STAFF PAPER

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IASB® meeting

Project	**Equity Method**
Paper topic	Changes in an associate's net assets that change the investor's ownership interest

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Purpose of this paper

1. At its April and June 2022 meetings, the International Accounting Standards Board (IASB) discussed the application question: *How does an investor apply the equity method when purchasing an additional interest in an associate while retaining significant influence*.

2. At its April 2022 meeting, the IASB asked the staff to develop the analysis of its preferred approach. Based on the IASB's tentative decisions to date, the preferred approach would require an investor:[1]

   (a) purchasing an additional interest in an associate while retaining significant influence, to:

      (i) recognise the additional share in the fair value of the associate's net assets at the purchase date;

      (ii) measure the cost of the additional interest at the fair value of the consideration transferred; and

      (iii) recognise any difference between (i) and (ii) as goodwill or a bargain purchase gain in profit or loss.

[1] A summary of the IASB's tentative decisions to date is included in Agenda Paper 13 *Cover paper* of this meeting.

(b) making a partial disposal while retaining significant influence, to:

(i) recognise the fair value of the consideration received;

(ii) derecognise a portion of the carrying amount of its investment in the associate[2];

(iii) recognise the difference between (i) and (ii) as a disposal gain or loss; and

(iv) reclassify a proportion of amounts recognised in other comprehensive income to profit or loss (paragraph 25 of IAS 28).

3. The equity method research project includes the following application question: *Whether an investor recognises its share of other changes in an associate's net assets, and if so, how is the change presented.*

4. At the June 2022 IASB meeting, the staff introduced its analysis of the question in paragraph 3 of this paper and explained that transactions and other events that change an associate's net assets may also change the investor's ownership interest, for example when an associate issues or redeems shares.

5. In this paper, the staff illustrate how an investor could apply the preferred approach to changes in the associate's net assets that change an investor's ownership interest while retaining significant influence.

Staff recommendation

6. The staff recommends the IASB proposes that when there is a change in an associate's net assets from the issue of equity instruments:

(a) if an investor's ownership interest increases and the investor retains significant influence, an investor applying the preferred approach recognises the increase as a purchase of an additional interest.

[2] AP13A for this session discusses practical expedients on how to measure the carrying amount of the portion of the investment to be derecognised in a partial disposal.

(b) if an investor's ownership interest decreases and the investor retains significant influence, an investor applying the preferred approach recognises the decrease as a partial disposal.

Structure of the paper

7. The paper is structured as follows:

   (a) Scope of the analysis (paragraphs 8–11 of this paper);

   (b) Overview of transactions that change an associate's net assets (paragraphs 12–15 of this paper);

   (c) Reporting the effect of changes in an associate's net assets that change an investor's ownership interest (paragraphs 16–35 of this paper);

   (d) Proportionate subscription (paragraphs 36–37 of this paper);

   (e) IASB past discussions (paragraphs 38–45 of this paper);

   (f) US GAAP requirements (paragraphs 46–48 of this paper);

   (g) Questions to the IASB; and

   (h) Appendix A (illustrative examples).

Scope of the analysis

8. The analysis in this paper has been developed for investments in associates. IFRS Accounting Standards also require the equity method of accounting for joint ventures and permit the equity method for investments in subsidiaries in the separate financial statements of a parent entity. At a later stage of the project, the staff will apply the IASB's tentative decisions to investments other than associates and discuss any implications with the IASB.

9. The analysis in this paper applies to changes in associate's net assets that change an investor's ownership interest, including transactions in which the investor subscribes new shares issued by an associate. In the analysis it is assumed that the investor pays or contributes cash and cash equivalents. If the investor contributes non-monetary assets

measured other than at fair value, there may be a difference between the fair value and the carrying amount of that asset.

10. The analysis in this paper does not apply to an associate's equity-settled share-based payment transactions that result in the associate issuing new shares to the counterparty and changing the investor's ownership interest. The staff has not yet analysed how an investor would apply the preferred approach to these transactions, in particular the question that the associate is required to recognise the share-based payment expense during the vesting period, while the change in the investor's ownership interest occurs on vesting, when and if new shares are issued to the counterparty.

11. At its April and June 2022 meetings, the IASB discussed an alternative approach for purchases of additional interest. This paper does not include an illustration of how an investor would apply the alternative approach to changes in an associate's net assets. If the IASB decides to consult on both the preferred and alternative approach, the staff will present an analysis of the alternative approach at a future meeting.

Overview of transactions that change an associate's net assets

12. Transactions that change the associate's net assets that may also change an investor's ownership interest include:

    (a) transactions in which the investor exchanges consideration with the associate, for example an investor being the sole party subscribing to newly issued shares in the associate (or an investor buys a greater or smaller proportion of the newly issued shares offered than its pre-transaction proportionate ownership interest); and

    (b) transactions in which the investor does not exchange consideration with the associate. The staff uses the term dilutions in this paper to refer to these transactions when other parties subscribe for the new shares issued by the associate and therefore, the investor's ownership interest decreases. The investor position is changed as its ownership interest decreases as does its share in the associate's net assets.

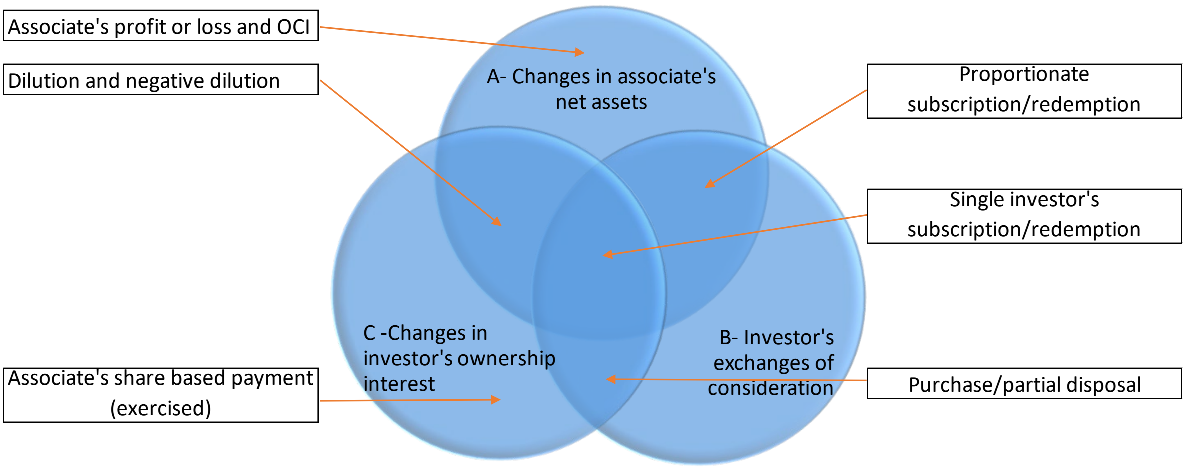
13. Not all transactions that change the associate's net assets also change the investor's ownership interest. For example, if all existing shareholders take part in an associate's share issue or redemption in proportion to their current ownership interests, the associate's net assets change, but the investor's ownership is unchanged.

14. Similarly, not all changes in an investor's ownership share change an associate's net assets. For example:

    (a) purchases or disposals of shares between investors do not change an associate's net assets. Consideration is exchanged between the buyer and seller.

    (b) equity-settled share-based payments. In the vesting period the associate recognises an expense in profit or loss and increases equity for an amount corresponding to the expense.

15. The following diagram illustrates the characteristics of transactions that may affect the measurement of an investor's interest in an associate and provides examples of transactions with different characteristics.



Reporting the effect of changes in an investee's net assets that change an investor's ownership interest

Introduction

16. In agenda paper 13B of the June 2022 IASB, the staff expressed the view that *all* transactions that change an investor's ownership interest in an associate while the investor retains significant influence, have economically similar outcome and, therefore, the reported outcomes for these transactions should be similar. IASB members supported the staff applying this view to the preferred approach and continuing the analysis of these transactions.

17. The staff has considered the view of one IASB member that an investor should not report a dilution of its interest in an associate while retaining significant influence because the investor does not exchange consideration with the associate or a third party.

18. Paragraph 1.12 of the *Conceptual Framework for Financial Reporting* (the Conceptual Framework) explains that general purpose financial statements provide information about the effects of transactions and *other events* that change a reporting entity's economic resources and claims.

19. The staff retains the view that a dilution changes an investor's economic resources, because after the transaction the investor has a smaller share of a larger pool of the investee's net assets and this change may affect for example the investor's cash flows from distribution of an associate.

20. The staff also believes that reporting the effect of a dilution is consistent with the definition of the equity method of accounting, that requires adjusting the initial cost of

the investment for the post-acquisition change in the investor's share of the investee's net assets[3].

21. Finally, the staff observes that the same information about the dilution (ie size of the share issue, subscription price and terms and conditions) would be available to the investor irrespective of the investor's decision to participate in the transaction. Therefore, there would not be additional costs to prepare the information compared to transactions the investor participates.

Application of the preferred approach to a dilution

22. In the following paragraphs, the staff explains how the preferred approach could be applied to a dilution. Assume a share issue with the following characteristics:

Table 1: Dilution

	Before share issue	**After share issue**
Investor's shares	250	250
Total shares	1,000	1,111
Ownership share	25%	22.5%

23. Applying the view *all* transactions that change an investor's ownership interest in an associate whilst retaining significant influence, have economically similar outcomes then the facts in table one would be equivalent to a partial disposal of a 2.5% interest.

24. Applying the preferred approach to a dilution as it were a partial disposal an investor would:

    (a) recognise the fair value of the consideration received. While in a partial disposal the investor receives consideration from the buyer of the shares, in a dilution the associate receives consideration in exchange for the new shares

[3] See paragraph 3 of IAS 28.

and the investor is compensated for the dilution with its share of the increase in the associate's net assets;

(b) derecognise a portion of the carrying amount of its investment in the associate.

25. Applying steps (a) and (b) to a dilution would require an investor to:

(a) adjust its share of the associate's net assets to its post-transaction ownership share. The post-transaction carrying amount of the associate's net assets[4] includes the consideration received by the associate in exchange for the new shares;

(b) derecognise a portion of any goodwill included in the carrying amount of its investment in the associate; and

(c) recognise the change in the carrying amount of the investment in the associate as a dilution gain or loss. The presentation of the gain or loss is discussed in paragraph 29 of this paper.

26. Appendix A provides an illustrative example of applying paragraphs 24 and 25 above.

27. If the IASB agrees with above analysis the next question is how the dilution gain or loss should be presented, that is, whether it should be presented in comprehensive income or equity. Paragraph 10 of IAS 28 refers to an investor's share of the associate's profit or loss and other comprehensive income and does not address other changes in the associate's net assets.

28. Applying the view that the economic effects of a dilution are economically similar to a partial disposal and therefore the reporting outcomes should be similar, the staff considers that the effect of a dilution should be reported in comprehensive income.

29. The staff also considered if the dilution gain or loss should be presented in profit or loss or other comprehensive income. As noted above, a dilution gain or loss is a change in the investor's economic resources. From the investor's perspective, changes in the

[4] In the context of the analysis, *the carrying amount of the associate's net assets* include the appropriate adjustments (basis differences) made by the investor at the date significant influence was obtained, and to the investor's share of profit or loss after that date.

associate's net assets meet the definition of income and expenses in the *Conceptual Framework*[5] because they represent an increase or decrease in the investor's assets.

30. Paragraph 7.17 of the *Conceptual Framework* states all income and expenses should be presented in profit or loss. In exceptional circumstances, the Board may decide that income or expenses are to be included in other comprehensive income when doing so would result in the statement of profit or loss providing more relevant information or providing a more faithful representation of the entity's financial performance for that period.

31. Analysing if the gain or loss arising from the dilution is part of the investor's performance is outside the scope of this project. However, the staff's view is that the gain or loss should be presented in profit or loss for the following reasons:
    (a) the staff did not identify exceptional circumstances that would require presentation in other comprehensive income;
    (b) presentation in profit or loss would be consistent with how the preferred approach would be applied to disposals on an interest whilst retaining significant influence;
    (c) although an investor does not participate in the transaction (contrary to a disposal) this could be as a result of an investor's decision;
    (d) presenting the gain or loss in other comprehensive income would trigger a further question on whether and when the change should be reclassified to profit or loss.

Application of the preferred approach to a single investor's subscription

32. In the following paragraphs, the staff explains how the preferred approach could be applied to a single investor subscription – that is, the investor subscribes 100% of the new shares issued by an associate.

[5] Paragraphs 4.68 and 4.69 of the Conceptual Framework provide a definition of income and expenses.

Table 2: Share issue to a single investor

	Before share issue	**After share issue**
Investor's shares	200	311
Total shares	1,000	1,111
Ownership share	20%	28%

33. Applying the view that *all* transactions that change an investor's ownership interest in an associate whilst retaining significant influence, have economically similar outcomes then the facts in table two would be equivalent to a purchase of an additional 8% interest.

34. Applying the preferred approach to an investor's single subscription as it were a purchase of an additional interest, an investor would:

(a) recognise its share of the associate's net assets adjusted for the post-transaction amount of the associate's net assets. The associate's net assets change for the consideration received by the associate for the new shares;

(b) recognise the additional ownership share (in the example above 8%) of the post-transaction fair value of the associate's net assets;

(c) recognise goodwill (or a bargain purchase gain) for any difference between the fair value of the consideration paid and the change in the investor's share in the associate's net assets; and

(d) recognise the fair value of the consideration paid to the associate to subscribe the new shares.

35. Appendix A provides an illustrative example.

Proportionate subscription (Investor maintains its ownership percentage)

36. For completion of the analysis on other changes in an associate's net assets an explanation of how an investor would apply the preferred approach to a proportionate subscription is included. In a proportionate subscription there is a change in the associate's net assets but not in the investor's ownership interest. In this circumstance, the transaction is not equivalent to a purchase or a disposal.

Table 3: Proportionate subscription

	Before share issue	**After share issue**
Investor's shares	200	220
Total shares	1,000	1,100
Ownership share	20%	20%

37. The investor share in the change of the associate's net assets should be equal to the payment made by the investor. The investor would simply increase its investment by an amount equal to the payment.

IASB past discussions

38. In 2011, the IFRS Interpretation Committee ('the Committee') received a request to clarify the accounting for the investor's share of the other changes in the investee's net assets that are not the investor's share of the investee's profit or loss or other comprehensive income, or distributions received.

39. The Committee recommended to the IASB a solution broadly aligned with the staff recommendation in paragraph 6 of this paper, and that call option transactions entered into by an investee over its own equity (such as share-based payments) would be excluded from the scope of the proposal.

40. In June 2012 the IASB decided to reject the Committee recommendation, because it did not address all of the types of other net asset changes that might occur in practice, in particular share-based payments in an associate.

41. In November 2012, the IASB published for comment the Exposure Draft *Equity Method: Share of Other Net Asset Changes*. The proposed amendment aimed to respond to diversity in practice that had arisen on how to apply the equity method to certain transactions entered into by an equity-accounted investee.

42. The IASB proposals set out in the Exposure Draft aimed to address this diversity by requiring an investor to:

    (a) recognise, in the investor's equity, the investor's share of other changes in the investee's net assets; and

    (b) reclassify to profit or loss the cumulative amount of those other changes previously recognised in equity when the investor discontinued the use of the equity method.

43. All respondents agreed that the investor should recognise their share of the associate's net asset changes, but most disagreed that the recognition should occur in equity. Some respondents stated that indirect changes in the investor's ownership interest such as dilutions are economically similar to direct changes like purchases and disposals, and the reporting should be the same[6].

44. In July 2013, the Committee discussed the comments received on the Exposure Draft and tentatively decided to resubmit its original proposal to the IASB. If the IASB was not persuaded by the original proposal, the Committee's preference was to recognise all type of other net asset changes as income or expenses in the investor's profit or loss.

45. In May 2014 due to diversity in the views among IASB members, the IASB decided not to finalise the proposed amendments and defer work on the topic to a future research project on the equity method.

Requirements in US GAAP

46. US GAAP has the following requirements in relation to changes in the investor's ownership while retaining significant influence:

[6] For more details, see [AP12C: Exposure Draft Equity Method: Share of Other Net Asset Changes (ifrs.org)]() of the October 2013 IASB meeting.

(a) Sales of stock of an investee by an investor shall be accounted for as gains or losses equal to the difference at the time of sale between selling price and carrying amount of the stock sold (ASC323-10-35-35);

(b) An equity method investor shall account for a share issuance by an investee as if the investor had sold a proportionate share of its investment. Any gain or loss to the investor resulting from an investee's share issuance shall be recognised in earnings (ASC323-10-40-1).

47. ASC 323-10-35-33 applies to the acquisition in stages of an interest in an associate. The investor shall add the cost of acquiring the additional interest in the investee to the current basis of the investor's previously held interest and adopt the equity method of accounting as of the date the investment becomes qualified for equity method accounting.

48. The staff understands that it is an accepted practice to apply the requirements in ASC 323-10-35-33 also to purchases of additional interest and other increases in the investor's ownership interest while retaining significant influence.

Questions to the IASB
1. Do you agree with the staff recommendation in paragraph 6 of this paper, that when there is a change in the associate's net assets that changes an investor's ownership interest: (a) if an investor's ownership interest increases and the investor retains significant influence, an investor applying the preferred approach recognises the increase as a purchase of an additional interest. (b) if an investor's ownership interest decreases and the investor retains significant influence, an investor applying the preferred approach recognises the decrease as a partial disposal. 2. Do you require the staff to bring back an analysis on how the investor applies the alternative approach to a change in an associate's net assets that changes an investor's ownership interest?

Appendix A—Illustrative examples

Dilution of an interest in an associate whilst retaining significant influence

A1. Investor purchases a 25% share in investee at 1/1/20X1 for a consideration of 1,400CU. and obtains significant influence.

A2. At the purchase date, the fair value of the associate's net assets is 4,400CU.

A3. The profit of the investee for the year ending on 31/12/20X1 is 800CU, including the effects of the adjustments based on the fair values of the investee's net assets at the date significant influence is obtained. The carrying amount of the associate's net assets at 31/12/20X1 is 5,200CU.

A4. The accounting entries for the year ending 31/12/20X1 are as follows:

To recognise the investment in the associate		
Dr Investment in associate	1,400	
Cr Cash		1,400
To recognise the investor's share of the associate's profit or loss		
Dr Investment in associate	200	
Cr Profit or loss		200

A5. At 31/12/20X1 the reconciliation of the carrying amount of the associate is:

	Acquisition	**Post-acquisition changes**	**Total**
Share of net assets	1,100	200	1,300
Goodwill	300	-	300
Total	1,400	200	1,600

A6. At 31/12/20X1, the share of the net assets included in the carrying amount of the associate is equal to 25% of the carrying amount of the associate's net assets.

A7. At 1/1/20X2 the associate issues new shares and the investor does not take part in the subscription. The new shares are 10% of the share capital after the share issue. The number of outstanding shares before and after the share issue is:

	Before share issue	After share issue
Investor's shares	250	250
Total shares	1,000	1,111
Ownership share	25%	22.5%

A8. At the subscription date the fair value of the associate is 8,000CU. Based on the fair value of the associate at the subscription date the subscription price is 888CU, equal to 10% of the fair value of the associate after the share issue.

A9. After the subscription, the carrying amount of the associate's net assets is (5,200 + 888) = 6,088CU.

A10. After the transaction, the carrying amount of the investment changes from 1,600CU to 1,640CU. The change of 40CU is recognised as a dilution gain in profit or loss.

A11. The reconciliation of the carrying amount of the associate is:

Share of net assets	1,370
Goodwill	270
Total	1,640

A12. The investor's share in the associate's net assets is calculated as 22.5% of the new carrying amount of the associate's net assets. The goodwill included in the investment decreases to reflect the decrease of its ownership share from 25% to 22.5%. The decrease is equal to (25%-22.5%) / 25% = 10% of the goodwill.

A13. The transaction is equivalent to a partial disposal of a 2.5% interest. In a disposal of a 2.5% interest, based on the fair value of the associate, the investor would receive (2.5% * 8,000CU) = 200CU and derecognise a portion of its investment for CU160, with a disposal gain of 40CU recognised in profit or loss.

Single investor's subscription

A14. Investor purchases a 20% share in investee at 1/1/20X1 for a consideration of 1,100CU and obtains significant influence.

A15. At the purchase date, the fair value of the associate's net assets is 4,400CU.

A16. The profit of the investee for the year ending on 31/12/20X1 is 700CU, including the effects of the adjustments based on the fair values of the investee's net assets at the date significant influence is obtained. The carrying amount of the associate's net assets at 31/12/20X1 is 5,100CU.

A17. The accounting entries for the year ending 31/12/20X1 are as follows:

To recognise the investment in the associate		
Dr Investment in associate	1,100	
Cr Cash		1,100
To recognise the investor's share of the associate's profit or loss		
Dr Investment in associate	140	
Cr Profit or loss		140

A18. At 31/12/20X1 the reconciliation of the carrying amount of the associate is:

	Acquisition	Post-acquisition changes	Total
Share of net assets	880	140	1,020
Goodwill	220	-	220
Total	1,100	140	1,240

A19. At 31/12/20X1 the share of net assets included in the carrying amount of the associate represents 20% of the carrying amount of the associate's net assets.

A20. At 1/1/20X2 the associate issues new shares and the investor subscribes 100% of the new shares. The new shares represent 10% of the share capital after the share issue. The number of outstanding shares before and after the share issue is:

	Before share issue	After share issue
Investor's shares	200	311
Total shares	1,000	1,111
Ownership share	20%	28%

A21. At the date the new shares are issued, the fair value of the associate's net assets is 5,400CU and the fair value of the associate is 7,000CU. Based on the fair value of the associate at the subscription date the subscription price is 777CU, equal to 10% of the fair value of the associate after the share issue.

A22. After the subscription, the investor would recognise its share of the associate's net assets for the post-transaction amount the associate's net assets is (5,100+777) = 5,877CU. The share of the previously held interest changes from 1,020 CU to (20% * 5,877) = 1,175CU.

A23. The investor recognises its share of the fair value of the associate's net assets (5,400+777) = 6,177CU. The share of the additional interest is (8% * 6,177) = 494CU.

A24. After the transaction, the carrying amount of the investment changes from 1,240CU to 2,017CU, equal to the subscription price paid to the associate. The reconciliation of the carrying amount of the associate is:

	Previously held interest			Additional interest	Total
	Before share issue	Adjustment	After share issue		
Share of net assets	1,020	155	1,175	494	1,669
Goodwill	220	-	220	128	348
Total	1,240	155	1,395	622	2,017

A25. The investor's share in the associate's net assets is calculated as 20% of the new carrying amount of the associate's net assets for the previously held interest; and 8% of the fair value of the associate's net assets for the additional interest. The residual change is recognised as goodwill on the additional interest.

A26. The transaction is equivalent to a purchase of an additional interest of 8%. In a purchase of an additional interest, based on the fair value of the associate, the investor would pay (8% * 7,000CU) =560CU. Using the preferred approach, the investor would measure the cost of the additional interest at the fair value of the consideration, with the additional share in the associate's net assets measured at (8%* 5,400CU) =432CU and the goodwill at (560 - 432) =128CU.