture does not change according to whether it is profitable or has net assets or is loss-making or has net liabilities or, once it has been accounted for as an associate or joint venture, whether the investor intends to keep its interest or dispose of it.

*A joint arrangement that is not an entity*

- 8 A reporting entity may enter a variety of commercial arrangements but not all of these result in the creation of entities. Even if the participants have a long-term interest and have joint control within an arrangement, that arrangement is not a joint venture as defined in the FRS unless it constitutes an entity. For a joint arrangement to amount to an entity, it must carry on a trade or business, meaning a trade or business of its own and not just part of its participants' trades or businesses. In its activities the joint arrangement must therefore have some independence (within the objectives set by the agreement governing the joint arrangement) to pursue its own commercial strategy in its buying and selling; it must either have access to the market in its own right for its main inputs and outputs or, at least, be able to obtain them from the participants or sell them to the participants on generally the same terms as are available in the market. The following indicate that the joint activities undertaken in a joint arrangement do not amount to its carrying on a trade or business of its own—and therefore that the joint arrangement is not an entity:
- (a) the participants derive their benefit from product or services taken in kind rather than by receiving a share in the results of trading;<sup>\*</sup> or

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<sup>\*</sup> This condition includes the possibility of a venturer taking in cash its share of the joint venture's product if the commodity is actively traded.

- (b) each participant's share of the output or result of the joint activity is determined by its supply of key inputs to the process producing that output or result.
- 9 In practice, a joint arrangement will not be an entity if, rather than its activities amounting to its carrying on a trade or business of its own, it is no more than a cost- or risk-sharing means of carrying out a process in the participants' trades or businesses—for example a joint marketing or distribution network or a shared production facility. Carrying on a trade or business normally denotes a continuing activity with repetition of the buying and selling activities and, therefore, a joint arrangement carrying out a single project (as, for example, occurs in the construction industry) is unlikely to be carrying on a trade or business of its own, being instead a facility or agent in its participants' trades or businesses. The nature of a joint arrangement may change over time—for example, a pipeline operated as a joint arrangement that initially provided a service only directly to the participants may develop into a pipeline business providing services to others, where access to the pipeline is sold in the market. Changes in the nature of a joint arrangement should be reflected in its accounting treatment.

*A joint venture*

- 10 An entity is a joint venture only with respect to an investor that shares control in it. An investor may have an interest in an entity that is a joint venture to some of its other investors. However, if that investor does not share control of the entity, the entity for that investor is merely an investment and should be accounted for as such.



## JOINT CONTROL

- 11 Joint control, like control itself, is a relationship that has a benefit aspect.\* The venturers exercise their joint control for their mutual benefit, each conducting its part of the contractual arrangement with a view to its own benefit. Each venturer that shares control should play an active role in setting the operating and financial policies of the joint venture, at least at a general strategy level. This does not preclude one venturer managing the joint venture provided that the venture's principal operating and financial policies are collectively agreed by the venturers and the venturers have the power to ensure that those policies are followed. In some cases an investor may qualify as the parent of an entity under the definition of a subsidiary in FRS 2 (for example by holding a majority of the voting rights in that entity) but contractual arrangements with the other shareholder mean that in practice the shareholders share control over their investee. In such a case the interests of the minority shareholder amount to "severe long-term restrictions" that "substantially hinder the exercise of the rights of the parent undertaking over the assets or management of the subsidiary undertaking".† The subsidiary therefore should not be consolidated but should instead be treated as a joint venture according to the requirements of this FRS.

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\* Control is defined in FRS 2 and FRS 5 to include a benefit aspect, ie the ability to direct is with a view to gaining economic benefits.

† Subsidiary undertakings where there are severe long-term restrictions of this sort are required by paragraph 25 of FRS 2 to be excluded from consolidation.

- 12 The effect of the requirement in the definition for consent to high-level strategic decisions of joint control is to give each venturer a veto on such decisions. This veto is what distinguishes a joint venturer from a minority holder of the shares in a joint stock company because the latter, having no veto, is subject to majority rule (except for the limited statutory protection for the minority). The requirement for each venturer's consent to high-level strategic decisions does not have to be set out in the joint venture agreement, provided that the joint venture works in practice on the basis of securing such consent.

*An associate*

#### PARTICIPATING INTEREST

- 13 One of the conditions for an investment to qualify as an associate is that its investor should have a participating interest. A participating interest includes an interest convertible into an interest in shares or an option to acquire shares. Start-up situations, or other operations in which an investor holds convertibles or options rather than the shares themselves, may therefore qualify as associates if an entity initially has a close involvement in the strategic operating and financial policies, despite only a limited equity interest (for example, by a management contract rather than a holding of shares), and has an option to purchase shares later.

## EXERCISE OF SIGNIFICANT INFLUENCE

- 14 For an investment to be an associate, its investor must exercise significant influence over the investee's operating and financial policies. The relationship between an investor and its associate can be contrasted with an interest in an ordinary fixed asset investment. The investor needs an agreement or understanding, formal or informal, with its associate to provide the basis for its significant influence. An investor exercising significant influence will be directly involved in the operating and financial policies of its associate. Rather than passively awaiting the outcome of its investee's policies, the investor uses its associate as a medium through which it conducts a part of its activities (although the associate need not be in the same business as the investor). Over time, the associate will generally implement policies that are consistent with the strategy of the investor and avoid implementing policies that are contrary to the investor's interests. Therefore, if an investee persistently implements policies that are inconsistent with its investor's strategy, that investor does not exercise significant influence over its investee.
- 15 The investor's active involvement in the operating and financial policies of its associate requires inter alia that it should have a voice in decisions on strategic issues such as determining the balance between dividend and reinvestment. The investor's long-term interest in the future cash flows of its investee is compatible with a policy of reinvestment by the investee; the investor may not, therefore, always press its investee to follow a strategy of paying high dividends. The investor's participation in policy decisions is with a view to gaining economic benefits from the activities of the investee; its expectation of gain through such participation exposes it to the risks relating to the investee's activities, including the possibility of losses being sustained.

- 16 The investor's involvement in its associate is usually achieved through nomination to the board of directors (or its equivalent) but may result from any arrangement that allows the investor to participate effectively in policy-making decisions. It is unlikely that an investor can exercise significant influence unless it has a substantial basis of voting power. A holding of 20 per cent or more of the voting rights in another entity suggests, but does not ensure, that the investor exercises significant influence over that entity.
- 17 The decisive feature in identifying investments that are associates is the actual relationship between investor and investee. The actual relationship usually becomes clear soon after an investment is acquired but arrangements (such as the number of board members the investor may nominate and the proposed decision-taking process) may be used to evaluate the relationship before its record is established. If the actual relationship develops differently from that assumed from the arrangements on acquisition, it may be necessary to modify the treatment originally adopted in the financial statements. Once the actual relationship has been established and the investor has qualified as exercising significant influence over an entity, it should be regarded as continuing to exercise such influence until an event or transaction removes the investor's ability to do so.

*Treatment of a joint arrangement that is not an entity*

- 18 **Participants in a joint arrangement that is not an entity should account for their own assets, liabilities and cash flows, measured according to the terms of the agreement governing the arrangement.**

- 19 A joint arrangement that is not an entity includes any contractual arrangement between the participants to conduct certain activities jointly where those activities do not amount to the joint arrangement carrying on a trade or business of its own. Paragraphs 8 and 9 give guidance on determining when activities constitute the carrying on of a trade or business by the joint arrangement and when, therefore, a joint arrangement is an entity. Those paragraphs also describe certain activities that are unlikely to constitute an entity.

*Accounting for joint ventures*

- 20 **In consolidated financial statements an investor should include its joint ventures using the gross equity method in all its primary financial statements. In the investor's individual financial statements, investments in joint ventures should be treated as fixed asset investments and shown either at cost, less any amounts written off, or at valuation.**
- 21 **Under the gross equity method the joint ventures should receive the same treatment as set out for associates in paragraphs 27-30 except that:**
- **in the consolidated profit and loss account the investor's share of its joint ventures' turnover should also be shown—but not as part of group turnover. In the segmental analysis too, the investor's share of its joint ventures' turnover should be clearly distinguished from the turnover for the group itself.**
  - **in the consolidated balance sheet the investor's share of the gross assets and liabilities underlying the net equity amount included for joint ventures should be shown in amplification of that net amount.**

- 22 **Except for items below profit before tax in the profit and loss account, any supplemental information given for joint ventures, either in the balance sheet or in the profit and loss account, must be shown clearly separate from amounts for the group and must not be included in the group totals.**
- 23 Because an investor's joint control of its joint venture is a more direct form of influence than the significant influence exercised over associates, a reporting entity that conducts a major part of its business through joint ventures may wish to give more detailed supplementary information about them. One option for including supplementary information about joint ventures is the columnar presentation based on the gross equity method included as an example in Appendix IV.

*A structure with the form but not the substance of a joint venture*

- 24 **A participant in a structure with the appearance of a joint venture but used only as a means for each participant to carry on its own business should account directly for its part of the assets, liabilities and cash flows held within that structure.**
- 25 Joint ventures are to be included using the gross equity method. However, sometimes a reporting entity operates through a structure that has the appearance of a joint venture, being a separate entity in which the participants hold a long-term interest and exercise joint management, but which confers extremely limited commonality of interest between the venturers because each venturer, in effect, operates its own business independently of the other venturers within

that structure. The nature of such a structure means that the framework entity acts merely as an agent for the venturers, with each venturer able to identify and control its share of the assets, liabilities and cash flows within that framework. In these cases, to reflect the substance of its operations each venturer should account directly for its share of the assets, liabilities and cash flows arising within the entity.

*Accounting for associates*

- 26 A reporting entity that prepares consolidated financial statements should include its associates in those statements using the equity method in all the primary statements. In the investor's individual financial statements, its interests in associates should be treated as fixed asset investments and shown either at cost, less any amounts written off, or at valuation.**

*The investor's consolidated profit and loss account*

- 27 In the investor's consolidated profit and loss account the investor's share of its associates' operating results should be included immediately after group operating result (but after the investor's share of the results of its joint ventures, if any). Any amortisation or write-down of goodwill arising on acquiring the associates should be charged at this point and disclosed. The investor's share of any exceptional items included after operating profit (paragraph 20 of FRS 3) or of interest should be shown separately from the amounts for the group. At and below the level of profit before tax, the investor's share of the relevant amounts for associates should be included within the amounts for the group, although for items below this level, such as taxation, the**

amounts relating to associates should be disclosed. Where it is helpful to give an indication of the size of the business as a whole, a total combining the investor's share of its associates' turnover with group turnover may be shown as a memorandum item in the profit and loss account but the investor's share of its associates' turnover should be clearly distinguished from group turnover. Similarly, the segmental analysis of turnover and operating profit (if given) should clearly distinguish between that of the group and that of associates.

*The investor's consolidated statement of total recognised gains and losses*

- 28 **In the consolidated statement of total recognised gains and losses the investor's share of the total recognised gains and losses of its associates should be included, shown separately under each heading, if the amounts included are material, either in the statement or in a note that is referred to in the statement.**

*The investor's consolidated balance sheet*

- 29 **The investor's consolidated balance sheet should include as a fixed asset investment the investor's share of the net assets of its associates shown as a separate item. Goodwill arising on the investor's acquisition of its associates, less any amortisation or write-down, should be included in the carrying amount for the associates but should be disclosed separately.**



*The investor's consolidated cash flow statement*

- 30 The investor's consolidated cash flow statement should include dividends received from associates as a separate item between operating activities and returns on investments and servicing of finance. Any other cash flows between the investor and its associates should be included under the appropriate cash flow heading for the activity giving rise to the cash flow. None of the other cash flows of the associates should be included.

*Applying the equity method and the gross equity method*

- 31 In calculating the amounts to be included in the investor's consolidated financial statements by the equity method for associates and the gross equity method for joint ventures, the same principles should be applied as are applied in the consolidation of subsidiaries.
- (a) When an entity acquires an associate or joint venture, fair values should be attributed to the investee's underlying assets and liabilities, identified using the investor's accounting policies, and these fair values should provide the basis for subsequent depreciation. Both the consideration paid in the acquisition and the goodwill arising should be calculated in the same way as on the acquisition of a subsidiary. The investee's assets used in calculating the goodwill arising on its acquisition should not include any goodwill carried in the balance sheet of the investee itself. Subject to the presentation requirement in paragraph 29 of the FRS, the goodwill balance should be treated in accordance with the provisions of FRS 10 'Goodwill and Intangible Assets'.

- (b) Where profits and losses resulting from transactions between the investor and its associate or joint venture are included in the carrying amount of assets in either entity, the part relating to the investor's share should be eliminated. Where the transaction provides evidence of the impairment of those assets or any similar assets, this should be taken into account.
- (c) In arriving at the amounts to be included by the equity method, the same accounting policies as those of the investor should be applied.
- (d) Where the period-end of an associate or joint venture differs from that of the investor, the entity should be included on the basis of financial statements prepared to the investor's period-end. Where this is not practicable, the entity should be included on the basis of financial statements prepared for a period ending not more than three months before the investor's period-end. Where using these financial statements would release restricted, price-sensitive information, financial statements prepared for a period that ended not more than six months before the investor's period-end may be used. Any changes after the period-end of the associate or joint venture and before that of its investor that would materially affect the view given by the investor's financial statements should be taken into account by adjustment.

- 32 Where the investor is a group, its share of its associate or joint venture is the aggregate of the holdings of the parent and its subsidiaries in that entity. The holdings of any of the group's other associates or joint ventures should be ignored for this purpose. Where an associate or joint venture itself has subsidiaries, associates or joint ventures, the results and net assets to be taken into account by the equity method are those reported in that investee's consolidated financial statements (including the investee's share of the results and net assets of its associates and joint ventures), after any adjustment necessary to give effect to the investor's accounting policies.
- 33 The investor may hold options, convertibles or non-equity shares in its associate or joint venture. In certain circumstances, the conditions attaching to such holdings are such that the investor should take them into account in reflecting its interest in its investee under the equity or gross equity method. In such cases, the costs of exercising the options or converting the convertibles, or future payments in relation to the non-equity shares, should also be taken into account. The necessary calculation depends on the relevant circumstances in any particular case but care should be taken not to count any interest twice—for example, by including a greater share of the investee under the equity method than that which would arise on the basis of the investor's existing equity holding while simultaneously writing up the value of options held in the investee to reflect an increase in market value.

- 34 To apply either the equity method or the gross equity method, the investor's share in its investee needs to be calculated. Where the investee is corporate, the investor's share is usually calculated at its proportional holding of ordinary shares in that entity because this is the basis of its entitlement to dividends and other distributions. In some cases the arrangements for sharing dividends and other distributions may be more complicated; for example, they may depend on the nature of the distribution to be made or the way that the underlying cash flows arise. In these cases the substance of the respective rights held needs to be assessed to establish the most appropriate measure of the investor's share.
- 35 Paragraph 31 requires procedures in applying the equity methods for associates and joint ventures that are similar to those used in the consolidation of subsidiaries. However, an investor controls its subsidiaries, thus providing access to the information necessary for these procedures, but it exercises only significant influence over its associates or jointly controls its joint ventures. Where access to information is limited, estimates may be used. However, if the information available to the investor is extremely limited, the investor's relationship with its investee will need to be reassessed because there may be doubt in such instances whether its influence is significant or whether it jointly controls its investment.
- 36 Among the adjustments required by paragraph 31 is the elimination of the investor's share of any profits or losses from transactions between the investor and its investee that are included in the carrying amount of assets in either entity. This adjustment applies only in the investor's consolidated financial statements. The adjustment required applies to transfers of assets or

liabilities to set up a joint venture or to acquire an initial stake in an associate as well as to all other transactions during the life of the associate or joint venture. Because associates and joint ventures are not part of the group, balances between the investor and its associates or joint ventures are not eliminated and therefore unsettled normal trading transactions should be included as current assets or liabilities.

- 37 Regulations on the dissemination of information may restrict the extent to which the financial statements of an investor may contain information about its associates and joint ventures unless such information is available to other interested parties at the same time. An investor should plan how to satisfy any regulations on the publishing of information about its associates and joint ventures.

### *Impairment*

- 38 **Where there has been an impairment in any goodwill attributable to an associate or joint venture, the goodwill should be written down. The amount written off in the accounting period should be separately disclosed.**
- 39 Any impairment in the underlying net assets of an associate or joint venture would normally be reflected at the level of the entity itself (ie by writing down the relevant assets) or in the adjustments made to apply the equity or gross equity method; accordingly, no further provision against the investor's share of these net assets should usually be necessary.

*Commencement or cessation of an associate or joint venture relationship*

- 40 The date on which an investment becomes an associate is the date on which the investor begins to fulfil the two essential elements of the definition of an associated undertaking: the holding of a participating interest and the exercise of significant influence. The date on which an investment ceases to be an associate is the date on which it ceases to fulfil either element. The date on which an investment becomes a joint venture is the date on which the investor begins to control that entity jointly with other venturers, provided it has a long-term interest. The date on which an investment ceases to be a joint venture is the date on which the investor ceases to have joint control.\* When an interest in an associate or joint venture is disposed of, the profit or loss arising on disposal should be calculated after taking into account any related goodwill that has not previously been either written off through the profit and loss account or attributed to prior period amortisation or impairment on applying the transitional arrangements of FRS 10 'Goodwill and Intangible Assets'.
- 41 Where an investment in an associate or joint venture is acquired or disposed of in stages, processes similar to those set out for subsidiaries in FRS 2 (paragraphs 50-52) should be followed.

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\* Paragraph 7 of the FRS is relevant in determining the date on which an investment ceases to be an associate or joint venture.

- 42 **When an entity ceases to be either an associate or joint venture, the initial carrying amount of any interest retained in the entity is based on the percentage retained of the final carrying amount for the former associate or joint venture at the date the entity ceased to qualify as such, including any related goodwill as required by paragraph 40. The initial carrying amount calculated on this basis should be reviewed and written down, if necessary, to its recoverable amount.**
- 43 When an entity ceases to be either an associate or joint venture, the investor may retain all or some of its interest in that entity as a simple investment. An interest in another entity that ceases to be a joint venture may still qualify as an associate. Once an interest qualifies as long-term it should continue to be treated as long-term, whether the investor intends to keep its interest or dispose of it. The initial carrying amount of any interest retained in a former associate or joint venture is a surrogate cost derived from the former carrying amount rather than any consideration paid. In applying the requirement to review and write down that initial amount, if necessary, to its recoverable amount, it should be noted that the recoverable amount may be affected by the amount that has been paid in dividend or by other distributions to owners. The treatment required for remaining investments in former associates and joint ventures is similar to that applied to any remaining interest in an entity that has ceased to be a subsidiary (paragraph 47 of FRS 2).

*The treatment of losses and interests in net liabilities*

- 44 **The investor should continue to record changes in the carrying amount for each associate and joint venture even if application of the equity method or gross equity method results in an interest in net liabilities rather than net assets. The only exception is where there is sufficient evidence that an event has irrevocably changed the relationship between the investor and its investee, marking its irreversible withdrawal from its investee as its associate or joint venture.**
- 45 Evidence that the necessary irrevocable change has taken place includes a public statement by the investor that it is withdrawing, with a demonstrable commitment to the process of withdrawal, or evidence that the direction of the operating and financing policies of the investee is to become the responsibility of the investee's creditors, including its bankers, rather than its equity shareholders. Where an interest in net liabilities arises, the amount recorded is shown as a provision or liability.

*Non-corporate associates and joint ventures*

- 46 **Where an investor has an interest in a non-corporate associate or joint venture, the investor should ensure that all its liabilities with respect to that entity are reflected appropriately in its financial statements.**



- 47 Where an investor has an interest in an unincorporated entity, a liability could arise—for example as a result of joint and several liability in a partnership—that would exceed the amount resulting from taking into account only the investor's share of net assets. In such circumstances it may be necessary either to include an additional amount for that liability or to report it as a contingent liability.

*An investor that does not prepare consolidated financial statements*

- 48 **Where an investor does not prepare consolidated financial statements, it should present the relevant amounts for associates and joint ventures, as appropriate, by preparing a separate set of financial statements or by showing the relevant amounts, together with the effects of including them, as additional information to its own financial statements. Investing entities that are exempt from preparing consolidated financial statements, or would be exempt if they had subsidiaries, are exempt from this requirement.**

*Investment funds*

- 49 Investment funds, such as those in the venture capital and investment trust industry, should include all investments that are held as part of their investment portfolio in the same way (ie at cost or market value), even those over which the investor has significant influence or joint control. Investments are held as part of an investment portfolio if their value to the investor is through their marketable value as part of a basket of investments rather than as media through which the investor carries out its business.

- 50 In the venture capital and investment trust industry, the business of the investor is to provide capital to other entities, often accompanied by advice and guidance. The stake taken by the investor and the rights attributable to that stake vary according to circumstances but the investor's relationship to its investment tends to be that of a portfolio investor. In these circumstances, for consistency, the stake is properly accounted for as an investment according to the method of accounting applied to other investments within that investment portfolio rather than as an associate or joint venture, even if the investor has significant influence or joint control. Outside their investment portfolio, venture capital funds and investment trusts may hold investments that qualify as associates or joint ventures. Such investments should be included using the equity method or the gross equity method, whatever the nature of their investor's business. For investment funds, investments that are associates or joint ventures often arise in a field of activity that is closely related or complementary to that of the investor.

### *Disclosures*

- 51 **The following disclosures should be made in addition to the amounts required on the face of the primary financial statements under the equity method or the gross equity method.**

*For all associates and joint ventures*

- 52 **The names of the principal associates and joint ventures should be disclosed in the financial statements of the investing group, showing for each associate and joint venture:**
- (a) **the proportion of the issued shares in each class held by the investing group, indicating any special rights or constraints attaching to them;**
  - (b) **the accounting period or date of the financial statements used if they differ from those of the investing group; and**
  - (c) **an indication of the nature of its business.**
- 53 **Any notes relating to the financial statements of associates and joint ventures, or matters that should have been noted had the investor's accounting policies been applied, that are material to understanding the effect on the investor of its investments should be disclosed, in particular noting the investor's share in contingent liabilities incurred jointly with other venturers or investors and its share of the capital commitments of the associates and joint ventures themselves.**
- 54 **If there are significant statutory, contractual or exchange control restrictions on the ability of an associate or joint venture to distribute its reserves (other than those shown as non-distributable), the extent of the restrictions should be indicated.**

- 55 **The amounts owing and owed between an investor and its associates or its joint ventures should be analysed into amounts relating to loans and amounts relating to trading balances. This disclosure may be combined with those required by FRS 8 ‘Related Party Disclosures’.**
- 56 **A note should explain why the facts of any particular case rebut either the presumption that an investor holding 20 per cent or more of the voting rights of another entity exercises significant influence over the operating and financial policies of that entity or the presumption that an investor holding 20 per cent or more of the shares of another entity has a participating interest.**

*Additional disclosures at 15 and 25 per cent thresholds*

- 57 **The disclosures required for all associates and joint ventures should be supplemented if certain thresholds are exceeded. The thresholds are applied by comparing the investor’s share for either its associates in aggregate or its joint ventures in aggregate or its individual associates or joint ventures, as appropriate, of the following:**
- **gross assets**
  - **gross liabilities**
  - **turnover**
  - **operating results**  
(on a three-year average)

with the corresponding amounts for the investor group (excluding any amount included by the equity method for associates and the gross equity method for joint ventures). If any of the relevant amounts for the investor's share exceeds the specified proportion of the same amounts for the investor group, the threshold has been exceeded and the additional disclosures required by paragraph 58 should be made.

58 The following are the additional disclosures that should be made.

(a) Where the aggregate of the investor's share in its associates exceeds a 15 per cent threshold with respect to the investor group, a note should give the aggregate of the investor's share in its associates of the following:

- turnover (unless it is already included as a memorandum item)
- fixed assets
- current assets
- liabilities due within one year
- liabilities due after one year or more.

(b) Where the aggregate of the investor's share in its joint ventures exceeds a 15 per cent threshold with respect to the investor group, a note should give the aggregate of the investor's share in its joint ventures of the following:

- fixed assets
- current assets
- liabilities due within one year
- liabilities due after one year or more.

**(c) Where the investor's share in any individual associate or joint venture exceeds a 25 per cent threshold with respect to the investor group, a note should name that associate or joint venture and give its share of each of the following:**

- turnover
- profit before tax
- taxation
- profit after tax
- fixed assets
- current assets
- liabilities due within one year
- liabilities due after one year or more.

If that individual associate or joint venture accounts for nearly all of the amounts included for that class of investment, only the aggregate, not the individual, information need be given, provided that this is explained and the associate or joint venture identified.

In addition to the disclosures in (a)-(c) above, further analysis should be given where this is necessary to understand the nature of the total amounts disclosed. In deciding into which balance sheet headings the amounts should be analysed, regard should be had to the nature of the businesses and, therefore, which are the most relevant and descriptive balance sheet amounts to disclose. It may be important to give an indication of the size and maturity profile of the liabilities held.

*Date from which effective*

- 59 **The accounting practices set out in the FRS should be regarded as standard in respect of financial statements relating to accounting periods ending on or after 23 June 1998. Earlier adoption is encouraged but not required.**

*Withdrawal of SSAP 1 and Interim Statement and amendment of FRS 1 (Revised 1996)*

- 60 **Except for smaller entities applying the FRSSSE, the FRS supersedes SSAP 1 'Accounting for associated companies' and withdraws the remaining paragraphs of the Interim Statement 'Consolidated Accounts'.**
- 61 **The FRS makes the following changes to FRS 1 (Revised 1996) 'Cash Flow Statements' in respect of the treatment of dividends received from associates and joint ventures.**
- (a) **In paragraph 7**  
 “• dividends from joint ventures and associates”  
**is inserted immediately below**  
 “• operating activities”.  
**In the following sentence “seven” is substituted for “six”.**
- (b) **In paragraph 11 the sentence**  
 “Dividends received from equity accounted entities should be included as operating cash flows where the results are included as part of operating profit.”  
**is deleted.**
- (c) **In paragraph 12 the sentence**  
 “The reconciliation should also show separately the difference between dividends received and results taken into account for equity accounted entities.”  
**is deleted.**

**(d) After paragraph 12 there is inserted:**

*“Dividends from joint ventures and associates*

**12A** Dividends received from joint ventures and associates should be included as separate items between operating activities and returns on investment and servicing of finance.”

**(e) In paragraph 14(b) the words**

“whose results are included as part of operating profit”  
**are deleted.**

**(f) In Appendix I the examples of cash flow statements are amended as follows.****EXAMPLE 2**

In the cash flow statement:

the figure for  
“**Cash flow from operating activities**”  
is amended to “15,672”

after which the following line is added:

“**Dividends received from associates** 350”.

In **Note 1**:

the first item in the reconciliation is amended to read:

“Operating profit 18,829 (1,616) 17,213”.

the lines from “Share of profit of associate” to “Profit of associate less dividends received” inclusive are deleted.



the figure for “Net cash inflow from continuing operating activities” is amended to “16,662”

and the total figure for “**Net cash inflow from operating activities**” is amended to “15,672”.

### **EXAMPLE 3**

Under “**Reconciliation of operating profit to net operating cash flows**”:

the figure for “Operating profits” is amended to “223.6”.

the lines “Associated undertakings - profit included” and “dividends received” and the following subtotal (7.5) are deleted.

the total for “*Net cash flow from trading activities*” is amended to “211.5”.

the figure for “**Net cash inflow from operating activities**” is amended to “1,096.6”.

In the **CASH FLOW STATEMENT**:

the figure for “**Net cash inflow from operating activities**” is amended to “1,096.6”

after which the following line is inserted:

“**Dividends from associates** 10.3”.

**EXAMPLE 4**

The figure for "Operating profit before taxation after interest" is amended to "300.2".

The lines "Share of profits of associates" and "Dividends received from associates" are deleted and the subtotal amended from "201.2" to "225.6".

The figure for "**Net cash inflow from operating activities**" is amended to "525.8".

In the **CASH FLOW STATEMENT**:

the figure for "*Net cash inflow from general business*" is amended to "484.4".

the figure for "**Net cash inflow from operating activities**" is amended to "**525.8**"

after which the following line is inserted:

"**Dividends from associates** 22.1".

**(g) At the end of paragraph 19 of Appendix III the sentence**

"Dividends from equity accounted entities should also be included as cash flows from operating activities if the results of those entities are included in operating profit."

**is deleted.**

## **ADOPTION OF FRS 9 BY THE BOARD**

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*Financial Reporting Standard 9 - 'Associates and Joint Ventures' was approved for issue by the ten members of the Accounting Standards Board.*

Sir David Tweedie (Chairman)

Allan Cook (Technical Director)

David Allvey

Ian Brindle

Dr John Buchanan

John Coombe

Raymond Hinton

Huw Jones

Professor Geoffrey Whittington

Ken Wild

## **APPENDIX I**

### **NOTE ON LEGAL REQUIREMENTS**

- 1 The general legal background to the requirements of the FRS are considered in paragraphs 2-6. Paragraphs 7-11 set out the relevant legal provisions in Great Britain with the corresponding references for Northern Ireland in paragraph 12 and the Republic of Ireland in paragraph 13.

#### ***Great Britain***

##### *The Companies Act 1985 and the approach taken in the FRS*

- 2 An associate is defined in the FRS as an entity in which the investor holds a participating interest, and over which it exercises significant influence, with the result that an associate will also qualify as an associated undertaking as defined in the Companies Act 1985. The requirement for associates to be included in the investor's consolidated financial statements using the equity method of accounting is also consistent with the requirement for associated undertakings in the Act.
- 3 A joint venture is defined in the FRS as an entity in which each joint venturer has a long-term interest and has joint control. A joint venturer, therefore, fulfils the conditions for having a participating interest and exercising a significant influence, with the result that all joint ventures meeting the definition in the FRS will also qualify as associated undertakings as defined in the Act. The Act does not define a 'joint venture', although it refers to 'managing jointly' in its description of non-corporate joint ventures that are permitted to be included using proportional consolidation.

- 4 The FRS requires joint ventures to be included in the investor's consolidated financial statements using the gross equity method. This method provides information in addition to that given by the traditional equity method and its use is therefore consistent with the requirement of the Act for associated undertakings to be included by the equity method.
- 5 The FRS notes that a reporting entity sometimes carries out some of its operations through entities with the form of a joint venture but where there is limited commonality of interest between the venturers as each, in effect, operates its own business within the structure. Unless these arrangements constitute an undertaking (as defined in section 259 of the Act), the Act is silent on the treatment, and the requirement of the FRS is that each of the participants should account for its share of the assets and liabilities directly as its own. Even in cases where the contractual arrangements are performed through the medium of an undertaking, if the nature of those arrangements means that the undertaking acts merely as an agent for the participants then, in such cases, they should follow the requirements of the FRS by accounting directly for their share of the assets and liabilities.
- 6 A similar analysis applies to the treatment of joint arrangements that are not entities. The FRS requires participants in such arrangements to account directly for their own assets, liabilities and cash flows. However, a joint arrangement may qualify as an undertaking under the Act even though it does not carry on its own trade or business (eg where the joint arrangement is a body corporate or a partnership). In such cases the nature of those arrangements means that the undertaking acts merely as an agent for the venturers and, therefore, they should account directly for their share of the assets and liabilities.

*The provisions of the Companies Act 1985*

- 7 The Act defines an “associated undertaking” in paragraph 20 of Schedule 4A.
- “(1) An “associated undertaking” means an undertaking in which an undertaking included in the consolidation has a participating interest and over whose operating and financial policy it exercises a significant influence, and which is not—
- (a) a subsidiary undertaking of the parent company, or
  - (b) a joint venture dealt with in accordance with paragraph 19 [of Schedule 4A].
- (2) Where an undertaking holds 20 per cent or more of the voting rights in another undertaking, it shall be presumed to exercise such an influence over it unless the contrary is shown.
- (3) The voting rights in an undertaking mean the rights conferred on shareholders in respect of their shares or, in the case of an undertaking not having a share capital, on members, to vote at general meetings of the undertaking on all, or substantially all, matters.
- (4) The provisions of paragraphs 5 to 11 of Schedule 10A (rights to be taken into account and attribution of rights) apply in determining for the purposes of this paragraph whether an undertaking holds 20 per cent or more of the voting rights in another undertaking.”

8 Section 260 of the Act defines a “participating interest” as follows:

“(1)... an interest held by an undertaking in the shares of another undertaking which it holds on a long-term basis for the purpose of securing a contribution to its activities by the exercise of control or influence arising from or related to that interest.

(2) A holding of 20 per cent or more of the shares of an undertaking shall be presumed to be a participating interest unless the contrary is shown.

(3) The reference in subsection (1) to an interest in shares includes—

(a) an interest which is convertible into an interest in shares, and

(b) an option to acquire shares or any such interest;

and an interest or option falls within paragraph (a) or (b) notwithstanding that the shares to which it relates are, until the conversion or the exercise of the option, unissued.

(4) For the purposes of this section an interest held on behalf of an undertaking shall be treated as held by it.”

9 Paragraph 22 of Schedule 4A requires that:

“(1) The interest of an undertaking in an associated undertaking, and the amount of profit or loss attributable to such an interest, shall be shown by the equity method of accounting (including dealing with any goodwill arising in accordance with paragraphs 17 to 19 and 21 of Schedule 4).

- (2) Where the associated undertaking is itself a parent undertaking, the net assets and profits or losses to be taken into account are those of the parent and its subsidiary undertakings (after making any consolidation adjustments).”
- 10 Paragraph 21 of Schedule 4A stipulates the position in the balance sheet and the profit and loss account formats of interests in associated undertakings and other participating interests and income from such interests.
- 11 The Act does not define a joint venture. However, paragraph 19 of Schedule 4A provides that:
- “(1) Where an undertaking included in the consolidation manages another undertaking jointly with one or more undertakings not included in the consolidation, that other undertaking (“the joint venture”) may, if it is not—
- (a) a body corporate, or
- (b) a subsidiary undertaking of the parent company,
- be dealt with in the group accounts by the method of proportional consolidation.
- (2) The provisions of this Part\* relating to the preparation of consolidated accounts apply, with any necessary modifications, to proportional consolidation under this paragraph.”

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\* The reference to ‘Part’ appears to mean Schedule 4A.



***Northern Ireland***

- 12 The legal requirements in Northern Ireland equivalent to those in Great Britain quoted in paragraphs 7-11 are set out in the following table.

<i>Great Britain: Companies Act 1985</i>	<i>Northern Ireland: Companies (Northern Ireland) Order 1986</i>
paragraph 20 of Schedule 4A	paragraph 20 of Schedule 4A
section 260	Article 268
paragraph 22 of Schedule 4A	paragraph 22 of Schedule 4A
paragraph 21 of Schedule 4A	paragraph 21 of Schedule 4A
paragraph 19 of Schedule 4A	paragraph 19 of Schedule 4A

***Republic of Ireland***

- 13 The legal requirements in the Republic of Ireland equivalent to those in Great Britain quoted in paragraphs 7-11 are set out in the following table.

<i>Great Britain: Companies Act 1985</i>	<i>Republic of Ireland: European Communities (Companies: Group Accounts) Regulations 1992</i>
paragraph 20 of Schedule 4A	Regulation 34
section 260	Regulation 35
paragraph 22 of Schedule 4A	Regulation 33
paragraph 21 of Schedule 4A	paragraph 10 of the Schedule
paragraph 19 of Schedule 4A	Regulation 32

## **APPENDIX II**

### **COMPLIANCE WITH INTERNATIONAL ACCOUNTING STANDARDS**

- 1 The International Accounting Standards Committee (IASC) has one standard for associates—IAS 28 ‘Accounting for Investments in Associates’—and another for joint ventures and other joint arrangements—IAS 31 ‘Financial Reporting of Interests in Joint Ventures’.

#### *IAS 28 ‘Accounting for Investments in Associates’*

- 2 For associates, the requirements of the FRS and IAS 28 are similar, both requiring the use of the equity method in the investor’s consolidated financial statements. There are the following minor differences.
  - IAS 28 defines an associate as an enterprise in which the investor has significant influence, whereas the FRS is consistent with companies legislation and defines an associate by the investor’s holding of a participating interest and exercise of significant influence. Furthermore, the emphasis in the FRS is on the actual exercise of significant influence, whereas IAS 28 defines significant influence as “the power to participate in the financial and operating policy decisions of the investee”. The IAS 28 definition would therefore apply to investors that had the ability to exercise significant influence but were not actually exercising it. This difference may have a limited effect in practice because the best evidence of an entity’s ability to exercise significant influence is the fact that it is exercising such an influence.

- IAS 28 contains a rebuttable presumption of significant influence where an investor holds, directly or indirectly through subsidiaries, 20 per cent or more of the voting power of the investee. There is a similar presumption of the exercise of significant influence in companies legislation. However, the FRS moves away from using a 20 per cent threshold as the defining threshold, noting that a holding of 20 per cent or more of the voting rights in another entity suggests, but does not ensure, that the investor exercises significant influence over that entity. The presumption of the exercise of significant influence at the 20 per cent threshold is rebutted if the investor does not fulfil the criteria for the exercise of significant influence.
- IAS 28 excludes from equity accounting any associate that is acquired and held exclusively with a view to its subsequent disposal in the near future or which operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor. The FRS does not have any specific exclusions but the conditions relating to the exercise of significant influence are unlikely to be fulfilled by an investment operating under severe long-term restrictions and the definition of a participating interest specifies an interest that is held on a long-term basis, which excludes one held exclusively with a view to disposal.
- IAS 28 requires an associate to be included in its investor's individual financial statements using the equity method or at cost or revalued amount. The FRS requires an associate to be carried at cost or valuation in its investor's individual financial statements.

- IAS 28 requires that the investor's consolidated income statement should reflect its share of the results of the operations of the investee. The FRS specifies that the investor's share of its associates' operating results should be brought into its consolidated profit and loss account immediately after the line showing group operating profit but after its share of the operating results of its joint ventures, if any.
- The FRS requires additional disclosures to the amounts shown under the equity method for associates that in aggregate exceed 15 per cent of gross assets, gross liabilities, turnover or, on a three-year average, operating result for the investing group and for each individual associate that exceeds 25 per cent of gross assets, gross liabilities, turnover or, on a three-year average, operating result for the investing group. These are not required by IAS 28.

### *IAS 31 'Financial Reporting of Interests in Joint Ventures'*

- 3 Although both the FRS and IAS 31 take joint control as the defining relationship between an investor and its joint ventures, IAS 31 defines a joint venture in terms of a contractual arrangement while the FRS defines a joint venture in terms of an entity.\* The effect of this difference in definition is that of the three types of joint venture identified in IAS 31—jointly controlled operations, jointly controlled assets and jointly controlled entities—only the last qualifies as a joint venture as defined in the FRS. IAS 31 does not include an explicit definition of an entity or guidance on how to distinguish jointly controlled operations and jointly controlled assets from jointly controlled entities. The

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\* As noted in Appendix I, the definition in the FRS is in line with companies legislation, where only 'associated undertakings' qualify to use the equity method.

FRS provides guidance on whether an entity exists, which depends on whether the joint activities amount to the carrying on of a trade or business. In the FRS jointly controlled operations and jointly controlled assets are dealt with as joint arrangements that are not entities. However, the treatment required for jointly controlled operations and jointly controlled assets is the same in the FRS and IAS 31—participants should recognise directly in their own financial statements, and consequently in their consolidated financial statements, their share of the assets and liabilities of jointly controlled operations and of any jointly controlled assets.

- 4 The FRS requires joint ventures to be included in their investor's consolidated financial statements using the gross equity method—which expands the traditional equity method with a note of the investor's share of the turnover, gross assets and liabilities of the joint ventures. In IAS 31, the equity method is an 'allowed alternative' for jointly controlled entities but the 'benchmark' treatment is proportional consolidation, with a choice of two reporting formats—including the investor's share of its joint ventures either line-by-line or as separate line items for assets, liabilities, profit and expenses.
- 5 IAS 31 requires interests in jointly controlled entities to be treated as ordinary investments if they:
  - (a) are acquired and held exclusively with a view to subsequent disposal in the near future; or
  - (b) operate under severe long-term restrictions that significantly impair their ability to transfer funds to the venturer.

The FRS has no need for such exclusions, because the conditions relating to the definition of a joint venture are unlikely to be fulfilled in these circumstances.

- 6 IAS 31 requires a venturer to disclose the aggregate amounts of each of current assets, long-term assets, current liabilities, long-term liabilities, income and expenses related to its interests in jointly controlled entities.\* The FRS instead requires additional levels of disclosure where joint ventures in aggregate exceed a 15 per cent threshold or individual joint ventures exceed a 25 per cent threshold of certain key indicators (paragraphs 57 and 58). The FRS requires amounts included for joint ventures to be analysed into at least fixed assets, current assets, liabilities due within one year and liabilities due after one year or more.

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\* Unless the venturer uses the reporting format for proportional consolidation where separate line items are included for the venturer's share of the assets, liabilities, income and expenses of its joint venture.

## APPENDIX III

### THE DEVELOPMENT OF THE FRS

#### History

- 1 For a variety of legal, tax, economic and other reasons, business activities are often conducted through a network of connected entities, including subsidiaries, joint ventures and associates. Joint ventures are increasingly popular as a means of gaining access to new markets, new technologies or scarce resources and sometimes as a means of sharing risks.
- 2 In March 1996 the Board issued FRED II 'Associates and Joint Ventures' containing proposals developed in the light of comments on its earlier Discussion Paper (July 1994) to revise the current standard, SSAP I 'Accounting for associated companies'. SSAP I was originally issued in 1971 as a response to the growing practice of entities of conducting parts of their businesses through associates. The standard ensured that the investor's consolidated financial statements reflected the effect of a reporting entity's investments in associates by including such entities using the equity method. SSAP I was revised in 1982.
- 3 The Board decided to carry out a full review of SSAP I because that standard:
  - did not cover the identification of, and accounting for, joint ventures.
  - encouraged but did not require additional disclosures where significant interests were included by equity accounting. There was little evidence of additional disclosures being made.



- permitted in the Board's view an, at times, too literal interpretation of the definition of an associated company (associate), which was applied to the form of the reporting entity's interest in another entity rather than the substance.
- 4 The proposals in FRED 11 were generally well received and the FRS carries forward unchanged the proposals on the following topics:-
- the definitions of associates and joint ventures
  - the inclusion of associates in the investor's consolidated financial statements using the equity method
  - the measurement principles required by the equity method
  - the commencement or cessation of an associate or joint venture relationship
  - the treatment of losses and interests in the net liabilities where losses have accumulated.
- 5 On three topics some respondents, albeit a minority, did not support the proposals in FRED 11 and put forward some well argued objections. The Board has considered carefully the comments made and has consulted further on these issues. To meet some of the concerns expressed, the proposed treatments in FRED 11 have been modified.

- Joint ventures are now treated as a single class of investment rather than the two classes proposed by FRED 11 and the gross equity method is now required for all joint ventures. The result is to give a better impression of the scale of resources committed to joint ventures in relation to those of the reporting entity than is conveyed by the traditional equity method.
- The investor's share of the results of its equity accounted entities is now included immediately after group operating profit rather than in group operating profit, as proposed in FRED 11.
- The level of detail required for additional disclosures for associates or joint ventures at a 15 per cent threshold has been reduced from that proposed in FRED 11—but further analysis is required where this is necessary to understand the nature of the amounts shown. The disclosures for individual associates or joint ventures that individually exceed a 25 per cent threshold in relation to the investor have been aligned with the disclosures in aggregate at the 15 per cent threshold.

### **The basic principles**

- 6 A key issue for the Board in considering associates and joint ventures has been the need to develop proposals for them that would form part of a coherent and consistent policy for the treatment of all of a reporting entity's interests in other entities and other joint arrangements that are not entities. The Board has therefore addressed how to distinguish joint ventures from associates on the one hand and subsidiaries on the other and how to distinguish associates from

simple investments. In the FRS these distinctions are based on the nature of the investor's relationship with the investee—which is also what justifies the different accounting treatments proposed to reflect the different interests.

- If the investor controls its investee, the investee is its subsidiary and should be consolidated.
- If the reporting entity participates in a joint arrangement that is not an entity (ie it does not carry on a trade or business of its own), it should account directly for its share of the assets, liabilities and cash flows of the joint arrangement according to the terms of the agreement governing the arrangement.
- If the investor controls the investee not by itself but jointly with other entities, the investee is its joint venture. A special accounting treatment—the gross equity method—is proposed to reflect this relationship.
- If the investor neither controls nor jointly controls its investee but still has significant influence over the investee's operating and financial policies, the investee is its associate. The equity method is traditionally used to reflect this relationship.
- If the investor neither controls nor jointly controls its investee, nor has significant influence over the investee's operating and financial policies, the investee is merely an investment. There is no special relationship to account for and the investor should include the investment in both its individual and consolidated financial statements in the same way.

- 7 The principles set out above are very similar to those underlying the proposals in FRED 11, but the latter have been modified in two following respects.

*(a) Joint arrangements that are not entities*

FRED 11 defined joint ventures as entities in a similar way to the FRS, thus also departing from the IASC standard on joint ventures, IAS 31, which includes as joint ventures not only jointly controlled entities but also jointly controlled operations and jointly controlled assets. FRED 11 considered jointly controlled operations and jointly controlled assets only briefly in its 'Explanation' section. The FRS addresses joint arrangements that are not entities much more fully by including a definition with an explanation of how to determine whether a set of activities constitutes an entity. In the FRS the treatment for such joint arrangements is the same as that proposed in FRED 11.

*(b) Joint ventures*

FRED 11 proposed identifying two classes of joint ventures: those where the venturers shared in common the benefits and risks, which were to be included by the equity method, and those where each venturer had its own separate interest, which were to be included by proportional consolidation. The FRS now emphasises the special nature of joint control by identifying joint ventures as a single class of investments wholly separate from associates, to be included by a special method of accounting—the gross equity method. However, in practice the difference from the proposals in FRED 11 may be limited because the sort of arrangement that, under FRED 11, would have been most clearly identifiable as a joint venture to be proportionally consolidated will, under the FRS, be accounted for by each participant bringing in directly its share of any assets, liabilities and cash flows to reflect the substance of the arrangement as a structure within which each participant carries on its own business.

## **A joint arrangement that is not an entity**

- 8 Paragraph 6 of the FRS identifies a joint arrangement that is not an entity as the way in which a reporting entity can further its economic activities through investments or joint arrangements that involves the reporting entity most directly. The FRS requires each participant in such a joint arrangement to account directly for its own share of the assets, liabilities and cash flows relating to the joint arrangement, its share being measured by reference to the terms of the joint arrangement. If a joint arrangement is not an entity, accounting treatments whose purpose is to reflect a reporting entity's interests in other entities in its consolidated financial statements—such as consolidation, proportional consolidation and equity accounting—are irrelevant in deciding how to treat that arrangement. The 'Explanation' section of FRED I I dealt in a similar way with joint arrangements.

## **Joint ventures**

### ***Definition***

- 9 The FRS sets out three conditions to be fulfilled for a joint arrangement to meet the definition of a joint venture.
- (a) The business activities undertaken under the joint arrangement must constitute an entity.
  - (b) The venturer must jointly control the entity.
  - (c) The investor's interest must be held for the long term.

In FRED I I condition (c) was not stated explicitly.

- 10 The definition of an entity in the FRS is built on that of an undertaking in companies legislation as proposed in FRED 11 but, in response to the comments, the FRS gives more guidance on the application of the definition, elaborating on a key aspect—the carrying on of a trade or business. The distinction between joint arrangements that are entities and those that are not is important because the equity method can apply only to interests in entities. For a joint arrangement that does not amount to an entity, the only possible accounting procedure is that each party involved should recognise directly its own share of assets, liabilities and cash flows, measured by reference to the agreement governing the joint arrangement.

### *Treatment*

- 11 The gross equity method required by the FRS for joint ventures amplifies the net amounts included under the equity method by showing in the consolidated profit and loss account and balance sheet the investor's share of its joint ventures' turnover, gross assets and gross liabilities. The manner in which these additional details are presented expands the information given by the traditional equity method without changing its nature—the investment in joint ventures is still shown as a net amount and joint ventures' turnover is excluded from that of the group. The effect of this is that the gross equity method, like the traditional equity method, is consistent with the use of control as the basis of asset recognition (in that the net investment represents the asset that is controlled by the venturer) while going some way to meet concerns expressed by a minority of respondents that the traditional equity method understated the scale of activity undertaken through joint ventures.

- 12 In addition to concerns about the adequacy of the equity method for joint ventures, some respondents who opposed the proposals in FRED 11 for joint ventures believed that either:
- (a) all joint ventures should be included by proportional consolidation, particularly because that is the benchmark treatment for joint ventures in IAS 31; or
  - (b) the division of joint ventures into two classes proposed in FRED 11 was either not valid in principle or difficult to apply in practice. FRED 11 proposed distinguishing between:
    - (i) the majority of joint ventures, where the venturers shared in common the benefits, risks and obligations of their joint venture as a separate business, which were to be included using the equity method; and
    - (ii) other joint ventures, where each venturer had a separate interest in the benefits, risks and obligations of the venture, which were to be included by proportional consolidation.
- 13 The difference of opinion between those supporting an equity method for joint ventures and those supporting proportional consolidation is reflected in an international debate on the treatment of joint ventures. IAS 31 notes that, in a jointly controlled entity (a joint venture under the FRS), a venturer has control over its share of future economic benefits through its share of the assets and liabilities of the venture. IAS 31 does not recommend the use of the equity method, on the grounds that proportional consolidation better reflects the substance and economic reality of a venturer's interest in a jointly controlled entity, ie control over the venturer's share of the future economic benefits. The Board rejects

proportional consolidation for joint ventures because it believes that it can be misleading to represent each venturer's joint control of a joint venture—which allows it to direct the operating and financial policies of the joint venture only with the consent of the other venturers—as being in substance equivalent to its having sole control of its share of each of that entity's assets, liabilities and cash flows. The key features of control are that the controlling party has the ability to direct or deploy what it controls without consultation and the ability to take the benefit from what it directs or deploys without question of entitlement. The problems with treating a venturer's joint control as equivalent to its sole control of its share are particularly clear for cash flow reporting where, under proportional consolidation, the venturer would include its share of the cash flows of its joint venture directly as its own cash flows.

- 14 Another argument on which IAS 31 supports proportional consolidation for jointly controlled entities is that it results in the joint arrangements of the investor being reflected in the same way in its consolidated financial statements, whether its joint activities are carried on through jointly controlled assets, jointly controlled operations or jointly controlled entities. However, the Board believes there is an essential difference between activities carried on directly by the reporting entity itself through its jointly controlled assets or operations and activities carried out through an entity controlled jointly with other entities. In jointly controlled assets or operations, the benefits, risks and obligations for each entity relate only to the entity's share of the assets and liabilities involved in the joint activity. In contrast, in a jointly controlled entity the investors usually share in common the benefits, risks and obligations of the entity as a whole rather than those of the individual assets and liabilities of that entity.



- 15 The Board believes that some flexibility is important to reflect the diversity of joint ventures and to enable reporting entities to reflect the nature of their interests. In some cases, the reporting entity may want to give more information about its joint venture on the face of its financial statements. Provided that any additional information given for joint ventures is in a form that is consistent with the gross equity method, the Board encourages experimentation. Appendix IV sets out an optional columnar presentation that may be used where joint ventures represent a major part of the reporting entity's business. The columnar presentation keeps separate the amounts relating to joint ventures from the amounts for the group itself and remains consistent with the equity method because it is formatted to provide an additional analysis of the net amounts included under the equity method.

**A structure with the form but not the substance of a joint venture**

- 16 The FRS requires that venturers should account directly for their own share of the assets, liabilities and cash flows of a structure with the appearance of a joint venture used only as a means for the each participant to carry on their own business. In spite of its appearance, such a structure is not a joint venture because of the extremely limited commonality of interest between the participants. The proposal in FRED 11 for proportional consolidation where a joint venture acts only as a framework for each venturer carrying on its own activities also recognised that the equity method was not appropriate in such cases.

## Associates

### *Identification*

- 17 As proposed in FRED 11, to be consistent with companies legislation, the FRS defines an associate by reference to its investor having a participating interest and exercising significant influence over it. In the earlier Discussion Paper, both associates and joint ventures were identified as a single class of investments called 'strategic alliances' and the emphasis was on the investor acting as a partner in the business of its investee. Some commentators found this emphasis on a partnership between an investor and its associate unhelpful and contrary to their understanding of a partnership. As a result the Board decided to drop the approach that used 'strategic alliances', and has reverted to the approach underlying SSAP 1, which emphasises participation in the operating and financial policies of the investee.
- 18 All investees qualifying as associates under the FRS would have qualified as associates under SSAP 1, which defined an associate as an interest held for the long term where the investor is in a position to exercise significant influence. However, an entity may have qualified as an associate under SSAP 1 yet not qualify as such under the definitions in the FRS because a long-term interest is not always a participating interest, and being in a position to exercise significant influence does not always amount to the actual exercise of such an influence. In practice, these differences may have a limited effect because the best evidence that an entity is in a position to exercise significant influence is that it is actually exercising such influence. Applying the definition in this FRS should ensure that the substance of the relationship between the investor and investee is reflected thus correcting any instances of the too literal application of the SSAP 1 definition—for example,

where the investor has a 20 per cent holding but in practice does not actually exercise significant influence.

*Treatment*

- 19 The requirement in the FRS for associates to be included in the investor's consolidated financial statements using the equity method of accounting represents no change to the requirements of SSAP 1 or the proposals in the Discussion Paper and FRED 11, the overwhelming majority of commentators agreeing with equity accounting for associates. Using the equity method for associates is in keeping with the principle that the assets and liabilities of a group are delineated by the extent of the parent's control because the equity method represents an investor's interest in an associate as a single asset—an investment—albeit one that is measured in terms of net assets and changes in net assets. An investor controls its interest in an associate but does not control its share of its associate's underlying assets and liabilities. For these reasons proportional consolidation is not appropriate for associates because it misrepresents the extent of the investor's influence over its associate's underlying assets and liabilities (and, in particular, its cash flows).
  
- 20 One possible alternative to the equity method would be to include associates at market value. However, providing information on that basis would not be consistent with the information provided by consolidated financial statements about a parent and its subsidiaries. Equity accounting for associates is consistent with consolidation for subsidiaries because it recognises the investor's share of its associates' results and changes in net assets, reflecting that associates are used as media through which the investor carries on its business, sometimes as substitutes for subsidiaries.

## Applying the equity method

- 21 Paragraph 33 of the FRS deals with cases where part of the investor's interest in its associate or joint venture arises from its holding of options, convertibles or non-equity shares. The basis of this paragraph is the requirement in FRS 5 (paragraph 14) that the substance of transactions should be reported. "In determining the substance of a transaction, all its aspects and implications should be identified and greater weight given to those more likely to have a commercial effect in practice." The investor should therefore account for the substance of its interest in its associates or joint ventures in cases where this is affected by its holdings of options, convertibles or non-equity shares. One example where an adjustment to the investor's interest may be necessary is where the price of exercising or converting options or convertibles is so low that there is commercially near-certainty that they will be exercised or converted.
- 22 Consistently with the exclusion of the results of associates or joint ventures from group operating profit, the FRS amends FRS 1 (Revised 1996) to include the cash flows relating to dividends received from associates and joint ventures as separate items between operating activities and returns on investment and servicing of finance in the investor's consolidated cash flow statement. FRED 11 proposed that the results of equity accounted entities should be included as part of group operating profit and therefore proposed that dividends received from such entities should be included as operating cash flows. The treatment in this FRS reflects the fact that dividends from associates and joint ventures are not on a comparable basis to the cash flows arising from the group's operating activities and have a different significance from its returns on investments.

## Disclosures

- 23 One of the Board's objectives in reviewing SSAP I was to improve the information given about associates and joint ventures, particularly where they play a significant part in the reporting entity's operations. The equity method, by including only the net assets and results, had been criticised as failing to show the full amount of resources and obligations arising from the venturer's involvement. SSAP I required more detailed information to be given where, in the context of the financial statements of the investing group, the results of one or more associated companies were so material, or the interests in them were so material, that more detailed information about them would assist in giving a true and fair view. This requirement resulted in little extra disclosure in practice.
- 24 The FRS follows FRED II and the earlier Discussion Paper in requiring a layered approach to disclosures, with additional disclosures of aggregate amounts only when associates or joint ventures represent a significant part of the reporting entity's business at a 15 per cent threshold and with additional disclosures on an individual basis only in the rare cases when an individual associate or joint venture exceeds a 25 per cent threshold. However, there are two changes in the disclosure requirements from those proposed in FRED II.
- (a) The FRS requires the 15 per cent threshold for additional aggregate disclosures to be applied separately for associates and joint ventures as these are now classified as two different categories of investment.
  - (b) The FRS reduces the disclosures required both in aggregate at the 15 per cent threshold and for individual associates and joint ventures at the 25 per cent threshold.

These changes should reduce the concerns about the level of required disclosures that some respondents noted on FRED 11—adverse comment was particularly marked in respect of the proposal for the disclosure of condensed financial information for any associate or joint venture that exceeded a 25 per cent threshold. The Board has successively attempted to meet concerns about the level of the disclosures by carefully targeting any disclosures to be required. FRED 11 itself reduced the number of disclosures proposed from those proposed in the Discussion Paper. The disclosures required at the 25 per cent threshold for individual associates and joint ventures are now consistent with those required in aggregate at the 15 per cent threshold, in particular the investor's share of the relevant amounts is to be disclosed rather than the amount relating to the whole associate or joint venture.

- 25 However, the FRS still includes a requirement for some additional individual disclosures for any highly significant associate or joint venture. The main objections to the proposal for individual disclosures in FRED 11 were that it would entail greater disclosure for some individual associates and joint ventures than for individual subsidiaries and might lead to the disclosure of commercially sensitive information. The Board has carefully considered these objections and, as a response, stresses the very high threshold level that is set to trigger the disclosures. An individual associate or joint venture rarely breaches this threshold—however, when it does, it plays such a significant role in a reporting entity while, unlike a subsidiary, outside the reporting entity's control, that the Board believes the proposed disclosures are necessary for the reporting entity to discharge its accountability and to give a true and fair view of its financial position and performance.

## **APPENDIX IV - EXAMPLES OF ALTERNATIVE WAYS OF GIVING INFORMATION ON JOINT VENTURES**

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*The examples set out in this appendix are provided for general guidance only and do not form part of the FRS.*

EXAMPLE 1 - the normal presentation using the equity method for associates and the gross equity method for joint ventures.

EXAMPLE 2 - an optional columnar presentation for joint ventures where they constitute a major part of the reporting entity's business.

Examples 1 and 2 use the same underlying information.

**EXAMPLE 1 - The normal presentation****CONSOLIDATED PROFIT AND LOSS ACCOUNT**

*The format is illustrative only. The amounts shown for 'Associates' and 'Joint ventures' are subdivisions of the item for which the statutory prescribed heading is 'Income from interests in associated undertakings'. The subdivisions may be shown in a note rather than on the face of the profit and loss account.*

	£m	£m
Turnover: group and share of joint ventures	320	
Less: share of joint ventures' turnover	<u>(120)</u>	
<b>Group turnover</b>		<u>200</u>
Cost of sales		<u>(120)</u>
Gross profit		80
Administrative expenses		<u>(40)</u>
<b>Group operating profit</b>		40
Share of operating profit in		
Joint ventures	30	
Associates	<u>24</u>	
		<u>54</u>
		94
Interest receivable (group)		6
Interest payable		
Group	(26)	
Joint ventures	(10)	
Associates	<u>(12)</u>	
		<u>(48)</u>
<b>Profit on ordinary activities before tax</b>		52
<b>Tax on profit on ordinary activities*</b>		<u>(12)</u>
<b>Profit on ordinary activities after tax</b>		40
Minority interests		<u>(6)</u>
<b>Profit on ordinary activities after taxation and minority interest</b>		34
Equity dividends		<u>(10)</u>
<b>Retained profit for group and its share of associates and joint ventures</b>		<u>24</u>
* Tax relates to the following:		
Parent and subsidiaries	(5)	
Joint ventures	(5)	
Associates	(2)	



**CONSOLIDATED BALANCE SHEET**

	£m	£m	£m
<b>Fixed assets</b>			
Tangible assets		480	
Investments			
<i>Investments in joint ventures:</i>			
<i>Share of gross assets</i>	130		
<i>Share of gross liabilities</i>	<u>(80)</u>		
		50	
<i>Investments in associates</i>		<u>20</u>	
			550
<b>Current assets</b>			
Stock		15	
Debtors		75	
Cash at bank and in hand		<u>10</u>	
		100	
<b>Creditors</b> (due within one year)		<u>(50)</u>	
<b>Net current assets</b>			<u>50</u>
<b>Total assets less current liabilities</b>			600
<b>Creditors</b> (due after more than one year)			(250)
<b>Provisions for liabilities and charges</b>			(10)
<b>Equity minority interest</b>			<u>(40)</u>
			<u>300</u>
<b>Capital and reserves</b>			
Called up share capital			50
Share premium account			150
Profit and loss account			100
<b>Shareholders' funds (all equity)</b>			<u>300</u>

**NOTES**

In the example, there is no individual associate or joint venture that accounts for more than 25 per cent of any of the following for the investor group (excluding any amount for associates and joint ventures):

- gross assets
- gross liabilities
- turnover
- operating results (on a three-year average).

**Additional disclosures for joint ventures (which in aggregate exceed the 15 per cent threshold)**

	£m	£m
<i>Share of assets</i>		
Share of fixed assets	100	
Share of current assets	<u>30</u>	
		130
<i>Share of liabilities</i>		
Liabilities due within one year or less	(10)	
Liabilities due after more than one year	<u>(70)</u>	
		<u>(80)</u>
Share of net assets		<u>50</u>

**Additional disclosures for associates (which in aggregate exceed the 15 per cent threshold)**

	£m	£m
Share of turnover of associates		<u>90</u>
<i>Share of assets</i>		
Share of fixed assets	4	
Share of current assets	<u>28</u>	
		32
<i>Share of liabilities</i>		
Liabilities due within one year or less	(3)	
Liabilities due after more than one year	<u>(9)</u>	
		<u>(12)</u>
Share of net assets		<u>20</u>

**EXAMPLE 2 - An optional presentation****CONSOLIDATED PROFIT & LOSS ACCOUNT**

The format is illustrative only. The amounts shown for 'Associates' and 'Joint ventures' are subdivisions of the item for which the statutory prescribed heading is 'Income from interests in associated undertakings'. The subdivisions may be shown in a note rather than on the face of the profit and loss account.

	£m <b>Group</b>	£m <b>Interests in joint ventures</b>	£m <b>Total</b>
<b>Turnover</b>	<u>200</u>	<u>120</u>	<u>320</u>
Cost of sales	<u>(120)</u>	<u>(85)</u>	<u>(205)</u>
Gross profit	80	35	115
Administrative expenses	<u>(40)</u>	<u>(5)</u>	<u>(45)</u>
<b>Operating profit</b>	40	<u>30</u>	<u>70</u>
<b>Share of operating profit in</b>			
Joint ventures	30		
Associates	<u>24</u>		
<b>Total operating profit: group and share of joint ventures and associates</b>	94		
Interest receivable (group)	6		
Interest payable			
Group	(26)		
Joint ventures	(10)		
Associates	<u>(12)</u>		
		<u>(48)</u>	
<b>Profit on ordinary activities before tax</b>	52		
<b>Tax on profit on ordinary activities*</b>	<u>(12)</u>		
<b>Profit on ordinary activities after tax (carried forward)</b>	40		
* Tax relates to the following:			
Parent and subsidiaries			(5)
Joint ventures			(5)
Associates			(2)

	£m
<b>Profit on ordinary activities after tax</b> ( <i>brought forward</i> )	40
Minority interests	<u>(6)</u>
<b>Profit on ordinary activities after taxation and minority interest</b>	34
Equity dividends	<u>(10)</u>
<b>Retained profit for group and its share of associates and joint ventures</b>	<u><u>24</u></u>

## CONSOLIDATED BALANCE SHEET

	£m <b>Group</b>	£m <b>Interests in joint ventures*</b>	£m <b>Total</b>
<b>Fixed assets</b>			
Tangible assets	480	100	580
Investments			
<i>Investments in joint ventures</i>	50	(50)	
<i>Investments in associates</i>	<u>20</u>		<u>20</u>
	550		600
<b>Current assets</b>			
Stock	15	5	20
Debtors	75	23	98
Cash at bank and in hand	<u>10</u>	<u>2</u>	<u>12</u>
	100	30	130
<b>Creditors</b> (due within one year)	<u>(50)</u>	<u>(10)</u>	<u>(60)</u>
<b>Net current assets</b>	<u>50</u>	<u>20</u>	<u>70</u>
<b>Total assets less current liabilities</b>	600	120	670
<b>Creditors</b> (due after more than one year)	(250)	(70)	(320)
<b>Provision for liabilities and charges</b>	<u>(10)</u>		<u>(10)</u>
<b>Net assets</b>	340		340
<b>Equity minority interest</b>	(40)		
	<u>300</u>		
<b>Capital and reserves</b>			
Called up share capital	50		
Share premium account	150		
Profit and loss account	100		
<b>Shareholders' funds (all equity)</b>	<u>300</u>		

**Additional disclosures**

The same additional disclosures should be made as in Example 1.

\* The boxed amounts, totalling 50 without the shaded amount, show the investor's share of the assets and liabilities of its joint ventures—the shaded (50) transfers this amount to the fixed assets of the group as 'investments in joint ventures'.



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