IFRS

STAFF PAPER

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Accounting Standards Advisory Forum

Project	**Equity Method**	
Paper topic	Changes in an investor's interest in an associate without a change of influence	
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Purpose of this paper

1. The purpose of this paper is to seek Accounting Standards Advisory Forum (ASAF) members' views on alternatives for addressing the application questions on changes in an investor's ownership interest in an associate without a change in significant influence.

Structure of this paper

2. This paper is structured as follows:
   (a) nature of the application questions on changes in an investor's ownership interest (paragraphs 3–6);
   (b) IAS 28 requirements relating to changes in an investor's ownership interest (paragraphs 7–12);
   (c) staff analysis (paragraphs 13–43);
   (d) questions for ASAF members;
   (e) Appendix 1—Illustrative examples; and
   (f) Appendix 2—Summary of identified principles underlying IAS 28.

Nature of the application question on changes in an investor's ownership interest

3. In this paper, the staff considers the following application question that has been identified applying the selection process set out in Agenda Paper 1:

> An investor acquires an additional interest in an associate with no change in significant influence (ie the investor has significant influence both before and after the transaction or event). How does the investor account for the difference, if any, between the consideration paid and the share of net assets acquired - including negative differences?

4. To address this application question, we need to consider how to apply the equity method to changes in an investor's interest in an associate (ie changes in the investor's share of the voting power of the associate). An investor's interest may change because of a variety of transactions, which may or may not directly involve the investor. Examples of transactions which directly involve the investor are purchases and disposals of shares or other equity instruments by the investor, the investor subscribing for a new share issue or the associate redeeming shares held by the investor. Examples of transactions which do not directly involve the investor are subscriptions and redemptions of shares by new or other shareholders of the associate.

5. When all existing shareholders subscribe or redeem shares in proportion to their ownership share, there is a change in the carrying value of the investor's share of the net assets of the associate but no change in the investor's percentage of ownership. The analysis in this paper applies to these transactions.

6. The analysis in this paper does not apply to:

   (a) stock splits and reverse splits that change neither the value nor the investor's percentage of ownership; and

   (b) transactions and events that change the associate's net assets but do not affect either the associate's profit or loss or other comprehensive income, or the investor's share of ownership – for example, accounting for changes in the cumulative translation adjustment on a foreign operation, or for a cash flow hedge in accordance with IFRS 9 *Financial Instruments*.

IAS 28 requirements relating to changes in an investor's ownership interest

7. Application of the equity method to changes in an investor's interest in an associate with no change in the investor's significant influence, may involve the following questions:
   - (a) for increases in the investor's interest:
     - (i) how is the increase in the investor's share in the net assets of the associate measured?
     - (ii) where is a difference between the consideration paid and the additional share in the net assets of the associate recognised?
   - (b) for decreases in the investor's interest:
     - (i) how does the investor measure the portion of its investment in the associate to be derecognised?
     - (ii) where is any difference between the consideration received and the derecognised portion of the investment in the associate recognised?
   - (c) for both increases and decreases in the investor's interest:
     - (i) does the investor remeasure its interest in the associate previously held/retained?
     - (ii) does the investor reclassify to profit or loss amounts previously recognised in other comprehensive income in relation to the associate?
8. IAS 28 does not include requirements in relation to the questions in paragraph 7(a) of this paper. The staff has been informed by stakeholders that there is diversity in practice in application of these questions and some have indicated they are application questions that the Board should address in this project. Consequently, the staff has considered these questions in the analysis in this paper.

9. IAS 28 does not include requirements in relation to the questions in paragraph 7(b) of this paper. However, the staff has not heard significant concerns about the lack of requirements or diversity in practice for these questions. Unless specifically required, gains or losses from disposals are recognised in profit or loss. Therefore, the staff has not considered these questions in its analysis below.

10. In relation to the question in paragraph 7(c)(i) of this paper, paragraph 24 of IAS 28 states that if an investment in an associate becomes an investment in a joint venture, or an investment in a joint venture becomes an investment in an associate, the entity continues to apply the equity method and does not remeasure the retained interest. The staff has assumed that the same requirement applies when the investor retains significant influence in the associate and continues applying the equity method. Therefore, the staff has not considered the question in paragraph 7(c)(i) of this paper in its analysis below.

11. In relation to the question in paragraph 7(c)(ii) of this paper, applying paragraph 25 of IAS 28, when the investor's interest is reduced in an associate without the investor losing significant influence, the investor reclassifies to profit or loss amounts previously recognised in other comprehensive income as if the investor had disposed of the related assets or liabilities, proportionately to the reduction its interest.

12. The staff has assumed the requirement in paragraph 25 of IAS 28 does not apply to increases in the investor's interest and note that would be no basis for reclassification proportionately to an 'increase' in the investor's interest. Furthermore, there is no change in status in the investment (no change in significant influence) and so there is no basis for full recycling as considered in paragraph 42 of IFRS 3 *Business Combinations*, that states:

> In a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss or other comprehensive income, as appropriate. In prior reporting periods, the acquirer may have recognised changes in the value of its equity interest in the acquiree in other

comprehensive income. If so, the amount that was recognised in other comprehensive income shall be recognised on the same basis as would be required if the acquirer had disposed directly of the previously held equity interest.

Therefore, the staff has not considered the question in paragraph7(c)(ii) of this paper in its analysis below.

Staff analysis

Background to the staff analysis

Approach to the analysis

13. To address the questions in paragraph 7(a) of this paper, the staff first considered the related requirements in IAS 28 (see paragraphs 8–12 of this paper) and the principles identified by the staff as underlying IAS 28 as discussed at the June 2021 Board meeting (see Appendix 2 to this paper). Based on this consideration, the staff determined that the questions cannot be addressed solely by applying these requirements and principles from IAS 28. Consequently, the staff has considered how to develop the missing principles needed to address them.

14. As discussed in Agenda Paper 1A, the staff has developed possible 'missing' principles by applying similar judgment as required when developing an accounting policy applying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, that is considering the applicability of the requirements in IFRS Standards dealing with similar and related issues and the definitions, recognition criteria and measurement concepts in the *Conceptual Framework for Financial Reporting*.

Assumptions and criteria used in the staff analysis

15. For simplicity, the analysis assumes that:

    (a) the transactions are settled in cash (no contributions or exchanges of non-monetary assets);

(b) when the investor sells or purchases shares in the associate, the transaction is not conducted with an entity under common control or with another associate of the investor; and

(c) the associate is a business.

16. The analysis has been prepared when the equity method is applied to investments in associates in the consolidated financial statements. At a later stage it will be considered if the analysis needs to be modified when the equity method is applied to:

(a) investments in joint ventures;

(b) investments in associates in the investor's separate financial statements; and

(c) investments in subsidiaries accounted for applying the equity method in the separate financial statements.

Developing principles for increases in an investor's interest (questions in paragraph 7a of this paper)

Requirements and principles in IAS 28

17. As noted in paragraph 8 of this paper, IAS 28 does not include requirements in relation to the questions in paragraph 7(a) of this paper. Furthermore, none of the principles in Appendix 2 to this paper are directly related to increases in an investor's interest in an associate with no change in the investor's significant influence. Nevertheless, the staff thinks that Principle D in Appendix 2 to this paper should be considered as it deals with similar and related issues. Principle D states:

> Fair value at the date that significant influence or joint control is obtained provides the most relevant information and faithful representation of an associate's or joint venture's identifiable net assets.

18. The rationale for considering Principle D would be the investor measures increases in its share of the net assets of an associate in the same way as it measures its initial share of the net assets of the associate. Therefore, the investor would measure the additional share of the net assets of the associate based on the net fair value of the associate's net assets at the date the transaction occurs.

19. A revised Principle D could be developed to address subsequent increases in an investor's interest that do not change the investor's significant influence as follows:

> Fair value at the date that an investor acquires an interest in an associate provides the most relevant information and faithful representation of an associate's identifiable net assets.

Missing principles and alternatives

20. The staff has identified four possible alternatives for accounting for increases in an investor's interest in an associate with no change in the investor's significant influence. At this stage, the staff has not identified a preferred alternative as there are different views on the four alternatives and their supporting rationale. For each alternative the staff present the principles and requirements in IFRS Standards that would support the alternative and possible rationale for the alternative:

	Alternatives			
Questions in paragraph 7a of this paper	**1**	**2**	**3**	**4**
How is the increase in the investor's share in the net assets of the associate measured?	Share of net fair value of associate's assets and liabilities	Share of net fair value of associate's assets and liabilities	At fair value of consideration paid	Using book values of the existing share of net assets in investor's financial statements
Where is a difference between the consideration paid and the additional share in the net assets of the associate recognised?	Goodwill (or bargain purchase gain)	Profit or loss	No difference arises	Profit or loss

21. The staff has considered if the difference between the consideration paid and the additional share in the net assets of the associate could be viewed as a contribution to, or distribution from, the investor and therefore be recognised in equity. The staff noted that Principle C presented at the June 2021 Board meeting (see Appendix 2 to this paper) states that:

> An investor's share of an associate's or joint venture's net assets is part of the reporting entity.

22. The staff noted that acquisition of the additional share in the net assets of the associate may arise from transactions between the associate and other shareholders, which are not transactions with owners in their capacity as owners from the investor's perspective. The staff therefore did not consider recognition of the difference in equity as a possible alternative.

Alternative 1: Share of net fair value of associate's assets and liabilities (difference is goodwill)

23. Under Alternative 1, the investor would measure its additional share in the net assets of the associate at the net fair value of the associate's identifiable assets and liabilities and recognise the difference between the consideration paid and this amount as goodwill (or a bargain purchase gain). Alternative 1 is supported by:

    (a) applying Principle D by analogy (see paragraph 17 of this paper).

    (b) applying the principle in paragraph 32 of IAS 28 by analogy that any difference between the investor's share in the net fair value of the investee's identifiable assets and liabilities and the cost of the investment is recognised as goodwill or income (bargain purchase gain).

24. Principle D was derived primarily from paragraph 32 of IAS 28 (see paragraph 34 of Agenda Paper 1A). Therefore, applying paragraph 32 of IAS 28 to the difference between the cost of the investment and the investor's additional share in the net assets of the associate would be consistent with the rationale for extending Principle D to cover increases in an investor's interest in an associate (see paragraph 18 of this paper)—ie applying the same principles as for measuring the investor's initial interest in the associate.

25. Goodwill is defined as:

> An asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised. (Appendix A of IFRS 3)

26. Applying paragraph 32 of IAS 28, goodwill is measured as a residual amount, being the difference between the cost of the investment and the entity's share of the net fair value of the associate's identifiable assets and liabilities. Goodwill that exists when an investor acquires an additional interest in an associate can be measured applying the same requirement for recognition of the initial interest in the associate.

27. The staff notes that an increase in the parent's ownership in a subsidiary does not give rise to a question about the measurement of the increase in the net assets, because a parent has already recognised 100% of the net assets of a subsidiary on acquiring control. Consequently IFRS 10 *Consolidated Financial Statements* does not require the parent entity to determine the fair value of the additional share of the net assets of the subsidiary.

Alternative 2: Share of net fair value of associate's assets and liabilities (difference in profit or loss)

28. Under Alternative 2, the investor would measure its additional share in the net assets of the associate at the net fair value of the associate's identifiable assets and liabilities and recognise the difference between the consideration paid and this amount in profit or loss. Alternative 2 is supported by:

    (a) applying Principle D by analogy (see paragraph 17 of this paper).

    (b) applying the requirements in paragraphs 5.1.1, 5.1.1A and B5.1.2A of IFRS 9 *Financial Instruments* by analogy that if the fair value of the instrument differs from the transaction price the difference is recognised as a gain or loss (if that fair value is evidenced by a quoted price in an active market for an identical asset or liability (ie a Level 1 input) or based on a valuation technique that uses only data from observable markets).

29. On one side, as noted above, Principle D was derived primarily from paragraph 32 of IAS 28. Therefore, it would seem inconsistent to analogise to only part of paragraph 32 of IAS 28 and then refer to IFRS 9 for a principle on how to account for the difference between the cost of the investment and the investor's additional share in the net assets of the associate.

30. On the other side, the staff notes that paragraph 4.3 of the *Conceptual Framework for Financial Reporting* defines an asset as a present economic resource controlled by the entity. Paragraph BC323 of the Basis for Conclusions on IFRS 3 explains that the Board concluded that goodwill represents a resource controlled by the entity because in a business combination the acquirer obtains the power to direct the policies and management of the acquiree (or, by analogy, the investor obtains the power to participate in the financial and operating policy decisions of the investee). The rationale may not apply to transactions in which there is no change in significant influence.

31. Alternatives 1 and 2 would require the investor to measure the initial share and the subsequent share of the net assets of the associate at the fair value of each exchange transaction. This method was previously criticised for resulting in the acquirer measuring the assets and liabilities of the subsidiary at a mixture of fair values at each acquisition date. IFRS 3 requires, for business combinations achieved in stages, the acquirer to remeasure its previously held equity interest at the acquisition date fair values and to measure net assets acquired at fair value.

32. Alternatives 1 and 2 (as well as Alternative 3 below) are cost accumulation methods and therefore a mixed measurement of the investor's share of the net assets in the associate would arise. The Board's decision to require remeasurement of previously held interests at fair value acknowledged that obtaining control was a significant economic event that warranted a change in the measurement of the investment and measuring net assets acquired at fair value at acquisition date. However, there is no such significant economic event that would require remeasurement of the investor's interest in an associate when there is no change in significant influence.

Alternative 3: Fair value of the consideration transferred

33. Under Alternative 3, the investor would apply a principle that the fair value of the consideration at the date that an investor acquires an additional interest in an associate provides the most relevant information and faithful representation of the cost of an investor's additional share in the net assets of an associate.

34. Alternative 3 is supported by applying the requirements for purchases of assets in other IFRS Standards by analogy, such as IAS 16 *Property Plant and Equipment* and

IAS 40 *Investment Property*. For instance, paragraph 6 of IAS 16 defines cost as the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction.

35. The measurement under Alternative 3 would normally be relatively easy to determine, in particular when the investor is settling the transaction with cash or other monetary assets. Moreover, no difference would arise between the cost of the additional investment and the measurement of the increase in the investor's share of the net assets of the associate.

36. Under this alternative, when the fair value of the consideration exceeds the investor's additional share of the fair value of the net assets of the associate, the excess amount would be allocated among the identifiable net assets. The investor's share of profit or loss after acquisition would include adjustments for the excess of consideration for changes in the identifiable net assets – for example, for depreciation of the excess amount of depreciable assets. The staff notes that this allocation would not increase the risk of impairment in subsequent periods compared to other alternatives because in accordance with paragraph 42 of IAS 28, the entire carrying amount of the investment is tested for impairment as a single asset.

Alternative 4: Book values of existing interest in the investor's financial statements

37. Under Alternative 4, the investor would apply a principle that the book value of the associate in the investor's financial statements at the date that an investor acquires an additional interest in an associate provides relevant information and faithful representation of an associate's identifiable net assets. In other words, the measurement of the additional share in the net assets of the associate would be based on the net fair value of the net assets of the associate at the date the investor acquired significant influence plus the post-acquisition changes in the net assets of the associate[1].

38. Alternative 4 may also be supported by the view that the benefits of requiring fair value measurement of the additional share of the net assets of the associate does not

[1] As a reminder, these amounts may be different from the amounts reported in the financial statements of the associate.

justify the costs incurred to provide that information (cost constraint on useful financial reporting).

39. The measurement of the share of the net assets in Alternative 4 could be derived by applying the requirement in paragraph B96 of IFRS 10 by analogy, which requires an adjustment to the carrying amounts of relative interests for changes in non-controlling interests in a subsidiary (ie acquiring an additional share in a subsidiary without a change in control).

40. The measurement under Alternative 4 would be easy to determine and would simplify the subsequent accounting, because the investor would apply the same adjustments to its whole share of the net assets of the associate.

41. Arguably a measurement based on book values is not compatible with the recognition of goodwill. Applying paragraph 32 of IAS 28, goodwill is measured as a residual amount, being the difference between the cost of the investment and the entity's share of the net fair value of the associate's identifiable assets and liabilities. Goodwill is measured in a similar way applying paragraph 32 of IFRS 3 and is essentially the difference between the consideration transferred and the net of the acquisition date fair values of the identifiable assets and liabilities. Paragraph BC314 of the Basis for Conclusion on IFRS 3 explains that the excess of the fair values over the book values of acquiree's net assets at acquisition is not conceptually part of the goodwill. Therefore, if the measurement of the additional share in the net assets is based on book values, the investor should expense any difference between the consideration paid and the measurement of the investor's additional share of the net assets of the associate.

Summary of alternatives and related principles

42. Based on the analysis above, the staff has therefore identified the following four possible alternatives and supporting principles that could be presented to the Board for discussion:

	Alternatives			
	1	**2**	**3**	**4**
Principles applied	Fair value at the date that an investor acquires an interest in an associate provides the most relevant information and faithful representation of an associate's identifiable net assets (Principle D) Any difference between the investor's share of the net assets of the associate and the cost of the investment is recognised as goodwill or income (bargain purchase).	Fair value at the date that an investor acquires an interest in an associate or provides the most relevant information and faithful representation of an associate's identifiable net assets (Principle D) If the fair value of the investor's share of the net assets of the associate differs from the transaction price the difference is recognised as a gain or loss.	Fair value of the consideration at the date that an investor acquires an interest in an associate provides the most relevant information and faithful representation of the cost of an investor's additional share in the net assets of an associate.	Book value[2] at the date that an investor acquires an interest in an associate, in a transaction that does not affect significant influence, provides relevant information and faithful representation of an associate's identifiable net assets.

43. Appendix 1 to this paper provides an illustrative example for each alternative.

[2] *Book value* here refers to the carrying amounts of the investee's net assets in the investor's financial statements.

44. **Questions for ASAF members**

Question for ASAF members
1. Do ASAF members have questions on the staff analysis in this paper? 2. What are ASAF members' views on the alternatives presented in this paper and their implications for the accounting for changes in the investor's interest in an associate with no change in significant influence?

Appendix 1—Illustrative examples

Illustrated example

A1. At the beginning of Year 1, an investor acquires a share of 20% in an associate for consideration of LC1,100 and obtains significant influence. In accordance with paragraph 32 of IAS 28, the investor determines that the fair value of the net assets of the associate at that date is LC4,400.

A2. At initial recognition, the investor recognises its share in the net assets of the associate at an amount of LC880 (20% of the current fair value of LC4,400). The investor recognises the difference of LC220 between the consideration paid and the amount attributed to its share in the net assets of the associate as goodwill and includes it in the measurement of the investment in the associate.

A3. At the end of Year 1, the associate's profit for the period is LC700.

A4. At the same date, the current book value of the net assets of the associate amounts to LC5,100 (LC4,400 + LC700); the fair value is assessed at LC 5,500.

A5. At the end of the reporting period, the investor recognises its share of profit or loss of LC140 (20% of LC700) and adjusts the investment in the associate. At that date, the carrying amount of the investment in the associate is LC1,240, comprising LC1,020 for the investor's share in the associate net assets and LC220 for the goodwill.

Increase by purchase of additional share

A6. The first example assumes that the investor acquires an additional share of 10%, for an amount of LC650.

A7. Under Alternatives 1 and 2, the investor would measure its new share in the net assets of the associate at LC550 (10% of LC5,500); under Alternative 3, the investor would measure it at LC650; under Alternative 4, the investor would measure it at LC510 (10% of LC5,100).

Table 1 – Increase by purchase of additional share

	Alt 1	Alt 2	Alt 3	Alt 4
Investment in associate	650	550	650	510
of which - share of net assets	*550*	*550*	*650*	*510*
of which - goodwill	*100*			
Comprehensive income		100		140
Cash	(650)	(650)	(650)	(650)

Increase in ownership interest from redemption from other shareholders

A8. The second example assumes that other shareholders redeem their shares representing 15% of the share capital of the associate and receive an amount of LC1,000.

A9. Following the transaction, the investor's share of ownership increases to 23.5%. The investor's prior share of net assets decreases from LC1,020 to LC820 (20% of the payment of LC1,000).

A10. Under Alternatives 1 and 2, the investor would measure its new share in the net assets of the associate at LC159 (3.5% of LC4,500). In this transaction, although the investor does not pay cash directly to other parties, it incurs in a decrease in the value in the share previously held. Under Alternative 3, the investor would measure the new share at the value given up of LC200. Under Alternative 4, the investor would measure it at LC145 (3.5% of LC4,100).

Table 2 – Increase by redemption from other shareholders

	Alt 1	Alt 2	Alt 3	Alt 4
Investment in associate		(41)		(55)
of which - share of net assets	*(41)*	*(41)*	-	*(55)*
of which - goodwill	*41*		-	
Comprehensive income		41		55

Appendix 2—Summary of Identified Principles underlying IAS 28

Principles Identified		Paragraph
Classification		
A	Power to participate is an investor’s shared power to affect changes in, and to access net assets.	IAS 28.3 *Definition* IAS 28.5-9 IAS 28.12–14
Boundary of the reporting entity		
B	Application of the equity method includes an investor’s share in the associate’s or joint venture’s net asset changes in an investor’s statement of financial position.	IAS 28.3 *Definition* IAS 28.10-11 IAS 28.35
C	An investor's share of an associate’s or joint venture’s net assets is part of the reporting entity.	IAS 28.28
Measurement on initial recognition		
D	Fair value at the date that significant influence or joint control is obtained provides the most relevant information and faithful representation of an associate’s or joint venture’s identifiable net assets.	IAS 28.30–31B IAS 28.32 IFRS 3 BC25/198
Subsequent measurement		
E	An investor recognises changes in an associate’s or joint venture’s net assets. An investor recognises the share of changes in net assets that it can currently access.	IAS 28.3 *Definition* IAS 28.10–13 IAS 28.26 IAS 28.28 IAS 28.30–31B IAS 28.33–36 (includes 35) IAS 28.37
F	An investor's maximum exposure is the gross interest in an associate or joint venture.	IAS 28.14A/29/38–43

<table>
<tr><th colspan="2">Principles Identified</th><th>Paragraph</th></tr>
<tr><td>G</td><td>When an investor has a decrease in its ownership interest in an associate or joint venture and continues to apply the equity method, it reclassifies amounts previously recognised in other comprehensive income.</td><td>IAS 28.24–25</td></tr>
<tr><td colspan="3">Derecognition</td></tr>
<tr><td>H</td><td>An investor:
(a) applies IFRS 3 and IFRS 10 if it obtains control of an associate or joint venture;
(b) applies IFRS 9 if it no longer has significant influence or joint control but retains an interest in a former associate or joint venture; and
(c) recognises a gain or loss and reclassifies amounts recognised in other comprehensive income on the date that significant influence or joint control is lost.</td><td>IAS 28.22–23
IFRS 3.41–42</td></tr>
<tr><td colspan="3">Unallocated (not being addressed in the project)</td></tr>
<tr><td colspan="2">Presentation</td><td>IAS 28.15/20–21</td></tr>
<tr><td colspan="2">Exceptions to the application of the equity method</td><td>IAS 28.16–19
IAS 28.27
IAS 28.36A</td></tr>
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