STAFF PAPER

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IASB Meeting

Project	**Equity Method: Share of Other Net Asset Changes**
Paper topic	Application of the proposals in the Exposure Draft to some specific fact patterns

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Introduction and background

1. In November 2012, the IASB published for comment the Exposure Draft *Equity Method: Share of Other Net Asset Changes* (proposed amendments to IAS 28 *Investments in Associates and Joint Ventures*).[1]

2. Based on the proposals in the Exposure Draft:

   (a) an investor should recognise, in the investor's equity, its share of the changes in the net assets of the investee that are not recognised in profit or loss or other comprehensive income ('OCI') of the investee, and that are not distributions received ('other net asset changes'); and

   (b) the investor should reclassify to profit or loss the cumulative amount of other net asset changes that had previously been recognised in equity when the investor discontinues the use of the equity method.

3. A considerable number of respondents disagreed with the IASB's proposals, for various reasons, but there was no predominant view of how to account for the other changes in share of net assets.

4. In October 2013, the IASB discussed the feedback from respondents on the Exposure Draft and the recommendations of the IFRS Interpretations Committee

[1] http://www.ifrs.org/Current-Projects/IASB-Projects/equity-accounting/Exposure-Draft-November-2012/Documents/ED-Equity-Method-Nov-2012-Web.pdf

(the 'Interpretations Committee'). The IASB directed the staff to conduct more analysis as to whether an investor should recognise its share of other net asset changes of the investee in the investor's profit or loss or OCI. In particular, the IASB directed the staff to include an analysis of how these alternatives are applied to share-based payment transactions.

5. In December 2013, the staff presented four different models as alternatives to the proposals in the Exposure Draft. The IASB observed that each model presented has challenges. The IASB noted that the proposed amendments are a short term solution to address diversity in practice until the IASB revisits the principles of the equity method of accounting. Consequently, the IASB tentatively decided to finalise the amendments based on the proposals in the Exposure Draft, subject to reviewing a further analysis of the application of those requirements to some specific fact patterns to check for any unintended consequences, and accordingly directed the staff to present the analysis.

Staff's analysis

6. In this paper, references to 'associate' should be read to include 'joint venture'. All monetary amounts are denominated in "currency units (CU)".

7. We used the following situations to analyse the application of the proposals in the Exposure Draft.

   (a) Decrease in investor's ownership interest in the associate as a consequence of an issue of ordinary shares by the associate to third parties

   (b) Increase in investor's ownership interest in the associate as a consequence of a buy-back of ordinary shares by the associate from other investors

   (c) Change in the investor's share of the investee's net assets as a consequence of transactions between the investee and non-controlling interests in the investee's subsidiary

(d) Potential ordinary shares or another class of equity

(i) Warrants issued by the associate to third parties

(ii) Preference shares issued by the associate to third parties

(iii) Equity-settled share-based payment by the associate to its employees

8. In preparing the analysis in this paper we reflected on the IASB's discussions in the October and December 2013 meetings, including the views expressed and questions asked by the IASB members. As a consequence, we have included the following facts and considerations in the examples:

(a) In all the situations considered by us, the investor:

(i) accounts for its investment in the investee using the equity method, and continues to classify the investee as an associate after the transaction; and

(ii) originally acquired the ordinary shares of the associate at the time of incorporation of the associate. Consequently, the carrying value of the investor's investment in the associate does not include any fair value adjustments or goodwill.

(b) In the Exposure Draft, the phrases "changes in investor's share of investee's net assets" and "investor's share of changes in investee's net assets" were used interchangeably. The two phrases could convey different meanings. The equity method is defined in IAS 28 as "a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition **change in the investor's share of the investee's net assets**." (Emphasis added). There is a change in the investor's share of the investee's net assets when:

(i) there is a change in the ownership interest of the investor in the investee; and

(ii) without a change in the investor's ownership interest in the investee, there is a change in the net assets of the investee that is attributable to the investor, for example, investee's comprehensive income and other changes in the investee's equity to which the investor has rights.

The proposals in the Exposure Draft are not intended to change the definition of the equity method. Hence, to be consistent with the definition of equity method, we have been consistent in this paper in our use of the phrase "Other Changes in Share of Net Assets" instead of "Share of Other Net Asset Changes". In preparing this paper we have ensured that we applied the definition of the equity method consistently across all examples, including the application of the phrase "change in the investor's share of the investee's net assets".

(c) The examples have been developed to include the associate's OCI balances in order to explain the impact of the proposals in the Exposure Draft on the investor's share of the associate's OCI. Further, the associate's OCI balance includes items of gain or loss that would be required to be reclassified to profit or loss on the disposal of the related assets or liabilities. We have considered the consequences of this for the examples.

(d) In all the examples in this paper, the OCI balance in the statement of financial position of the investor is the investor's share of the associate's OCI resulting from the use of equity method and does not include any other OCI balances of the investor.

(e) In July 2009, the Interpretations Committee noted[2] that reclassification of amounts to profit or loss from other comprehensive income in accordance with paragraph 19A of the superseded version of IAS 28 (as revised in 2003) (corresponds to paragraphs 23 and 25 of IAS 28 (as amended in 2011)) is generally required as part of determining the gain or loss on a disposal of an associate, and that this applies to all reductions in the investor's ownership interest, whatever the cause. These discussions of the Interpretations Committee are relevant to the situation in which the investor's ownership interest in the associate decreases. We have ensured that the examples are consistent with the past discussions of the Interpretations Committee.

[2] [IFRIC Update—July 2009: Potential effect of IFRS 3 *Business Combinations* (as revised in 2008) and IAS 27 *Consolidated and Separate Financial Statements* (as amended in 2008) on equity method accounting The IFRIC staff noted that the FASB's Emerging Issues Task Force (EITF) had added to its agenda EITF Issue No. 08-6 *Equity Method Investment Accounting Considerations*. EITF 08-6 addresses several issues resulting from the joint project by the IASB and FASB on accounting for business combinations and accounting and reporting for non-controlling interest that culminated in the issue of IFRS 3 (as revised in 2008) and IAS 27 (as amended in 2008) and SFAS 141(R) and SFAS 160. At its meeting in May 2009, the IFRIC deliberated how an equity method investee's issue of shares should be accounted for. The IFRIC noted that paragraph 19A of IAS 28 provides guidance on the accounting for amounts recognised in other comprehensive income when the investor's ownership interest is reduced, but the entity retains significant influence. The IFRIC noted that there was no specific guidance on the recognition of a gain or loss resulting from a reduction in the investor's ownership interest resulting from the issue of shares by the associate. However, the IFRIC also noted that reclassification of amounts to profit or loss from other comprehensive income was generally required as part of determining the gain or loss on a disposal. Paragraph 19A of IAS 28 applies to all reductions in the investor's ownership interest, no matter the cause. The IFRIC concluded that the agenda criteria were not met mainly because, given the guidance in IFRSs, it did not expect divergent interpretations in practice. Therefore, the IFRIC decided not to add this issue to its agenda.]

Example 1—Decrease in investor's ownership interest in the associate as a consequence of an issue of ordinary shares by the associate to third parties

9. The following example illustrates the accounting by the investor for a decrease in the investor's ownership interest in the associate as a consequence of an issue of ordinary shares by the associate to third parties.

Facts

P holds 30% of the ordinary shares of M. On 31 December 20X1 M issues 160 additional ordinary shares for CU500. As a consequence of the issue of the additional shares, P's holding in M reduces to 25%. The carrying value of the investment in P's financial statements before the issue of the additional shares by M is CU300. The statement of financial position of M before and after the issue of additional shares is as follows:

	Before transaction CU	After transaction CU
Net assets	1,000	1,500
Equity attributable to equity holders of M		
800 Ordinary shares (nominal value CU1 each)	800	960
Share premium	-	340
Retained earnings	150	150
Other comprehensive income	50	50
	1,000	1,500

Analysis

The issue of additional shares by M resulted in a net increase in P's share of M's net assets by CU75, which is computed as follows:

	CU
Reduction in P's share of M's net assets as a consequence of decrease in P's holding in M from 30% to 25% (CU300 x 5/30)	(50)
Increase in P's share of M's net assets as a consequence of the issue proceeds of the additional shares (CU500 x 25%)	125
Net increase in P's share of M's net assets	75

There are other ways of computing CU75, which are not presented here to avoid confusion.

P records the following journal entry:

	Debit CU	Credit CU
Investment in M	75	
Equity		75

P will also reclassify to profit or loss 5/30 of its cumulative share of M's OCI. Cumulative balance of M's OCI accounted by P using the equity method is CU15 (CU50 x 30%). The amount reclassified to profit or loss as a consequence of reduction in P's holding in M is CU3 (CU15 x 5/30) and based on the IFRIC's discussions in July 2009 (see paragraph 8(e)) P records the following journal entry:

	Debit CU	Credit CU
OCI	3	
Profit or loss		3

The cumulative balances relating to P's investment in M in the statement of financial position of P before and after the decrease in ownership interest are as follows:

Statement of financial position	Before CU	Change CU	After CU
Assets			
Investment in associate	300	75	375
Equity attributable to equity holders of P			
Retained earnings	45	3	48
Other comprehensive income	15	(3)	12
Other changes in share of associate's net assets	-	75	75

In the income statement, P will recognise a gain of CU3 as a consequence of reclassification of a proportionate amount of OCI.

Example 2—Increase in investor's ownership interest in the associate as a consequence of a buy-back of ordinary shares by the associate from other investors

10. The following example illustrates the accounting by the investor for an increase in the investor's ownership interest as a consequence of a buy-back of ordinary shares by the associate from other investors.

Facts

P holds 30% of the ordinary shares of M. On 31 December 20X1 M buys back 114 ordinary shares from other investors for CU300. As a consequence of the buy-back, P's holding in M increases to 35%. The carrying value of the investment in P's financial statements before the buy- back of the shares by M is CU300. The statement of financial position of M before and after buy-back of shares is as follows:

	Before transaction	After transaction
	CU	CU
Net assets	1,000	700
Equity attributable to equity holders of M		
800 Ordinary shares (nominal value CU1 each)	800	800
114 Treasury shares (nominal value CU1 each)	-	(300)
Retained earnings	150	150
Other comprehensive income	50	50
	1,000	700

Analysis

The buy-back of shares by M resulted in a net decrease in the value of P's share of M's net assets by CU55, which is computed as follows:

	CU
Reduction in P's share of M's net assets as a consequence of consideration paid for buy-back of ordinary shares (CU300 x 30%)	(90)
Increase in P's share of M's net assets as a consequence of increase in P's holding in M from 30% to 35% (CU700 x 5%)	35
Net decrease in P's share of M's net assets	(55)

There are other ways of computing CU55, which are not presented here to avoid confusion.

P records the following journal entry:

	Debit CU	Credit CU
Equity	55	
Investment in M		55

The cumulative balances relating to P's investment in M in the statement of financial position of P before and after the increase in the ownership interest are as follows:

Statement of financial position	Before CU	Change CU	After CU
Assets			
Investment in associate	300	(55)	245
Equity attributable to equity holders of P			
Retained earnings	45	-	45
Other comprehensive income	15	-	15
Other changes in share of associate's net assets	-	(55)	(55)

Unlike the first example on dilution of ownership interest, there is no adjustment to the investor's share of the associate's OCI balance in this example, which is consistent with the accounting for acquisition of ownership interest in an associate for the first time or any subsequent acquisition of ownership interest for cash.

Example 3—Change in the investor's share of the investee's net assets as a consequence of transactions between the investee and non-controlling interests in the investee's subsidiary

11. The following example illustrates the accounting by the investor for a change in the investor's share of the investee's net assets without a change in the investor's ownership interest in the investee as a consequence of transactions between the investee and non-controlling interests in the investee's subsidiary.

Facts

P holds 30% of the ordinary shares of M. The carrying value of the investment in M as at 31 December 20X0 in P's financial statements is CU276. M has a subsidiary in which M has 70% ownership interest. M's consolidated profit and OCI attributable to the owners of M for the year 20X1 are CU200 and CU50 respectively. Profit attributable to the NCI in M's subsidiary for 20X1 is CU10.

On 31 December 20X1, M acquires an additional 20% ownership interest from the non-controlling interests ('NCI') in its subsidiary for CU70. The carrying value of the 20% ownership interest in M's subsidiary is CU60. There is no OCI in the financial statements of M's subsidiary.

The movement in retained earnings of M is as follows:		20X1
	CU	CU
Opening balance of retained earnings		100
Profit for the year attributable to the owners of M		200
Change in the proportion held by NCI		
- Consideration paid by M	70	
- Reduction in the carrying value of NCI	(60)	
Excess amount paid to NCI directly recognised in equity		(10)
Closing balance of retained earnings		290

The statements of financial position of M as at 31 December 20X0 and 20X1 are as follows:

	As at 31 December	
	20X0	20X1
	CU	CU
Net assets	1,000	1,190
Equity attributable to equity holders of M		
800 Ordinary shares (nominal value CU1 each)	800	800
Retained earnings	100	290
Other comprehensive income	20	70
	920	1,160
Non-controlling interests	80	30
Total equity	1,000	1,190

Analysis

There is no change in the ownership interest of P in M because of the transaction between M and the NCI in M's subsidiary. However, there is a change in the amount of M's net assets that are attributable to P. P recognises the following changes in its share of M's net assets for 20X1:

	20X1 CU
Opening balance of P's investment in M	276
Share of M's profit (CU200 x 30%)	60
Share of M's OCI (CU50 x 30%)	15
Other changes in P's share of M's net assets (CU10 x 30%)	(3)
Closing balance of P's investment in M	348

The cumulative balances relating to P's investment in M in the statements of financial position of P as at 31 December 20X0 and 20X1 are as follows:

	31 December		
Statement of financial position	20X0 CU	Change CU	20X1 CU
Assets			
Investment in associate	276	72	348
Equity attributable to equity holders of P			
Retained earnings	30	60	90
Other comprehensive income	6	15	21
Other changes in share of associate's net assets	-	(3)	(3)

Potential ordinary shares or another class of share capital issued by the associate

12. A consistent challenge throughout this project has been to determine how an associate's transactions in potential ordinary shares or other classes of share capital issued by the associate should be accounted for by the investor. The associate's share-based payment transactions are the most common example. There is a view that the investor should account for its share of all potential ordinary shares (classified as equity under IAS 32 *Financial Instruments: Presentation*) issued by the associate in the investor's equity. This is because this

would reflect the potential dilution from these transactions, and accounting for the potential dilution provides relevant information for the investor's shareholders. It is important to note that although such instruments reduce the ownership interest of the investor in the associate when converted, they may not always dilute the 'value' of the investor's ownership interest.

13. A question that arises for accounting purposes is whether the investor is entitled to a share in the proceeds from the issue of such instruments. In other words, should a portion of the issue proceeds of potential ordinary shares be attributed to the investor?

14. Although there is no explicit guidance in IFRSs on the classification of instruments within equity and the attribution of net assets to each class of share capital, there is some guidance in the following standards:

    (a) IAS 1 *Presentation of Financial Statements* requires disclosures for each class of share capital;

    (b) IAS 28 requires the investor, while computing its share of profit or loss of the investee, to adjust for dividends, whether or not declared, on cumulative preference shares held by parties other than the investor and are classified as equity;

    (c) IAS 33 *Earnings per Share* requires attribution of earnings to different classes of share capital for the purpose of computing earnings per share.

    (d) Further, analogy may be drawn to the guidance in IFRS 3 *Business Combinations* and IFRS 10 *Consolidated Financial Statements* on recognition of NCI. Non-controlling interest is defined as "the equity in a subsidiary not attributable, directly or indirectly, to a parent" (IFRS 10 Appendix A). Potential ordinary shares or another class of shares issued by the subsidiary to third parties are recognised as NCI by the parent in its consolidated financial statements.

15. Potential ordinary shares carry contractual rights and restrictions that may be different from ordinary shares. These instruments may not give its holder current access to the returns associated with an ownership interest. Consequently, the

investor may or may not have rights over the proceeds of the potential ordinary shares issued by the associate to third parties depending upon:

(a) the terms of issue of the potential ordinary shares, for example, when will the potential ordinary shares give to the holder access to the returns associated with an ownership interest? When this occurs, this would represent a dilution of ownership interest for the ordinary shareholder.; and

(b) the laws in the jurisdiction in which the associate is incorporated; how do such laws affect the investor's rights to a share in the issue proceeds of potential ordinary shares.

16. When the investor does not have rights to the proceeds from the issue of potential ordinary shares or other class of equity instruments, we think that the definition of equity method, and by analogy to the guidance on NCI, lead us to conclude that no share of the proceeds should be allocated to the investor.

17. We have applied this approach, along with the proposals in the Exposure Draft to the following examples.

Example 4—Warrants issued by the associate to third parties

Facts

P holds 30% of the ordinary shares of M. The carrying value of the investment in M in P's financial statements is CU300. On 31 December 20X1 M issues 160 warrants, which are classified as equity, to third parties for CU0.2 per warrant which is their fair value. The terms of issue of the warrants are as follows:

- The warrants have a term of 1 year.
- The warrants convert into 160 ordinary shares.
- The proceeds from the issue of the warrants are not attributable to the ordinary shareholders until conversion or expiry of the exercise period.
- The warrant holders are not entitled to a proportionate share of M's net assets in the event of liquidation prior to conversion.
- The warrant holders are required to pay a further consideration of CU2 per warrant on conversion of warrants into ordinary shares.

- If the warrant holders do not exercise their right to require M to convert the warrants into ordinary shares, no amount is refunded to the warrant holders.

On conversion of warrants into ordinary shares, P's holding in M reduces to 25%. M's profit and OCI for the year 20X2 are CU180 and CU40 respectively. The statement of financial position of M before and after issue of warrants, and after conversion of warrants is as follows:

	As at 31 December		
	20X1		20X2
	Before issue CU	After issue CU	After conversion CU
Net assets	1,000	1,032	1,572
Equity attributable to equity holders of M			
Ordinary shares (nominal value CU1 each)	800	800	960
Share warrants	-	32	-
Share premium	-	-	192
Retained earnings	150	150	330
Other comprehensive income	50	50	90
	1,000	1,032	1,572

Analysis

The warrants represent equity in the associate attributable to the warrant holders. Consequently, P will not have a share in the issue proceeds of the warrants prior to the conversion. Hence, P will not account for the change in M's net assets because there is no change in P's share of M's net assets as at 31 December 20X1.

For the year 20X2, P recognises its share of M's profit or loss of CU54 (CU180 x 30%) and its share of M's OCI of CU12 (CU40 x 30%). Consequently the carrying value of P's investment in M as on 31 December 20X2 before accounting for change in P's ownership interest in M because of conversion of warrants is CU366 (CU300 + CU54 + CU12).

On 31 December 20X2, when the warrants are converted into ordinary shares, there is a net increase of CU27 in P's share of M's net assets, which is computed as follows:

	CU
Reduction in P's share of M's net assets as a consequence of decrease in P's holding in M from 30% to 25% (CU366 x 5/30)	(61)
Increase in P's share of M's net assets as a consequence of the proceeds from the warrants on issue and on conversion (CU352 x 25%)	88
Net increase in P's share of M's net assets	27

P will also reclassify its share of M's OCI to profit or loss to the extent of CU5 ((CU90 x 30%) x 5/30) based on the IFRIC's discussions in July 2009 (see paragraph 8(e)).

The carrying value of P's investment in M increases from CU300 as at 31 December 20X1 to CU393 as at 31 December 20X2 on account of P's share of M's profit or loss for 20X2 of CU54, P's share of M's OCI for 20X2 of CU12 and other changes in P's share of M's net assets of CU27.

The cumulative balances relating to P's investment in M in the statement of financial position of P before and after the issue of the warrants and after conversion of warrants are as follows:

	As at 31 December			
	20X1		20X2	
	Before issue CU	After issue CU	Change CU	After conversion CU
Assets				
Investment in associate	300	300	93	393
Equity attributable to equity holders of P				
Retained earnings	45	45	59	104
Other comprehensive income	15	15	7	22
Other changes in share of associate's net assets	-	-	27	27

In the above example, if the warrants lapsed unexercised, then the proceeds received from the issue of the warrants become attributable to the ordinary shareholders. Consequently, P's net assets attributable to M would change by CU9.6 although P's ownership interest in M does not change. P would account for CU9.6 (CU32 x 30%) in its equity, which represents other change in P's share of M's net assets.

Example 5—Preference shares (classified as equity) issued by the associate to third parties

Facts

P holds 30% of the ordinary shares of M. On 31 December 20X1 M issues 500 preference shares, which are classified as equity, to other investors for CU1 each. The terms of issue of the preference shares are as follows:

- The preference shares have a nominal value of CU1 each.
- The preference shares give their holders a right to a preferential dividend in priority to the payment of any dividend to the holders of ordinary shares.
- Upon liquidation of M, the holders of the preference shares are entitled to receive out of the assets available for distribution the amount of CU1 per share in priority to the holders of ordinary shares. The holders of the preference shares do not have any further rights on liquidation.

The carrying value of the investment in P's financial statements before issue of preference shares by M is CU300. The statement of financial position of M before and after issue of preference shares is as follows:

	Before issue CU	After issue CU
Net assets	1,000	1,500
Equity attributable to equity holders of M		
Ordinary shares (nominal value CU1 each)	800	800
Preference shares (nominal value CU1 each)	-	500
Retained earnings	150	150
Other comprehensive income	50	50
	1,000	1,500

Analysis

P does not have a right over the preference shares of CU500 since it represents equity attributable to the preference shareholders. Consequently, there is no change in P's share of M's net assets, and P will not account for its share of the issue proceeds of preference shares.

18. The examples illustrate that the investor does not account for its share of the proceeds from the issue of the potential ordinary shares or other class of share capital by the associate to third parties if the resultant changes in the equity of the investee are not attributable to the investor.

Applicability to share-based payment transaction

19. We think that the approach illustrated above for warrants issued by the associate to third parties, would also apply to accounting for equity-settled share-based payments of the associate. The investor will record its share of the share-based payment expense when it recognises its share of the associate's profit or loss. However, applying the same approach as illustrated above for warrants, the investor will not recognise a share of the credit recorded in the associate's equity during the vesting period. This is because the equity component of the share-based payment transaction represents equity attributable to the counterparty in the share-based payment transaction. This view is also supported by the Basis for Conclusions in IFRS 2 *Share-based payment* on accounting for share options that are forfeited or lapse after the end of the vesting period. Paragraph BC219 of IFRS 2 is reproduced below.

> The lapse of a share option at the end of the exercise period does not change the fact that the original transaction occurred, ie goods or services were received as consideration for the issue of an equity instrument (the share option). The lapsing of the share option does not represent a gain to the entity, because there is no change to the entity's net assets. In other words, although some might see such an event as being a benefit to the remaining shareholders, it has no effect on the entity's

financial position. **In effect, one type of equity interest (the share option holders' interest) becomes part of another type of equity interest (the shareholders' interest). The Board therefore concluded that the only accounting entry that might be required is a movement within equity, to reflect that the share options are no longer outstanding (ie as a transfer from one type of equity interest to another)**. (Emphasis added)

20. The following example illustrates the accounting by the investor for equity-settled share-based payment by the associate to its employees.

Example 6—Facts

P holds 30% of the ordinary shares of M. The carrying value of P's investment in M in P's financial statements as at 31 December 20X0 is CU600. On 1 January 20X1 M issued 200 share options to its employees with the following terms:

- Each grant is conditional upon the employee working for M over the next 2 years. The options have to be exercised as soon as they vest.
- The employees are not entitled to a proportionate share of M's net assets in the event of liquidation prior to the exercise of the options.
- The employees are required to pay an exercise price of CU2 per share on exercise of the options.
- M shall not vary the terms of the options in any manner detrimental to the interests of the option holders.

M estimated that the fair value of each share option is CU1.5, and 90% of the options will vest. On 31 December 20X2, 80% of the options vested, and 75% of the options are exercised. M recognises the following amounts during the vesting period, for services received as consideration for the share options:

Year	Calculation	Expense for the year CU	Cumulative equity CU
1	200 options x 90% x CU1.5 x 1/2 years	135	135
2	(200 options x 80% x CU1.5 x 2/2 years) – 135	105	240

M transfers CU15 (CU240 x 5/80) directly to retained earnings in respect of options that are not exercised.

M issues 150 ordinary shares and receives cash of CU300 on exercise of options. M records ordinary share capital of CU150 and share premium of CU375, which is the total of premium (CU150) paid on exercise of options and the cumulative grant date fair value of the options exercised (CU225) recognised during the vesting period. P's holding in M reduces to 27% on issue of ordinary shares to the employees.

M's profit and OCI for the year 20X1 are CU300 and CU20 respectively, and for the year 20X2 are CU200 and CU30 respectively. The statements of financial position of M as at 31 December 20X0, 20X1 and 20X2 are as follows:

	As at 31 December		
	20X0 CU	20X1 CU	20X2 CU
Net assets	2,000	2,455	3,090
Equity attributable to equity holders of M			
Ordinary shares (nominal value CU1 each)	1,350	1,350	1,500
Share options	-	135	-
Share premium	-	-	375
Retained earnings	500	800	1,015
Other comprehensive income	150	170	200
	2,000	2,455	3,090

Analysis

The share options represent associate's equity that is attributable to the employees as holders of the options. Consequently, there is no change in M's net assets that are attributable to P, and P will not account for its share of the share options prior to exercise.

P recognises the following changes in its share of M's net assets for the 2 years:

	20X1 CU	20X2 CU
Opening balance of P's investment in M	600	696
Share of M's profit (CU300 x 30% for 20X1) (CU200 x 30% for 20X2)	90	60
Share of M's OCI (CU20 x 30% for 20X1) (CU30 x 30% for 20X2)	6	9
Other changes in P's share of M's net assets		
- Stock options not exercised (CU15 x 30%)	-	5
- Net increase in P's share of M's net assets as a consequence of issue of shares by M on exercise of share options (see below)	-	64
Closing balance of P's investment in M	696	834

The net increase of CU64 is computed as follows:

	CU
Reduction in P's share of M's net assets as a consequence of decrease in P's holding in M from 30% to 27% (CU770 x 3/30)	(77)
Increase in P's share of M's net assets as a consequence of the proceeds from the share options on issue and on conversion (CU525 x 27%)	141
Net increase in P's share of M's net assets	64

P will also reclassify its share of M's OCI to profit or loss to the extent of CU6 ((CU200 x 30%) x 3/30) based on the IFRIC's discussions in July 2009 (see paragraph 8(e)).

The cumulative balances relating to P's investment in M in the statements of financial position of P as at 31 December 20X0, 20X1 and 20X2 are as follows:

	As at 31 December				
	20X0	20X1		20X2	
		Change		Change	After exercise
	CU	CU	CU	CU	CU
Assets					
Investment in associate	600	96	696	138	834
Equity attributable to equity holders of P					
Retained earnings	150	90	240	66	306
Other comprehensive income	45	6	51	3	54
Other changes in share of associate's net assets	-	-	-	69	69

21. This approach is different from the manner in which the proposals in the Exposure Draft were applied to share-based payment transaction in the December 2013 staff paper because there was an assumption in the staff paper that the investor generally recognises its share of all changes in the associate's equity, and when the investor recognises a share of the credit recorded in associate's equity, the appropriate place to record it was equity. However, in this paper we have additionally considered whether the investor has a share in the movements in the associate's equity. Consequently, we think that changes in the associate's net assets that are not attributable to the investor are not recognised by the investor.

Support for the above approach from some respondents

22. In the Exposure Draft, one of the questions on which the IASB invited comments is as follows:

> The IASB proposes to amend IAS 28 so that an investor should recognise its share of other net asset changes of the investee in the investor's equity. Do you agree? Why or why not?

23. While the respondents did not question whether the investor should recognise other net asset changes of the investee, about one quarter of the respondents highlighted the need to understand and analyse the situations in which the investee's net assets could change and accordingly determine the most appropriate accounting treatment. Those respondents were not supportive of a single accounting treatment for all other changes in the investee's net assets.

24. While most of the respondents commented on the accounting for a deemed disposal and an indirect acquisition, some respondents[3] explicitly commented that the investor should not account for call options issued by the investee for the following reasons:

    (a) The increase in net assets arising from the issue of call options to third parties is not attributable to the investor.

    (b) Based on the requirements of paragraph 12 of IAS 28 that the investor's ownership interest in the investee should be determined solely on the basis of existing ownership interests, it is appropriate to recognise the effect of dilution of call options on exercise of the right to receive shares.

25. We think that the examples and the analysis above are responsive to the above comments that were received on the Exposure Draft.

[3] Grant Thornton International Limited, Israel Accounting Standards Board, KPMG IFRG Limited, The Japanese Institute of Certified Public Accountants, Accounting Standards Council Singapore, Deloitte Touche Tohmatsu Limited, Ernst & Young Global Limited, Financial Executives International Canada, European Financial Reporting Advisory Group, Swiss Holdings

Staff's conclusions

26. Based on the above examples, we think that the tentative decision of the IASB to require the investor to recognise other changes in share of net assets in equity does not give rise to unintended consequences.

27. However, we note that the following additional aspects of equity method are relevant and important to the application of the proposed amendments.

    (a) An investor in an associate should recognise only the changes in its share of the associate's net assets. Consequently, if there are changes in net assets of the associate that are not attributable to the investor, the investor should not recognise a share of those changes.

    (b) When there is a reduction in the investor's ownership interest in the associate, the Interpretations Committee previously discussed that the proportionate amount of OCI should be reclassified to profit or loss irrespective of the cause of that reduction in the ownership interest. We think that this requirement of IAS 28 is already clear and independent of the other issues being considered. Consequently, we do not see a reason to amend this requirement.

Application of these conclusions to a subsidiary accounted for using the equity method by the parent in its separate financial statements

28. In the December 2013 meeting, some members of the IASB asked the staff to assess the impact of the proposals in this Exposure Draft on the Exposure Draft *Equity Method in Separate Financial Statements (*proposed amendments to IAS 27). The specific question was, whether the proposals when applied to an investment in subsidiary accounted for using the equity method in the separate financial statements of a parent would provide results that are different from the consolidated financial statements of the parent.

29. We think that the proposals in the Exposure Draft, when applied to an investment in subsidiary accounted for using the equity method in the separate financial statements of a parent, will provide consistent results as the consolidated financial statements of the parent for the following reasons:

    (a) Changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions in the parent's consolidated financial statements. The parent recognises directly in equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the parent.

    (b) Any potential ordinary shares or another class of share capital issued by the subsidiary to third parties are classified by the parent as non-controlling interests and the parent accounts for its share of issue proceeds of such instruments only to the extent of change in its share of subsidiary's equity.

Staff's recommendations

30. We recommend the following:

    (a) minor edits to the proposed amendments in paragraph 10 of IAS 28, to maintain consistency with the definition of the equity method.

        (i) See Appendix A for the proposed edits marked for changes from the current standard; and

        (ii) See Appendix B for the proposed edits marked for changes from the Exposure Draft.

    (b) include the following illustrative examples in IAS 28 demonstrating the accounting for changes in the investor's share of the investee's net assets:

        (i) Change in the investor's share of the investee's net assets as a consequence of the investee issuing additional ordinary shares to third parties (example 1 of this paper);

(ii) Equity-settled share-based payment by the investee to its employees (example 6 of this paper); and

(iii) Change in the investor’s share of the investee’s net assets as a consequence of transaction between the investee and non-controlling interests in the investee’s subsidiary (example 3 of this paper).

Questions to the IASB

1. Is the IASB satisfied that the proposals in the Exposure Draft do not give rise to unintended consequences, on the basis of the above examples?

2. Does the IASB agree to finalise the amendments on the basis of the proposals in the Exposure Draft, subject to the proposed edits to ensure consistency of the amendments with the focus on the “change in the investor's share of the investee's net assets” in the definition of the equity method?

Appendix A

Recommended edits to paragraph 10 of IAS 28 marked for changes from the current standard

Paragraphs 10, 22, 23, 25 and the heading before paragraph 25 are amended. Paragraph 45A is added. New text is underlined and deleted text is struck through.

Equity method

10 Under the equity method, an investor initially recognises its ~~on initial recognition the~~ investment in an associate or a joint venture ~~is recognised~~ at cost. Thereafter, ~~and~~ the carrying amount is increased or decreased to recognise changes in the investor's share of the investee's net assets ~~share of the profit or loss of the investee after the date of acquisition.~~ in the following manner:

(a) The investor's share of the investee's profit or loss is recognised in the investor's profit or loss.

(b) The investor's share of the investee's components of other comprehensive income is recognised in the investor's other comprehensive income (see IAS 1 *Presentation of Financial Statements*). Such changes include those arising from the remeasurements of the net defined benefit liability (asset), from the revaluation of property, plant and equipment and from foreign exchange translation differences.

(c) Distributions received from an investee reduce the carrying amount of the investment. Such distributions include dividends in cash or other assets and returns of invested capital.

(d) The changes in the investor's share of the investee's net assets arising from changes in the equity of the investee that are attributable to the investor, other than profit or loss or other comprehensive income and distributions received, are recognised in the investor's equity. Those changes include:

 (i) changes in the equity of the investee that result in a change in the investor's ownership interest in the investee, as a consequence of, for example, the issue of additional shares to third parties or the buy-back of shares from third parties by the investee, or the issue of shares by the investee on exercise of share options granted by the investee under an equity-settled share-based payment; and

 (ii) changes in the equity of the investee that do not result in a change in the investor's ownership interest in the investee, but are attributable to the investor, such as, share options granted by the investee under an equity–settled share-based payment that lapse unexercised, or transactions between the investee and the non-controlling interests in the investee's subsidiary.

~~Adjustments to the carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's other comprehensive income. Such changes include those arising from the revaluation of property, plant and equipment and from foreign exchange translation differences. The investor's share of those changes is recognised in the investor's other comprehensive income (see IAS 1 *Presentation of Financial Statements*).~~

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Appendix B

Recommended edits to paragraph 10 of IAS 28 marked for changes from the proposed amendments in the Exposure Draft Equity Method: Share of Other Net Asset Changes

The changes from the Exposure Draft are marked up in red ink.

Paragraphs 10, 22, 23, 25 and the heading before paragraph 25 are amended. Paragraph 45A is added. New text is underlined and deleted text is struck through.

Equity method

10 Under the equity method, an investor initially recognises its ~~on initial recognition the~~ investment in an associate or a joint venture ~~is recognised~~ at cost. Thereafter, ~~and~~ the carrying amount is increased or decreased to recognise changes in the investor's share of the investee's net assets ~~share of the profit or loss of the investee after the date of acquisition.~~ in the following manner:

(a) The investor's share of the investee's profit or loss is recognised in the investor's profit or loss.

(b) The investor's share of the investee's components of other comprehensive income is recognised in the investor's other comprehensive income (see IAS 1 *Presentation of Financial Statements*). Such changes include those arising from the remeasurements of the net defined benefit liability (asset), from the revaluation of property, plant and equipment and from foreign exchange translation differences.

(c) Distributions received from an investee reduce the carrying amount of the investment. Such distributions include dividends in cash or other assets and returns of invested capital.

(d) The changes in the investor's share of the investee's net assets ~~changes~~ arising from changes in the equity of the investee that are attributable to the investor, other than profit or loss or other comprehensive income and distributions received, ~~is~~ are recognised in the investor's equity. Those changes include:

(i) changes in the equity of the investee that result in a change in the investor's ownership interest in the investee, as a consequence of, for example,~~. Examples of such changes include those arising from movements in the share capital of the investee (for example, when an investee~~ the issue~~s~~ of additional shares to third parties or the buy~~s-~~back of shares from third parties by the investee, or the issue of shares by the investee on exercise of share options granted by the investee under an equity-settled share-based payment~~)~~; and

(ii) changes in the equity of the investee that do not result in a change in the investor's ownership interest in the investee, but are attributable to the investor, such as, share options granted by the investee under an equity–settled share-based payment that lapse unexercised, or transactions between the investee and the non-controlling interests in the investee's subsidiary ~~movements in other components of the investee's equity (for example, when an investee accounts for an equity-settled share-based payment transaction)~~.

~~Adjustments to the carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's other comprehensive income. Such changes include those arising from the revaluation of property, plant and equipment and from foreign exchange translation differences. The investor's share of those changes is recognised in the investor's other comprehensive income (see IAS 1 *Presentation of Financial Statements*).~~

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