IFRS Accounting

Staff paper

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IASB® meeting

Date	**September 2023**
Project	**Equity Method**
Topic	**Towards an Exposure Draft—Implications of applying the IASB's tentative decisions to investments in joint ventures**
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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 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.

Purpose of this paper

3. The purpose of this paper is to:
   (a) discuss application of the equity method to investments in joint ventures; and
   (b) consider the staff's preliminary analysis on whether the IASB's tentative decisions hold for investments in joint ventures.

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

4. The IASB is not asked to make decisions at this meeting. The staff are 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 6–9 of this paper);

   (b) history of applying the equity method for investments in joint ventures (paragraphs 10–12 of this paper);

   (c) changes in an investor's ownership interest while continuing to apply the equity method (paragraphs 13–17 of this paper);

   (d) staff's preliminary analysis (paragraphs 18–31 of this paper); and

   (e) questions for the IASB.

Scope of the analysis

6. 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.[2]

7. 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 joint ventures is to consider any possible unintended consequences (including inconsistencies) with the requirements in IAS 28, IFRS 11, IFRS 10 *Consolidated Financial Statements* or the *Conceptual Framework for Financial Reporting* (*Conceptual Framework*).

[2] The IASB decided not to undertake a fundamental review of the equity method, see paragraph 32 of AP13: Project objective and approach of October 2020 IASB meeting that explained a fundamental review could include assessing: what the objective of the equity method is—a one-line consolidation method or a measurement method; or whether the equity method is necessary, or whether it should be replaced by one of the measurement bases in the *Conceptual Framework*.

8. Given the Equity Method project's objective is to develop answers to application questions, the staff have not reconsidered the IASB's decision when developing IFRS 11 to apply the equity method to investments in joint ventures. Instead, we have focused on whether the rationale for the IASB's tentative decisions, in answering the application questions, holds for investments in joint ventures, including whether there are other factors the IASB should consider.

9. It should also be noted that the IASB has completed the *Post-implementation Review of IFRS 10, IFRS 11 and IFRS 12 Disclosure of Interests in Other Entities* and concluded that the requirements of IFRS 10, IFRS 11 and IFRS 12 are working as intended.[3]

History of applying the equity method for investments in joint ventures[4]

Development of IFRS 11

10. The staff think that to identify if there are any unintended consequences of applying the IASB's tentative decisions to investments in joint ventures, it would be useful to first review why the IASB decided the equity method of accounting was appropriate for joint ventures.

11. In developing IFRS 11, the IASB decided that investors should recognise their interests in joint ventures using the equity method as applicable in IAS 28. Although the IASB acknowledged that significant influence and joint control are different, the IASB decided that the equity method is the most appropriate method to account for investments in joint ventures because it is a method that accounts for an investor's interest in the net assets of an investee.[5]

[3] See Report and Feedback Statement: Post-implementation Review of IFRS 10, IFRS 11 and IFRS 12.

[4] See paragraphs 35–43 of AP13B: Perceived conflict between IFRS 10 and IAS 28 for more history on allowing to apply the equity method to investments in jointly controlled entities.

[5] Paragraph BC41 of the Basis for Conclusions on IFRS 11.

12. The IASB also reasoned that the disclosure requirements in IFRS 12 would:

    (a) improve the quality of the information provided to users of financial statements relating to an investor's interest in joint ventures; and

    (b) give users a better basis for assessing the effect on the reporting entity of the activities carried out through joint ventures.[6]

Changes in an investor's ownership interest while continuing to apply the equity method

13. In identifying if there are any unintended consequences of applying the IASB's tentative decisions to investments in joint ventures, the staff have reviewed the requirements in IAS 28 that are relevant to the IASB's tentative decisions.

14. Paragraph 24 of IAS 28 states that (emphasis added):

    > If an investment in an associate becomes an investment in a joint venture or an investment in a joint venture becomes an investment in an associate, the entity **continues** to apply the **equity method** and **does not remeasure** the retained interest.

15. In reaching the conclusion in paragraph 14 on this paper, as part of deliberating the requirements for discontinuing the use of the equity method, the IASB reconsidered whether its previous decision in an earlier project to characterise the loss of joint control or loss of significant influence as a significant economic event was appropriate.

16. It concluded that, although significant, the events fundamentally differ from the loss of control. It noted that the cessation of the parent-subsidiary relationship results in the derecognition of assets and liabilities because the composition of the group changes. If joint control or significant influence is lost, the group's composition is unaffected.[7]

[6] Paragraph BC45 of the Basis for Conclusions on IFRS 11.

[7] Paragraph BC28 of the Basis for Conclusions on IAS 28.

17. The IASB also acknowledged that in the case of losing joint control and obtaining a significant influence, the nature of the investment changes. However, in this instance, both investments (the joint venture and the associate) continue to be measured using the equity method. Considering there is no change in:

    (a) the group boundaries; or

    (b) the measurement requirements,

    the IASB concluded that losing joint control and obtaining significant influence is not an event that warrants remeasurement of the retained interest at fair value.[8]

Staff's preliminary analysis

18. Agenda paper 13 of this meeting sets out the IASB's tentative decisions in the project to date. From this list, the staff have identified the following two categories of tentative decisions to analyse for possible unintended consequences when applied to investments in joint ventures:[9]

    (a) *purchasing an additional interest*—the IASB has tentatively decided that an investor purchasing an additional interest in an investee would recognise 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. See paragraphs 20–22 of this paper.

    (b) *transactions with equity-accounted investments*—the IASB has tentatively decided that an investor would recognise the full gains or losses on all transactions with its investee. See paragraphs 23–31 of this paper. Agenda Paper 13C of this meeting proposes new disclosure requirements to support that IASB's tentative decision.

[8] Paragraph BC30 of the Basis for Conclusions on IAS 28.

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

19. We have not analysed other tentative decisions further because the staff think the rationale of those tentative decisions holds for investments in joint ventures, for example:

    (a) *recognition of losses*—the IASB has tentatively decided that an investor that has reduced the carrying amount of its investment in an investee to nil and has therefore stopped recognising its share of an investee's losses would not recognise any unrecognised losses on purchasing an additional interest in the investee.

        The staff think that:

        (i) the immediate recognition of unrecognised losses, on purchasing an additional interest, may not provide a faithful representation.[10]

        (ii) even though the situation is possible in theory, the staff think that it is more likely that a joint arrangement agreement will stipulate how losses are shared by joint venturers. Paragraph 39 of IAS 28 will apply when joint venturers have incurred legal or constructive obligations on behalf of the joint venture.

[10] See paragraphs 24–29 of AP13B: Application question—Purchase of additional interest in an associate and share of unrecognised losses for more details.

(b) *Ownership changes other than purchases of an additional interest*—the IASB has tentatively decided that when the investor's ownership increases or decreases, an investor would recognise that change as a purchase of an additional interest or as a partial disposal.

The staff think that:

(i) joint arrangement agreements will include clauses on how joint venturers can dispose of shares or raise further capital. As the changes resulting from these circumstances could affect the joint arrangement itself, it is less likely to happen; however,

(ii) if it happens, it could lead to additional dynamics. For example:

— a joint arrangement is set up in which joint venturers A, B and C each holds 33.33% of the joint venture;

— joint control exists between the three parties; and

— the contractual terms include an 'exit' clause, in which if any joint venturer wishes to exit, it should first offer its ownership interest equally (proportionality) to the other joint venturers.

Assuming C wished to exit, then the possibilities that could arise for joint venturer A are set out in Table 1 of this paper:

Table 1: Ownership changes other than purchases of an additional interest

Possibilities	How would A account for each possibility?
1. A and B accepted the exit offer from C and joint control is retained. The ownership interest of A becomes 50% and B becomes 50%.	The IASB's tentative decision set out in paragraphs 18(a) and 19(b) of this paper apply; see the analysis in paragraph 20 of this paper for more details.
2. B does not accept the exit offer from C, whereas A accepts, and, as a result: — A obtains control of the former joint venture and its ownership interest becomes 66.66%. — B loses joint control, and possibly obtains significant influence.	The acquisition method of accounting under IFRS 3 *Business Combinations* applies.
3. A does not accept the exit offer from C, whereas B accepts, and, as a result: — B obtains control of the former joint venture, and its ownership interest becomes 66.66%. — A loses joint control, and possibly obtains significant influence.	Paragraph 24 of IAS 28 provides guidance in this case.

Changes in ownership interest on purchasing an additional interest

20. As noted in paragraph 18(a) of this paper, the IASB's tentative decision is that the investment is an accumulation of purchases. In Table 2 of this paper, the staff have set out whether the IASB's rationale applies to investments in joint ventures.[11]

[11] See paragraphs 16–32 of AP13A: Purchase of an additional interest in an associate while retaining significant influence for more details.

Table 2: IASB rationale for purchasing an additional interest

IASB's rationale for investments in associates	Whether the same applies to investments in joint ventures
Measuring the investor's additional share of the associate's net identifiable assets and liabilities, while retaining significant influence, at fair value provides the most relevant information.	The comparable circumstance would be acquiring additional interest while retaining joint control. Therefore, the same rationale applies because the measurement at fair value provides more comparable and understandable information.
The IASB tentative decision is consistent with the requirements in paragraphs 21A and B33C of IFRS 11 for the purchase of additional interests in a joint operation, in which the activity of the joint operation constitutes a business, for example: — apply the principles in IFRS 3 that do not conflict with the guidance in IFRS 11, including those on measuring identifiable assets/liabilities at fair value. — previously held interests in the joint operation are not remeasured if the joint operator retains joint control.	The same rationale applies; see above. Also, previously held interests in the joint venture would not be remeasured as the joint venturer: — retains joint control, with no change in the measurement requirements; and — does not obtain control, ie no change to the group's boundaries as defined in IFRS 10. See paragraphs 13–17 of this paper for further details.

21. In the staff's view, the analysis in Table 2 of this paper demonstrates that the IASB's rationale for the tentative decision set out in paragraph 18(a) of this paper holds for investments in joint ventures.

22. At the March 2023 IASB meeting, a few IASB members asked whether that IASB's tentative decision would also be applied, if an investor has, immediately before purchasing an additional interest, an investment in an associate and on purchasing that additional interest it obtains joint control, and its investment becomes an investment in a joint venture. Paragraph 24 of IAS 28 states that, an investor continues to apply the equity method and does not remeasure the retained interest if an investment in an associate becomes an investment in a joint venture or an investment in a joint venture becomes an investment in an associate.[12]

[12] The staff have also considered the requirement in paragraph 24 of IAS 28 as part of the analysis of AP13A: Purchase of an additional interest in an associate while retaining significant influence.

Transactions with equity-accounted investments

23. As noted in paragraph 18(b) of this paper, the IASB has tentatively decided that an investor would recognise the full gains or losses on all transactions with its investee. In Table 3 of this paper, the staff have set out whether the IASB's rationale applies to investments in joint ventures.[13]

Table 3 IASB's rationale for transactions with equity-accounted investments

IASB's rationale for investments in associates	Whether the same applies to investments in joint ventures
Recognising the full gains or losses on all transactions between an investor and its associate:[14] — is consistent with the IASB's most recent thinking about the 'loss of control' reasoned in both IFRS 10 and IFRS 15 *Revenue from Contracts with Customers*. — is consistent with the definition of a 'group' and the *Conceptual Framework*, where the associate is not part of the group. — simplifies the effort needed and costs of applying the equity method procedures. — removes the diversity that has emerged in practice, which would enhance comparability and provide useful and consistent information (with less disruption to reported earnings in future periods) to users of financial statement.	The comparable circumstance would be recognising the full gains or losses on all transactions between a joint venturer and its joint venture. Therefore, the same rationale applies; in particular, because the joint venture is also not controlled by the joint venturer.

24. In the staff's view, the analysis in Table 3 of this paper demonstrates that the IASB's rationale for the tentative decision set out in paragraph 18(b) of this paper holds for investments in joint ventures.

[13] See paragraphs 20–94 of AP13B: Perceived conflict between IFRS 10 and IAS 28 for more details.
[14] See also paragraphs 35–43 of AP13B: Perceived conflict between IFRS 10 and IAS 28 for further discussion that restricting gains or losses was not about the application of the equity method; instead, it was about the rationale supporting proportionate consolidation, which the IASB removed when developing IFRS 11.

25. However, as part of the outreach activities undertaken to answer the application questions for investments in associates, a few respondents cautioned that some joint venturers could potentially manage earnings—for example, the joint venturer could sell assets to its joint venture at a profit and, without the requirement to eliminate the joint venturer's share of that profit (paragraph 28 of IAS 28), the profit or loss could be overstated if the transaction is not on market terms.

26. To address the concerns in paragraph 25 of this paper, the staff have considered whether applying the IASB's tentative decision to investments in joint ventures, ie to require the joint venturer to recognise the full gains or losses on all transactions with its joint venture, would result in not providing users with useful information.

27. The staff note that the accounting incentives of a joint venturer could vary. For example, a joint venturer:

    (a) could sell assets to a joint venture at a loss (not at a profit); and/or

    (b) might wish to obtain future tax benefits by recognising partial gains or losses (not full gains or losses).

28. Also, the outreach activities undertaken, with user advisory committees from different regions and with the Capital Markets Advisory Committee to answer the application questions to investments in associates, provided evidence that disclosure of the amount of the gains or losses, at the transaction date, arising from transactions between an investor and its associate:

    (a) complements the disclosure requirements in IAS 24 *Related Party Disclosures*, allowing users the flexibility to consider gains or losses in analysing the associate's performance;

    (b) helps to understand the reasonableness, fairness and sustainability of these transactions (and their pricing) and benchmark against market terms; and

    (c) helps to understand whether there is a conflict of interest, that is, whether these transactions are at arm's length (on market terms).[15]

[15] See AP13C: Perceived conflict between IFRS 10 and IAS 28—feedback summary of the outreach activities undertaken with users.

29. Therefore, in the staff's view:

    (a) the IASB should not introduce requirements solely for anti-abuse reasons;

    (b) the feedback, from users of financial statements on disclosing gains or losses arising from transactions between an investor and its associate, is also relevant for transactions between a joint venturer and its joint venture; [16] and

    (c) disclosing that gain or loss, as noted in (b), would be similar to the IASB's decision on whether the equity method was appropriate method to account for investments in joint ventures, see paragraph 12 of this paper.

30. Furthermore, although the staff acknowledge that the burden on joint venturers to obtain information from joint ventures is likely to be less than the burden on investors to obtain information from associates,[17] the staff think that how easily a joint venturer can access the information does not justify the IASB deviating from its tentative decision, creating two versions of the equity method.

31. Finally, because the IASB has concluded that the equity method was appropriate for both investments in joint ventures and associates, any attempt to create two versions of the equity method would introduce unnecessary complexity in the literature of the IFRS Accounting Standards.

Questions for the IASB

Questions for the IASB
1. Do IASB members have comments or questions on the preliminary analysis in this paper?
2. Do you require any further information before the staff bring a decision-making paper to the IASB?

[16] See Agenda Paper 13C of this meeting.

[17] See paragraph 79(a) of AP13B: Perceived conflict between IFRS 10 and IAS 28.