Staff paper

Agenda reference: 6

Accounting Standards Advisory Forum meeting

Date	**December 2022**
Project	**Equity Method project**
Topic	**Project update and transactions between an investor and its associate–an acknowledged inconsistency between the requirements of IFRS 10 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures***

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Objective of the session

1. The objective for the session is to:

   (a) provide ASAF members with an update of the Equity Method project; and

   (b) ask for views on alternatives to answering the application question: *How should an investor recognise gains and losses that arise from the sale of a subsidiary to its associate applying the requirements of IFRS 10* Consolidated Financial Statements *and IAS 28* Investments in Associates and Joint Ventures*?*

2. The papers for this session are as follows:

   (a) Paper 6 (this paper)—update on the Equity Method project;

   (b) Paper 6A (slide presentation)—Transactions between an investor and its associate–an acknowledged inconsistency between the requirements of IFRS 10 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures.*

   (c) Paper 6B—Agenda paper AP13C of the IASB meeting, September 2022.

   (d) Appendix—Application questions in the scope of the project.

Update on the Equity Method project

Scope and approach

3. Following the 2011 Agenda Consultation the IASB added a research project on the Equity Method to its work programme. The IASB commenced work on that project in June 2015, tentatively deciding to undertake a limited-scope research project to address application problems arising from the equity method.

4. In May 2016, following a review of the progress on that project and feedback on the 2015 Agenda Consultation the IASB decided to defer the project and consider the need for a wider research project

after completion of the Post implementation Reviews of IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities*.

5. The *IASB Work Plan 2017-2021 Feedback Statement 2015 Agenda Consultation* included a project on the equity method of accounting on the IASB research pipeline, with the following description.

> A number of queries on equity accounting and its interaction with the accounting for other ways of holding interests in other entities have been raised with the Interpretations Committee. The Board thinks that it will be able to consider this topic most effectively and efficiently after it has assessed feedback from the forthcoming Post-implementation Review of IFRS 11 *Joint Arrangements.*

6. At its October 2020 meeting, the IASB met to discuss the objective and approach to the equity method of accounting research pipeline project. The IASB decided to move the project to the research programme and agreed the objective of the project is:

> To assess whether application problems with the equity method, as set out in IAS 28 *Investments in Associates and Joint Ventures*, can be addressed in consolidated and individual financial statements by identifying and explaining the principles of IAS 28.

7. The IASB decided that to achieve this objective, the project should be focused on:

    (a) identifying application questions and deciding which of these questions to address.

    (b) addressing these application problems by identifying and explaining the principles that underlie IAS 28. Identifying and explaining these principles may also help the IASB develop new requirements, new application guidance or other amendments to IAS 28.

Project status

Selecting the application questions

8. At its March 2021 meeting, the IASB discussed the process of selecting application questions for consideration in the project. The Appendix to this paper sets out the list of application questions in the scope of the project.

9. Application questions were identified from the following sources:

   (a) submissions to the IFRS Interpretation Committee;

   (b) past work of the IASB;

   (c) comments from the Global Preparers Forum at the November 2014 meeting;

   (d) research report published by the Korean Accounting Standards Board in September 2014; and

   (e) outreach to national standard-setters, accounting firms and regulators in 2021. The staff received 21 responses to the outreach.

10. In selecting the application questions, the staff noted that the process of identifying application questions is iterative, and the IASB may consider adding questions during the research project. For example, the IASB may conclude that it is possible to apply a solution to an application question that was eliminated in the selection process or decide that an application question should not be solved within the scope of the project.

11. In compiling the list of application questions, the staff highlighted to the IASB that some application questions with recurrent themes had been excluded in the selection process as they did not relate to application of the equity method. The staff explained its intention to make the IASB aware of these questions, so that the IASB can consider at a future date whether these questions warrant extending the scope of the project:

   (a) ownership interests that provide access to benefits. Feedback from the outreach indicated that there are challenges in determining which instruments should be considered as part of the investment in associate or how to determine the percentage of ownership when shares have entitlements that vary over the life of the investee.

   (b) reciprocal interests. Reciprocal interests occur when an associate or joint venture holds an interest in an investor or an investor's subsidiary and can give rise to double counting of net assets between the investor and the associate.

   (c) non-coterminous reporting period and uniform accounting policies. IAS 28 requires an investor to adjust the financial statements of the associate for the effects of significant transactions or events when the end of the reporting period of the associate is different from that of the investor. Feedback on the initial list of application questions included that an investor may not have sufficient information to comply with these requirements.

Identifying the principles underlying IAS 28

12. The IASB reviewed IAS 28 and set out the principles that underlie it[1]. The IASB also agreed how to develop additional principles to guide how an entity applies the equity method in situations to which none of these underlying principles apply.

13. The staff has also undertaken research on possible implications arising from some IASB projects, including the consolidation project (leading to the revised IFRS 10), the joint arrangements project (leading to IFRS 11), the business combinations project (leading to IFRS 3 *Business Combinations*) and the conceptual framework project.

IASB's tentative decisions

14. The IASB has discussed questions A1 to A3 in the Appendix and tentatively decided:

    (a) to consult with stakeholders on measuring the cost of an investment, when an investor obtains significant influence, as the fair value of the consideration transferred, including the fair value of any previously held interest in the investee;

    (b) to explore an approach ('preferred approach') whereby an investor that purchases an additional interest in an associate after obtaining significant influence, measures the investment in an associate as an accumulation of purchases;

    (c) that an investor applying the preferred approach:

        (i) would recognise a gain in profit or loss if the purchase of an additional interest is a bargain;

        (ii) would measure the portion of the carrying amount of an investment in an associate to be derecognised in a partial disposal using:

            (i) a specific identification method, if the investor can identify the specific portion of the investment being disposed of and its cost; and

            (ii) the last-in, first-out method, if the specific portion of the investment being disposed of cannot be identified.

        The IASB however decided to explore practical methods of measuring the portion of the carrying amount of an investment in an associate to be derecognised.

        (iii) when a change in the associate's net assets changes the investor's ownership interest from the issue of equity instruments and the investor retains significant influence:

            (i) would recognise the increase as a purchase of an additional interest;

            (ii) would recognise the decrease as a partial disposal– that is, any (dilution) gain or loss is recognised in profit or loss.

[1] The identified principles can be found in Appendix B of Agenda Paper 13 for the September 2022 IASB meeting.

Next steps

15. The IASB will continue to discuss the application questions. At a later stage of the project, the staff will apply the IASB's tentative decisions to investments accounted for under the equity method other than investments in associates and discuss any implications with the IASB.

16. The IASB will also consider the type of consultation document to be issued as an output of the project.

Questions for ASAF members	
1.	Do ASAF members have questions or comments on the update of the Equity Method research project?

Appendix–Application questions in the scope of the project

A	**Changes in an investor's interest while retaining significant influence**
A1	How does an investor apply the equity method when purchasing an additional interest in an associate while retaining significant influence?
A2	How does an investor apply the equity method when disposing of an interest in an associate while retaining significant influence?
A3	Whether an investor recognises its share of other changes in an associate's net assets, and if so, how is the change presented?
B	**Recognition of losses**
B1	Whether an investor that has reduced its interest in an investee to nil is required to 'catch up' unrecognised losses if it purchases an additional interest in the investee?
B2	Whether an investor that has reduced its interest in an investee to nil continues eliminating its share of gains arising from a downstream transaction?
B3	Whether an investor that has reduced its interest in an investee to nil recognises each component of comprehensive income separately? For example, in a financial year, an investee recognises a loss in comprehensive income that includes, a profit in its statement of profit and loss, and a loss in its statement of other comprehensive income
C	**Transactions between investor and associate**
C1	Whether to recognise the portion of the investor's share of gain that exceeds the carrying amount of its investment in the investee in a downstream transaction?
C2	Whether the investor's share of gain or loss is eliminated from the carrying amount of the investment in the investee or the acquired asset in an upstream transaction?
C3	Whether the provision of service and transactions that are not transfer of assets are upstream or downstream transaction?
C4	How should an investor recognise for gains and losses that arise from the sale of a subsidiary to an investee given the requirements of IFRS 10 *Consolidated Financial Statement* and IAS 28 *Investments in Associates and Joint Ventures*?
D	**Transactions between two associates**
D1	Whether the requirement for adjustment of gains and losses in intra-group transactions between subsidiaries should be applied by analogy to transactions between investees that are accounted for applying the equity method?
E	**Impairment**
E1	Whether the decline in fair value is assessed in relation to the original purchase price or the carrying amount at the reporting date?
F	**Initial recognition**
F1	Whether the investor recognises deferred tax assets and liabilities on the differences between the fair value and the tax base of its share of the investee's net assets?
G	**Contingent consideration**
G1	How to initially and subsequently account for contingent consideration in the acquisition of an investee applying IAS 28?