NEGATIVE INVESTMENT
IN
JOINT VENTURES / ASSOCIATED ENTITIES

INTRODUCTION

AASB 128. 38 provides:

> "38. Investments in associates accounted for using the equity method shall be classified as *non-current assets*. ..."

APPLICATION

Any "joint venture" where *"joint control"* does not exist is required to be accounted for using the equity method.

"Joint control" is defined as follows:

> Joint control is the contractually agreed sharing of control over an economic activity and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers).[1]

***Joint control* - the requirement for unanimous consent of all parties sharing control -** is an **essential** element of all *joint ventures. "Consent" usually imparts a connotation of active agreement rather than passive acquiescence.*

THE QUESTION

We raised the question as to the appropriate treatment when the equity of an associated entity was negative. In our experience, this occasionally happens where the cash inflow to the associated entity is largely related to the contributions made by Councils, and the payment of those contributions is itself controlled by the Councils budget/management plan authorisation procedures.

THE CORRESPONDENCE SO FAR

From: David Maxwell, Coalface Software Solutions
Date: Wednesday, 16 March 2005 1:07 PM
To: Claire Locke, Technical Department, ICAA

> "AASB 128.38 prescribes that "investments in associates accounted for using the equity method shall be classified as non-current assets."

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1. IPSAS 8 refers to "binding" arrangement rather than "contractual" arrangement. We suggest that, for local governments, this definition should be interpreted in the same manner.

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Coalface Software Solutions
PO Box 5450
Wagga Wagga NSW 2650

Tel 02 6925 9988
Mob 0408 293 396
Fax 02 6925 9922
davemax@ozemail.com.au
www.coalface.com.au

ABN 34 065 129 377

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NEGATIVE INVESTMENT IN ASSOCIATED ENTITIES

What is the treatment where the associate's equity is negative?

A number of Councils are involved in joint venture entities (usually with other Councils and/or State Government Departments) for various functions as a means of delivering the relevant services in the most cost effective manner. (Joint regional libraries is probably the most common single example, particularly in rural NSW.)

It can happen that such joint venture entities have a negative equity, particularly where funding contributions from joint venturers are determined by reference to the immediate cash requirements of the joint venture entity, rather than on a commercial basis.

The accounts for the joint venture are prepared on a going concern basis as there is a binding agreement between the Councils that they will continue to fund the operation. (In political terms, there is little likelihood that they will terminate the arrangement, as it still continues to be the most cost effective method of providing the service.)"

From: Jeffrey Knapp, Technical Consultant, ICAA
Date: Fri, 18 Mar 2005 12:15
To: David Maxwell, Coalface Software Solutions

"I am on the technical desk today and will respond to your query. The technical team's email is techsec@icaa.org.au and you should use this rather than individual accounts if you want to get a relatively fast response.

Another way of stating your question is 'is it possible to have a negative asset for an investment in an associate?'. The answer is no. Paragraphs 29-30 of AASB 128 deal with the issue of what to do with losses from the associate once you have reduced the investment account to nil."

From: David Maxwell, Coalface Software Solutions
Date: Fri, 18 Mar 2005 15:18
From: Jeffrey Knapp, Technical Consultant, ICAA

"AASB 128.30 states "After the investor's interest is reduced to zero, additional losses are provided for, and a liability is recognised, only to the extent that the investor has incurred legal or constructive obligations or made payments on behalf of the associate."

These are instances where the investor has a binding arrangement to contribute future sums to the venture."

AIFRS HOTSPOTS

From: David Maxwell, Coalface Software Solutions
Date: Tue, 5 May 2005 15:29
From: Jeffrey Knapp, Technical Consultant, ICAA

I don't have any record of a response to my follow up request. Could you please re-send it?
The question really is:
"Where an entity has a legal or constructive obligation to make future payments to or on behalf of the associate, and a liability is recognised, how is that liability disclosed?"

We will keep you informed of progress.