

STAFF PAPER

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IASB[®] meeting

Project	Equity Method
Paper topic	Partial disposals—how to measure the portion to be derecognised
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Purpose and background of this paper

1. At its June meeting, the International Accounting Standards Board (IASB) continued its discussion, as part of its project on the equity method of accounting, on the application question: *How does an investor apply the equity method when purchasing an additional interest in an associate while retaining significant influence.*
2. To answer this application question the IASB has tentatively decided on a preferred approach which measures the investment in the associate (after having obtained significant influence) as an accumulation of purchases and would apply as follows:
 - (a) an investor purchasing an additional interest in an associate while retaining significant influence:
 - (i) recognises, at the date of purchasing an additional interest, its additional share in the fair value of the associate's net assets; and
 - (ii) measures the cost of that additional interest at the fair value of the consideration transferred.
 - (b) an investor disposing of an interest in an associate while retaining significant influence measures the portion of the carrying amount of the investment to be derecognised 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 (LIFO) method, if the specific portion of the investment being disposed of cannot be identified.
- 3. The IASB asked the staff to explore practical methods of measuring the portion of the carrying amount of an investment in an associate to be derecognised, with the aim of ensuring that the benefit to reporting financial information outweighs the cost to provide and use that financial information.
- 4. The purpose of this paper is to discuss possible practical methods of measuring the portion of the carrying amount of an investment in associate to be derecognised to decide if the IASB should amend its tentative decision at the June 2022 meeting.

Staff recommendation

- 5. The staff recommends the IASB:
 - (a) retains its tentative decision from the June 2022 meeting—an investor applying the preferred approach to a partial disposal, while retaining significant influence, would measure the portion of the carrying amount of an investment in an associate to be derecognised 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 (LIFO) method, if the specific portion of the investment being disposed of cannot be identified.
 - (b) if the IASB decides to proceed to standard-setting, it considers a relief to allow the weighted average method to be used as a practical expedient on transition for an investment in an associate held at the transition date.

Structure of the paper

6. The paper is structured as follows:
 - (a) background (paragraphs 7–11 of this paper);
 - (b) practical alternatives (paragraphs 12–39 of this paper);
 - (c) staff conclusion (paragraphs 40–42 of this paper); and
 - (d) question to the IASB.

Background

7. At its June 2022 meeting, the IASB discussed how an investor would apply the preferred approach when disposing of an interest in an associate while retaining significant influence (a partial disposal). An investor would:
 - (a) recognise the fair value of the consideration received;
 - (b) derecognise a portion of the carrying amount of its investment in the associate;
 - (c) recognise the difference between (a) and (b) as a disposal gain or loss; and
 - (d) reclassify a proportion of amounts recognised in other comprehensive income to profit or loss (paragraph 25 of IAS 28).
8. At its June 2021 meeting, the IASB discussed:
 - (a) principles (which provide a toolbox to help the IASB answer application questions) identified as underlying IAS 28; and
 - (b) the approach to answering application questions that cannot be resolved using the identified principles.¹

¹ June 2021 IASB Board Meeting [AP13: Identifying the principles in IAS 28 Investments in Associates and Joint Ventures \(ifrs.org\)](#)

9. Agenda paper 13A of the June 2022 IASB meeting noted that IAS 28 does not include requirements on how to measure the portion of the carrying amount of the investment in an associate to be derecognised in a partial disposal. The staff considered the requirements in other IFRS Accounting Standards for similar transactions including:
- (a) paragraph 25 of IAS 2 *Inventories* requires to assign cost to inventories, unless they are not ordinarily interchangeable, by using the first-in first-out (FIFO) or weighted average cost formula.
 - (b) paragraph 3.2.13 of IFRS 9 *Financial Instruments* requires that, if the transferred asset is part of a larger financial asset and the part transferred qualifies for derecognition, the previous carrying amount of the larger financial asset shall be allocated between the part that continues to be recognised and the part to be derecognised on the basis of the relative fair values of those parts at the date of the transfer.
10. The staff noted, in agenda paper 13A of the June 2022 IASB meeting, that applying the preferred approach an investor would measure its investment in the associate as an accumulation of purchases after obtaining significant influence. The investor's share of the associate's net assets (and thereby the goodwill included in each layer) are measured by reference to the fair value at the date of each purchase after the investor has obtained significant influence. As a consequence, the staff recommended reflecting the layers in identifying the portion of the carrying amount of an investment in an associate to be derecognised, as set out in paragraph 2.
11. The staff thinks there are limited circumstances, in which an investor can specifically identify the proportion being disposed; examples include the investor purchasing an additional interest and writing a call option on that additional interest or when the shares in the associate are held by different entities in the investor's group.

Practical alternatives

12. In responding to the IASB's request to explore practical alternatives of measuring the portion of the carrying amount of an investment in an associate to be derecognised, the following practical expedients have been considered:
 - (a) measuring the portion of the carrying amount to be derecognised using a weighted average method, if the investor cannot identify the specific portion of the investment being disposed of and cannot apply the LIFO method;
 - (b) requiring the use of a weighted average method (instead of the LIFO method) when the specific portion of the investment being disposed cannot be identified; or
 - (c) allowing an entity an accounting policy choice to be applied consistently to all partial disposals.

13. The staff assessed each of these practical alternatives using the following criteria:
 - (a) how the alternative would affect the relevance and faithful representation of the financial information;
 - (b) how consistent the alternative would be with the preferred approach;
 - (c) whether the alternative would be easier to apply than using a specific identification method or the LIFO method;
 - (d) whether the alternative would reduce the cost to produce the financial information.

Staff analysis

14. The staff analysis continues to use the preferred approach to the example in which the investor purchases an additional interest while retaining significant influence. In this example, the measurement of the portion of the carrying amount of the associate to be derecognised will affect the amount of the disposal gain or loss. If these circumstances do not apply – for example, the investment in the associate has been obtained in a single transaction – any measurement method would result in the same measurement of the portion of the carrying amount to be derecognised.

Alternative—weighted average method if LIFO cannot be applied

15. The staff first considered the use of a weighted average method—if the investor cannot identify the specific portion of the associate being disposed and cannot apply the LIFO method, because the investor lacks the information to do so.
16. Using a weighted average method, if the investor holds a 30% interest in the associate and disposes 6% the investor derecognises $(6/30) = 20\%$ of the carrying amount of the investment in the associate.
17. The analysis of how this alternative meets the criteria in paragraph 13 of this paper, depends on whether the investments in the associate was acquired after the transition date (new investments) or whether the investments in the associate was held at the transition date. This is because an investor may not have the information on individual purchases to apply the LIFO method for investment held at the transition date, whereas if the preferred approach is introduced the investor would retain this information.

New investments

18. If the preferred approach is introduced, an investment in an associate would include different layers and the investor would determine the share of the associate's net assets and goodwill for the original layer (the layer that provided the investor with significant influence) and for each additional layer. The investor would then apply the equity method procedures to carry forward the share of the associate's net assets included in each layer. The share of profit or loss for each layer would include the appropriate adjustments for the measurement differences, for example, for depreciation of the depreciable assets based on their fair values at the acquisition date of each layer.
19. On a partial disposal, an investor applying the LIFO method would need to know the percentage of ownership and the carrying amount of each layer, measured in accordance with paragraph 18.
20. For example, if an investor held a 25% interest when it obtained significant influence, acquired an additional 15% and then disposed 20%, the investor applying the LIFO method would determine that the portion of the investment to be derecognised is the whole additional layer and $(5/25) = 20\%$ of the original layer.
21. If the preferred approach is introduced, it is expected that an investor would retain information on purchases and disposals after the transition date; the investor would therefore be able to measure the carrying amount of the specific portion being disposed of (when the specific portion is identifiable); or apply the LIFO method. As a consequence, the weighted average method would generally not be needed for new investments.
22. Since the weighted average method would generally not be needed, the staff thinks this alternative would have little impact on the criteria in paragraph 13(a) and (b) of this agenda paper.

23. In relation to the criteria in paragraph 13(c) and (d), there is no significant difference in the cost or complexity of applying a weighted average method compared to a LIFO method, when the information is available. A weighted average method would be simpler to apply if the investor had a high number of additions and disposals while the investor retains significant influence, but the staff thinks that this situation would be infrequent. For this reason, the staff thinks that the practical expedient would have little impact on the criteria in paragraph 13(c) and (d) of this paper.

Investments held at the transition date

24. Investments held in associates at the transition date may have been held for long periods of time and an investor may not have information about individual purchases and disposals of the investment in the associate. The investor may not be able, or it may be impracticable for the investor, to determine the carrying amounts of individual layers in the associate's net assets and goodwill as if the investor had always applied the preferred approach. Moreover, the investor may have previously used a different accounting policy for the purchase of additional interests in an associate while retaining significant influence.
25. The staff considers that for these investments the weighted average method alternative could provide a significant reduction of the costs to prepare the financial information.

Conclusion

26. The staff is not recommending this practical alternative for new investments in associates because the benefit would be limited: firstly, it would be rarely used and secondly, having potentially three different methods – the specific identification, the LIFO and the weighted average method – would result in complexity and reduced comparability.
27. The staff is recommending this practical alternative should be considered in developing transitional requirements to the preferred approach if the IASB decides to proceed to standard-setting and introduces the preferred approach.

Alternative—weighted average method

28. The staff then considered whether a weighted average method should be used instead of to the LIFO method, when the investor is not able to use a specific identification method.
29. A weighted average method enables a user of financial statements to understand how the portion of the carrying amount of the investment to be derecognised has been measured, because as explained in paragraph 16 in this paper, the portion is measured as the proportionate share of the carrying amount of the investment.
30. In the analysis presented at the June 2022 IASB meeting, the staff argued that a weighted average method is inconsistent with the layers in the preferred approach. Using the preferred approach when the investor purchases an additional interest in an associate while retaining significant influence a separate layer of the investment is recognised. The inconsistency arises because the weighted average method reflects a view that each share (interest) is part of a pool of identical assets and are interchangeable and therefore ignores the separate layers.
31. The staff acknowledges that an investment in an associate can be viewed by an investor as a single asset and may be managed as such. Furthermore, shares belonging to the same class of share confer the same rights and obligations to the investor and therefore participate equally in providing the investor with significant influence. Possible exceptions include if a portion of the investment is held by a venture capital organisation, or a mutual fund, unit trust or similar entities including investment-linked insurance fund.
32. The staff has considered a pro-rata allocation, which would reflect the view that the investor is disposing of a proportionate share of each layer. A pro-rata allocation method could be used for partial disposals as it acknowledges the existence of separate layers in the preferred approach and results in the same outcome as the weighted average method in accounting for a partial disposal. For example, if the original layer represents 25% and the additional layer represents 10%, in a partial disposal of 7% the investor is viewed as disposing 5% of the original layer and 2% of the additional layer.

33. However, the staff considers that a better representation of the transaction in the example in paragraph 32 is that the investor is disposing part of the additional layer and retains the original layer that provided the investor with significant influence.

Conclusion

34. The analysis presented at the June 2022 IASB meeting was not driven by how an investor manages the investment but the objective of maintaining a consistent rationale in developing solutions to the application questions with the equity method project.
35. The staff considers that the weighted average and pro-rata methods do not meet the criteria in paragraph 13(b) of this paper as they create inconsistencies with other tentative decisions of the IASB on the preferred approach. Therefore the staff is not recommending this alternative.

Alternative— accounting policy choice

36. This alternative would allow an entity to select its accounting policy to measure the portion of the carrying amount of the investment in the associate to be derecognised in a partial disposal. This alternative would codify current practice, as IAS 28 does not include requirements on how to measure the portion to be derecognised in a partial disposal.
37. In relation to the criteria in paragraph 13 of this paper, the staff’s view is that:
- (a) investors are most likely to select an accounting policy that they consider easy to apply and cost-effective;
 - (b) relevance and faithful representation of the information would then depend on the investor’s accounting policy choice; and
 - (c) consistency of the outcome with the preferred approach would also depend on the investor’s policy choice.
38. Permitting an accounting policy choice would not improve comparability between different entities. However, requiring that the accounting policy choice to be applied consistently to all the investor’s investments in an associate would ensure comparability over time.

39. The staff does not see benefit in codifying current practice as this does not meet the project objective of answering application questions.²

Staff conclusion

40. Having considered the alternatives, the staff continues to support the IASB’s tentative decision at its June 2022 meeting as it is consistent with the preferred approach. That said, the staff acknowledges for investments held at the transition date investors may not have the information to apply the LIFO method and therefore transition relief should be considered when, and if, the IASB considered transitional requirements.
41. Whilst the staff continues to support the IASB’s tentative decision at its June 2022 meeting we do plan to ask the Accounting Standards Advisory Forum (ASAF) members for their views on the possible effects of the IASB’s tentative decisions on the application questions. We will report the views of the ASAF members to the IASB at a future meeting.
42. Furthermore, the staff notes that the next stage in the process of this project would be to publish a consultation document. Therefore, the IASB could seek input on the alternatives discussed in the agenda paper as part of that consultation.

Questions to the IASB
<p>Does the IASB agree with the recommendation in paragraph 5 of this agenda paper:</p> <p>(a) to retain its tentative decisions on how to measure the portion of the carrying amount of an investment in associate to be derecognised, when the investor applying the preferred approach disposes of its investment while maintaining significant influence?</p> <p>(b) to consider introducing a relief to allow using the weighted average method as a practical expedient on transition for an investment held at the transition date?</p>

² See [AP13 of the October 2020 IASB Meeting](#) and the [IASB Update October 2020](#)