STAFF PAPER

October 2021

Accounting Standards Advisory Forum

Project	**Equity Method**
Paper topic	Application questions

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Purpose of this paper

1. The purpose of this paper is to seek the Accounting Standards Advisory Forum (ASAF) members' views on application questions that have recurrent themes but are outside the scope of the equity method project of the International Accounting Standards Board (Board).

Background

2. Paragraphs 8–12 of Agenda Paper 1 for this meeting summarise the process for selecting application questions within the project's scope. The process was outlined to the Board at its March 2021 meeting.

3. At the March 2021 Board meeting, it was noted that some application questions that had recurrent themes had been excluded from the project's scope when applying the selection process. The staff explained its intention to make the Board aware of these questions, so that the Board could consider whether these questions warrant extending the scope of the project.

4. The remainder of this paper considers application questions with recurrent themes excluded in the selection process.

Application questions with recurrent themes excluded in the selection process

Ownership interests that provide access to benefits

5. The first group of application questions concerns which ownership interests in an investee are considered in determining the cost of the investment. For the purposes of this paper, the staff defined cost as:

> Cost of the associate or joint venture—fair value at the date significant influence or joint control is obtained of the financial instruments that give current access to the identifiable net assets of the associate or joint venture.

6. IAS 28 states:

    (a) When potential voting rights or other derivatives containing potential voting rights exist, an entity's interest in an associate or a joint venture is determined solely on the basis of existing ownership interests and does not reflect the possible exercise or conversion of potential voting rights and other derivative instruments, unless paragraph 13 of IAS 28 applies (paragraph 12 of IAS 28).

    (b) In some circumstances, an entity has, in substance, an existing ownership as a result of a transaction that currently gives it access to the returns associated with an ownership interest. In such circumstances, the proportion allocated to the entity is determined by taking into account the eventual exercise of those potential voting rights and other derivative instruments that currently give the entity access to the returns (paragraph 13 of IAS 28).

    (c) When instruments containing potential voting rights in substance currently give access to the returns associated with an ownership interest in an associate or a joint venture, the instruments are not subject to IFRS 9 *Financial Instruments* (paragraph 14 of IAS 28).

7. Feedback on the initial list of application questions included that there are challenges in determining which instruments should be considered part of the cost of the

investment. Instruments identified include redeemable preference shares/perpetual instruments. Furthermore, questions included whether instruments with different features should be bifurcated and IFRS 9 and IAS 28 applied to the relevant components of the instrument.

8. The feedback also noted that investees may have several classes of equity shares with varying entitlements to net profits, equity or liquidation preferences. Some instruments may also have entitlements that vary over the economic life of the investee or change upon reaching determined thresholds. In these circumstances, determining the appropriate percentage of ownership interest may be challenging.

9. In applying the selection process (see paragraph 2 of this paper), these questions were excluded because they related to the scope of application of the equity method whereas the project's scope is limited to application questions with the equity method. The Board has directed the staff to undertake a limited-scope project to consider application questions with the equity method.

10. Furthermore, the staff noted that addressing these questions may potentially involve changing the scope of application of the equity method. The project will not reconsider significant influence as the basis to apply the equity method or redefine significant influence. There is a possibility that addressing these application questions could lead to a broader reconsideration of significant influence. For this reason, the staff initial assessment is that these application questions are outside the project's scope.

11. However, given that these application questions were included in the feedback from several participants and that in the view of some participants these questions are the most pressing concern with the application of IAS 28 staff considers the matter should be highlighted to the Board.

Reciprocal interests

12. Reciprocal interests can occur when an associate or joint venture holds an interest in an investor or an investor's subsidiary. Reciprocal interests can give rise to double

counting of net assets between the investor and the associate and IAS 28 does not include requirements on how to address this question.

13. In April 2003, the IFRS Interpretations Committee considered circumstances in which entity A owns an interest in entity B, and entity B concurrently owns an interest in entity A. The Interpretations Committee decided not to develop an Interpretation on this issue because paragraph 20 of IAS 28 requires elimination of reciprocal interests (through application of consolidation concepts). The Interpretations Committee noted these issues should be reconsidered once the Business Combinations phase II project was finalised.

14. In applying the selection process, questions on reciprocal interests were excluded because it was considered that those application questions could not be solved without amending other IFRS Standards. That is, they relate to how an investor determines the effective ownership interest needed to apply equity method, however, the project scope is restricted to when applying the equity method.

Non coterminous reporting period and uniform accounting policies

15. Paragraph 33 of IAS 28 requires the financial statements of the associate or joint venture to be prepared as of the same date as the financial statements of the reporting entity, unless it is impracticable to do so. When the financial statements are prepared as of a different date, the difference between the two reporting dates shall be no more than three months and adjustments shall be made for the effects of significant transactions or events that occur between the two dates.

16. Paragraph 35 of IAS 28 requires an investor to use financial statements of the associate that are prepared using uniform accounting policies for like transactions and events in similar circumstances.

17. Feedback on the initial list of application questions included that an investor may not have sufficient information to comply with the requirements in paragraphs 33–35 of IAS 28 and/or the ability to require the associate to provide the necessary information.

18. In addition, it was noted that there may be restrictions in using the financial statements of an associate when the investor issues its financial statements before the associate, and the associate is a listed entity.

19. In applying the selection process, these questions were excluded because it was considered the application question could not be resolved without fundamentally rewriting IAS 28. The application questions were not related to either clarity or missing requirements; but practical application of IAS 28 requirements. The questions raised in paragraphs 15–16 of this paper are a matter of practicality and cost in applying the requirements, not a matter of explaining the principles that underlie the equity method.

Questions for ASAF members

Question for ASAF members
What are ASAF members' views on the application questions that have recurrent themes but have been excluded from the project in applying the selection process? Please consider if these questions occur frequently in your jurisdiction and what information you would like the staff to share with the Board.