IASB meeting

Date	**October 2022**
Project	**Equity Method research project**
Topic	**Project direction**
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Objective of the session

1. The objective of the session is to summarise the status of the Equity Method research project and ask the International Accounting Standards Board (IASB) to continue the project with its current objective and approach.

Structure of the paper

2. The paper is structured as follows:
   (a) background of the project;
   (b) project status;
   (c) type of consultation document;
   (d) question to the IASB;
   (e) Appendix A—Process to select application questions;
   (f) Appendix B—Principles identified as underlying IAS 28; and
   (g) Appendix C—Selected application questions.

Background of the project

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, however, 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 that 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 Board develop new requirements, new application guidance or other amendments to IAS 28.

8. The IASB decided not to undertake a fundamental review of the equity method because it would require more time and resources. In agreeing the approach in paragraph 7 of this paper some IASB members expressed concerns as to whether the IASB would be able to address the application questions. The IASB, therefore, asked the staff to review the progress of the research project at regular intervals.

9. The staff thinks that as the IASB has started to address application questions now is an appropriate time to review the progress of the project.

Project status

Selecting the application questions

10. At its March 2021 meeting, the IASB discussed the process of selecting application questions for consideration in the project. Appendices A and C to this paper set out the process for selecting the application questions and the list of application questions in the scope of the research project.

11. Application questions were identified from the following sources:

(a) submissions to the IFRS Interpretations Committee (the 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.

12. 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.

13. 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. The staff explained its intention to make the IASB aware of these questions, so that the IASB could consider at a future date whether these questions warrant extending the scope of the project.

Identifying the principles underlying IAS 28

14. The IASB reviewed IAS 28 and set out the principles that underlie it, these principles are set out in Appendix B to this paper. The IASB also agreed to a process of identifying missing principles, by analogising to the principles that underlie IAS 28 and applying the judgment 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 Accounting Standards dealing with similar and related issues and the definitions, recognition criteria and measurement concepts in the *Conceptual Framework for Financial Reporting*.

15. The staff has also spent some time researching 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 the revised IFRS 3 *Business Combinations)* and the conceptual framework project.

Answering the application questions

16. The application questions in the scope of the project have not been ranked by priority. However, the staff thinks that for the project to be successful it is important to answer those application questions that have been the subject of the IASB or the Committee's activities in the past. Application questions that have been the subject of IASB or Committee's activities in the past include:

(a) *Exposure Draft Equity Method: Share of Other Net Asset Changes (proposed amendments to IAS 28 Investments in Associates and Joint Ventures)* – issued in November 2012 to address the recognition of an investor's share of the changes in the net assets of the investee that are not recognised in profit or loss or other comprehensive income of the investee or are not distributions. The IASB decided not to finalise the amendments proposed in the Exposure Draft.

(b) *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* – issued in September 2014 to address the issues arising from the perceived inconsistency between the requirements in IAS 28 and IFRS 10 when accounting for the contribution of a subsidiary to a joint venture or associate (resulting in the loss of control of the subsidiary). The effective date of the amendments has been indefinitely deferred.

(c) *IFRIC Agenda Decision Investment in a subsidiary accounted for at cost: Step acquisition* – issued in January 2019. The Committee concluded an entity may determine the cost of its investment in a subsidiary using either fair value as deemed cost approach (the fair of the initial interest at the date of obtaining control of the subsidiary, plus any consideration paid for the additional interest); or an accumulated cost approach (the consideration paid for the initial interest plus any consideration paid for the additional interest).

17. The IASB made tentative decisions on two of the application questions in paragraph 16 of this paper:

(a) *Whether an investor recognises its share of other changes in an associate's net assets, and if so, how is the change presented?* This application question is linked to paragraph 16(a) of this paper. The IASB has tentatively decided that when the investor retains significant influence, an investor applying the preferred approach would recognise an increase in its ownership interest as a purchase of an additional interest, and a decrease as a partial disposal.

(b) *How does an investor apply the equity method when purchasing an additional interest in an associate while retaining significant influence?* This application question is linked to paragraph 16(c) of this paper. The IASB is developing a preferred approach in which, after obtaining significant influence, an investor recognises, at the date of purchasing an additional interest, its additional share in the fair value of the associate's net assets and measures that additional interest at the fair value of the consideration transferred (that is as an accumulation of purchases). The IASB has asked the staff to consider further how an investor that applies its preferred approach in measuring the portion of the investment to be derecognised when the investor partially disposes of its investment and retains significant influence.

18. The IASB has also discussed the third application question in paragraph 16 of this paper: How should an investor recognise gains and losses from the sale of a subsidiary to an investee given the requirements of IFRS 10 and IAS 28? This application question is linked to paragraph 16(b) of this paper. The staff expects to bring a decision-making paper on this application question to the IASB in Q1 2023.

19. The staff acknowledges the developing solutions to the application questions has taken longer than anticipated. The following reasons have contributed to this:

    (a) In developing solutions, it has been necessary to extend the analysis to incorporate aspects that the staff had initially considered may sit outside the scope of the project – for example, the analysis of how the equity method interacts with the boundary of the reporting entity[1] or how the unit of account may be affected by the introduction of the preferred approach for the purchase of additional interests in an associate.

    (b) Identifying the principles underlying IAS 28 was expected to provide a basis for addressing the application question. However, the staff has more often had to use the process of identifying the missing principles. On reflection this was to be expected because the application questions relate to topics where IAS 28 is silent while the principles are derived from the existing requirements.

20. Whilst acknowledging that the project has taken longer than anticipated to develop solution to application questions the staff notes that the IASB made tentative decisions on two application questions and discussed a third application question, on questions that are important to the project's success. The staff is still persuaded that it is possible to develop solutions to the application questions applying the approach agreed by the IASB (see paragraph 7).

21. The staff thinks the accounting firms and regulators are most interested in the equity method project because answering the application questions will support consistent application of the Standard. Answering application questions will also assist preparers, however, the staff thinks some of the application questions arise infrequently for preparers.

22. In contrast, investors focus on the value of equity accounted investments and not how the investment has been accounted for, therefore some investors may be unaware of the complexity of applying the equity method. However, the project could benefit users by removing divergent accounting practices.

23. The staff is recommending that the IASB continue with the equity method project applying the approach in paragraph 7 of this paper.

[1] See Agenda Paper 13C for the September 2022 IASB meeting

Type of consultation document

24. The staff does not consider that the IASB should decide on the type of consultation document to publish at this time.

25. Paragraph of 4.12 of the *Due Process Handbook* (the 'Handbook') states that the main output of the research programme is expected to be discussion papers and research papers. Discussion papers are issued by the IASB and present the analysis and collective views of the IASB on a particular topic, although the discussion will reflect and convey any significant differences in IASB members' views.

26. Paragraph 5.5 of the Handbook states that the IASB would normally propose to make major amendments to a Standard only after it has published a discussion paper and considered the comments it receives from the consultation. The IASB might conclude that a discussion paper is not necessary because it has sufficient input from a research paper, request for information or other research to proceed directly to an exposure draft.

27. The following factors could be considered in deciding the type of consultation document:

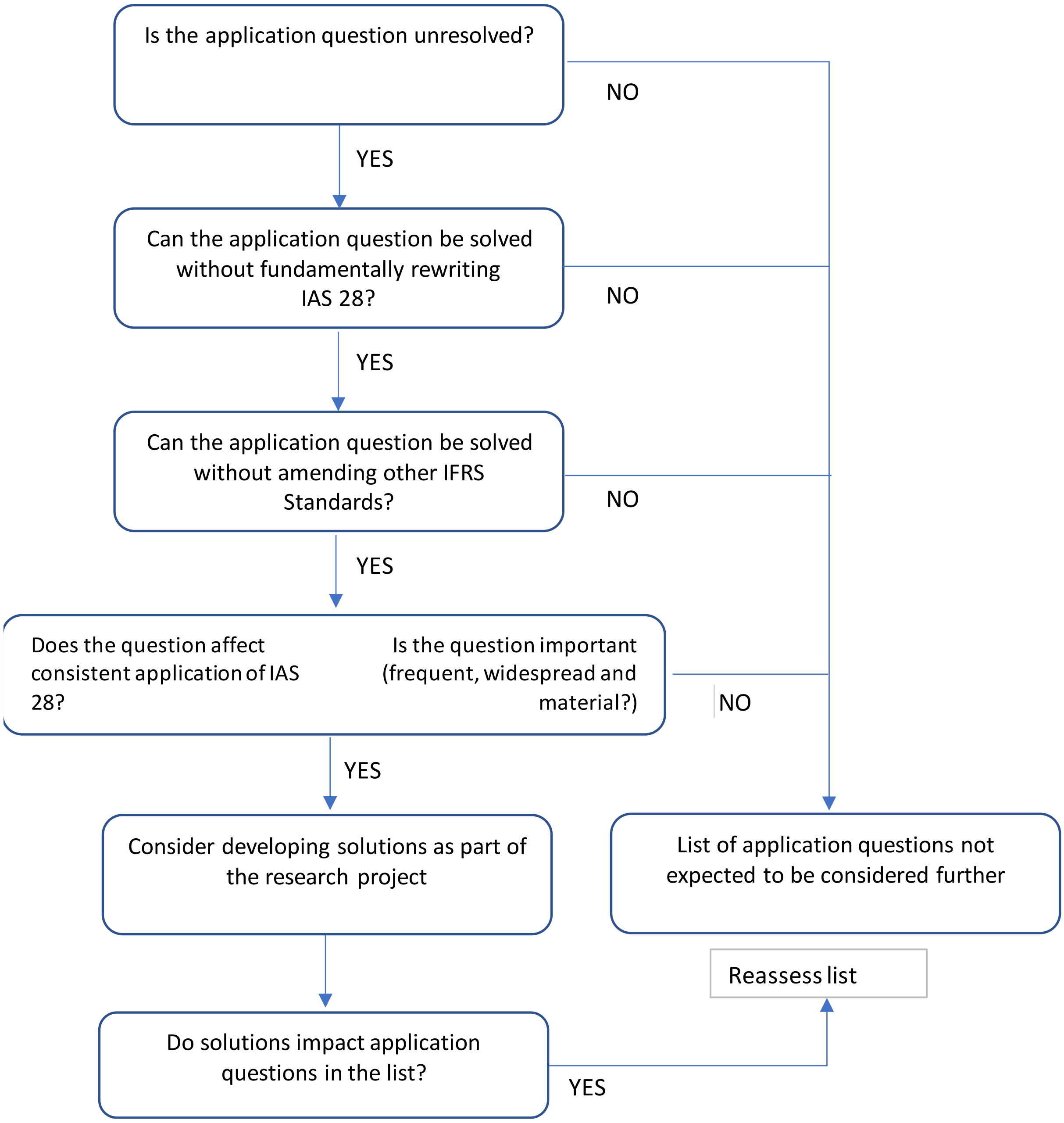
    (a) Whether the IASB reaches a single view on the solutions to the application issues or identifies a range of alternatives. A discussion paper allows to consult stakeholders on alternatives;

    (b) Whether the identified solutions change fundamental features of the equity method. The equity method has been in use for a long time, and it is important to understand the impact of potential new requirements or amendments to existing requirements which would affect current practices and financial statements. If the identified solutions change the fundamental features of the equity method, a discussion paper provides a better chance to stakeholders to provide feedback on the potential impact on financial statements. The staff acknowledges that assessing what features of the equity method are fundamental is a matter of judgment.

28. The staff recommends that the IASB considers the type of consultation document after developing solutions to the application questions and having considered the effects of potential changes to the application of the equity method.

Question to the IASB
Does the IASB agree to continue the Equity Method research project with its current objective and approach?

Appendix A—Process to select application questions



Appendix B—Principles identified as underlying IAS 28

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
G	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.	IAS 28.24–25
Derecognition		
H	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.	IAS 28.22–23 IFRS 3.41–42
Unallocated (not being addressed in the project)		
Presentation		IAS 28.15/20–21

Exceptions to the application of the equity method	IAS 28.16–19 IAS 28.27 IAS 28.36A

Appendix C — Selected application questions

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?