Staff paper

Agenda reference: 13B

IASB® meeting

Date	**November 2023**
Project	**Equity Method**
Topic	**Towards an Exposure Draft—Transitional provisions**
Contacts	Filippo Poli (fpoli@ifrs.org) Edlyn Chigerwe (edlyn.chigerwe@ifrs.org)

This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (IASB). This paper does not represent the views of the IASB or any individual IASB member. Any comments in the paper do not purport to set out what would be an acceptable or unacceptable application of IFRS® Accounting Standards. The IASB's technical decisions are made in public and are reported in the IASB® *Update*.

Introduction and purpose of this paper

1. At its meeting in April 2023 the IASB decided to move the Equity Method research project to its standard-setting work plan and work towards publishing an exposure draft as the next due process step. This agenda paper discusses the transitional provisions to be proposed in that exposure draft.

2. The Equity Method project objective is to develop answers to application questions on the equity method, as set out in IAS 28 *Investments in Associates and Joint Ventures*, using the principles derived from IAS 28 where possible. The IASB has made tentative decisions to answer 19 application questions for investments in associates, joint ventures and investments in subsidiaries in separate financial statements accounted for using the equity method. Appendix A to this paper provides a summary of the IASB's tentative decisions in the project.

3. In this paper, the following terms are used:

   (a) the date of initial application is the beginning of the annual reporting period in which an investor or a joint venturer[1] would first apply the proposed requirements arising from the IASB's tentative decisions; and

   (b) the transition date is the beginning of the annual reporting period immediately preceding the date of initial application.

Staff recommendation

4. The staff recommend the IASB to propose that an investor or a joint venturer:

   (a) retrospectively applies the requirement to be proposed that an investor or a joint venturer recognises the full gain or loss on all transactions with its associates or joint ventures;

   (b) recognises and measures contingent consideration at its fair value at the transition date. The investor or joint venturer recognises a corresponding adjustment, if any, to the carrying amount of its investments in associates or joint ventures; and

   (c) prospectively applies all the other requirements to be proposed from the transition date.

[1] This Agenda paper refers to 'an investor or a joint venturer' to be consistent with terms used in IAS 28, which sets out the requirements for application of the equity method when accounting for investments in associates and joint ventures (paragraph 1 of IAS 28). However, the proposed transitional provisions would also apply to a parent that elects to apply the equity method to its investments in subsidiaries in its separate financial statements.

Structure of this paper

5. This paper is structured as follows:

   (a) transitional requirements in IFRS Accounting Standards (paragraphs 6–7 of this paper);

   (b) staff analysis (paragraphs 8–34 of this paper);

   (c) question for the IASB; and

   (d) Appendix A—Summary of IASB's tentative decisions and proposed transitional provisions.

Transitional requirements in IFRS Accounting Standards

6. Paragraph 19 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* states that:

   (a) an entity shall account for a change in accounting policy resulting from the initial application of an IFRS Accounting Standard in accordance with the specific transitional provisions, if any, in that IFRS Accounting Standard; and

   (b) when an entity changes an accounting policy upon initial application of an IFRS Accounting Standard that does not include specific transitional provisions applying to that change, or changes an accounting policy voluntarily, it shall apply the change retrospectively.

7. Retrospective application would result in the most useful information for users of financial statements. An entity would be required to present its financial statements as if the proposed requirements had always been effective. Therefore, information presented for prior periods would be comparable.

Staff analysis

8. Given paragraph 19 of IAS 8, the staff have assessed whether the IASB should propose retrospective application of the requirements to be proposed in the exposure draft.

9. Some of the proposals to be included in the exposure draft apply to transactions that occurred in a previous reporting period, such as the new requirements to be proposed for purchases of additional interests. Their retrospective application might be complex and costly because it could require information (such as fair values of assets or liabilities) for transactions that occurred long before the effective date of the new or amended requirements to be proposed.

10. In developing the recommended transition requirements, the staff took into consideration the following:

    (a) entities may have had different accounting policies on transition; and

    (b) there will be interactions between the different proposals in the exposure draft, for example, between the proposed requirements for purchases of an additional interest and the recognition of deferred taxes arising from recognising the investor or joint venturer's share of the associate or joint venture's net assets at fair value.

11. Given paragraph 10 of this paper, the staff think a single transitional provision for all of the proposed new requirements may not achieve an appropriate balance between costs and benefits.

IASB's tentative decisions in this project

12. Appendix A of this paper summarises the IASB's tentative decisions and the staff recommendations for transitional provisions. The staff analysis is set out as follows:

    (a) transactions with equity accounted investments (paragraphs 13–15 of this paper);

    (b) contingent consideration (paragraphs 16–22 of this paper);

    (c) impairment (paragraphs 23–26 of this paper);

    (d) recognition of losses and components of comprehensive income (paragraphs 27–28 of this paper); and

    (e) other tentative decisions (paragraphs 29–33 of this paper).

Transactions with equity accounted investments

13. The IASB will propose an amendment to the requirements for the recognition of gains and losses arising on transactions between the investor or joint venturer and its associates or joint ventures. The IASB will propose that an investor or a joint venturer recognises the full gain or loss on all transactions with its associates or joint ventures. The staff note that under the current requirements:

    (a) at the transaction date, investors or joint venturers recognise only the gain or loss to the extent of the unrelated investors' interests in the associate or joint ventures; and

    (b) subsequently, investors or joint venturers recognise the restricted portion of the gain or loss when the transferred asset is sold to third parties or consumed over time. Therefore, entities need to track the restricted portion of the gain or loss.

14. If the restricted portion of the gain or loss on previous transactions with associates and joint ventures has not yet been fully recognised, then at the transition date investors and joint venturers will have recognised only a portion of the gain or loss. Retrospective application would require an investor and joint venturer to recognise the amount of the restricted portion of gain or loss:

    (a) in retained earnings for transactions that occurred before the transition date; and/or

    (b) in profit or loss in the comparative period for transactions that occurred in the comparative period.

15. The staff note that the information on the restricted portion of gain or loss should be readily available to preparers, as that information is needed to apply the requirements in IAS 28. The staff therefore recommend the IASB proposes retrospective application of the requirements to be proposed for the reasons as described in paragraph 7 of this paper.

Contingent consideration

16. The IASB will propose that on obtaining significant influence in an associate or joint control of a joint venture, an investor or a joint venturer recognises contingent consideration as part of the cost of the investment and measures that contingent consideration at fair value; and for each subsequent reporting period:

    (a) for contingent consideration classified as equity—an investor or a joint venturer would account for its subsequent settlement within equity; and

    (b) for other contingent consideration—an investor or a joint venturer would measure it at fair value at each reporting date and recognise changes in fair value in profit or loss.

17. This proposal will add new requirements to IAS 28. However, the staff think that some entities may already apply, by analogy, the requirements for contingent consideration arrangements in IFRS 3 *Business Combination* to investments in associates and joint ventures. If so, retrospective application of the proposed requirements for these entities would not result in any adjustment.

18. However, if an investor or a joint venturer has not recognised the contingent consideration arrangement as part of the cost of the investment, retrospective application would require an investor or a joint venturer to:

(a) measure the fair value of the contingent consideration at the date of obtaining significant influence or joint control;

(b) recognise the amount in paragraph 18(a) of this paper as part of the carrying amount of investment in the associate or joint venture;

(c) measure the fair value of the contingent consideration at the transition date (to subsequently measure the contingent consideration);

(d) remeasure the liability or the asset for the amount in paragraph 18(c) of this paper; and

(e) recognise in retained earnings the difference between the amount in paragraphs 18(a) and 18(c) of this paper.

19. The staff note that retrospective application may be complex because an investor or a joint venturer would need to determine the fair value of the contingent consideration at the date of obtaining significant influence or joint control, which may have occurred long before the transition date. The measurement of the contingent consideration may be linked to unobservable inputs such as the future performance of the associate or joint venture. Determining those inputs on transition for the date of obtaining significant influence or joint control would involve the use of hindsight.

20. That said, recognition and measurement of a contingent consideration at fair value provides useful information about an entity's future cash flows. Therefore, we do not think that it would be appropriate to allow entities to continue not recognising or using another measurement base for contingent consideration once the proposed amendments are applied. Furthermore, allowing entities to apply the proposed amendments for contingent consideration arrangements only to transactions that occur after the transition date will not result in comparability among entities or between reporting periods.

21. The staff think that on transition an investor or a joint venturer, that has not applied IFRS 3 requirements by analogy, should recognise the fair value of the contingent consideration at the date of transition as part of the carrying amount of the investment. This would be consistent with the IASB's tentative decision on measuring the cost of the investment and would not require the use of hindsight. Recognising the contingent consideration as part of the carrying amount of the investment at the transition date does not require changing the amount at which the share of the associate of joint venture's net assets is carried. Any change in fair value after transition date would be recognised either in equity, if the contingent consideration is classified in equity, or in profit or loss.

22. The staff therefore recommend the IASB proposes that at the transition date, an investor or a joint venturer, that has not applied the IFRS 3 requirements for contingent consideration arrangements by analogy, is required to recognise the fair value of contingent consideration as part of the carrying amount of the investment in the associate or joint venture.

Impairment

23. The IASB will propose the following amendments to IAS 28 impairment requirements:

    (a) change the term 'cost' to 'carrying amount' in paragraph 41C of IAS 28;

    (b) add as objective evidence of impairment, a purchase price an investor pays for an additional interest in an associate, or a selling price for part of the interest, that is lower than the carrying amount of the investment in the associate at the date of the purchase or sale of that interest; and

    (c) remove the term 'significant or prolonged'.

24. These proposals will amend the conditions under which an investor or a joint venturer tests its investment in an associate or joint venture for impairment but will not change how the investor or joint venturer determines the recoverable amount of the investment.

25. The staff think that retrospective application of these proposals should not be permitted because the investor or joint venturer would need to use hindsight to:

    (a) assess if the amendment proposed in paragraph 23 of this paper would have triggered the need to test the investment(s) for impairment; and

    (b) if the investor assesses there would have been a need to test for impairment, to determine the recoverable amount of the investment.

26. The staff therefore recommend that the IASB proposes an investor or a joint venturer apply the amendments for impairment prospectively.

Recognition of losses and components of comprehensive income

27. The IASB will propose the following amendments to the requirements in IAS 28 on recognition of losses:

    (a) an investor would recognise its share of an associate's comprehensive income until its interest in the associate is reduced to nil;

    (b) when an investor has reduced the carrying amount of its investment in an associate to nil, the investor would recognise separately its share of each component of the associate's comprehensive income; and

    (c) if an investor's share of an associate's comprehensive income is a loss that is larger than the carrying amount of its investment in the associate, an investor would recognise, in order:

        (i) its share of the associate's profit and loss; and

        (ii) its share of the associate's other comprehensive income.

28. The staff think that there is an interaction between the IASB's proposal in paragraph 27(a) and its proposal for when an investor or a joint venturer purchases or disposes of an interest in an associate or joint venture. This is because retrospective application of the recognition of losses would impact the carrying amount of the investment. The staff think prospective application of this proposal would be consistent with the staff recommendation on the proposal for purchase or disposal of an interest in an associate or joint venture.

Other tentative decisions

29. The remaining tentative decisions are summarised as follows:

    (a) initial recognition of an investment in an associate or joint venture—see tentative decision 7 and 18 in Appendix A of this paper;

    (b) purchase of an additional interest in an associate—see tentative decision 8-10 and 15 in Appendix A of this paper;

    (c) other changes in ownership interests—see tentative decision 11 and 13 in Appendix A of this paper; and

    (d) partial disposal of an interest in an associate—see tentative decision 14 in Appendix A of this paper;

30. The remaining IASB proposals will apply when the investor or joint venturer initially recognises and measures the investment, or when the investor's ownership interest changes. The proposals will require an investor to use information at the date of the transaction, such as the fair value of the consideration paid, fair value of the share of the associate's net assets and share of unrecognised losses.

31. For an investor that recognised and measured these transactions using an accounting policy different from what the IASB will propose, retrospective application would require measuring the fair value of assets and liabilities at the original date of the transaction and then adjusting the amounts recognised applying the equity method from that date until the transition date. These amounts would be needed to adjust the carrying amount of the investment at the transition date, including the share of net assets and the goodwill included in the carrying amount. This could be quite complex and, in some cases, would require hindsight, such as when assessing fair values at the original date of the transaction.

32. We illustrate the implications of retrospective application for some of the remaining tentative decisions. For example:

    (a) *changes in an investors interest on obtaining significant influence or joint control*—we think some entities may have measured the previously held interest at the original cost[2]. Retrospective application would require an investor or a joint venturer to remeasure the fair value of the previously held interest at the date of obtaining significant influence or joint control.

    (b) *changes in an investor's interest while retaining significant influence: additional purchase*—unless an investor has measured an additional share as the IASB will propose, retrospective application would require an investor or a joint venturer in an associate or a joint venture to measure the fair value of the additional share of the associate or joint venture's net assets at the date of obtaining significant influence or joint control, which requires hindsight. The investor would also need to adjust the cumulative share of profit or loss from the date of the transaction date to the transition date.

    (c) *initial recognition of an investment in an associate–deferred taxes*—some entities may not have recognised the deferred tax assets (or liabilities) arising from recognising its share of the associate's net identifiable assets and liabilities at fair value. Retrospective application would require an investor to determine the deferred tax assets (or liabilities) at the date significant influence was obtained and recognise them, which would change the goodwill initially included in the cost of the investment. The investor would also need to adjust the cumulative share of profit or loss from the date significant influence was obtained to the transition date, to account for the reversal of the initial deferred tax asset (or liability).

[2] See the IFRS Interpretations Committee's January 2019 Agenda Decision IAS 27 *Separate Financial Statement* Investment in a subsidiary accounted for at cost: Step acquisition.

33. These examples show the complexity involved in requiring retrospective application. The staff think that the costs would exceed the benefits and therefore recommends that the IASB propose an investor or a joint venturer applies the proposed requirements arising from these tentative decisions prospectively, that is, only to transactions occurring after the transition date.

Staff conclusion

34. Considering paragraphs 5–33 of this paper, in the staff's view, the IASB proposes that an investor or a joint venturer:

    (a) retrospectively applies the requirement to be proposed that an investor or a joint venturer recognises the full gain or loss on all transactions with its associates or joint ventures;

    (b) recognises and measures contingent consideration at its fair value at the transition date. The investor or joint venturer recognises a corresponding adjustment, if any, to the carrying amount of its investments in associates or joint ventures; and

    (c) prospectively applies all the other requirements to be proposed from the transition date.

Questions for the IASB
1. Does the IASB agree with the staff recommendation in paragraph 4 of this paper?

Appendix A— Summary of IASB's tentative decisions and proposed transitional provisions

Application questions	IASB Meeting	IASB's tentative decisions	Proposed transitional provisions
Transactions with equity accounted investments			
How should an investor recognise gains or losses that arise from the sale of a subsidiary to its associate, applying the requirements in IFRS 10 *Consolidated Financial Statements* and IAS 28?	March 2023	1. The IASB tentatively decided: • that an investor would recognise the full gain or loss on all transactions with its associate. • to propose improvements for the disclosure requirements when an investor recognises the full gain or loss on transactions with its associate.	Retrospective application. See paragraphs 13-15.
Whether to recognise the portion of the investor's share of gain that exceeds the carrying amount of its investment in the investee in a downstream transaction?	March 2023	2. The IASB's tentative decision, at its March 2023 meeting, on the perceived conflict between IFRS 10 and IAS 28 resolves these application questions.	
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 in an upstream transaction?			
Whether the provision of service and transactions that are not transfer of assets are upstream or downstream transaction?			

Application questions	IASB Meeting	IASB's tentative decisions	Proposed transitional provisions
Transactions with equity accounted investments			
Whether the requirement for adjustment of gains or losses in intra-group transactions between subsidiaries should be applied by analogy to transactions between investees that are accounted for applying the equity method?	March 2023	3. The IASB's tentative decision, at its March 2023 meeting, on the perceived conflict between IFRS 10 and IAS 28 resolves these application questions.	Retrospective application. See paragraphs 13-15 of this paper.
Does an investor eliminate its portion of gain or loss in a downstream transaction against the transaction gain or loss or the share of the associate's profit or loss?[3]			

[3] At its July 2023 meeting, the IASB decided to expand the project's scope by adding this application question that is considered resolved by its tentative decisions.

<table>
<tr><th>Application questions</th><th>IASB Meeting</th><th>IASB's tentative decisions</th><th>Proposed transitional provisions</th></tr>
<tr><td colspan="4">Transactions with equity accounted investments</td></tr>
<tr><td>An investor sells an item of property, plant and equipment to an associate and leases it back:
(a) IFRS 16 Leases requires to recognise only the amount of gain or loss that relates to the rights transferred; whereas
(b) IAS 28 requires to adjust for the investor's portion of gain or loss.
Concerns were expressed about possible double counting.[4]</td><td>March 2023</td><td>4. The IASB's tentative decision, at its March 2023 meeting, on the perceived conflict between IFRS 10 and IAS 28 resolves this application question, resolving any concern about possible double counting.</td><td>Retrospective application. See paragraphs 13-15 of this paper.</td></tr>
<tr><td colspan="4">Contingent consideration</td></tr>
<tr><td>How to, initially and subsequently, recognise and measure contingent consideration on obtaining significant influence in an associate applying IAS 28?</td><td>June 2023</td><td>5. The IASB tentatively decided that:
• on obtaining significant influence in an associate, an investor would recognise contingent consideration as part of the cost of the investment and measure that contingent consideration at fair value; and</td><td>Limited retrospective application. See paragraphs 16-22 of this paper.</td></tr>
</table>

[4] At its July 2023 meeting, the IASB decided to expand the project's scope by adding this application question that is considered resolved by its tentative decisions.

Application questions	IASB Meeting	IASB's tentative decisions	Proposed transitional provisions
Contingent consideration			
	June 2023	• for each subsequent reporting period: — *for contingent consideration classified as equity*—an investor would account for its subsequent settlement within equity. — *for other contingent consideration*—an investor would measure it at fair value at each reporting date and recognise changes in fair value in profit or loss.	Limited retrospective application. See paragraphs 16-22 of this paper.
Impairment			
Does an investor assess a decline in fair value in relation to the original purchase price or the carrying amount at the reporting date?	July 2023	6. The IASB tentatively decided to propose amendments to IAS 28: • to change the term 'cost' to 'carrying amount' in paragraph 41C of IAS 28. • to add as objective evidence of impairment a purchase price an investor pays for an additional interest in an associate, or a selling price for part of the interest, that is lower than the carrying amount of the investment in the associate at the date of the purchase or sale of that interest. • to remove the term 'significant or prolonged'.	Prospective application. See paragraphs 23-26 of this paper.

Application questions	IASB Meeting	IASB's tentative decisions	Proposed transitional provisions
Changes in an investor's interest on obtaining significant influence			
How does an investor determine the initial carrying amount of an investment in an associate?[5]	April 2022 March 2023	7. In answering the application question(s) on applying the equity method to changes in ownership interests while retaining significant influence, the IASB tentatively decided how an investor measures the cost of an investment on obtaining significant influence. Therefore, the IASB's tentative decision, at its April 2022 meeting, resolves these application questions.	Prospective application. See paragraph 29-33 of this paper.
An investor, with a previously held interest in an entity, acquires an additional interest and obtains significant influence. Does the initial measurement include the original purchase cost of the previously held interest or the carrying amount of that interest applying IFRS 9 *Financial Instruments*?[6]			
Changes in an investor's interest while retaining significant influence			
How does an investor apply the equity method when purchasing an additional interest in an associate while retaining significant influence?	April 2022 March 2023	8. The IASB tentatively decided that an investor would measure the cost of an investment, when an investor obtains significant influence, at the fair value of the consideration transferred, including the fair value of any previously held interest in the associate.	Prospective application. See paragraph 29-33 of this paper.

[5] At its July 2023 meeting, the IASB decided to expand the project's scope by adding this application question that is considered resolved by its tentative decisions.

[6] At its July 2023 meeting, the IASB decided to expand the project's scope by adding this application question that is considered resolved by its tentative decisions.

Application questions	IASB Meeting	IASB's tentative decisions	Proposed transitional provisions
Changes in an investor's interest while retaining significant influence			
	April 2022 March 2023 June 2022	9. The IASB tentatively decided that an investor purchasing an additional interest in an associate while retaining significant influence would recognise any difference between the cost of the additional interest and its additional share in the net fair value of the associate's identifiable assets and liabilities either as goodwill, or as a gain from a bargain purchase. 10. The IASB tentatively decided that an investor purchasing an additional interest in an associate (that is a bargain purchase), while retaining significant influence, would recognise a gain from a bargain purchase in profit or loss.	Prospective application. See paragraph 29-33 of this paper.

Application questions	IASB Meeting	IASB's tentative decisions	Proposed transitional provisions
Changes in an investor's interest while retaining significant influence			
Whether an investor recognises its share of other changes in an associate's net assets while retaining significant influence, and if so, how is the change presented?	September 2022 June 2023	11. The IASB tentatively decided that when the investor's ownership interest: • increases and the investor retains significant influence, the investor would recognise that increase as a purchase of an additional interest. • decreases and the investor retains significant influence, the investor would recognise that decrease as a partial disposal. 12. The IASB tentatively decided not to develop proposals on how an investor applies the equity method when an associate grants an equity-settled share-based payment or a share warrant	Prospective application. See paragraph 29-33 of this paper.
How does an investor account for the associate's issuance of shares while retaining significant influence? Common transactions include the repurchase or issuance of shares by the associate.[7]		13. In answering the application question(s) on applying the equity method to changes in ownership interests while retaining significant influence, the IASB tentatively decided how an investor accounts for changes in an associate's net assets that change the investor's ownership interest from the issue of equity instruments. Therefore, the IASB's tentative decision, at its September 2022 meeting, resolves this application question.	

[7] At its July 2023 meeting, the IASB decided to expand the project's scope by adding this application question that is considered resolved by its tentative decisions.

Application questions	IASB Meeting	IASB's tentative decisions	Proposed transitional provisions
Changes in an investor's interest while retaining significant influence			
How does an investor apply the equity method when disposing of an interest in an associate while retaining significant influence?	December 2022	14. The IASB tentatively decided that an investor applying the equity method is measuring a single investment in an associate. Accordingly, in a partial disposal, an investor would be required to measure the portion of the investment in the associate to be derecognised as a proportion of the carrying amount of the investment at the date of the disposal.	Prospective application. See paragraph 29-33 of this paper.

Application questions	IASB Meeting	IASB's tentative decisions	Proposed transitional provisions
Recognition of losses			
Whether an investor that has reduced its interest in an associate to nil is required to 'catch up' unrecognised losses if it purchases an additional interest in the associate?	December 2022	15. The IASB tentatively decided that an investor applying the equity method that has reduced the carrying amount of its investment in an associate to nil and has therefore stopped recognising its share of an associate's losses would not recognise any unrecognised losses on purchasing an additional interest in the associate.	Prospective application. See paragraph 29-33 of this paper.
Whether an investor that has reduced its interest in an associate to nil recognises each component of comprehensive income separately?	December 2022	16. The IASB tentatively decided: • to clarify that an investor would recognise its share of an associate's comprehensive income until its interest in the associate is reduced to nil. • that when an investor has reduced the carrying amount of its investment in an associate to nil the investor would recognise separately its share of each component of the associate's comprehensive income. • that if an investor's share of an associate's comprehensive income is a loss that is larger than that carrying amount of its investment in the associate, an investor would recognise in order its share of the associate's profit or loss, and its share of the associate's other comprehensive income.	Prospective application. See paragraphs 27-28 of this paper.

Application questions	IASB Meeting	IASB's tentative decisions	Proposed transitional provisions
Recognition of losses			
Whether an investor that has reduced its interest in an associate to nil continues eliminating its share of gains arising from a downstream transaction?	March 2023	17. The IASB's tentative decision, at its March 2023 meeting, on the perceived conflict between IFRS 10 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures* resolves this application question.	Prospective application. See paragraph 29-33 of this paper.
Initial recognition of an investment in an associate–Deferred taxes			
Does an investor account for a deferred tax asset (or liability) arising from recognising its share of the associate's net identifiable assets and liabilities at fair value?	April 2023	18. The IASB tentatively decided that an investor would account for, and include in the carrying amount of its investment in an associate, a deferred tax asset (or liability) arising from recognising its share of the associate's net identifiable assets and liabilities at fair value.	Prospective application. See paragraph 29-33 of this paper.