Equity Method: Share of Other Net Asset Changes

Background

1 In November 2012, the IASB published ED/2012/3 *Equity Method: Share of Other Net Asset Changes* ('the ED'). The ED dealt with the issue of how an investor should account, under the equity method, for its share of the changes in the net assets of an investee that are not recognised in profit or loss or other comprehensive income of the investee, and are not distributions received ('other net asset changes'). Such changes may arise when the investee issues additional shares or buys back shares from third parties. They may also arise when an investee accounts for an equity settled share-based payment transaction.

2 The ED proposed that an investor should recognise directly in equity – that is outside of profit or loss, or other comprehensive income – its share of other net asset changes. In addition, the ED proposed reclassification to profit or loss of the cumulative amount that the investor previously recognised directly in equity when the investor discontinues the use of the equity method.

3 EFRAG and most other constituents did not support the ED. However, the IASB is proposing to finalise the amendments on the same basis as they were included in the ED on the grounds that the proposed amendments will reduce diversity in practice and are a return to previous practice.

4 EFRAG still has significant concerns regarding the amendments. In particular, the amendments contradict a key principle of IAS 1 *Presentation of Financial Statements*: that all non-owner changes in equity are presented in comprehensive income. This principle that was only introduced in 2007. The proposals are also not consistent with the notion of a 'group' as defined in IFRS 10 *Consolidated Financial Statements.*

Objective of the session

5 The objective of this session is to discuss the issues arising from the introduction of a new category of recyclable equity transactions.

Responses to the Exposure Draft

ASAF members

6 As shown in the table below a majority of ASAF members (in comment letters to the IASB and/or EFRAG) did not support the proposals. Of those that expressed support, most expressed concerns regarding the proposals.

Member/representative	**Support the ED on recognising directly in equity?**	**Support recycling if recognised directly in equity?**
Chinese Accounting Standards Committee	Yes	Yes
Accounting Standards Committee of Germany	Yes – it is a short term solution	Yes
United Kingdom Financial Reporting Council	Yes – its pragmatic	No
Canadian Accounting Standards Board	No	Yes – if recognising directly in equity
Accounting Standards Board of Japan	No	No

Asian-Oceanian Standard Setters Group	No	No
Australian Accounting Standards Board	No	No
Group of Latin American Standard Setters	No	No
Hong Kong Institute of Certified Public Accountants	No	No
Spanish Accounting and Auditing Institute	No	–
Pan African Federation of Accountants		
South African Financial Reporting Standards Council		
United States Financial Accounting Standards Board		

Overall responses to the ED

7 According to the IASB's comment letter analysis approximately three-quarters of those commenting on the ED did not support the proposed requirements at all.

8 Approximately one-eighth of respondents supported the proposed requirements and a further one-eighth supported recognising other net asset changes directly in equity, but did not support the proposed recycling requirements.

IASB decision to proceed with the amendments

9 The IFRS Interpretations Committee ('Interpretations Committee') recommended that the IASB not proceed on the basis set out in the ED, but instead revert to the Interpretations Committee's preferred option which involved different accounting treatments depending on how the other net asset changes came about:

(a) changes in net assets that result in reductions/increases in the investor's ownership interest would be accounted for as partial disposals (through profit and loss) and incremental purchases (recognised at cost), respectively; and

(b) call option transactions entered into by an investee over its own equity would be excluded from the scope of the amendment.

10 The IASB staff made an alternative proposal that other net asset changes be recognised in other comprehensive income.

11 The IASB discussed the issue at its meetings in October and December 2013. In October 2013, the IASB tentatively rejected the following options:

(a) aborting the project, because of the need to address existing diversity in practice;

(b) proceeding with the IASB's proposal in the Exposure Draft, because of a number of concerns about departing from current IFRS literature; and

(c) proceeding with the Interpretations Committee's original proposal to the IASB, because it does not address call option transactions entered into by an investee over its own equity (such as share-based payments).

12 The IASB staff was directed 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 other comprehensive income. In particular, the IASB directed the staff to include an analysis of how these options are applied to share-based payment transactions.

13 In December 2013, the IASB continued its discussions and acknowledged that a number of respondents were concerned that the proposals would cause a departure from some other aspects of current IFRS literature. At the meeting the IASB discussed four different models (see the Appendix) as alternatives to the proposals in the ED, but observed that each model had challenges for the accounting of other net asset changes.

14 The IASB tentatively decided to finalise the amendments on the basis of the proposals in the ED because they were a short-term practical solution to address diversity in practice until the IASB revisits the principles of the equity method.

The 2007 amendments to IAS 1

15 Prior to the 2007 amendments to IAS 1, standards such as IAS 39 *Financial Instruments: Recognition and Measurement* (available-for-sale investments) and IAS 16 *Property, Plant and Equipment* (revaluation model) required items that met the definition of income and expense to be recognised 'directly in equity', but to be disclosed separately from transactions with owners.

16 Subsequent amendments to other standards following from the 2007 amendments to IAS 1 replaced requirements to recognise 'directly in equity' with a requirement to recognise 'in other comprehensive income'.

17 Paragraph IN6 of IAS 1 sets out the key principle:

IAS 1 requires an entity to present, in a statement of changes in equity, all owner changes in equity. All non-owner changes in equity (ie comprehensive income) are required to be presented in one statement of comprehensive income or in two statements (a separate income statement and a statement of comprehensive income). Components of comprehensive income are not permitted to be presented in the statement of changes in equity.

EFRAG's concerns

18 EFRAG is concerned that the proposed amendments reintroduce a category of transactions that are recognised 'directly in equity' (with recycling), which was deliberately eliminated in 2007 and replaced by a requirement to recognise such amounts in OCI.

19 In our view, introducing a third way of reporting performance (in addition to recognition in profit or loss and OCI), is a step that should not be taken as a practical expedient in the context of a narrow-scope amendment. Rather it requires a solid conceptual underpinning to avoid that the category is used inconsistently by the IASB and to deal with the risk that users might need a 'third' performance statement in the future.

20 For these reasons, we are against the way the IASB intends to finalise the proposals.

Appendix

Accounting treatment for other net asset changes	Proposed by	Reason rejected
Deemed acquisitions and disposals	Interpretations Committee	It does not address call option transactions entered into by an investee over its own equity (such as share-based payment). It would also add further complexity due to the non-symmetrical approach between a reduction and an increase in the investor's ownership interest.
Investor's other comprehensive income with recycling on discontinuation of the equity method	The IASB staff at the July 2013 Interpretations Committee meeting	Conceptually flawed and would create a new category of OCI. Dilution gains and losses from call options would be temporarily deferred in OCI until they are exercised whereas other changes in net assets would be recycled from OCI only when the equity method is discontinued.
Deemed acquisitions and disposals except for call option transactions (which would be accounted for through the investor's other comprehensive income)	IASB staff	It would combine the problems of both the Interpretations Committee proposal and the IASB staff proposal.
Investor's profit or loss	Second choice of the Interpretations Committee and Alternative view (of Mr Ochi) in the original ED	Other net asset changes in an investee do not meet the definition of income and expenses. Gains or losses may also not reflect the economics of transactions (e.g. gain as a result of the investee issuing a warrant at fair value).