STAFF PAPER

March 2014

IASB Meeting

Project	**Equity Method: Share of Other Net Asset Changes**
Paper topic	Other decisions and summary of due process followed

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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]

Summary of the proposed amendments to IAS 28

2. Paragraph 3 of IAS 28 defines the equity method 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".

3. As a result of a consequential amendment to IAS 28 made as part of the 2007 revision to IAS 1 *Presentation of Financial Statements*, paragraph 10 of IAS 28 is unclear on the accounting for changes in the investor's share of the investee's net assets other than the investor's share of the investee's comprehensive income or distributions received ('other changes in the investor's share of the investee's net assets').

4. Consequently, the IASB proposed to require an investor to:

   (a) recognise, in the investor's equity, the other changes in the investor's share of the investee's net assets; and

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

(b) reclassify to profit or loss the cumulative amount of those other changes previously recognised in equity, when the investor discontinues the use of the equity method.

5. The IASB proposed that an entity should apply the proposed amendments to IAS 28 retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Outcome of the IASB's redeliberations

6. The comment letter analysis prepared by the staff was discussed at the July 2013 meeting of the IFRS Interpretations Committee ('Interpretations Committee'). The comment letter analysis and the recommendations of the Interpretations Committee were discussed by the IASB in the October 2013 meeting, and the IASB directed the staff to present an analysis of the application of the proposals in the Exposure Draft to some specific fact patterns to check for any unintended consequences.

7. The staff presented its analysis in the December 2013 and February 2014 meetings of the IASB. The IASB was satisfied that the staff's analysis of the proposed amendments did not reveal any unintended consequences, and tentatively decided to proceed with the finalisation of the amendment.

8. The purpose of this paper is to:

   (a) consider the comments received on the transition requirements of the proposed amendments;

   (b) assess whether the proposed amendments can be finalised or need to be re-exposed before finalisation;

   (c) discuss the mandatory effective date of the final amendment;

   (d) explain the steps in the due process taken by the IASB until now (see Appendix) and seek confirmation from the IASB of satisfactory compliance with the due process requirements so far; and

   (e) seek the approval of the IASB for commencing the ballot process and ask if any IASB member intends to dissent from the final amendment.

Staff analysis and recommendations

9. In this paper, references to 'associate' should be read to include 'joint venture'.

Comments on the transition requirements

10. The Exposure Draft proposed that entities should apply the proposed amendments retrospectively. 22 out of 78 respondents[2] were concerned about retrospective application. Respondents disagreed with the retrospective application of the proposals on the following grounds:

    (a) Potential costs incurred in reassessing transactions already accounted for may well exceed the benefits, especially for investors that have investees with frequent equity transactions and more complex group structures.

    (b) Adjusting the effects of past transactions would provide very limited benefit to the users of the financial statements who are more concerned with the current and future performance of the entity.

    (c) Retrospective application would result in double counting because other changes in the investor's share of the investee's net assets would be reclassified to equity on first application of the amendment and then would be reclassified to profit or loss again when the investor ceases to use the equity method.

    (d) The proposals in the Exposure Draft are meant to address the diversity in practice in the short term and that these are not based on conceptual principles. Consequently, preparers should not be burdened with retrospective application of the proposed amendments.

    (e) Prospective application would be consistent with the other proposed narrow-scope amendments such as ED/2012/6 *Sale or Contribution of*

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[2] Roche Group, Hong Kong Association of Banks, The Swedish Financial Reporting Board, KPMG, Accounting Standards Board of Japan, Japan Foreign Trade Council, Asian-Oceanian Standard-Setters Group, The Japanese Institute of Certified Public Accountants, Korea Accounting Standards Board, Accounting Standards Council of Singapore, Deloitte Touche Tohmatsu, Porsche Automobil Holding SE, Ernst & Young, Telefonica, Petrobras, Accounting Standards Board of Canada, CINIF, GLASS, BusinessEurope, ACTEO, Hong Kong Institute of Certified Public Accountants, and BDO.

Assets between an Investor and its Associates or Joint Venture and ED/2012/7 *Acquisition of an Interest in a Joint Operation*.

11. We understand the concerns and views expressed by the respondents. We think that the following are the likely consequences of retrospective application of the proposals in the Exposure Draft to the transactions in the periods prior to the earliest period presented in the financial statements of the investor in which the proposed amendments are adopted:

    (a) For indirect decreases in the investor's ownership interest in the investee that were accounted for by the investor as a sale of a proportionate share of the investment, retrospective application will result in a reallocation within equity with no change in the total equity at the beginning of the earliest period presented.

    (b) For indirect increases in the investor's ownership interest in the investee that were accounted for by the investor as purchase of a proportionate share of the investment, the investor would:

        (i) eliminate any goodwill and fair value adjustments recognised in the carrying value of the investment from those transactions;

        (ii) reverse any excess of the investor's share of the net fair value of the investee's identifiable assets and liabilities over the cost of the investment that was recognised in profit or loss;

        (iii) recalculate the change in the investor's share of the investee's net assets for all those transactions and adjust the carrying value of the investment in the associate with the corresponding adjustment to equity; and

        (iv) unwind the fair value adjustments to the investor's share of the investee's profit or loss recognised in profit or loss after those transactions

        The above adjustments would result in a change in the carrying value of the investment in the associate and the equity as at the beginning of the earliest period presented.

(c) For the other changes in the investee's net assets that are not attributable to the investor but accounted for by the investor, the investor would reverse these amounts by increasing/decreasing the carrying value of the investment with a corresponding adjustment to equity.

12. Some preparers may possess all the information required for retrospective application of the proposed amendments whereas some preparers may have to incur costs in terms of time and resources to assimilate the information. The costs could be significant if the investor has many investments in associates or the investments were held for a long period, or the associate has frequent equity transactions.

13. We recommend that entities should be required to apply the proposed amendments to IAS 28 prospectively to the other changes in the investor's share of the investee's net assets occurring in the annual periods beginning on or after the effective date of the final amendment. Early application of the final amendment should be permitted. This is consistent with the transition requirements in the forthcoming final amendments to IFRS 10 and IAS 28 *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*.

Finalisation or re-exposure

14. According to the due process requirements, the IASB essentially needs to consider whether the revised proposals include any fundamental changes on which respondents have not had the opportunity to comment because they were not contemplated.

15. The IASB has tentatively decided to make two changes from the original proposals in the Exposure Draft.

(a) First, to clarify that an investor in an associate should recognise only the changes in its share of the associate's net assets. In other words, 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. This clarification is needed to maintain consistency between paragraphs 3 and 10 of IAS 28. The IASB tentatively decided to finalise the proposed amendments with this recommendation.

(b) Secondly, the recommendation in this paper to change the transition requirements from retrospective application to prospective application of the proposed amendments.

16. Both the above recommendations are based on comments from the respondents and extensive analysis of the implications and likely effects of the proposed amendments. The first recommendation is only a clarification and not a fundamental change from the Exposure Draft. Consequently, we think that a re-exposure is not needed and the proposed amendments to IAS 28 should be finalised.

Mandatory effective date of the final amendment

17. According to the due process requirements, a mandatory effective date is set so that jurisdictions have sufficient time to incorporate the new requirements into their legal systems and those applying IFRS have sufficient time to prepare for the new requirements.

18. This is a narrow-scope amendment with the objective of reducing diversity in practice as quickly as possible. Accordingly, we think that the mandatory effective date should be set as early as possible, while considering the fact that jurisdictions have sufficient time to prepare for the new requirements.

19. We expect to publish the final amendments in Q2 of 2014. We recommend that the mandatory effective date be set at 1 July 2015.

Confirmation of due process steps and compliance

20. The due process steps followed by the staff so far and the actions taken are documented in the Appendix. The due process steps applicable so far have been completed.

Intention to dissent

21. In February 2014, when the IASB tentatively decided to finalise the proposed amendments, three members of the IASB voted against the finalisation of the proposed amendment. We formally ask if any IASB member intends to dissent from the final amendment before we ballot.

Questions for the IASB
1. Does the IASB agree that the proposed amendments should be applied prospectively? 2. Does the IASB agree that the proposed amendments to IAS 28 should be finalised without re-exposure? 3. Does the IASB agree with 1 July 2015 as the mandatory effective date for the final amendment? 4. Is the IASB satisfied that all due process steps applicable so far have been complied with? 5. Do any IASB members intend to dissent from the final amendment?

Appendix

Due Process Steps for the Finalisation of a Standard, Practice Guidance or Conceptual Framework chapter

A1. The following table sets out the action taken against each of the due process steps applicable so far to the proposed amendments to IAS 28.

Step	*Required/ Optional*	*Actions*
Consideration of information gathered during consultation		
The IASB posts all of the comment letters that are received in relation to the ED on the project pages.	Required if request issued	All comment letters that the IASB received on the ED were posted on the project webpage.
Round-tables between external participants and members of the IASB.	Optional	Not required as this is a narrow-scope project.
IASB meetings are held in public, with papers being available for observers. All decisions are made in public sessions.	Required	The comment letter analysis prepared by the staff was discussed at the July 2013 meeting of the IFRS IC, and the October 2013 meeting of the IASB. The consequences of the application of the proposals in the ED were discussed in the December 2013 and February 2014 meetings of the IASB to check for unintended consequences. The IASB tentatively decided to finalise the amendment. The project webpage contains full description and up-to-date information including the staff papers and links to the relevant sections of the IASB Update and the IFRIC Update. The staff papers were posted in a timely fashion.
Analysis of likely effects of the forthcoming Standard or major amendment, for example, costs or on-going associated costs.	Required	Sine this is a narrow scope project and the consequences are expected to be limited, the staff believes that an effect analysis is not necessary. However, the IASB considered the effect of the proposed amendment on the costs of applying the amendment at the time of transition, which is documented in the staff papers.
Email alerts are issued to registered recipients.	Optional	Not required as this is a narrow-scope project.
Outreach meetings to promote debate and hear views on proposals that are published for public comment.	Optional	Not required as this is a narrow-scope project.
Regional discussion forums are organised with national standard-setters and the IASB.	Optional	Not required as this is a narrow-scope project.

Step	*Required/ Optional*	*Actions*
Finalisation		
Due process steps are reviewed by the IASB.	Required	The IASB will review the due process steps in this meeting.
Need for re-exposure of a Standard is considered.	Required	The IASB will consider the need for re-exposure in this meeting. The staff recommends finalisation of the amendment (refer to the analysis in this paper).
The IASB sets an effective date for the Standard, considering the need for effective implementation, generally providing at least a year.	Required	The IASB will discuss the mandatory effective date for the final amendment in this meeting. The staff recommends 1 July 2015 (refer to the analysis in this paper).