IFRS

STAFF PAPER

December 2021

Emerging Economies Group

Project	**Equity Method**	
Paper topic	Project Update	

CONTACT(S)	Filippo Poli	fpoli@ifrs.org
	Michelle Fisher	mfisher@ifrs.org
	Hazirah Hasni	hhasni@ifrs.org

Introduction

1. In this session, the Emerging Economies Group (EEG) members are provided with an update of the International Accounting Standard Board's (IASB) Equity Method research project.

Structure of the paper

2. The paper is structured as follows:

   (a) project background and update;

   (b) application questions within the scope of the project;

   (c) question for EEG members; and

   (d) Appendix—principles identified as underlying IAS 28.

Project background and update

3. The equity method of accounting has been long established in IFRS Standards. IAS 28 *Accounting for Investments in Associates and Joint Ventures* was originally issued in 1989 and later revised in 2003 and 2011. Over time application questions

have been raised on the equity method, some of which resulted in amendments by the IASB and agenda decisions by the IFRS Interpretations Committee (Committee).

Objective and approach of the project

4. At its October 2020 meeting, the IASB discussed the objective and approach of the Equity Method research project. The IASB decided that the objective of the Equity Method research project is:

> To assess whether application questions with the equity method, as set out in IAS 28 *Investments in Associates and Joint Ventures*, can be addressed in consolidated and individual financial statements by identifying and explaining principles in IAS 28.[1]

5. The IASB decided that to achieve the objective, it would apply the following approach:

   (a) identify application questions and decide which of these questions to include in the scope of the project; and

   (b) address the application questions by identifying and explaining the principles that underlie IAS 28.

Process for identifying application questions within the scope of the project

6. At its March 2021 meeting, the IASB agreed on a process for selecting application questions for consideration in the project.[2]

7. The staff applied the selection process to a list of application questions identified from previous submissions to the Committee, past work of the IASB and other activities.

8. Applying the criteria in the selection process, the staff excluded some application questions with recurrent themes. The staff plans to make the IASB aware of these

[1] October 2020 IASB meeting [AP13: Project objective and approach (ifrs.org)]

[2] March 2021 IASB meeting [AP13: Project update and next steps (ifrs.org)]

questions, so the IASB can consider whether these questions warrant extending the scope of the project.

9. The staff consider the selection of application questions to be an iterative process. As the project progresses, it may be that solutions can be found to application questions that have been excluded or conversely solutions found could raise new questions. Therefore, the staff will continue to reassess the application questions included in the scope of the project.

10. At its October 2021 meeting, the IASB was presented with the application questions identified as within the scope of the project based on the criteria agreed with the IASB.[3] The application questions are presented in paragraphs 20–27 of this paper.

Process for identifying the principles in IAS 28

11. At its June 2021 meeting, the IASB discussed the principles identified by the staff as underlying IAS 28 (included in the Appendix to this paper).[4] The objective of identifying the principles is to provide the IASB with a toolbox that can help the IASB to address the selected application questions. The principles themselves will not address the application questions. The staff anticipates the principles will enable the IASB to address application questions and thereby identify possible amendments to IAS 28.

12. The staff identified the principles by reviewing the requirements in IAS 28, as well as the relevant paragraphs in its Basis for Conclusions. The staff first grouped the requirements in IAS 28 by topic. For each group of requirements, the staff then identified its underlying principle. To formulate some of the principles the staff also had to consider the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*) and the requirements in other IFRS Standards.

13. Having completed the analysis, the staff has identified circumstances that IAS 28 does not address. The staff refers to these circumstances as ‘missing principles’.

[3] October 2021 IASB meeting AP13: Application questions selected and proposed next steps (ifrs.org)

[4] June 2021 IASB meeting AP13: Identifying the principles in IAS 28 Investments in Associates and Joint Ventures (ifrs.org)

14. The staff's analysis did not assess whether the principles are mutually consistent. Some stakeholders have commented that the requirements in IAS 28 are based on inconsistent perspectives on the nature and purpose of the equity method.

15. The staff encountered difficulties in identifying underlying principles when the application problems involve the interaction of the requirements in IAS 28 with other IFRS Standards, such as IFRS 3 *Business Combinations* and IFRS 10 *Consolidated Financial Statements*. The staff's initial research has indicated that this may be because significant changes were made to accounting for the acquisition of a subsidiary and consolidation procedures by the Business Combinations project completed in 2008 and Consolidation project completed in 2011, and it is not clear how some of these changes affect IAS 28. In particular, paragraph 26 of IAS 28 states that:

> Many of the procedures that are appropriate for the application of the equity method are similar to the consolidation procedures described in IFRS 10. Furthermore, the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for the acquisition of an investment in an associate or a joint venture.

For example, remeasurement of a retained or pre-existing interest in an investee is a fundamental principle in IFRS 3 and IFRS 10 but it is not clear how this principle is applied to equity method investment in the scope of IAS 28.

16. At its October 2021 meeting, the IASB decided the staff should research the implications of differences between the principles in IAS 28 and those in other IFRS Standards relating to business combinations and consolidation before considering the application questions.

17. The staff will bring the research findings to a future IASB meeting.

Application questions within the scope of the project

18. Applying the criteria agreed with the IASB the staff has identified and grouped the application questions by topic, in paragraphs 20–27 of this paper.

19. For simplicity, the application questions refer to associates and joint ventures accounted for applying IAS 28 as‘investees’ when describing the application question.

Increases and decreases in an investor’s interest without a change in significant influence

20. There are two application questions in the scope of the project for this topic:

    (a) paragraph 32 of IAS 28 requires an investor to measure its share of the investee’s identifiable assets and liabilities at their fair value at the date significant influence is obtained. The application question arising is when the investor increases its interest in the investee without a change in significant influence:

        (i) if and how does the investor measure the additional share of the investee’s net assets; and

        (ii) if the investor’s additional share of the investee’s identifiable net assets is measured at an amount different from the consideration paid, how does the investor account for the difference.

    (b) an investee may issue shares to other investors resulting in a dilution of the investor’s interest. The application question is how to present the change in the measurement of the investor’s interest from various events that do not affect significant influence.

Recognition of losses

21. Applying paragraphs 38–39 of IAS 28, when an investor’s interest in its investee is reduced to zero, the investor discontinues recognising its share of further losses. It resumes recognising its share of profit only after its share of profit equals the share of losses not recognised. The following application questions are related to paragraphs 38–39 of IAS 28.

    Whether an investor that has reduced its interest in an investee to nil:

(a) is required to 'catch up' unrecognised losses if it purchases an additional interest in the investee. The staff notes that to address this question, the IASB will need to address how to account for increases in an investor's interest without a change in significant influence (see paragraph 20 of this paper).

(b) continues eliminating its share of gains arising from a downstream transaction.

(c) recognises each component of comprehensive income separately. For example, in a financial year, an investee recognises a loss in comprehensive income that includes, a profit in its statement of profit and loss, and a loss in its statement of other comprehensive income.

Transactions between investor and associate

22. Applying paragraph 28 of IAS 28, an investor is required to eliminate its share of gain or loss in an upstream and downstream transaction with an investee. The following application questions are related to paragraph 28 of IAS 28:

(a) in a downstream transaction, whether to recognise the portion of the investor's share of gain that exceeds the carrying amount of its investment in the investee.

(b) in an upstream transaction, whether the investor's share of gain or loss is eliminated from the carrying amount of the investment in the investee or the acquired asset.

(c) if the provision of service and transactions that are not transfer of assets are upstream or downstream transaction.

(d) how should an investor account for gains and losses that arise from the sale of a subsidiary to an investee given the conflicting requirements between IFRS 10 and IAS 28. In a transaction where an investor sells a subsidiary to its investee, paragraph 25 of IFRS 10 requires the investor to recognise in full the gain or loss from the sale of a subsidiary, remeasuring any retained interest whereas paragraph 28 of IAS 28 requires an investor to eliminate the gain or loss to the extent of the retained interest in the former subsidiary.

Transactions between two associates

23. Paragraph 26 of IAS 28 states that procedures appropriate for the application of the equity method are similar to the consolidation procedures described in IFRS 10. The application question is whether the adjustment of gains and losses in intra-group transactions between subsidiaries should be applied by analogy to transactions between investees under the equity method.

Share of other changes in net assets

24. The application question is whether an investor recognises its share of the investee's other changes in net asset as result of transactions other than distributions received, and if so, how the investor's share of other changes in net assets is presented.

Impairment

25. According to paragraph 41B of IAS 28, in assessing impairment of the net investment in an investee, a decline in fair value of the investee may be evidence of impairment when considered with other available information. The application question seeks clarification as to whether the decline in fair value is assessed in relation to the original purchase price or the carrying amount at the reporting date.

Initial recognition

26. Paragraph 32 of IAS 28 requires an investor to recognise its share of the fair value of the investee's net assets at the date significant influence is obtained. The application question is whether the investor recognises deferred tax assets and liabilities on the differences between the fair value and the tax base of its share of the investee's net assets.

Contingent consideration

27. IAS 28 does not provide specific guidance in accounting for contingent consideration arising on the acquisition of an investee. The application question seeks clarification on the initial and subsequent accounting for contingent consideration in the acquisition of an investee applying IAS 28. In practice, paragraph 39 of IFRS 3 is commonly referenced as paragraph 26 of IAS 28 states that the application of the equity method is similar to the consolidation procedures, and IFRS 3 provides guidance on the initial recognition and subsequent measurement for contingent consideration arising on the acquisition of subsidiaries.

Question for EEG members

Question for EEG members
Do EEG members have any comments on: (a) the interaction of IAS 28 with Business Combinations project completed in 2008 and Consolidation project completed in 2011; and (b) the application questions identified in this paper?

Appendix—Principles identified as underlying IAS 28

	Principles identified	Paragraph
Classification		
A	Power to participate is an investor's shared power to affect changes in, and to access net assets.	IAS 28.3 *Definition* IAS 28.5-9 IAS 28.12–14
Boundary of the reporting entity		
B	Application of the equity method includes an investor's share in the associate's or joint venture's net asset changes in an investor's statement of financial position.	IAS 28.3 *Definition* IAS 28.10-11 IAS 28.35
C	An investor's share of an associate's or joint venture's net assets is part of the reporting entity.	IAS 28.28
Measurement on initial recognition		
D	Fair value at the date that significant influence or joint control is obtained provides the most relevant information and faithful representation of an associate's or joint venture's identifiable net assets.	IAS 28.30–31B IAS 28.32 IFRS 3 BC25/198
Subsequent measurement		
E	An investor recognises changes in an associate's or joint venture's net assets. An investor recognises the share of changes in net assets that it can currently access.	IAS 28.3 *Definition* IAS 28.10–13 IAS 28.26 IAS 28.28 IAS 28.30–31B IAS 28.33–36 (includes 35) IAS 28.37
F	An investor's maximum exposure is the gross interest in an associate or joint venture.	IAS 28.14A/29/38–43
G	When an investor has a decrease in its ownership interest in an associate or joint venture and continues to apply the equity method, it reclassifies amounts previously recognised in other comprehensive income.	IAS 28.24–25

Principles identified		Paragraph
Derecognition		
H	An investor: (a) applies IFRS 3 and IFRS 10 if it obtains control of an associate or joint venture; (b) applies IFRS 9 if it no longer has significant influence or joint control but retains an interest in a former associate or joint venture; and (c) recognises a gain or loss and reclassifies amounts recognised in other comprehensive income on the date that significant influence or joint control is lost.	IAS 28.22–23 IFRS 3.41–42
Unallocated (not being addressed in the project)		
Presentation		IAS 28.15/20–21
Exceptions to the application of the equity method		IAS 28.16–19 IAS 28.27 IAS 28.36A