

GS 015
(November 2009)

Guidance Statement GS 015
*Audit Implications of
Accounting for Investments in
Associates*

Issued by the **Auditing and Assurance Standards Board**



Australian Government

Auditing and Assurance Standards Board

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AUTHORITY STATEMENT

The Auditing and Assurance Standards Board (AUASB) issues Guidance Statement GS 015 *Audit Implications of Accounting for Investments in Associates* pursuant to section 227B of the *Australian Securities and Investments Commission Act 2001*, for the purposes of providing guidance on auditing and assurance matters.

This Guidance Statement provides guidance to assist the auditor to fulfil the objectives of the audit or assurance engagement. It includes explanatory material on specific matters for the purposes of understanding and complying with AUASB Standards. The auditor exercises professional judgement when using this Guidance Statement.

The Guidance Statement does not prescribe or create new mandatory requirements.

Dated: 24 November 2009

M H Kelsall
Chairman - AUASB

GUIDANCE STATEMENT GS 015

Audit Implications of Accounting for Investments in Associates

Application

- 1 This Guidance Statement has been formulated by the Auditing and Assurance Standards Board (AUASB) to provide guidance to auditors on audit implications arising from the application of Accounting Standard AASB 128 *Investments in Associates*.

Issuance Date

- 2 This Guidance Statement is issued on 24 November 2009 and replaces AGS 1032 *The Audit Implications of Accounting for Investments in Associates* which was issued in July 2002.

Introduction

- 3 AASB 128 requires an investor to recognise an investment in an associate by applying the equity method in its consolidated financial statements and at cost or in accordance with Accounting Standard AASB 139 *Financial Instruments: Recognition and Measurement* in its own separate financial statements.

If the investor is not required to prepare consolidated financial statements, AASB 128 requires recognition of an investment in an associate by applying the equity method in its own separate financial statements.

- 4 This Guidance Statement does not apply to the audit of investments in associates held by venture capital organisations, mutual funds, unit trusts and similar entities including investment-linked insurance funds when they are measured at fair value through profit and loss or are classified as held for trading and accounted for in accordance with AASB 139 or are an investment classified as held for sale in accordance with AASB 5 *Non-current Assets Held for Sale and Discontinued Operations*.
- 5 This Guidance Statement discusses audit implications for auditors who do not have direct access to information from an associate of an

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investor and which may restrict the auditor's ability to gather sufficient appropriate audit evidence.

- 6 The audit implications and audit responses included in this Guidance Statement may apply to obtaining audit evidence for Joint Ventures that may be equity accounted for under Accounting Standard AASB 131 *Interests in Joint Ventures*.

Definitions

- 7 For the purpose of this Guidance Statement, the following term has the meaning attributed below:

Associate means an entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture.
[See also AASB 128]

Objectives of the Audit

- 8 The overall objective of the auditor as described in ASA 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Australian Auditing Standards*, is to obtain reasonable assurance about whether the financial report as a whole is free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial report is prepared, in all material respects, in accordance with an applicable financial reporting framework.
- 9 To obtain reasonable assurance, the auditor obtains sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enables the auditor to draw reasonable conclusions on which to base the auditor's opinion.
- 10 The investor's auditor gathers sufficient appropriate audit evidence to evaluate:
- (a) representations made by those charged with governance of the investor as to the existence and ownership of the investment, and the existence or otherwise of significant influence;
 - (b) the appropriateness of the carrying amounts of an investment, the investor's share of the associate's profits

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- and losses, including the required adjustments and dividends received or receivable from an associate;
- (c) the appropriateness of adjustments to the carrying amounts of an investment due to post-acquisition changes in an associate's reserves;
 - (d) the adequacy of financial report disclosure; and
 - (e) the appropriateness of other equity accounting adjustments such as adjustments for dissimilar accounting policies and elimination of unrealised profits and losses.

Planning

Understanding the Entity and its Environment and Assessing the Risks of Material Misstatement

- 11 The auditor needs to obtain an understanding of the entity and its environment and assess the risks of material misstatement in a financial report audit in accordance with ASA 315 *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. The auditor needs to perform risk assessment procedures to obtain an understanding of the entity and its environment, including its internal control.
- 12 If the auditor assesses significant risks in the area of investments in associates, this will impact all areas of the audit including planning, audit testing and gathering of appropriate audit evidence to mitigate these risks.

Planning an Audit of Investments in Associates

- 13 The audit of equity accounting balances and adjustments requires adequate attention during the planning of the audit. The auditor develops the audit plan in accordance with ASA 300 *Planning an Audit of a Financial Report* and ASA 330 *The Auditor's Responses to Assessed Risks* to ensure that sufficient appropriate audit evidence concerning the investment in associates is made available to the auditor of the investor. The auditor considers materiality and its relationship with audit risk in accordance with ASA 320 *Materiality and Audit Adjustments* and in conjunction with the auditor's risk assessments, in the planning and conduct of the audit.

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- 14 The investor's auditor may meet with the management of the investor and plan in relation to such matters as:
- (a) the provision of evidence to support identification of associates;
 - (b) the nature and the adequacy of policies and adjustments between the investor and the associate for dissimilar accounting policies, transactions, balances, and reciprocal shareholdings;
 - (c) the accounting timetable and the availability of the associate's financial reports (especially in relation to the provision of information required for the application of equity accounting), and any other information considered necessary;
 - (d) the procedures to identify events subsequent to balance date for the associate; and
 - (e) contact with the associate's auditor where necessary, when the associate is not audited by the investor's auditor.
- 15 The investor's auditor also considers whether there are any legal restrictions that may affect the availability of information from an associate. There may be legal restrictions applicable to the communication of confidential information by those charged with governance, to third parties. However, representatives of the investor on the investee's governing body may make available information to the investor they represent. This is normally subject to the condition that it is done with the knowledge of the investee governance body, and is in the best interests of the investee. If the investor is not able to obtain necessary information from the investee, the presumption of significant influence requires further clarification. The refusal by the investee may demonstrate a lack of significant influence by the investor or may be the result of a legal restriction on the investee as to the information it can make available. Legal restrictions may also apply to the investor publishing information about the associate which has not been made available to the other equity holders of the associate.

Identification of Associates

- 16 The responsibility for establishing whether or not significant influence exists rests with those charged with governance of the

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investor. The evidence used to determine significant influence is obtained by the auditor and documented in the audit working papers.

- 17 Generally, where an investor holds directly or indirectly, 20 per cent or more of the voting power in an investee, in the absence of evidence to the contrary, there could be the presumption of significant influence. However, this percentage is not an absolute cut-off point. In certain cases, an investee will qualify as an associate, notwithstanding that the investor's voting power in the investee is less than, or has fallen below, 20 per cent. The converse also applies. Hence, voting power in an investee comprises only part of the audit evidence to support significant influence.
- 18 AASB 128 provides examples of factors which individually, or in combination, may indicate the existence of significant influence. In cases where those charged with governance of the investor are asserting that the provisions of AASB 128 apply, the auditor would expect to be provided with evidence to support the assertion. The auditor examines and evaluates that evidence in accordance with *ASA 500 Audit Evidence*.
- 19 Examples of the evidence that the auditor examines, depending on the assertions being made, are:
- (a) the investee's constituent document. This may indicate that the remainder of the voting power of the investee is concentrated with a limited number of equity holders, which precludes the investor from exercising significant influence, or alternatively, that the remainder of the voting power is so widely dispersed that the investor is able to exercise significant influence;
 - (b) the composition of the investee governance body, and if available, extracts of documents indicating that policy decisions made by the investor concerning the investee have been implemented by the investee, with particular reference to control over the distribution or retention of the investee's profits;
 - (c) the agreements and actual level of technical and/or physical facility dependence by the investee on the investor, and an evaluation of that dependence in terms of the investee's overall technical and physical facilities;

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- (d) the type and volume of transactions between the investor and the investee and the terms of trading between the entities, the status and details of loans and current accounts with the investee, and details of any guarantees to third parties provided by or on behalf of the investee, with an evaluation, in terms of the investee's overall position, of the level of financial dependence by the investee on the investor; and
 - (e) the agreements and actual level and type of staff interchange or staff services between the investor and investee.
- 20 The auditor evaluates the information presented by the management or governing body of the investee, and applies a combination of procedures appropriate to the circumstances, to form an opinion on the assertion of significant influence, or otherwise, made by those charged with governance. Such procedures could include:
- (a) an examination and evaluation of the investor's system of internal control over transactions between the investor and investee as a basis for understanding the type and volume of transactions between the investor and investee;
 - (b) inspection of relevant contracts and agreements between the investor and investee;
 - (c) inspection of the investor's minutes of meetings for details of decisions made concerning the relationship between the investor and the investee, and the activities of both parties;
 - (d) discussions with relevant investor personnel, and where possible, relevant investee personnel, and/or examination of a statement from the investee stating that it accepts the investor is in a position to exercise significant influence over it;
 - (e) confirmation of transactions and balances with the investee;
 - (f) confirmation and enquiry with external parties, for example: solicitors as to the existence and interpretation of agreements; banks as to the existence and details of guarantees; and credit agencies as to enquiries that cannot be dealt with directly by the auditor;

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- (g) computation and checking of details with supporting accounting records; and
- (h) analysis of the financial reports of the associate.

Information from Associates

21 To audit equity accounting adjustments, relevant information about an associate is required for the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions. AASB 128 requires the investor to use the most recent financial information available to the equity holders of the associate and if the reporting dates of the associate and that of the investor are different; the difference shall be no more than three months. The auditor ascertains whether this information is adequate, and in form and content appropriate for the purpose of accounting for the equity interests of an investor. This aspect of the audit emphasises the need for adequate planning as detailed in paragraphs 13 and 14.

Adjustments are required to:

- (a) address differences in the accounting policies adopted by an associate to achieve consistency with the accounting policies of the investor;
- (b) eliminate intra group balances, transactions, income and expenses in full between the associate and:
 - (i) the investor and its controlled entities (the economic entity);
 - (ii) another associate of the investor.

22 Using materiality and knowledge of internal controls, the auditor assesses the risk attached to these adjustments.

23 In some cases unaudited financial information is provided by the associate for equity accounting purposes. Unaudited financial reports or other information and data provide evidential matter which is not of itself sufficient appropriate audit evidence for the investor's auditor to evaluate the accounting for investments in associates. In this respect, the auditor needs to consider the impact of matters noted in the following paragraphs to assess whether there is a limitation of scope.

Audit Evidence

The Reliability of Financial Reports and Other Information Provided about an Associate

24 Evidence pertaining to the application of the equity method may be available in the following forms:

(a) Audited Financial Reports

Financial reports of an associate available to the equity holders of that associate generally constitute sufficient appropriate audit evidence as to the equity in the underlying net assets and results of operations of an associate when such statements have been audited by the investor's auditor, or by another independent auditor. Where an associate is audited by another auditor, the investor's auditor considers the principles in ASA 600 *Special Considerations - Audits of a Group Financial Report (Including the Work of Component Auditors)*, in particular those in relation to understanding the work of component auditors.

(b) Unaudited Financial Reports

When the information provided about the investee is unaudited, the investor's auditor uses professional judgment to assess audit risk and to design appropriate audit procedures to evaluate the equity accounting adjustments and disclosures. Sufficient appropriate audit evidence may be obtained for example:

- (i) by having the associate's auditor perform appropriate audit procedures, in which case the principles of ASA 600 apply; or
- (ii) by gaining access to the associate to apply audit procedures; or
- (iii) by supplementing a review or agreed-upon procedures report provided by another auditor on the financial information, with additional procedures as appropriate.

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In those cases where the auditor of the investor is unable to obtain the access required to enable audit procedures to be carried out, or is unable to obtain evidence of sufficient quality from another auditor, there may be a limitation on the scope of the audit. In such cases, the auditor complies with the requirements in ASA 705 *Modifications to the Opinion in the Independent Auditor's Report*.

Subsequent Events

- 25 Where a time lag exists between the balance date of an associate and that of the investor, the auditor ascertains the procedures by which those charged with governance of the investor have attempted to make themselves aware of any significant events or transactions of the associate, that have arisen subsequent to the date of the associate's financial statements, to the date on which the auditor signs the auditor's report on the investor's financial report. Audit procedures could include:
- (a) enquiry of the appropriate levels of the investor's management, and review of actions taken;
 - (b) comparison to any interim financial statements and/or management reports of the associate, where possible;
 - (c) examination of any correspondence between the investor and associate;
 - (d) where possible, discussion with those charged with governance and/or auditors of the associate; and
 - (e) comparison to other appropriate evidence, including industry literature, financial press disclosures, external credit organisations.
- 26 In the event of the investor auditor being informed of, or becoming aware of, any significant events or transactions of an associate occurring during the period between balance dates and the date on which the auditor signs the auditor's report on the investor's financial report, the auditor makes additional enquiries to evaluate the impact of these events or transactions on the carrying amount of the investment in the financial report. The auditor obtains evidence that management has accounted for or adequately disclosed such events in the financial report.

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- 27 The investor auditor considers whether there are any significant events or transactions involving the investor which impact on the equity interest in an associate disclosed in the financial report. The provisions of Accounting Standard AASB 110 *Events After Balance Sheet Date*, and ASA 560 *Subsequent Events* apply.

Audit Reporting

The Auditor's Report

- 28 The auditor's opinion is on the investor's financial report which includes the equity accounting adjustments. The auditor's report is prepared in accordance with ASA 700 *Forming an Opinion and Reporting on a Financial Report* and where appropriate, ASA 800 *Special Considerations-Audits of Financial Reports Prepared in Accordance with Special Purpose Frameworks*.
- 29 In those cases where the auditor of the investor is unable to obtain sufficient appropriate audit evidence, there may be a limitation on the scope of the audit. In such cases, the auditor complies with the requirements in ASA 705 *Modifications to the Opinion in the Independent Auditor's Report*.
- 30 Where a significant uncertainty about the associate exists, the resolution of which may materially affect the financial report, the auditor complies with the requirements in ASA 706 *Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*.

Review Engagements

- 31 In a review of a financial report the auditor or the assurance practitioner makes enquiries and performs analytical and other review procedures to enable the auditor to conclude whether, on the basis of the procedures performed, anything has come to the auditor's attention that causes the auditor to believe that the financial report is not prepared (or presents fairly), in all material respects, in accordance with the applicable financial reporting framework.
- 32 The guidance in this Guidance Statement for planning an audit and audit evidence issues regarding an investment in an associate, applies, as appropriate, to the review of an investor's financial report.

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- 33 Where a review is conducted by the auditor of the entity, ASRE 2410 *Review of a Financial Report Performed by the Independent Auditor of the Entity* applies. Where reviews are undertaken by assurance practitioners who are not the auditor of the entity ASRE 2400 *Review of a Financial Report Performed by an Assurance Practitioner Who is Not the Auditor of the Entity* applies. Both ASRE 2400 and ASRE 2410 contain illustrative procedures in the Appendices that may be helpful when completing review engagements.

Conformity with International Pronouncements

- 34 There is no equivalent International Auditing Practice Statement (IAPS) to this Guidance Statement.