IFRS Accounting

Staff paper

Agenda reference: 13A

IASB® meeting

Date	**October 2023**
Project	**Equity Method**
Topic	**Towards an Exposure Draft—Implications of applying the IASB's tentative decisions to investments in subsidiaries in separate financial statements**
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Introduction

1. IAS 28 *Investments in Associates and Joint Ventures* and IFRS 11 *Joint Arrangements* require application of the equity method when an investor has investments in associates or joint ventures. IAS 27 *Separate Financial Statements* permits application of the equity method in separate financial statements for investments in subsidiaries, associates and joint ventures.

2. At its July 2023 meeting, the International Accounting Standards Board (IASB) concluded its discussions on application questions in the scope of the Equity Method project for investments in associates.[1] The IASB's approach was to develop answers to the application questions for investments in associates and, later, consider any implications for other investments accounted for applying the equity method.

[1] Access the summary of the IASB's tentative decisions.

3. At its September 2023 meeting, the IASB:
   (a) discussed application of the equity method to investments in subsidiaries in separate financial statements;
   (b) considered informal feedback from outreach with national standard-setters and regional bodies (NSSs) in jurisdictions where parent entities prepare separate financial statements and account for investments in subsidiaries using the equity method as described in IAS 28;
   (c) considered the staff's preliminary analysis of possible ways forward; and
   (d) asked the staff to prepare a paper for decision-making.[2]

Purpose of this paper

4. The purpose of this paper is to ask the IASB to:
   (a) consider the staff analysis that includes feedback from Accounting Standards Advisory Forum (ASAF); and
   (b) decide whether its tentative decisions on application questions for investments in associates apply when parents elect to use the equity method to investments in subsidiaries in their separate financial statements.

Staff recommendation

5. The staff recommend the IASB applies its tentative decisions on application questions for investments in associates when parents elect to use the equity method to investments in subsidiaries in their separate financial statements.

[2] See September 2023 IASB meeting; Agenda Paper 13A.

Structure of this paper

6. The paper is structured as follows:

   (a) approach to staff's analysis (paragraph 7 of this paper);

   (b) September 2023 IASB discussion (paragraphs 8–11 of this paper);

   (c) feedback from ASAF (paragraphs 12–13 of this paper);

   (d) staff's analysis (paragraphs 14–36 of this paper):

      (i) conceptual matters (paragraphs 15–25 of this paper); and

      (ii) effects in practice of applying Alternative 1—*Equity method as would be described in IAS 28* (paragraphs 26–36 of this paper); and

   (e) question for the IASB.

Approach to staff's analysis

7. The staff's approach to assessing whether the IASB's tentative decisions on application questions for investments in associates can be applied when parents elect to use the equity method to investments in subsidiaries in their separate financial statements (see paragraph 2 of this paper) is to consider any possible unintended consequences (including inconsistencies) with the requirements in IAS 27, IFRS 10 *Consolidated Financial Statements* and the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*).

September 2023 IASB discussion

8. Agenda Paper 13A of the September 2023 IASB meeting discussed:

    (a) types of reporting entities and their financial statements as per the *Conceptual Framework* and IAS 27;

    (b) whether the concept of control in IFRS 10 applies to a parent's separate financial statements;

    (c) history of the equity method as a measurement option in separate financial statements;

    (d) informal feedback from outreach with NSSs;

    (e) the following two alternatives:

        (i) Alternative 1—*Equity method as would be described in IAS 28.*

        (ii) Alternative 2—*Equity method as would be described in IAS 28, with a requirement to restrict gains or losses from transactions between the parent and its subsidiaries*;

    (f) why the staff have not considered alternatives that would change this project's scope; and

    (g) an illustrative example that demonstrated Alternative 2 would include costs/complexities.

9. At the September 2023 meeting, IASB members said:

    (a) given this project's scope, the IASB should retain only one version of the equity method. A second version of the equity method for subsidiaries should, if needed, be considered in a separate project on the requirements for separate financial statements in IAS 27.

    (b) the objective of separate financial statements appears to differ among jurisdictions. Therefore, the reasons for applying the equity method in separate financial statements also differ.

10. One IASB member said, in some jurisdictions, separate financial statements determine dividends and taxes and are a way of reflecting the consolidated results of a parent entity. Therefore, if there are differences between separate and consolidated financial statements:

    (a) this can impact payments of dividends and taxes; and

    (b) these differences would be difficult to track, especially for companies making dividends based on profits.

11. In this paper, 'differences between separate and consolidated financial statements' refers to differences between the amounts reported in:

    (a) shareholder's equity in a parent's separate financial statements; and

    (b) the equity attributable to the parent as in its consolidated financial statements.

Feedback from ASAF

12. ASAF members were asked for their views on Agenda Paper 13A of the September 2023 IASB meeting. Overall, ASAF members supported the IASB staff's analysis, including the conceptual matters, for continuing to apply the equity method as would be described in IAS 28 when a parent elects to use the equity method to account for its investments in subsidiaries in its separate financial statements.

13. One ASAF member said the IASB should retain the current requirements in IAS 28 for investments in subsidiaries in separate financial statements and said the tentative decision, that an investor would recognise the full gain or loss on all transactions with its equity-accounted investments, would increase the differences between separate and consolidated financial statements, which could impact dividend distribution and taxable income amounts in their jurisdiction.

Staff analysis

14. In the following sections of this paper, the staff have drawn on the analysis from Agenda Paper 13A of the September 2023 IASB meeting noted in paragraph 8 of this paper. To help the IASB's discussion the staff have grouped the analysis into:

    (a) conceptual matters; and

    (b) effects in practice of applying Alternative 1—*Equity method as would be described in IAS 28*.

Conceptual matters

Types of reporting entities and their financial statements

15. In this paper, the staff discuss two types of reporting entities. These reporting entities' financial statements are referred to as:

    (a) *consolidated financial statements*—which provide information about the assets, liabilities, equity, income and expenses of both the *parent and its subsidiaries* (the group) as a single reporting entity; and

    (b) *separate financial statements of a parent entity*—which provide information about the assets, liabilities, equity, income and expenses of the *parent as a standalone entity* (and not about those of its subsidiaries), accounting for investments in subsidiaries as equity investments using one of the three measurement options.[3]

16. In the staff view, consolidated financial statements and separate financial statements of a parent entity are intended to provide different information.[4]

[3] See paragraphs 3.15 and 3.17 of the *Conceptual Framework* and paragraphs 4 and 10 of IAS 27.

[4] See paragraph 3.18 of the *Conceptual Framework*.

Concept of control in IAS 27

17. Consistent with the *Conceptual Framework*, the Basis for Conclusions on IAS 27 explains that the IASB has drawn a distinction between:

    (a) accounting for investments in subsidiaries, joint ventures and associates in separate financial statements as equity investments—that is, *control of an asset*; and

    (b) accounting for the economic entity (subsidiaries) that a parent controls in consolidated financial statements—that is, *control of an entity*.[5]

18. Accordingly, the staff think that the concept of control in IAS 27 is about the *control of an asset*:

    (a) in a parent's separate financial statements, the parent's investments in its subsidiaries (similar to investments in joint ventures or associates, or an investment in a financial instrument in the scope of IFRS 9 *Financial Instruments*) are recognised as assets of the parent, as assets in an investor-investee relationship.

    (b) the measurement options in IAS 27 should not change the conclusion that the parent recognises its investments as assets in an investor-investee relationship, as discussed in (a).

History of the equity method as a measurement option in separate financial statements

19. In 2003, when the IASB removed the measurement option to use the equity method for investments in subsidiaries, joint ventures and associates in separate financial statements, it reasoned that for separate financial statements, the focus is on the performance of the assets as investments.[6]

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[5] See paragraph BC4.40 of the Basis for Conclusions on the *Conceptual Framework*, and paragraphs BC7–BC8 of the Basis for Conclusions on IAS 27.

[6] Paragraphs BC9–BC10 of the Basis for Conclusions on IAS 27.

20. In 2012, the IASB decided to restore the measurement option to use the equity method for investments in subsidiaries, joint ventures and associates in separate financial statements because the law in some jurisdictions requires listed companies to present separate financial statements using the equity method for investments in subsidiaries, joint ventures and associates.[7]

21. Some respondents to the Exposure Draft, which proposed restoring the equity method option, asked the IASB to provide guidance on how to align amounts reported in separate financial statements with amounts reported in consolidated financial statements. However, the IASB decided not to provide such guidance and reasoned that a parent that elects to use the equity method for its investments in subsidiaries in its separate financial statements should follow the methodology in IAS 28 as applicable to an associate or a joint venture.[8]

22. Paragraph BC10G of the Basis for Conclusions on IAS 27 discusses some requirements that may cause differences between separate and consolidated financial statements when the equity method is used in separate financial statements for investments in subsidiaries:

    (a) goodwill impairment testing;

    (b) subsidiary that has a net liability position; and

    (c) capitalisation of borrowing costs.

23. The staff also understand, from the informal outreach with NSSs, other requirements also create differences, such as acquisition-related costs. In a business combination, acquisition-related costs are recognised as an expense in the period in which they are incurred. In contrast, the cost of an equity-accounted investment comprises its purchase price and any directly attributable expenditure necessary to obtain it.[9]

[7] Paragraphs BC10A–BC10B of the Basis for Conclusions on IAS 27.

[8] Paragraphs BC10G–BC10H of the Basis for Conclusions on IAS 27.

[9] *IFRIC Update*, July 2009, Agenda Decision.

24. Considering paragraphs 19–23 of this paper, the staff observe that:

    (a) the equity method can apply to investments in subsidiaries, joint ventures or associates in the separate financial statements of a parent entity (not only to investments in subsidiaries) and is one of the measurement options, alongside measurement at cost or in accordance with IFRS 9.

    (b) the IASB's thinking, that in separate financial statements the performance of the assets as investments, did not change either in removing or later restoring the equity method option in IAS 27.

    (c) the IASB rejected the idea of two versions of the equity method when restoring the equity method option in IAS 27.

    (d) the IASB rejected providing guidance to align amounts reported in separate and consolidated financial statements; hence, differences can arise between separate and consolidated financial statements when the equity method is used in separate financial statements for investments in subsidiaries.

Conclusion based on the conceptual matters

25. Considering paragraphs 15–24 of this paper, in the staff's view:

    (a) the IASB should apply its tentative decisions on application questions for investments in associates when parents elect to use the equity method to investments in subsidiaries in their separate financial statements. That is, Alternative 1—*Equity method as would be described in IAS 28*.

    (b) considering this project's scope and objective, Alternative 1 would not create unintended consequences with the IASB's reasoning in IAS 27, IFRS 10 and the *Conceptual Framework*.

Effects in practice of applying Alternative 1—Equity method as would be described in IAS 28

26. In the following sections of this paper, the staff discuss the expected effects in practice of the IASB tentative decisions when the equity method is used in separate financial statements for investments in subsidiaries.

Key message from NSSs and ASAF

27. The feedback from informal outreach with NSSs and the ASAF provide evidence that the use of the equity method in separate financial statements for investments in subsidiaries is prevalent only in a few jurisdictions. The feedback also suggests there is some divergence in practice on how the equity method is applied in separate financial statements for investments in subsidiaries. The equity method is either:

    (a) applied as described in IAS 28; or

    (b) applied by analogising to IFRS 3 *Business Combinations* and IFRS 10 to align amounts reported in separate and consolidated financial statements.[10]

Differences between separate and consolidated financial statements

28. Table 1 of this paper sets out the key IASB tentative decisions and whether these decisions could cause new differences between separate and consolidated financial statements. Paragraphs 22–23 of this paper discuss the current requirements in IAS 28 that cause existing differences.

[10] See paragraphs 32–39 of September 2023 IASB meeting; Agenda Paper 13A for further details on informal feedback from outreach with NSSs.

Table 1: Differences between separate and consolidated financial statements

IASB's tentative decision(s)	Whether it causes new differences?
1. *Changes in ownership interest on purchasing of an additional interest*—an investor recognises any difference between the cost of the additional interest (being the fair value of the consideration transferred) and its additional share in the net fair value of the investee's identifiable assets and liabilities either as goodwill, or as a gain from a bargain purchase. The investment is an accumulation of purchases. 2. *Disposing of an interest*—an investor measures the portion of the investment to be derecognised as a proportion of the carrying amount of the investment at the date of the disposal. The investor is measuring a single investment in an investee.	In answering this application question the IASB will propose new requirements in IAS 28. IAS 28 currently has no specific requirements on changes in ownership interest. Whether there are implications from the IASB's tentative decision depends on the parent entity's accounting policy. If the parent entity is: — applying an accumulation of purchases approach—**no new** differences between separate and consolidated financial statements arise. — analogising to IFRS 3 and IFRS 10—**new** differences between separate and consolidated financial statements arise because the IASB's tentative decision is that the investment is an accumulation of purchases. Those parent entities that analogise to IFRS 3 and IFRS 10: - remeasure previously held interests when they acquire control over a former associate, analogising to step acquisitions in IFRS 3; and - recognise changes in their ownership interest in a subsidiary, while retaining control, as equity transactions (as if transactions with owners in their capacity as owners), analogising to paragraph 23 of IFRS 10. Applying the IASB's tentative decision, any difference resulting from purchasing an additional interest in a subsidiary would be recognised either as goodwill, or as a gain from a bargain purchase in profit or loss.

IASB's tentative decision(s)	Whether it causes new differences?
3. *Transactions with equity-accounted investments*—where an investor would recognise the *full* gain or loss on all transactions with its investee, rather than *partially* restricting the gain or loss.	In answering this application question the IASB will propose changes to the requirements in paragraph 28 of IAS 28. For parent entities that restrict or eliminate gain or loss, **new** differences between separate and consolidated financial statements may arise. IAS 28 will no longer partially restrict the recognition of gains and losses. A parent entity applying the equity method in separate financial statements will not be able to analogise to paragraph B86(c) of IFRS 10.

29. The staff observe that some differences between separate and consolidated financial statements may arise from the inconsistent application of the equity method in the circumstances that IAS 28 does not include requirements and entities analogise to IFRS 3 and IFRS 10. Therefore, the effect of the IASB's tentative decisions will depend on entities' accounting policies.

30. There are already differences between separate and consolidated financial statements when the equity method is used in separate financial statements for investments in subsidiaries and:

    (a) the IASB's tentative decision on changes in ownership interest on purchasing of an additional interest or on a partial disposal may cause new differences between separate and consolidated financial statements, depending on accounting policies applied.

    (b) the IASB's tentative decision on transactions with equity-accounted investments may cause new differences between separate and consolidated financial statements.

Further considerations and conclusion

31. The staff acknowledge that in some jurisdictions there is a desire to have no differences between the amounts reported in:

    (a) the shareholder's equity of a parent's separate financial statements; and

    (b) the equity attributable to the parent as in its consolidated financial statements.

    However, that is not possible when applying the equity method as described in IAS 28, and so while IASB's tentative decisions could increase the differences between separate and consolidated financial statements, the issue is not new.[11]

32. Comments from IASB members, as noted in paragraph 9(b) of this paper, alongside the feedback from informal outreach with NSS and the ASAF, provide evidence that the objective of separate financial statements appears to differ among jurisdictions. Accordingly, it is unclear who are the primary users of separate financial statements.

33. The staff understand that, in some jurisdictions:

    (a) payments of dividends are based on separate financial statements; and

    (b) both separate and consolidated financial statements are issued as part of a single set of financial statements.

    Therefore, the staff think that in these circumstances, investors and other primary users of the consolidated financial statements may aim to understand both separate and consolidated financial statements. The staff note that a parent entity could disclose additional information about reconciling, for example, the accounting profit to the profits that can be distributed (similar to other jurisdictions that cannot pay a dividend from an unrealised foreign currency exchange gain) if it is considered relevant to the primary users of its financial statements.

[11] As noted in paragraphs 45–46 of Agenda Paper 13A of the September 2023 IASB meeting, alternatives that would create a new equity method that aligns amounts reported in separate and consolidated financial statements are outside the scope of the project

34. At a future meeting, the staff will bring a paper to the IASB on possible improvements to disclosure requirements for investments in subsidiaries in separate financial statements, including whether to propose that a parent discloses its gains or losses on transactions to its subsidiaries.[12]

35. Therefore, in the staff's view, deviating from any of the IASB's tentative decisions would be problematic for various reasons:

    (a) it would create two versions of the equity method. In the staff view, any benefit of doing so is doubtful, given it would require the IASB to change this project's scope and introduce unnecessary complexity into IFRS Accounting Standards.

    (b) it would be inconsistent with the conclusion reached on conceptual matters discussed in paragraphs 15–25 of this paper, which creates unintended consequences (or inconsistencies) with the IASB's reasoning in IAS 27, IFRS 10 and the *Conceptual Framework*.

    (c) it may be perceived as a 'cherry-picking' as it lacks conceptual merit:

        (i) other requirements would still cause differences between separate and consolidated financial statements, as discussed in paragraphs 22–23 of this paper.

        (ii) it would raise questions about the basis for determining which differences between separate and consolidated are or are not considered to be acceptable.

36. In the staff view, considering paragraphs 26–35 of this paper, the IASB should apply its tentative decisions on application questions for investments in associates when parents elect to use the equity method to investments in subsidiaries in their separate financial statements. That is, Alternative 1—*Equity method as would be described in IAS 28*.

[12] Similar to the IASB tentative decision for investments in associate; the IASB Update September 2023.

Question for the IASB

Question for the IASB
1. Does the IASB agree with the staff recommendation in paragraph 5 of this paper to apply its tentative decisions on application questions for investments in associates when parents elect to use the equity method to investments in subsidiaries in their separate financial statements?