IFRS Accounting

Staff paper

Agenda reference: 13A

IASB® meeting

Date	**March 2024**
Project	**Equity Method**
Topic	**Towards an Exposure Draft—Transitional requirements**
Contact	Filippo Poli (fpoli@ifrs.org)

Introduction and purpose of this paper

1. At its November 2023 meeting, the International Accounting Standards Board (IASB) completed its technical discussions on the application questions in the scope of the Equity Method project. The Equity Method project's objective is to develop answers to application questions on the equity method, as set out in IAS 28 *Investments in Associates and Joint Ventures*, using the principles derived from IAS 28 where possible. Agenda Paper 13 *Towards an Exposure Draft—Cover paper* of this meeting provides a summary of the IASB's tentative decisions in the project.

2. At its November 2023 meeting, the IASB tentatively decided to propose that an investor or a joint venturer would:

   (a) retrospectively apply the requirements to recognise the full gain or loss on all transactions with its associates or joint ventures;

   (b) recognise and measure contingent consideration at fair value at the transition date[1], and recognise any corresponding adjustment to the carrying amount of its investments in associates or joint ventures; and

   (c) prospectively apply all the other requirements from the transition date.

[1] The transition date for applying the new requirements to be proposed in the exposure draft is the beginning of the annual reporting period immediately preceding the date of initial application.

3. The purpose of this paper is to respond to IASB member questions at the November 2023 meeting, and to clarify the IASB's tentative decision in paragraph 2(a) of this paper, following feedback on how paragraph 2(a) would be applied.

Staff recommendation

4. The staff recommend the IASB clarify its tentative decision that an investor or a joint venturer would retrospectively apply the requirement to recognise the full gain or loss on all transactions with its associates or joint ventures. An investor or joint venturer would apply the proposed requirement by recognising the remaining portion of the restricted gain or loss. The cumulative effect of that gain or loss would be recognised as an adjustment to the opening balance of retained earnings at the transition date in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (see paragraph 14 of this paper).

5. The staff also recommend the IASB propose:

   (a) that, on initial application of the proposed requirements, if an investor or joint venturer had previously estimated the recoverable amount of an investment in an associate or joint venture at transition date, an investor or joint venturer would reduce the carrying amount to its recoverable amount. An investor or joint venturer would recognise the reduction as an adjustment to the opening balance of retained earnings (see paragraph 23 of this paper).

   (b) that an investor or joint venturer that chooses (or is required) to present more than one period of comparative information may present comparative information for any additional prior periods:

      (i) adjusted for the effects of the proposed requirements. The transition date would be the beginning of the earliest adjusted comparative period presented; or

(ii) not adjusted for the effects of the proposed requirements. The investor or joint venturer would identify the comparative information as unadjusted and disclose that comparative information has been prepared on a different basis, explaining that basis (see paragraph 38 of this paper).

(c) an exemption from disclosing the information required by paragraph 28(f) of IAS 8 for the current period and for any additional prior period that the investor or joint venturer presents unadjusted (see paragraph 50 of this paper).

Structure of this paper

6. This paper is structured as follows:

(a) clarifying retrospective application of the IASB's tentative decision to recognise the full gain or loss on all transactions with its associates or joint ventures (paragraphs 7–14 of this paper);

(b) assessing whether the investment is impaired at the transition date (paragraphs 15–23 of this paper);

(c) entities presenting more than one period of comparatives (paragraphs 24–38 of this paper); and

(d) disclosure of the effects of the adjustments (paragraphs 39–50 of this paper).

Clarifying retrospective application of the IASB's tentative decision to recognise the full gain or loss on all transactions with its associates or joint ventures

Background

7. The staff received some feedback that applying the IASB's tentative decision in paragraph 2(a) of this paper (to retrospectively recognise the full gain and loss on all transactions with associates or joint ventures) might cause undue cost and effort for preparers in some circumstances. The feedback involves the transfer of a subsidiary to the associate and highlights that the IASB's proposal may require an entity to recompute and/or reassess all the following from the original date of the transaction:
   (a) depreciation and amortisation expenses on the transferred assets;
   (b) impairment;
   (c) gains or losses on partial disposals of the investment;
   (d) foreign gains or losses of a foreign operation;
   (e) capitalisation of borrowing costs; and
   (f) effectiveness of hedging relationships.

8. Further feedback noted that:
   (a) certain entities may not have processes or systems to track previous transactions, and this may require tremendous effort in terms of time and resources to be deployed in tracking such historical information; and
   (b) the historical transactions may have been completed or settled and no longer included in the financial statements and restating that information may not provide valuable information to the users of the financial statements.

Staff analysis

9. In Agenda Paper 13B of the November 2023[2] meeting, the staff explained that retrospective application would require an investor or a joint venturer to recognise the remaining restricted portion of a gain or loss:

   (a) in retained earnings for transactions that occurred before the transition date; or

   (b) in the statement of profit or loss for the comparative period for transactions that occurred in the immediately preceding period (see paragraphs 24–37 of this paper for a discussion of entities that present additional comparative information).

10. In developing Agenda Paper 13B of the November 2023 meeting, the staff considered that:

    (a) if an entity had recognised in full the restricted portion of gain or loss before the transition date, there would be no need to make any adjustments. In other words, in this situation, there would be no need to restate the effects for each prior period.

    (b) if an entity had not recognised in profit and loss the restricted portion of the gain or loss at the transition date, the information to make the adjustment for the unrecognised portion of gain or loss should be available to preparers because that information is needed to apply the requirements in IAS 28. After the transaction, an investor or joint venturer is required to release the restricted portion of the gain or loss when the transferred asset is sold to third parties or as it is consumed over time; therefore, the staff expect entities will be tracking the restricted portion of the gain or loss to make the adjustment.

[2] See Agenda Paper 13B Transitional Provisions for the November 2023 IASB meeting.

(c) the adjustment in paragraph 10(b) of this paper would not affect aspects such as hedging relationships because the carrying amount of the investment is only adjusted at transition date (see paragraphs 15–22 of this paper for a discussion of impairment).

11. In some circumstances, it may be impracticable to determine the unrecognised portion of the gain or loss. Paragraph 27 of IAS 8 states that when it is impracticable for an entity to apply a new accounting policy to all prior periods, it applies the new policy prospectively from the start of the earliest period practicable. Given paragraph 27 of IAS 8, the staff do not think that an additional relief is needed.

12. The staff think that feedback on the IASB's tentative decision to require retrospective application assumed that the IASB would be requiring any entity to restate all prior period transactions as if the gain or loss had not been restricted on the date of the transaction with the associate or joint venture. As explained in paragraph 10 of this paper, this was not the staff's intention when recommending retrospective application. The aim was the investor would recognise the remaining portion of restricted gain or loss on the transaction at the transition date, by restating equity and the carrying amount of the investment.

13. The staff plan to include a question on the transitional requirements in the Invitation to Comment on the upcoming Exposure Draft.

Staff recommendation

14. The staff recommend the IASB clarify its tentative decision that an investor or a joint venturer would retrospectively apply the requirement to recognise the full gain or loss on all transactions with its associates or joint ventures. An investor or joint venturer would apply the proposed requirement by recognising the remaining portion of the restricted gain or loss. The cumulative effect of that gain or loss would be recognised as an adjustment to the opening balance of retained earnings at the transition date in accordance with IAS 8.

Question for the IASB
Does the IASB agree with the staff recommendation in paragraph 14 of this paper?

Assessing whether the investment is impaired at the transition date

Background

15. At its November 2023 meeting, some IASB members expressed a concern that an investor might be required to recognise an impairment loss (in profit or loss) after restating the carrying amount of the investment at transition date. These members asked the staff to consider whether an investor should be required to assess and recognise any impairment loss at transition date in equity.

Staff analysis

16. The staff consider if there is no indication of impairment at the transition date, requiring the investor to test the investment for impairment would be unnecessary and involve costs without additional benefit.

17. The staff then considered allowing investors to test an investment for impairment at the transition date, when recognising the remaining restricted portion of a gain or loss as an adjustment to the opening balance of retained earnings at transition date. For many investments in associates or joint ventures, a market price will not be available; therefore, an investor would have to assess the recoverable amount using estimates of the associate's future earnings or dividends. However, an investor would have to assess the recoverable amount retrospectively with reference to the conditions existing at the transition date. This assessment would require the use of hindsight. Paragraph 53 of IAS 8 states that hindsight should not be used when applying a new accounting policy to correcting amounts for a prior period.

18. Finally, the staff considered a situation in which an investor or joint venturer had previously tested an investment for impairment at the transition date because of the presence at that date of some of the indicators of impairment in either IAS 28 or IAS 36 *Impairment of Assets*. In this situation, the investor or joint venturer would have estimated the recoverable amount of the investment at the transition date.

19. In this situation, when the investor restates the investment (for instance, to recognise the remaining portion of a restricted gain or loss) on initial application of the proposed requirements, the restated carrying amount of the investment could exceed the recoverable amount estimated by the investor at the transition date. Applying IAS 36, an investor would be required to recognise that impairment loss in profit and loss. Arguably, requiring recognition of that loss in the statement of profit or loss in the period of initial application would not provide a faithful representation of the performance for the period, because the impairment event had occurred earlier.

20. To resolve the possible outcome in paragraph 19 of this paper, the IASB could propose that, after restating the investment at transition date, the investor reduces the carrying amount of the investment to its recoverable amount with the reduction being recognised in retained earnings. Recognition of the impairment loss in retained earnings would apply if, and only if, the investor had previously estimated the recoverable amount at transition date.

21. To illustrate, assume that the proposal to recognise gains and losses in full became effective for the annual reporting period beginning on or after 1 January 2027, so that the transition date is 1 January 2026. Also assume:

    (a) in the investor’s annual financial statements for the period ending 31 December 2025, there is an investment in an associate with a carrying amount of CU1,500;

    (b) at that date, the investor had tested the investment for impairment and determined a recoverable amount of CU1,800; and

(c) at that date, the carrying amount of the investment included (as a deduction) the restricted portion of a gain in a downstream transaction for CU400.

22. Applying the tentative decision in paragraph 2(a) of this paper, the investor would adjust the investment to CU1,900 with the change recognised in retained earnings. Applying the approach described in paragraph 20 of this paper, the investor would compare the adjusted carrying amount with the recoverable amount of the investment estimated at transition date and would reduce the carrying amount by CU100 by recognising an impairment loss as an adjustment in retained earnings at the transition date.

Staff recommendation

23. Based on paragraphs 15–22 of this paper, the staff recommend the IASB propose that, on initial application of the proposed requirements, if an investor or joint venturer had previously estimated the recoverable amount of an investment in an associate or joint venture at the transition date, an investor or joint venturer would reduce the carrying amount to its recoverable amount. An investor or joint venturer would recognise the reduction as an adjustment to the opening balance of retained earnings.

Question for the IASB
Does the IASB agree with the staff recommendation in paragraph 23 of this paper?

Entities presenting more than one period of comparatives

Background

24. In Agenda Paper 13B of the November 2023 IASB meeting, the staff defined the transition date for applying the new requirements to be proposed in the exposure draft as the beginning of the annual reporting period immediately preceding the date of initial application.

25. Some entities may present comparative information for more than one period, on a voluntary basis or because their jurisdiction has legal requirements to present more than one period of comparative information. These entities would need to comply with paragraph 38C of IAS 1 *Presentation of Financial Statements*, which requires such entities to prepare any additional comparative information presented in accordance with IFRS Accounting Standards.

26. At its November 2023 IASB meeting, some IASB members asked the staff to consider the implications for entities that present more than one period of comparative information.

Staff analysis

27. In previous projects, the IASB has set out transitional requirements for entities that present more than one period of comparative information. For example, IFRS 17 *Insurance Contracts* states:

    (a) in paragraph C25 that:

        (i) an entity may also present adjusted comparative information for any earlier period presented, but is not required to do so; and

        (ii) if an entity presents adjusted comparative information for any earlier period, the reference to 'the beginning of the immediately preceding period' shall be read as 'the beginning of the earliest adjusted comparative period presented'; and

(b) in paragraph C27 that, if an entity presented unadjusted comparative information for any earlier period, it should clearly identify the information that had not been adjusted, disclose that it had been prepared on a different basis and explain that basis.

28. Were the IASB to modify the transition date to be the beginning of the earliest period presented and provide relief from adjusting comparative information, paragraph 29 of this paper illustrates the effects for an investor that presents two comparative statements of profit or loss.

29. Assuming that the proposed requirements became effective for the annual reporting period beginning on or after 1 January 2027:

(a) for the tentative decision in paragraph 2(a) of this paper, the investor would be required to present the statement of profit or loss for the current period (year ending on 31 December 2027) and the comparative period (year ending on 31 December 2026) prepared on the same basis. That is both periods would include in full the gains or losses arising from transactions between the investor and its associates and joint venturers. If the investor was presenting comparative information for a third period, it could choose whether to restate the comparative amounts for the period ending on 31 December 2025;

(b) for the tentative decision in paragraph 2(b) of this paper, an investor would be required to measure the liability for contingent consideration at the end of the current period (year ending on 31 December 2027) and the comparative period (year ending on 31 December 2026) and include the change in the fair value of the liability for contingent consideration in profit or loss. It also would be required to measure the liability at the beginning of the comparative period (1 January 2026) and recognise a corresponding adjustment to the carrying amount of the investment. If the investor was presenting comparative information for a third period, it could choose whether to restate the comparative amounts for the period ending on 31 December 2025; and

(c) for the IASB's remaining tentative decisions in this project, the investor would be required to apply the proposed requirements on a prospective basis on transactions occurring or on after 1 January 2026. The investor could choose whether to apply the requirements also to transactions occurring or on after 1 January 2025.

30. The staff would, in general, support requiring all periods to be presented on a comparable basis. As noted in paragraph 10(b) of this paper, for the tentative decision in paragraph 2(a) of this paper, entities should be able to provide the information to recognise the restricted portion of gains or losses at each reporting date. The staff think that the information should be equally available for additional comparative periods presented.

31. Furthermore, in reaching its tentative decision to propose that an investor or joint venturer recognises in full gains or losses on transactions with its associates and joint ventures, the IASB took into consideration the feedback that restricting gains and losses and their subsequent recognition does not provide useful information and creates 'noise' for users of financial statements. The staff think the logical flow from this feedback is not to provide relief for additional comparative information presented.

32. That said, applying the tentative decisions in paragraphs 2(b) and 2(c) of this paper to additional comparative periods presented might require the investor to determine amounts at the date of the transaction that could require the use of hindsight. For example, assume that in the fact pattern in paragraph 28 of this paper, an investor had purchased an additional interest in an associate on 1 April 2025 and had not measured the additional share of the associate's net assets at fair value, as the IASB has tentatively decided to require. If the IASB did not to provide relief, the investor presenting additional comparative information would have to measure these fair values at the date of the purchase (that is, 1 April 2025). Recognising and measuring the investor's additional share of the net assets at fair value would affect the investor's share of profit or loss in the preceding periods. Furthermore, measuring those fair values could be complex and might require the use of hindsight.

33. For the reason explained in paragraph 32 of this paper, the staff think that the IASB should provide transitional relief for entities that present additional comparative information. We have considered a few alternatives:

    (a) **allow** (but do not require) the restatement of additional comparative information presented for the effect of all the proposed requirements;

    (b) **specify** the restatement of additional comparative information presented for the effect of the proposed requirements:

        (i) **require** restatement to recognise the full gains or losses on transactions with associates and joint ventures; and

        (ii) **allow** restatement of the additional comparative information for the effect of the other proposed requirements; or

    (c) **prohibit** the restatement of additional comparative information for the effect of all the proposed requirements. Entities that present additional comparative information would identify them as unadjusted.

34. The first alternative provides relief similar to other IFRS Accounting Standards and is the easiest for entities to apply[3]. However, there would be three categories of entities: those that do not present any additional comparative information, those that present restated additional comparative information and those that present unadjusted additional comparative information.

35. The second alternative extends the rationale used by the IASB in developing the transitional requirements. However, it would involve significant complexity in separating the different requirements for the restatement of the additional comparative information.

[3] Paragraph 53 of IAS 8 would not permit an entity to use hindsight when applying a new accounting policy. The first alternative is not meant to permit the use of hindsight.

36. The third alternative would ensure comparability between all entities that present additional comparative information but would impair comparability between the different periods presented by the same entity. It also would be the least costly to apply because it does not require any adjustment to previously reported amounts.

37. The staff recommend, on balance, the IASB propose the first alternative in the exposure draft. Arguably, comparability between entities is already missing because most entities do not present additional comparative information; therefore, providing a choice to those entities that present additional comparative information does not significantly impair comparability further.

Staff recommendation

38. The staff recommend the IASB propose that an investor or joint venturer that chooses (or is required) to present more than one period of comparative information may present comparative information for any additional prior periods:

    (a) adjusted for the effects of the proposed requirements. The transition date would be the beginning of the earliest adjusted comparative period presented; or

    (b) not adjusted for the effects of the proposed requirements. The investor or joint venturer would identify the comparative information as unadjusted and disclose that comparative information has been prepared on a different basis, explaining that basis.

Question for the IASB
Does the IASB agree with the staff recommendation in paragraph 38 of this paper?

Disclosure of the effects of the adjustments

Background

39. When initial application of an IFRS Accounting Standard has an effect on the current period or any other period, paragraph 28(f) of IAS 8 requires an entity to disclose, for the current period and each prior period presented to the extent practicable, the amount of the adjustment for each financial statement line item affected, and if IAS 33 *Earnings per Share* applies to the entity, for basic and diluted earnings per share.

40. At its November 2023 meeting, some IASB members noted that the IASB has given relief from disclosing the information required in paragraph 28(f) of IAS 8 in other projects and asked the staff to consider whether the same relief should be proposed.

Staff analysis

Effects on the immediately preceding period

41. The IASB's tentative decisions in paragraph 2 of this paper will require an investor to adjust its comparative statements of financial position and its comparative statement of profit or loss. To illustrate, assume that the new requirements became effective for the annual reporting period beginning on or after 1 January 2027 so that the transition date is 1 January 2026.

42. When presenting its annual financial statements for the period ending 31 December 2026, an investor:

    (a) would have restricted a portion of gains or losses arising from upstream and downstream transactions that occurred during the period ending 31 December 2026; and

    (b) would have recognised a portion of restricted gains or losses arising from upstream and downstream transactions that occurred before 1 January 2026.

43. When presenting its annual financial statements for the period of initial application, an investor would be required to adjust its comparatives for the immediately preceding period for the amounts described in paragraph 42 of this paper and determine the adjustment for each financial statement line item affected. As a result, the investor would have the information needed to provide the disclosure required by paragraph 28(f) of IAS 8 in relation to the immediately preceding period.

Effects on the current period

44. To provide the information required by paragraph 28(f) of IAS 8 for the effects on the current period of recognising in full gains or losses arising from downstream and upstream transactions, an investor would need to:

    (a) determine the portion of gains or losses that it would have restricted on transactions occurring during the period, had the entity applied the requirement in paragraph 28 of IAS 28 to restrict the gains or losses on such transactions; and

    (b) determine the portion of unrecognised gains or losses from prior periods that would have been released in the period.

45. An entity would need to maintain separate systems, processes and controls to gather the data needed to prepare the disclosure.

46. In reaching the decision to require recognition in full of gains or losses arising from transactions between an investor and its associates, the IASB also considered that recognition in full of these gains or losses would simplify the accounting and reduce costs for preparers, because they would not be required to gather information to determine the amount of gains or losses to restrict (for example, the investor would not be required to determine if the transferred asset is still recognised in the associate's financial statements or how much the asset has been depreciated).

47. The staff also note that the IASB has granted exemptions from disclosing the information required by paragraph 28(f) of IAS 8 in some IFRS Accounting Standards:

   (a) paragraph C4 of IFRS 15 *Revenue from Contracts with Customers* allowed an entity to omit disclosing the information for the current period and for any additional comparative periods presented;

   (b) paragraph C3 of IFRS 17 exempted an entity from disclosing the information; and

   (c) paragraph 97Y of the Exposure Draft *Financial Instruments with Characteristics of Equity* (Proposed Amendments to IAS 32 *Financial Instruments: Presentation*, IFRS 7 *Financial Instruments: Disclosures* and IAS 1) proposes that an entity is not required to provide the information.

48. Arguably, the effects of the requirements in paragraph 47 of this paper were more significant than the potential effects of the proposed requirements in this project. However, there would still be costs involved and, as noted in paragraph 31 of this paper, the feedback on the restriction (and subsequent reversal of the restriction) of gains or losses from transactions with associates or joint ventures is that it does not provide useful information to users of financial statements. Furthermore, the other proposed requirements apply to transactions that may not occur frequently (such as purchases of additional interests or partial disposals). Therefore, the cost to provide the information is likely to exceed the benefit. The staff therefore recommend the IASB allow entities an exemption from disclosing the information required by paragraph 28(f) of IAS 8 for the current period when first applying the requirements.

Effects on additional prior periods presented

49. As noted above, an entity may present information for additional comparative prior periods. In paragraph 38 of this paper, the staff recommend that an investor or joint venturer be allowed to present unadjusted additional comparative information. Requiring the entity to disclose quantitative information about the effects on that additional comparative period would, in effect, negate the transition relief. Therefore, the staff recommend the IASB allow entities an exemption from disclosing the information required by paragraph 28(f) of IAS 8 for any additional prior period that the entity presents unadjusted.

Staff recommendation

50. The staff recommend the IASB propose an exemption from disclosing the information required by paragraph 28(f) of IAS 8 for the current period and for any additional prior period that the investor or joint venturer presents unadjusted.

Question for the IASB
Does the IASB agree with the staff recommendation in paragraph 50 of this paper?