IASB meeting

Date	**December 2022**
Project	**Equity Method research project**
Topic	**Application question – Recognition of losses and components of comprehensive income**
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Purpose of this paper

1. The purpose of this paper is to ask the International Accounting Standards Board (IASB) whether an investor that has reduced its interest in an investee to zero recognises each component of comprehensive income separately.

Structure of the paper

2. The paper is structured as follows:

   (a) description of the application question;

   (b) staff analysis and recommendation;

   (c) extending the application question; and

   (d) questions to the IASB.

Description of the application question

3. Paragraph 38 of IAS 28 *Investments in Associates and Joint Ventures* requires that, if an entity's share of losses equals or exceeds its interest in the associate, the entity discontinues recognising its share of further losses. The interest in the associate includes any long-term interests that in substance form part of the net investment in the associate.

4. Paragraph 39 of IAS 28 requires that, after the entity's interest is reduced to zero, additional losses are provided for, and a liability is recognised, only to the extent that the entity has incurred a legal or constructive obligation or made payments on behalf of the associate. If the associate subsequently reports profits, the entity resumes recognising its share of those profits only after its share of profits equals the share of losses not recognised.

5. Paragraph 82 of IAS 1 *Presentation of Financial Statements* requires an entity to present the share of the profit or loss from associates in the profit or loss section of the statement of comprehensive income (or the separate statement of profit or loss); and paragraph 82A of IAS 1 requires an entity to present the share of other comprehensive income of associates in the other comprehensive income section.

6. The application question in paragraph 1 of this paper concerns a fact pattern in which:

   (a) an investor has reduced its net investment in the associate to zero; and

   (b) the associate subsequently reports a loss (or a profit) in profit and loss, and an income (or an expense) in other comprehensive income, with the loss exceeding the income.

7. For example, assume that entity E has reduced its investment in associate A to zero. In the following period, entity E's share of losses in the associate is 150CU and entity E's share of the associate's income in other comprehensive income is 100CU. Entity E does not have a legal or constructive obligation to make payments on behalf of the associate.

8. A question arises as to whether the investor recognises:

   (a) nothing; or

   (b) a share of loss of 100CU and a share of income in other comprehensive income of 100CU, with no change to the carrying amount of the net investment in the associate.

Staff analysis and recommendation

Recognition of the share of profit and loss and other comprehensive income

9. The staff thinks that the first step in answering the application question is to clarify whether the requirements in paragraph 38 of IAS 28 apply to the investor's share of changes in the associate's other comprehensive income.

10. Requirements on recognising and discontinuing recognition of the investor's share of losses in the associate are included in paragraphs 10 and 38 of IAS 28 respectively. Paragraph 10 refers to the investors share of changes in the associate's other comprehensive income such as revaluation of property, plant and equipment or foreign exchange translation differences, while paragraph 38 refers to the investor's share of losses. It could be argued that losses presented in other comprehensive income can be recognised after the investor's interest in the associate has been reduced to zero.

11. In the staff's view an investor should recognise its share of comprehensive income (whether presented in profit and loss or other comprehensive income); when its share equals or exceeds its interest in the associate, the investor discontinues recognising its share of further losses.

12. The staff recommends the IASB proposes to clarify that an investor recognises its share of comprehensive income until its interest in the associate is reduced to zero, and additional losses are provided for, and a liability is recognised, only to the extent that the investor has incurred a legal or constructive obligation or made payments on behalf of the associate.

Conceptual Framework–Profit or loss and other comprehensive income

13. The application question addresses recognition and presentation of items in different sections of comprehensive income. The staff thinks that it is helpful to refer to the presentation and disclosure of income and expense in the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*).

14. Paragraph 7.16 of the Conceptual Framework states that the statement of profit or loss is the primary source of information about an entity's financial performance. Further paragraph 7.16 notes many users of financial statements incorporate the total for profit or loss in their analysis either as a starting point for that analysis or as the main indicator of the entity's financial performance.

15. For this reason, paragraph 7.17 of the *Conceptual Framework* states all income and expenses are to be included, in principle, in the statement of profit or loss. However, the Board may decide in exceptional circumstances that income or expenses arising from a change in the current value of an asset or liability are to be included in other comprehensive income when doing so would result in the statement of profit or loss providing more relevant information or a more faithful representation of the entity's financial performance.

16. In 2011, the IASB issued *Presentation of Items in Other Comprehensive Income (Amendments to IAS 1)* and introduced paragraph 82A to require an entity to present amounts of other comprehensive income, including the share of the other comprehensive income of associates. In 2014, the IASB issued *Disclosure Initiative (Amendments to IAS 1)* to clarify the application of paragraph 82A.

Principles underlying IAS 28

17. At the June 2021 meeting, the IASB discussed the principles that have been identified as underlying the requirements in IAS 28[1]. The principles provide the IASB with a toolkit that can help in analysing the application questions and developing solutions.

18. In relation to the application question in paragraph 1 above, the staff thinks that principles E and F are relevant to the analysis:

    (a) Principle E—An investor recognises changes in an associate's net assets. An investor recognises the share of changes in net assets that it can currently access;

    (b) Principle F—An investor's maximum exposure is the gross interest in an associate.

[1] See Agenda Paper 13 *Identifying the principles in IAS 28* Investments in Associates and Joint Ventures of the June 2021 IASB meeting and IASB Update June 2021

19. Principle E and F combined would suggest that an investor recognises its share of the changes in the associate's net assets, unless this results in recognising losses that exceed the investors net investment in the associate.

Staff recommendation

20. Applying IAS 1 when the carrying amount of the net investment in the associate exceeds zero, an investor recognises and presents separately its share of profit or loss and its share of other comprehensive income.

21. By adding paragraph 82A to IAS 1, the IASB concluded that disaggregating information in profit or loss and other comprehensive income provides relevant information, including an investor's share in the associate's comprehensive income.

22. The staff recommends that in the fact pattern in paragraph 6 of this paper, an investor that has reduced its interest in an associate to zero recognises its share of each component of comprehensive income separately. That is an investor recognises and presents in accordance with IAS 1 two items of the same amount (one positive and one negative).

23. The recommendation would provide users of financial statements with information about the investor's share in the associate's comprehensive income and its disaggregation, while not recognising losses the investor has no liability for.

24. If no amount was recognised, an investor would need to monitor its share of unrecognised losses and amounts recognised in other comprehensive income to apply the requirement in paragraph 39 of IAS 28. For this reason, the staff considers that there is no additional cost associated with the staff recommendation.

Extending the application question

25. There is a similar fact pattern where a question arises on how to apply the requirements in paragraph 38 of IAS 28, in which:

    (a) the investor's share of the associate's profit or loss and changes in the associate's other comprehensive income are both negative (comprehensive losses); and

    (b) the sum of the two exceeds the carrying amount of the investment in the associate.

26. Assume that entity E has an investment in associate A with a carrying amount of 100CU. At the end of the reporting period, entity E's share of losses in the associate amounts to 80CU and entity E's share of changes in the associate's other comprehensive income amounts to (40CU). Does the investor recognise:

    (a) 80CU in profit or loss and 20CU in other comprehensive income, leaving a share of changes in the associate's other comprehensive income unrecognised for 20CU;

    (b) 60CU in profit or loss and 40CU in other comprehensive income, leaving a share of losses unrecognised for 20CU; or

    (c) some other combination of total comprehensive income of 100CU?

27. IAS 28 does not specify an order in which the investor should recognise the components of total comprehensive income.

28. Material from accounting firms acknowledges that different approaches are acceptable, and that the choice of the approach could be based on whether the timing of the expense in other comprehensive income can be determined.

29. The IASB explained in paragraph BC7.17 of the *Basis for Conclusion of the Conceptual Framework* that it is not possible to produce a robust conceptual definition of profit or loss or other comprehensive income. The two statements do not have a separate objective. However as noted earlier in this paper the IASB explained that:

    (a) the profit or loss is the primary source of information about an entity's financial performance in the reporting period;

    (b) in principle, all income and expense are included in the statement of profit or loss;

    (c) in exceptional circumstances, the IASB may decide that income and expenses arising from changes in the current value of an asset are to be included in other comprehensive income, when doing so would result in the statement of profit or loss providing more relevant information or providing more faithful representation of the entity's financial performance for that period; and

    (d) income and expenses that arise on a historical cost measurement basis are included in the statement of profit or loss.

30. Based on the above, the staff thinks that losses in profit and loss would be recognised before losses in other comprehensive income.

31. The staff recommends the IASB proposes that in the fact pattern in paragraph 22 of this paper, the investor recognises first its share of the associate's profit and loss; and second its share of the associate's other comprehensive income until its interest in the associate is reduced to zero.

32. Paragraph 22(c) of IFRS 12 *Disclosure of Interests in Other Entities* requires an investor to disclose the unrecognised share of losses of a joint venture or associate, both for the reporting period and cumulatively if the entity has stopped recognising its share of losses of the joint venture or associate when applying the equity method.

Questions to the IASB
Does the IASB agree with the staff recommendations that: 1) an investor recognises its share of comprehensive income until its interest in the associate is reduced to zero. Additional losses are provided for, and a liability is recognised, only to the extent that the investor has incurred a legal or constructive obligation or made payments on behalf of the associate (paragraph 12 of this paper); 2) an investor that has reduced its interest in an associate to zero recognises its share of each component of comprehensive income separately. That is an investor recognises and presents in accordance with IAS 1 two items of the same amount (one positive and one negative) (paragraph 22 of this paper); and 3) in the circumstance an investor's share of comprehensive income in an associate is negative and it exceeds the carrying amount of the investment, the investor recognises first its share of the associate's profit and loss; and second its share of the associate's other comprehensive income until its interest in the associate is reduced to zero (paragraph 31 of this paper)?