Financial Accounting Standard No. (24)

Investments in Associates

Contents

Preface

This standard sets out the accounting principles for recognising, measuring, presenting and disclosing the investments in associate entities made by an Islamic financial institutions (IFI)[1] and/or made by entities under its control.

(1) Referred to hereafter as institution or institutions including Islamic banks.

Statement of the Standard

1. **Scope of the Standard**

   This standard is applicable to financial statements prepared and presented by an Islamic financial institution (IFI). This standard sets out the principles for determining entities that are deemed to be associates and prescribes the accounting for investments in associates by parent/reporting entity.

   This standard shall not apply to investments made by venture capital entities, or by mutual funds and similar entities.

   Should the requirement of this standard be in conflict with an IFI's charter or the laws and regulations of the country in which it operates, a disclosure should be made to that effect. (para. 1)

2. **Definitions**

   Associate: An entity in which the IFI has significant influence.

   Consolidated financial statements: Financial statements for a group of entities prepared and presented as those for a single entity.

   Separate financial statements: Financial statements for a parent in which the shareholdings in subsidiaries and associates are accounted for solely as an investment either at cost or fair value.

   Significant influence: The capacity of an entity to affect substantially (but not control) the financial and operating policies of another entity.

   Voting rights: Rights for voting at an entity's shareholders' meeting or other similar forums. (para. 2)

3. **Determination of an Associate**

   3/1 An entity shall be classified as an associate of an IFI if the IFI can exercise significant influence on the investee entity. Significant influence is presumed to exist if an IFI holds, directly or indirectly through its subsidiaries, 20% or more of the voting rights in an entity, unless it can be clearly demonstrated otherwise. Conversely, significant influence may also exist through an agreement with the entity's other shareholders or the entity itself regardless of the level of shareholding that the IFI has in the said entity. (para. 3)

3/2 Significant influence, attributable to investments funded by the following, is considered for determination of an associate:

a) IFI's owners' equity and liabilities, or

b) Unrestricted investment accounts. (para. 4)

3/3 Voting rights in an entity include those that are accorded through shares or other equity or financing instruments as well as those that are obtained through agreement with the entity's other shareholders or the entity itself. For the purpose of this standard, determination of voting rights shall include current voting rights and currently-exercisable voting rights. (para. 5)

4. Accounting Treatment for Investments in an Associate Entity

4/1 Initial recognition of the IFI's investment in associate

The IFI's investment in an associate shall be initially recognized when the investment is made and included in the financial statements under the heading "Investment in Associates". (para. 6)

An investment not initially recognized as investment in associate shall also be included in the financial statements under the heading "Investment in Associates" when it subsequently meets the criteria for determination of investment in associates. (para. 7)

4/2 Measurement of the IFI's investment at the time of initial recognition

The IFI's investment in an associate shall be initially measured at cost. (para. 8)

4/3 Subsequent measurement of the IFI's investment in associate

4/3/1 The IFI's investment in an associate shall be measured at the end of a financial period at carrying amount and adjusted to include the IFI's share in the profit or loss of the associate after the investment date. (para. 9)

4/3/2 The IFI's share in the profit or loss of the associate shall be based solely on the IFI's shareholding in the associate and not on the voting rights. (para. 10)

4/3/3 The IFI's investment shall also be adjusted to include changes in the IFI's proportionate interest in the associate resulting from changes in that entity's equity – including from revaluation of assets – that have not been recognised in that entity's profit and loss. (para. 11)

4/3/4 The carrying amount shall be decreased in cases the IFI has received dividend or other distributions from the associate. (para. 12)

4/3/5 If there is any profit or loss in the associate entity that arises from transactions between the IFI and that entity, the IFI's share in the profit or loss arising from those transactions shall be eliminated. Intragroup losses indicating impairment losses shall be recognised in the financial statements. (para. 13)

4/3/6 In cases where the IFI's share of loss in the associate exceeds the carrying amount of the IFI's investment and any long-term participation, that in substance forms part of IFI's net investment, in that entity, the IFI shall discontinue recognition of further losses. A liability shall be recognized for any additional losses to the extent of the IFI's legal obligation, or to the extent of any payment that the IFI has made on behalf of the associate. If there is subsequent profit reported by the associate, the IFI shall recognize its share of that profit only after the liability has been fully offset. (para. 14)

4/3/7 The IFI's share in the profit or loss of the associate shall be recognized in the IFI's consolidated financial statements as at the reporting date based upon the associate's latest available financial statements. (para. 15)

4/3/8 The associate shall prepare a financial statement as at the same reporting date of the IFI. If it is not practicable for the associate to do so, the difference between the reporting date of the associate and that of the IFI shall be no more than three months. In such cases, effect of significant transactions that occur between the reporting dates shall be adjusted in the financial statements of an associate. (para. 16)

4/3/9 The same accounting policy shall be applied to the associate's financial statements and the IFI's financial statements. If financial statements of the associate are prepared based on a different accounting policy, adjustments shall be made in the separate financial statements of associate. (para. 17)

4/3/10 The IFI shall cease to account for investment in associate according to the preceding paragraphs, when the IFI cannot exercise significant influence on the associate. (para. 18)

4/3/11 Associates acquired with the intention of disposal within twelve months shall be accounted for at cost less impairment. However, if the associate is not disposed off within twelve months, the IFI shall account for the investment in associate retrospectively in accordance with 4/3/1 to 4/3/6. (para. 19)

4/4 Impairment losses

The IFI shall determine impairment in the value of investment in associate at each reporting date and recognize the impairment loss in the statement of income. (para. 20)

4/5 Separate financial statements

Investment in associates presented in the separate financial statements of an IFI shall be accounted for either at cost or fair value. (para. 21)

5. Disclosure Requirements

The IFI's financial statements shall incorporate disclosure on its associates including on the following:

a) List of associate entities with accompanying details including names, nature of business activities, country of incorporation, the IFI's shareholding (directly or indirectly through other entities), and the IFI's level of voting rights (directly or indirectly through other entities) attributable to 3/2. (para. 22)

b) The reasons why IFI is presumed to have significant influence over associate entity where less than 20% shares of the entity are owned by IFI. (para. 23)

c) Summary of financial information of the associates including total assets, liabilities, revenues and profit or loss. (para. 24)

d) Disclosures on significant restrictions regarding financial or commercial transactions or shareholding relationship between any of the associates and the IFI. (para. 25)

e) The fair value of investments in associates for which there are published price quotations. (para. 26)

f) Amount of IFI's contingent liabilities which may arise due to IFI's obligation for settlement of associate entities liabilities. (para. 27)

g) Amount of IFI's share of contingent liabilities of associate. (para. 29)

h) Reasons as to why adjustment to dissimilar accounting policies cannot be made. (para. 30)

i) The share of unrecognized losses from operations of associates both for the period and cumulatively, if an investor has discontinued recognition of the share of losses of an associate. (para. 31)

6. Effective Date

This Standard shall be effective for financial periods beginning 1 Muharram 1431 A.H. or 1 January 2010 A.D. However, earlier adoption of this standard is encouraged. (para. 32)

Adoption of the Standard

The Standard on Investment in Associates was adopted by the Accounting and Auditing Standards Board in its meeting No. (35) held on 6 Rabi' II, 1430 A.H., corresponding to 2 April 2009 A.D.

Members of the Board

1. Mr. Muhammad Said Abdul-Wahab	Chairman
2. Mr. Hamad Abdullah Eqab	Deputy Chairman
3. Sheikh. Dr. Abdul-Sattar Abu Ghuddah	
4. Sheikh. Essam Mohammed Ishaq	
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13. Mr. Murtada Khidr Mohamed Abu Zaid	
14. Mr. Prakash Pathmanathan	
15. Mr. Oliver Agha	
16. Mr. Jalil Al-Aali	
17. Dr. Mohamad Nedal Alchaar	Member/ Secretary General/ Rapporteur

Appendix (A)
Brief History of
the Preparation of the Standard

In its meeting No. (32) held in Manama, Kingdom of Bahrain on 22 Rabi’ II, 1428 A.H., corresponding to 9 May 2007 A.D., the Accounting and Auditing Standard Board decided to develop a new Standard on Investments in Associates.

Subsequently, a consultant was commissioned to prepare a preliminary study and exposure draft of the Standard on Investments in Associates. Preparation of the preliminary study and exposure draft was overseen by the Accounting Standards Committee.

The preliminary study and exposure draft were discussed by the Accounting Standards Committee through a series of meetings and telephone conference calls.

The preliminary study and exposure draft were also deliberated by Accounting and Auditing Standard Board in its meeting No. (33) held in Manama, Kingdom of Bahrain on 24 Jumada I, 1429 A.H., corresponding to 29 May 2008 A.D. The Accounting and Auditing Standards Board also decided to review the Standard on Consolidation taking into consideration the development of the new Standard on Investments in Associates.

The development of the Standard on Investments in Associates was carried out concurrently with the review of the Standard on Consolidation.

The exposure draft of the Standard on Investments in Associates was deliberated again by the Accounting and Auditing Standards Board at its meeting No. (34) held in Manama, Kingdom of Bahrain on 14 Dhul-Qa'dah 1429 A.H., corresponding to 12 November 2008 A.D.

Listening session of the exposure draft was convened in Manama, Kingdom of Bahrain on 24 Safar 1430 A.H., corresponding to 19 February 2009 A.D., to gather comments from the Islamic finance industry as well as accounting and auditing professions.

The exposure draft was revised in light of the comments made in Accounting and Auditing Standards Board meeting No. (34) and the listening session.

The Accounting and Auditing Standards Board adopted the Standard on Investments in Associates at its meeting No. (35) held on 6 Rabi' II, 1430 A.H., corresponding to 2 April 2009 A.D.

Appendix (B)
Reasons for the Standard

The primary reasons for developing the standard, amongst others, include:

a) Significance of investments in the statement of financial position of the IFIs as compared to other assets.

b) Differences in the determination of entities that are subject to associate accounting.

c) Differences in the bases applied in the treatment of investment in entities acquired through IFI's owners' equity, unrestricted investment accountholders' funds, restricted investment accountholders' funds and combination of these funds.

d) No existing guidance from AAOIFI that addresses the presentation, accounting and disclosure for entities which are subject to associate accounting.

Appendix (C)
Basis for Conclusions

The conclusions reached by this standard mainly emanate from the application of the objectives of financial accounting as specified in the previous Financial Accounting Statement No. (1): Objectives of Financial Accounting for Islamic Banks and Financial Institutions, and the concepts of financial accounting as specified in the previous Financial Accounting Statement No. (2): Concepts of Financial Accounting for Islamic Banks and Financial Institutions to the extent applicable.

Scope of the Standard

We concluded that the standard should cover the principles to be applied when determining entities that are deemed to be associates, and the accounting rules to be followed for investments in such associates. This standard is to complement Financial Accounting Standard No. (23): Consolidation (FAS 23). We have deliberately decided not to provide indicative circumstances and instances for identification of significant influence and have left it to the discretion of management. We understand that the inclusion of such indicative circumstances and instances in the Standard will not cover all possible scenarios giving rise to significant influence in the associate entity and may restrict the application of this Standard by the IFIs.

Determination of an Associate Entity

The revised FAS (23) concludes that determination for consolidation should be based on the power to exercise control over an entity, notwithstanding the fact that the IFI holds less than 50% of the voting rights in the investee entity. The revised Standard does not strictly follow the legal form of control; rather, it stipulates a comprehensive criteria for identification of control over subsidiaries. Before revising the standard and broadening the criteria for identification of control, corresponding Shari’a implications were considered in detail and due caution was undertaken in this regard. Through detailed discussions with Shari'a scholars, it was ensured that broadening of criteria for identification of control in accordance with the best accounting practices does not result in any violation of Shari'a precepts.

In the revised Standard, the criteria for determination of control and consolidation have been changed in accordance with the latest best accounting practices. Under the revised Standard, it is not mandatory for an IFI to hold 50% or more shares of the subsidiary.

In the revised FAS (23), it has been decided that the consolidation of a subsidiary is required regardless of the level of shareholding that the IFI has in the said entity. An entity shall be considered as a subsidiary of the IFI even if the IFI holds less than 50% of shareholding or voting rights in that entity. Voting rights in an entity include those that are accorded through shares or other equity or financing instruments as well as those that are obtained through agreement with the entity's other shareholders or the entity itself.

Also in the revised FAS (23), it has been stipulated that the voting rights emanating from investments funded by (I) IFI's owners' equity and liabilities, and (II) unrestricted investment accounts, should be taken into account at the time of determination of subsidiary and consolidation thereof.

For this Financial Accounting Standard No. (24): Investments in Associates, it was decided that the same above said basic principles should apply. It was concluded that if a parent has significant control over the investee entity then the parent's investment in the said entity should be subject to accounting treatment under this standard.

For this Financial Accounting Standard No. (24): Investments in Associates, the Accounting and Auditing Standards Board decided that all the accounting issues pertaining to and emanating from business combination would not fall under the ambit of this Standard. The Board recommended the issuance of a separate Standard on Business Combinations for Islamic financial institutions.

It was also agreed and recommended by the Board that this standard should not embody guidance on investments held for disposal; rather, a separate standard entailing detailed guidance on the subject should be issued. The Board recommended the use of conceptual framework till the issuance of a separate standard on investments held for disposal.

Accounting Treatment and Disclosure Requirements

We considered the international best practices on accounting for investments in associates and disclosure requirement for such investments, and the standard has incorporated the substance of these international best practices. Guidance regarding prohibition of amortization of goodwill has not been included in the Standard in order to avoid duplication as guidance on this issue has already been provided by the conventional standards and the same is also not in contradiction with Shari'a precepts.

It was also decided that investments in associates held for disposal within twelve months should be carried at cost less impairment, if any.

We also considered including guidance on treatment for business combinations including goodwill and intangibles but concluded to limit this standard to consolidation only and to develop a possible separate standard for business combination at a later phase. In the interim, international practice for assessment of goodwill and intangible assets should be followed.