STAFF PAPER

27 February 2014

Prepared for Capital Markets Advisory Committee Meeting

Project	Equity Method of Accounting		
Paper topic	Project Scope		
CONTACT(S)	Michelle Sansom	msansom@ifrs.org	+44 020 7246 6963

Introduction

1. The Feedback Statement to the International Accountings Standards Board's (IASB) 2011 Agenda Consultation noted:

> The equity method of accounting for some investments is often criticised. Some question whether it provides helpful information to users, while others note the complexities and inconsistencies it creates when it interacts with other requirements in IFRS—such as goodwill impairment, share based payments and joint arrangements. The research project will involve a fundamental assessment of the equity method in terms of its usefulness to investors and difficulties for preparers.

2. As a result the IASB added a research project on the equity method of accounting. In this session we are seeking input from members of the Capital Markets Advisory Committee (CMAC) to help us develop the scope of this research project.

Background

3. The equity method of accounting is required when an entity (investor) has joint control of, or significant influence (associate) over, an investee.

4. The equity method of accounting aims to recognise that investors may conduct business though entities which they do not control (and are therefore outside the group for consolidation purposes) but are able to control jointly or significantly influence the activities of those entities. In these circumstances it is thought that the recognition of dividend income alone does not provide users of financial statements with adequate information about the performance of the investor. Therefore the investor is required to recognise its share of the profit or loss in the investee to provide better information about its net assets and profit or loss.

5. The equity method of accounting:

   (a) Recognises an investment in an associate or a joint venture at cost on acquisition.

   (b) Similar to consolidation procedures, the entity's share of the net assets of the joint venture or associate are adjusted to fair value on acquisition to determine the amount of goodwill, if any.

   (c) The cost is subsequently adjusted to reflect the investor's share of the profits or losses of the associate or joint venture.

   (d) Dividends received are deducted from the carrying amount (that is, the cost plus or minus the investor's share of the profit or losses) of the associate or joint venture.

   (e) The investor's share of profits or losses from transactions between the investor and the associate or joint venture (for example, sales of assets from an associate to an investor) are eliminated.

6. As noted above, in response to its 2011 Agenda Consultation the IASB received comments that the use of the equity method of accounting needed some further consideration. In summary there were two points raised:

   (a) The equity method of accounting lacks a conceptual underpinning and this gives rise to diversity in its application. In part, it was recognised that since the equity method of accounting had been devised significant changes have been made to accounting standards. The lack of conceptual underpinning and the changes in accounting standards are considered to be causing complexity in financial reporting.

(b) Whilst acknowledging the need to review the equity method of accounting, some respondents, did not support a move to a fair value model.

Questions

7. To assist us in developing the scope of this research project, we would appreciate your input on the following questions:

Equity method of accounting
1. When analysing an entity, what information do you consider related to its investments in associates and/or joint ventures? For example, do you consider the share of profits, dividend income, and/or carrying amounts for these investees?
2. Is it important to your analysis that you understand the transactions between the investor and its associate and joint venture entities? If so, why is this information important to you and how do you use if in your analysis?