Staff paper

Agenda reference: 13A

IASB® meeting

Date	**September 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 to other investments accounted for applying the equity method.

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

Purpose of this paper

3. The purpose of this paper is to:

   (a) discuss application of the equity method to investments in subsidiaries in separate financial statements;

   (b) summarise 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 applicable in IAS 28; and

   (c) consider the staff's preliminary analysis on possible ways forward.

4. The IASB is not asked to make decisions at this meeting. The staff is seeking IASB members' advice at this meeting and will use this advice, alongside advice from Accounting Standards Advisory Forum members, to refine the preliminary analysis and develop recommendations for decision-making at a future IASB meeting.

Structure of this paper

5. The paper is structured as follows:

   (a) scope of the analysis (paragraphs 7–8 of this paper);

   (b) history of the equity method as a measurement option in separate financial statements (paragraphs 9–17 of this paper);

   (c) reporting entities (paragraphs 18–19 of this paper);

   (d) concept of control in IAS 27 (paragraphs 20–31 of this paper);

   (e) informal feedback from outreach with NSSs (paragraphs 32–43 of this paper);

   (f) possible ways forward (paragraphs 44–59 of this paper); and

   (g) questions for the IASB.

6. There are two appendices to this paper:

   (a) Appendix A—Extracts from IAS 27 and *Conceptual Framework for Financial Reporting (Conceptual Framework).*

   (b) Appendix B—Illustrative example—Implications of restricting gains or losses (fully versus partially), on transactions between a parent and its non-wholly owned subsidiary, to differences between separate and consolidated financial statements.

Scope of the analysis

7. The Equity Method project's objective is to develop answers to application questions about the equity method, as set out in IAS 28, using the principles derived from IAS 28 where possible. The IASB decided not to undertake a fundamental review of the equity method.[2]

8. The staff's approach to assessing implications from the IASB's answers to the application questions (see paragraph 2 of this paper) to investments in subsidiaries in separate financial statements is to consider any possible unintended consequences (including inconsistencies) with the requirements in IAS 27, IFRS 10 *Consolidated Financial Statements* or the *Conceptual Framework*.

[2] See paragraph 32 of AP13: Project objective and approach of October 2020 IASB meeting that explained a fundamental review includes assessing:

(a) what the objective of the equity method is—a one-line consolidation method or a measurement method.

(b) whether the equity method is necessary, or whether it should be replaced by one of the measurement bases in the *Conceptual Framework*.

(c) whether significant influence should be the basis of when to apply the equity method.

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

Background

9. In 2003, the IASB amended IAS 27 to remove the measurement option to use the equity method for all investments included in separate financial statements (that is, investments in subsidiaries, joint ventures and associates) and require only the use of cost or IAS 39 *Financial Instruments: Recognition and Measurement*.[3] The IASB reasoned that:

   (a) although the equity method would provide users with some profit or loss information similar to that obtained from consolidation, such information is reflected in the investor's consolidated or individual financial statements and does not need to be provided to the users of its separate financial statements.

   (b) for separate financial statements, the focus is upon the performance of the assets as investments.

   (c) separate financial statements prepared with investments measured at either fair value or the cost method would be relevant; for example, using the cost method can result in relevant information when these financial statements may be needed only by particular parties to determine the dividend income from subsidiaries.[4]

10. 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, mainly because the laws in some jurisdictions require listed companies to present separate financial statements using the equity method for investments in subsidiaries, joint ventures and associates.[5]

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[3] Paragraph BC9 of the Basis for Conclusions on IAS 27 describes that '… the **equity method** as one of **the measurement options**'.

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

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

Differences between amounts reported in separate and consolidated financial statements

11. In restoring the equity method's measurement option in IAS 27, some respondents to the Exposure Draft argued that the carrying amount of an investment in a subsidiary accounted for using the equity method in a parent's separate financial statements should equal the net assets of the subsidiary attributable to the parent as reported in the parent's consolidated financial statements. However, some requirements may cause differences, in which case the two would not be equal, for example:

   (a) *impairment testing requirements*—in consolidated financial statements, goodwill is tested for impairment as a separate asset; whereas in separate financial statements, goodwill is tested as part of the investment in the subsidiary.

   (b) *subsidiary that has a net liability position*—consolidated financial statements include all losses of the subsidiary; whereas in separate financial statements, the parent stops recognising its share of losses when the carrying amount of the investment is nil unless there is a legal or constructive obligation to make good the losses.

   (c) *capitalisation of borrowing costs*—in consolidated financial statements, when a parent borrows funds and its subsidiary uses them for the purpose of obtaining a qualifying asset, the borrowing costs incurred by the parent are considered to be directly attributable to its subsidiary's qualifying asset; whereas in separate financial statements, the parent cannot capitalise those borrowing costs on the investment in the subsidiary.[6]

[6] Paragraph BC10G of the Basis for Conclusions on IAS 27.

12. Respondents to the Exposure Draft asked the IASB to consider providing guidance on the differences listed in paragraph 11 of this paper to align:

    (a) the carrying amount of investment in a subsidiary in the parent's separate financial statements; with

    (b) the net assets of the subsidiary that are attributable to the parent as reported in the parent's consolidated financial statements.

13. The IASB decided not to provide such guidance and reasoned that a parent that opted 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.[7]

Staff's preliminary analysis

14. Considering the history of the equity method's measurement option in IAS 27, set out in paragraphs 9–13 of this paper, the staff observe that removing and restoring the equity method's measurement option in IAS 27:

    (a) applies to all investments in separate financial statements (that is, investments in subsidiaries, joint ventures and associates) and not only to investments in subsidiaries; and

    (b) is one of the measurement options, alongside the cost and fair value methods.

15. The staff also observe that restoring the equity method's measurement option in IAS 27:

    (a) did not mean the IASB's thinking, that the focus on separate financial statements is on the performance of the assets as investments, was superseded; and

    (b) should not be viewed as an attempt to make separate financial statements a proxy (or a substitute) for the consolidated financial statements of the investor.

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

16. As noted in paragraphs 12–13 of this paper, the IASB rejected the idea of two versions of the equity method, consequently:

    (a) when applying the equity method in separate financial statements, there are no exceptions to the equity method as described in IAS 28; and

    (b) the IASB did not intend to align amounts reported in separate and consolidated financial statements.

17. The staff think that if the IASB intended otherwise it would have considered requiring the use of, instead of providing an option to use, the equity method as the sole method of accounting for equity investments in separate financial statements as suggested by some respondents to the Exposure Draft of IAS 27.[8]

Reporting entities

18. Appendix A to this paper sets out how:

    (a) IAS 27 defines separate financial statements; and

    (b) the *Conceptual Framework* provides distinct types of reporting entities.

19. The staff observe that, for the topic discussed in this paper, there are three types of reporting entities. These reporting entities' financial statements are referred to as:

    (a) *Parent's 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;

    (b) *Parent's separate financial statements*—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), treating investments in subsidiaries (also in joint ventures and associates) as equity investments using one of the three measurement options; and

[8] See paragraph 8 of AP14: Analysis of comment letters of March 2014 IASB meeting for further details.

(c) *Subsidiary's own financial statements*—which provide *information* about the assets, liabilities, equity, income and expenses of *any particular subsidiary*.[9]

Concept of control in IAS 27

Background

20. Paragraphs BC4.40 of the Basis for Conclusions on the *Conceptual Framework* explains that, on introducing a definition of control, the *Conceptual Framework* uses the concept of control both in:

    (a) the definition of an asset (*control of an asset*); and

    (b) its description of a parent's control of its subsidiaries (*control of an entity)*.

21. Paragraphs BC7–BC8 of the Basis for Conclusions on IAS 27 explain 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; and

    (b) accounting for the economic entity (subsidiaries) that a parent controls in consolidated financial statements.

22. Paragraph BC93 of the Basis for Conclusions on IFRS 3 *Business Combinations* explains that the IASB observed that using the concept of *control of an entity* provides the basis for establishing the existence of a parent-subsidiary relationship.

23. Paragraph BCZ182 of the Basis for Conclusions on IFRS 10 explains that the IASB views the loss of *control of a subsidiary* as a significant economic event and an investor-investee relationship differs significantly from a parent-subsidiary relationship.

[9] For further details, please see paragraphs BC3.22–BC3.25 of the Basis for Conclusions on the *Conceptual Framework*.

Staff's preliminary analysis

24. Considering paragraphs 20–23 of this paper, and that a parent's separate financial statements provide information about the parent as a standalone entity while treating investments in its subsidiaries as equity investments using one of the three measurement options, the staff think that the concept of control in IAS 27 is about the *control of an asset*.

25. Therefore, 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. The staff think this principle should be consistently applied.

26. In the staff's view, this is consistent with the IASB's thinking when it removed and restored the use of the equity method's measurement option in IAS 27, that is, it was for all investments (that is, investments in subsidiaries, joint ventures and associates) and not only for investments in subsidiaries. Also, IFRS 10 and its basis for consolidation do not apply to a parent's separate financial statements.

27. As noted in paragraphs 11 and 35(b) of this paper:

    (a) some respondents, to the Exposure Draft of IAS 27, asked the IASB to consider providing guidance that by opting the measurement option of the equity method the amounts reported in separate financial statements should be aligned with those in the consolidated financial statements; and

    (b) some jurisdictions, as part of the outreach with the NSSs, apply the measurement option of the equity method by analogising to IFRS 3 and IFRS 10 to align the amounts reported in separate and consolidated financial statements, as if the same one economic entity.

28. In the staff's view, supposing that the principles of IFRS 10 were meant to apply in separate financial statements, the application of those principles should not be restricted to when the equity method measurement option is used to account for investments in subsidiaries but should also apply when those investments are measured at cost or fair value.

29. Applying this view, if a parent had opted to apply the cost or fair value methods to account for its investments in subsidiaries in its separate financial statements:

    (a) the carrying amount of an investment in a subsidiary in the parent's separate financial statements; *would not*

    (b) equal the net assets of the subsidiary that are attributable to the parent in the parent's consolidated financial statements.

    Accordingly, applying either the cost or fair value method impedes the argument expressed in paragraph 27 of this paper.

30. For example, if a parent opted to apply the cost method, it would not restrict gains or losses, as described in paragraph 28 of IAS 28, on its transactions with its subsidiaries. Instead, the parent would recognise the full gain or loss on all transactions with its subsidiaries, like transactions with a third party, and as the IASB tentative decided for transactions between an investor and its associate, see IASB Update March 2023.

31. Therefore, in the staff's view, opting between the measurement options in IAS 27 should not change an investor-investee relationship, and IFRS 10 does not apply to parents' separate financial statements regardless of which measurement option a parent opts it to use in IAS 27.

Informal feedback from outreach with NSSs

Scope of the outreach

32. The staff undertook outreach with some of the NSSs in jurisdictions where parent entities prepare separate financial statements and account for investments in subsidiaries using the equity method as applicable in IAS 28:

    (a) three from the Americas region, particularly from Latin America;

    (b) two from Asia-Oceania region; and

    (c) one from Europe region.

33. The staff have sought to understand:

    (a) the use of separate financial statements and the prevalence of using the equity method;

    (b) how parent entities apply the equity method in practice in separate financial statements to specific transactions; and

    (c) whether the IASB's tentative decisions would affect users of separate financial statements and their decision-making.

Key message

34. Overall, the feedback did not provide evidence that using the equity method in separate financial statements for investments in subsidiaries is widespread amongst jurisdictions. Instead, it is prevalent only in a few jurisdictions.

35. Of those prevalent jurisdictions in paragraph 34 of this paper, a divergence in practice has emerged on how parent entities apply the equity method in separate financial statements for investments in subsidiaries. For example:

    (a) some apply the equity method as applicable in IAS 28 that follows the same principles for investments in associate.

(b) some apply the equity method by analogising to IFRS 3 and IFRS 10, in which the parent and its subsidiaries are accounted for as one economic entity in the parent's separate financial statements. Of those:

(i) some aim to align the carrying amount of its investment in a subsidiary in the parent's separate financial statements; with the net assets of the subsidiary attributable to the parent as in the parent's consolidated financial statements, whereas

(ii) others aim to align amounts reported in the shareholder's equity in the parent's separate financial statements, with the equity attributable to the owners of the parent in consolidated financial statements.[10]

(c) some apply a mixture between (a) and (b).

Summary of feedback

Use of separate financial statements

36. From the jurisdictions interviewed, we understand that separate financial statements are mainly used to declare dividends, for tax calculations and/or fulfil commercial law requirements. Also:

(a) in some jurisdictions, separate financial statements are considered to provide useful information to users and regulators about the parent entity's individual performance and financial position.

(b) in most jurisdictions, where parent entities prepare separate financial statements, both separate and consolidated financial statements are issued as part of a single set of financial statements.

[10] See the illustrative example in Appendix B to this paper. It further explains that the two approaches in (i) and (ii) can result in different outcomes in some circumstances, for which they would be perceived as having two different objectives.

Prevalence of using the equity method in separate financial statements

37. From the jurisdictions interviewed, we understand that the use of the equity method:

    (a) in some jurisdictions, is a local requirement but there is divergence in how it is applied in practice. This is because it is viewed as 2-steps (dual purpose), that is, it is applied as an accounting technique to account for investments as a one-line consolidation.

    (b) in some jurisdictions, is permitted but not widely applied:

        (i) a few parent entities opt to use the equity method option; whereas

        (ii) almost all parent entities opt the use cost method option because applying the equity method as applicable in IAS 28 is either more complex than the cost method or leads to different outcomes than the consolidated financial statements.

    (c) is not permitted in a few jurisdictions; that is, the option has been removed.

How parent entities apply the equity method in practice

38. There was mixed feedback on how parent entities apply the equity method to investments in subsidiaries in practice:

    (a) in some jurisdictions, parent entities apply the equity method as applicable in IAS 28 that follows the same principles for investments in associate.

    (b) in some jurisdictions, particularly, those who viewed the equity method as a one-line consolidation method, parent entities apply the equity method by analogising to IFRS 3 and IFRS 10, aiming to achieve one of the approaches set out in paragraph 35(b) of this paper. For example, parent entities:

        (i) have capitalised borrowing costs on the investment in the subsidiary, see paragraph 11(c) of this paper;

        (ii) have continued recognising its share of further losses, see paragraph 11(b) of this paper;

(iii) remeasure previously held interests (or retained interests) when they acquire control over a former associate (or lose control over a former subsidiary and retain significant influence), like step acquisitions in IFRS 3 (or step disposals in IFRS 10), ie as a significant economic event. Also, in a step acquisition, like IFRS 3, they measure the fair value of assets and liabilities acquired at the acquisition date, thereby determining the amount of goodwill on that basis;

(iv) account for changes in their ownership interest in a subsidiary, while retaining control, as equity transactions in separate financial statements, like the consolidated financial statements (ie transactions with owners in their capacity as owners), as if paragraph 23 of IFRS 10 applies; and

(v) fully restricted gains or losses on transactions with their non-wholly owned subsidiaries, as if paragraph B86(c) of IFRS 10 applies.

(c) in a few jurisdictions:

(i) those who are part of the same region of jurisdictions in (b), parent entities apply a mixture between (a) and (b).

(ii) parent entities apply (a) when applying IFRS Accounting Standards, but when applying their local GAAP, they apply the thought process of (b).

Whether the IASB's tentative decisions would affect users

39. There was mixed feedback on whether the IASB's tentative decisions would affect users:

(a) for the jurisdictions that apply the equity method as set out in paragraph 38(a) of this paper, the IASB's tentative decisions are not expected to have a significant effect as most of IASB's tentative decisions align with the current practice already. However, a few respondents to the outreach of those jurisdictions expressed a concern that the IASB's tentative decision that an investor would recognise the full gain or loss on all transactions with its associate would increase the differences between separate and consolidated financial statements.

(b) for the jurisdictions that apply the equity method as set out in paragraph 38(b) of this paper, the tentative decisions will increase differences between separate and consolidated financial statements. Some respondents in those jurisdictions said that most users analyse the performance based on consolidated financial statements. However, differences in the parent entity's reported financial performance and financial position between consolidated and separate financial statements could affect their decision-making.

Staff's preliminary analysis

40. From the analysis in paragraphs 32–39 of this paper, the staff identified two IASB's tentative decisions that might increase the differences between separate and consolidated financial statements:

(a) changes in ownership interest on purchasing of an interest, where an investor recognises any difference between the cost of the additional interest 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; and

(b) transactions with equity-accounted investments, where an investor recognises the full gain or loss on all transactions with its investee.[11]

Changes in ownership interest on purchasing an additional interest

41. The staff considered the following:

(a) the history of the equity method as a measurement option in IAS 27 for all investments;

(b) the concept of control in IAS 27 is about the *control of an asset*; and

(c) a parent's investments in subsidiaries, joint ventures and associates are being accounted for as equity investments in an investor-investee relationship.

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

Therefore, the staff think that, in separate financial statements, any change in the entity's ownership interest resulting in a change in the classification of the investment, while continuing to apply the equity method, is not a change to the existing investor-investee relationship.

42. The staff observe that the view in paragraph 41 of this paper is aligned with the IASB's reasoning in its tentative decision; that is, changes in ownership interest on purchasing an additional interest is an accumulation of purchases. Because the feedback provided evidence that some jurisdictions already apply such an accounting in practice, the staff do not consider the matter needs to be considered further. The staff also think that the IASB's tentative decisions on changes in ownership interest on purchasing an additional interest do not have unintended consequences when applied in separate financial statements.

Transactions with equity-accounted investments

43. The IASB's tentative decision set out in paragraph 40(b) of this paper, that is, recognising the full gain or loss on all transactions with equity-accounted investments, would change current practice, for entities that either applied the requirement as in

(a) paragraph 28 of IAS 28, thereby partially restricting gain or loss; or

(b) paragraph B86(c) of IFRS 10, thereby fully restricting gain or loss,

The staff, therefore, have discussed alternatives in paragraph 44 of this paper.

Possible ways forward

44. The staff identified the following two possible alternatives:

(a) Alternative 1—*Equity method as applicable in IAS 28.*

(b) Alternative 2—*Equity method as applicable in IAS 28, with a requirement to restrict gains or losses from transactions between the parent and its subsidiaries.*

It should be noted that '*Equity method as applicable in IAS 28*' refers to the equity method as it would be amended by the IASB's tentative decisions.

45. The staff have not considered alternatives that would change this project's scope. For example, alternatives that would create a new equity method, for example an equity method that aligns amounts reported in separate and consolidated financial statements, as applied by some jurisdictions in paragraph 38(b) of this paper.

46. The staff observe that the alternatives in paragraph 45 of this paper:

(a) would create two versions of the equity method, introducing unnecessary complexity in IFRS Accounting Standards.

(b) would be inconsistent with the IASB's decision, in 2012, of not providing guidance to limit differences between separate and consolidated financial statements, see paragraph 13 of this paper for further details.

(c) would be inconsistent with the IASB's most recent thinking in the *Conceptual Framework*, see paragraph 19 of this paper for further details.

(d) would be inconsistent with the IASB's thinking, when it has drawn a distinction between accounting for investments in separate financial statements as equity investments (as an investor-investee relationship); and accounting for the economic entity that a parent controls, see the staff's preliminary analysis in paragraphs 24–31 of this paper for further details.

Alternative 1—Equity method as applicable in IAS 28

47. Alternative 1 would require a parent, that opted to apply the equity method to account for its investment in subsidiaries in its separate financial statements, to continue to apply the equity method in IAS 28 as applicable to an associate or a joint venture.

48. The staff observe that Alternative 1 would:

    (a) retain one version of the equity method, which is consistent with the IASB's decision, in 2012, of not providing additional guidance to limit differences between separate and consolidated financial statements.

    (b) be consistent with the IASB's thinking, where it has drawn a distinction between accounting for investments in subsidiaries, joint ventures and associates in separate financial statements as equity investments (as assets of the parent in an investor-investee relationship); and accounting for the economic entity (subsidiaries) that a parent controls in consolidated financial statements.

49. Considering this project's scope and objective, the staff think that Alternative 1 would not create unintended consequences with the IASB's reasoning in IAS 27, IFRS 10 and the *Conceptual Framework*.

Alternative 2—Equity method as applicable in IAS 28, with a requirement to restrict gains or losses from transactions between the parent and its subsidiaries

50. Alternative 2 would require a parent, that opted to apply the equity method to account for its investment in subsidiaries in its separate financial statements, to follow the methodology in IAS 28 as applicable to an associate or a joint venture, but would introduce a requirement to restrict gains or losses from transactions between the parent and its subsidiaries.

51. Alternative 2 could be perceived as middle ground alternative (between Alternative 1 and the alternatives that have not been considered as set out in paragraphs 45–46 of this paper), as it may limit the differences between amounts reported in separate and consolidated financial statements.

52. The question that we need to answer is: whether IASB should introduce a requirement to restrict gains or losses similar to the requirement in:

(a) paragraph 28 of IAS 28 (which the IASB tentatively decided to eliminate it at its March 2023 meeting); that is, to restrict the gains or losses to the extent of the non-controlling interests of a subsidiary, if any—so that, *partially restricting gain or loss*; or

(b) paragraph B86(c) of IFRS 10; that is, to restrict the gains or losses in full, even if there is non-controlling interests of a subsidiary—so that, *fully restricting gain or loss*.

53. The staff note that:

(a) if a parent has wholly owned subsidiaries, either approach in paragraph 52 of this paper results in the same accounting outcome. Different accounting outcomes arise if the transactions are between a parent and its non-wholly owned subsidiaries.

(b) introducing a requirement based on paragraph B86(c) of IFRS 10 (*full restricting gain or loss*) is not a viable option in this project's scope; this is because:

(i) it has never been part of the equity method procedures; and

(ii) the IASB's tentative decision at its March 2023 meeting was about to eliminate the requirement in paragraph 28 of IAS 28 (*partial restricting gain or loss*).

However, for comparison purposes only, the staff have used it in the following paragraphs of this paper and the illustrative example in Appendix B.

54. Because of the divergence in practice:

(a) as in some jurisdictions parent entities *partially restrict gains or losses* on transactions with their non-wholly owned subsidiaries; whereas in others parent entities *fully restrict gains or losses*; and

(b) as to what approach could be used of the two approaches in paragraph 35(b) of this paper to align amounts reported in separate and consolidated financial statements,

the question we need to answer is: if the IASB were to introduce a requirement to restrict gains or losses on transactions with subsidiaries in a parent's separate financial statements, what is the purpose of introducing that requirement?

55. To answer this question, the staff developed an illustrative example, to assess the implications of restricting gains or losses (fully versus partially), on transactions between a parent and its non-wholly owned subsidiary, to differences in the amounts reported between separate and consolidated financial statements, see Appendix B of this paper.

56. Considering paragraphs B2–B5 of Appendix B to this paper, the staff note that:

(a) to align the carrying amount of ABC's investment in XYZ in its separate financial statements (CU720) with the net assets of XYZ attributable to ABC as in ABC's consolidated financial statements (CU720), then ABC should *partially* restrict gain on transactions with XYZ (*as if paragraph 28 of IAS 28 applies for an associate*); whereas

(b) to align amounts reported in the shareholder's equity of ABC's separate financial statements (CU1,600) with the equity attributable to ABC as in ABC's consolidated financial statements (CU1,600), then ABC should *fully* restrict gain on transactions with XYZ (*as if paragraph B86(c) of IFRS 10 applies*).

57. Therefore, in the staff's view, it is doubtful whether the benefits of introducing requirements like those in paragraph 28 of IAS 28 (*partial restricting gain or loss*) into IAS 27 for investments in subsidiaries would outweigh costs to parent entities. In other words, it raises questions on whether the purpose of doing so would be served; because, on transactions between a parent and its non-wholly owned subsidiary, it does not help (see paragraph 56(b) of this paper) to align amounts reported in:

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

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

58. The staff also observe that Alternative 2 would have some challenges, because it:

    (a) would create two versions of the equity method, which requires the IASB to change this project's scope and introduces unnecessary complexity in the literature of the IFRS Accounting Standards.

    (b) would be inconsistent with the IASB's decision, in 2012, of not providing additional guidance to limit differences between separate and consolidated financial statements.

    (c) may be perceived as a 'cherry-picking' as it lacks conceptual merit, while there are still other requirements may cause differences between separate and consolidated financial statements, see paragraphs 11 and 38(b) of this paper for further explanations on these other requirements and differences.

59. Considering this project's scope and objective, the staff think that Alternative 2 may create unintended consequences with the IASB's reasoning in IAS 27, IFRS 10 and the *Conceptual Framework*.

Questions for the IASB

Questions for the IASB
1. Do IASB members have comments or questions on the preliminary analysis in this paper? 2. Considering the Equity Method project's scope and objective, what are your views on the alternatives set out in paragraph 44 of this paper? 3. Do you require any further information before the staff bring a decision-making paper to the IASB?

Appendix A—Extracts from IAS 27 and *Conceptual Framework*

A1. Paragraph 4 of IAS 27 defines separate financial statements as follows (emphasis added):

> Separate financial statements are those presented by an entity in which the entity could elect, subject to the requirements in this Standard, **to account for its investments in subsidiaries**, joint ventures and associates either at cost, in accordance with IFRS 9 *Financial Instruments*, or **using the equity method as described in IAS 28** *Investments in Associates and Joint Ventures.*

A2. Paragraph 3.10 of the *Conceptual Framework* states that (emphasis added):

> A reporting entity is an entity that is required, or **chooses**, to prepare financial statements. A reporting entity can be a **single entity** or a portion of an entity or can comprise more than one entity…

A3. Paragraph 3.11 of the *Conceptual Framework* states that (emphasis added):

> Sometimes one entity (parent) has control over another entity (subsidiary). If a **reporting entity** comprises **both** the **parent** and **its subsidiaries**, the reporting entity's financial statements are referred to as '**consolidated financial statements**'… If a reporting entity is the **parent alone**, the reporting entity's financial statements are referred to as '**unconsolidated financial statements**'…

A4. Paragraph 3.15 of the *Conceptual Framework* states that (emphasis added):

> **Consolidated** financial statements provide **information** about the assets, liabilities, equity, income and expenses of **both** the **parent** and **its subsidiaries** as a **single reporting entity**…

A5. Paragraph 3.16 of the *Conceptual Framework* states that (emphasis added):

> **Consolidated** financial statements are **not** designed to provide **separate information** about the assets, liabilities, equity, income and expenses of **any particular subsidiary**. A **subsidiary's own financial statements** are designed to provide **that information**.

A6. Paragraph 3.17 of the *Conceptual Framework* states that (emphasis added):

> **Unconsolidated** financial statements are designed to provide **information** about the **parent's** assets, liabilities, equity, income and expenses, and **not about those of its subsidiaries**… **Another way** to provide information about **some** or **all** assets, liabilities, equity, income and expenses of the **parent alone** is in **consolidated** financial statements, in the **notes**.

A7. Paragraph 3.18 of the *Conceptual Framework* states that (emphasis added):

> …when consolidated financial statements are required, **unconsolidated** financial statements **cannot serve** as a **substitute** for **consolidated** financial statements. Nevertheless, a parent may be required, or choose, to prepare unconsolidated financial statements in addition to consolidated financial statements.

A8. Paragraph 3.2 of the *Conceptual Framework* states that (emphasis added):

> The **objective of financial statements** is to provide **financial information** about the reporting entity's assets, liabilities, equity, income and expenses that is useful to users of financial statements in assessing the prospects for future net cash inflows to the **reporting entity** and in assessing management's stewardship of the entity's economic resources (see paragraph 1.3).

Appendix B—Illustrative example—Implications of restricting gains or losses (fully versus partially), on transactions between a parent and its non-wholly owned subsidiary, to differences between separate and consolidated financial statements

B1. The example illustrates how the full versus partial restricting gain or loss, on transactions between a parent and its non-wholly owned subsidiary, plays a role that the two approaches listed in paragraphs 35(b)(i)–35(b)(ii) of this paper can result in different outcomes.

B2. For example, on a downstream transaction in which:[12]

(a) parent ABC acquires 70% of subsidiary XYZ at year 1 for a consideration of CU1,000 and obtains control.

(b) at that date, the fair value of the net assets of XYZ is CU1,000.

(c) in year 2, ABC sells a property, plant and equipment (PPE) to XYZ at CU1,000; ABC's net book value is CU600.

(d) ABC applies the equity method in its separate financial statements.

B3. ABC's consolidated financial statements (CFSs) would be:

	at year 1				at year 2			
	ABC	**XYZ**	**Elimination entries**	**CFSs**	**ABC**	**XYZ**	**Elimination entries**	**CFSs**
Cash	–	1,000	–	1,000	1,000	–	–	1,000
Investment in XYZ	1,000	–	(1,000)	–	1,000	–	(1,000)	–
Goodwill	–	–	300	300	–	–	300	300
PPE	600	–	–	600	–	1,000	(400)	600
Total	**1,600**	**1,000**	**(700)**	**1,900**	**2,000**	**1,000**	**(1,100)**	**1,900**
Share capital	1,600	1,000	(1,000)	1,600	1,600	1,000	(1,000)	1,600
P&L/RE	–	–	–	–	400	–	(400)	–
NCI	–	–	300	300	–	–	300	300
Total	**1,600**	**1,000**	**(700)**	**1,900**	**2,000**	**1,000**	**(1,100)**	**1,900**

[12] For simplicity:

— assume no profit or loss has been made in XZY in year 1 and year 2, and no depreciation for the property, plant and equipment is computed.

— the goodwill recognised is related only to the controlling interest acquired; see paragraph 19(b) of IFRS 3.

B4. So, at year 2, the net assets of XYZ attributable to ABC as in ABC's CFSs would be as follows:

	at year 2
Assets of XYZ in ABC's consolidated financial statements	600
Share of ABC (600*70%)	420
Goodwill	300
Net assets of XYZ attributable to ABC as in ABC's CFSs	**720**

B5. ABC's separate financial statements (SFSs) would be:

	at year 2, ***partially*** restricted gain			at year 2, ***fully*** restricted gain		
	ABC	**Equity Method**	**SFSs**	**ABC**	**Equity Method**	**SFSs**
Cash	1,000	–	1,000	1,000	–	1,000
Investment in XYZ	1,000	(280)	720	1,000	(400)	600
Total	**2,000**	**(280)**	**1,720**	**2,000**	**(400)**	**1,600**
Share capital	1,600	–	1,600	1,600	–	1,600
P&L/RE	400	(280)	120	400	(400)	–
Total	**2,000**	**(280)**	**1,720**	**2,000**	**(400)**	**1,600**

B6. Considering paragraphs B2–B5 of this paper, the staff note that:

(a) to align the carrying amount of ABC's investment in XYZ in its separate financial statements (CU720) with the net assets of XYZ attributable to ABC as in ABC's consolidated financial statements (CU720), then ABC should *partially* restrict gain on transactions with XYZ (*as if paragraph 28 of IAS 28 applies for an associate*); whereas

(b) to align amounts reported in the shareholder's equity of ABC's separate financial statements (CU1,600) with the equity attributable to ABC as in ABC's consolidated financial statements (CU1,600), then ABC should *fully* restrict gain on transactions with XYZ (*as if paragraph B86(c) of IFRS 10 applies*).