IFRS Accounting

Staff paper

Agenda reference: 13C

IASB® meeting

Date	**September 2023**
Project	**Equity Method**
Topic	**Towards an Exposure Draft—Possible improvements to disclosure requirements for investments in associates**
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Introduction and purpose of this paper

1. The purpose of this paper is to ask the International Accounting Standards Board (IASB) to decide whether to propose amendments to improve the disclosure requirements for investments in associates arising from its tentative decisions on the Equity Method project to date.

2. The recommendation in this paper applies to investments in associates. The IASB will be asked at a future meeting whether its tentative decisions, including the possible improvements to disclosure requirements, should also be applied to investments in joint ventures and to investments in subsidiaries in separate financial statements.

Staff recommendation

3. The staff recommend the IASB propose amendments to IFRS 12 *Disclosure of Interests in Other Entities*:

   (a) to require an investor to disclose gains or losses arising from an increase or decrease in the associate's net assets that changes the investor's ownership interest if the investor continues applying the equity method and does not exchange consideration with its associate.

(b) to require an investor to disclose, for contingent consideration arrangements:

(i) *on obtaining significant influence in an associate*—the amount recognised at the acquisition date; a description of the arrangement and the basis for determining the amount of the payment; and an estimate of the range of outcomes (undiscounted).

(ii) *for each reporting period after the acquisition date until the investor collects or settles the contingent consideration or it is cancelled or expires*—any changes in the recognised amounts, including any differences arising upon settlement; any changes in the range of outcomes (undiscounted) and the reasons for those changes; and the valuation techniques and key model inputs used to measure the contingent consideration.

(c) to require an investor to disclose gains or losses resulting from transactions with its associates.

(d) to introduce a disclosure objective to disclose information that enables users to evaluate the changes in the amounts in an investor's financial statements arising from investments in associates.

(e) to require an investor to disclose a reconciliation between the opening and closing carrying amount of the investments in associates, to meet the objective in (d).

Structure of this paper

4. This paper is structured as follows:

(a) staff analysis:

(i) background (paragraphs 5–8 of this paper);

(ii) approach to the analysis (paragraph 9 of this paper);

(iii) implications of the IASB's tentative decisions (paragraph 10 of this paper);

(1) changes in an investor's interest while retaining significant influence (paragraphs 11–12 of this paper);

(2) contingent consideration (paragraphs 13–15 of this paper);

(3) transactions with associates (paragraphs 16–18 of this paper); and

(4) other topics (paragraph 19 of this paper);

(iv) input from users of financial statements (paragraphs 20–29 of this paper); and

(v) Post-implementation Review of IFRS 12 (paragraphs 30–32 of this paper); and

(b) question for the IASB.

Staff analysis

Background

5. Paragraph 20 of IFRS 12 requires an investor to disclose information on:

(a) the nature, extent and financial effects of its interests in joint arrangements and associates, including the nature and effects of its contractual relationship with the other investors with joint control of, or significant influence over, joint arrangements and associates; and

(b) the nature of, and changes in, the risks associated with its interests in joint ventures and associates.

6. Paragraphs 21–23 and B10–B20 of IFRS 12 set out disclosure requirements for investments in associates and joint ventures.

7. Paragraph 9 of IAS 24 *Related Parties* identifies an entity as a related party when one entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member). Paragraph 6 of IAS 24 states that a related party relationship could have an effect on the profit or loss and financial position of an entity. Paragraph 8 of IAS 24 explains that knowledge of an entity's transactions, outstanding balances, including commitments, and relationships with related parties may affect assessments of the entity's operations by users of financial statements, including assessments of the risks and opportunities facing the entity.

8. Finally, paragraph 24 of IFRS 8 *Operating Segments* requires an entity to disclose the amount of investments in associates accounted for by the equity method for each reportable segment, if the amount is included in the measure of segment assets reviewed by the chief operating decision maker or is otherwise regularly provided to the chief operating decision maker, even if not included in the measure of segment assets.

Approach to the analysis

9. In assessing possible improvements to the disclosure requirements, the staff considered:

   (a) implications of the IASB's tentative decisions on the Equity Method project;

   (b) input from users of financial statements; and

   (c) findings from the Post-implementation Review of IFRS 12.

Implications of the IASB's tentative decisions

10. The IASB has made tentative decisions[1] on:

    (a) changes in an investor's interest while retaining significant influence;

    (b) contingent consideration;

    (c) transactions with associates;

    (d) recognition of losses;

    (e) initial recognition of an investment in an associate—deferred taxes; and

    (f) impairment.

Changes in an investor's interest while retaining significant influence

11. At its September 2022 meeting, the IASB discussed how an investor recognises and measures changes in an associate's net assets that change the investor's ownership interest when the investor retains significant influence (dilution gains or losses). Applying the IASB's tentative decision, an investor would recognise a gain or loss in its profit or loss, as in a partial disposal whilst retaining significant influence.

12. Disclosing the gain or loss when the associate's net assets change which changes the investor's ownership interest and the investor retains significant influence would be helpful to users because:

    (a) the gain or loss arises from changes in an associate's net assets, and not from a cash transaction of the investor (that is, the investor does not directly exchange cash or other monetary items with the associate or third parties). Users are interested in understanding whether items in profit or loss generate cash or are part of the performance of an entity; and

[1] See Agenda Paper 13 *Towards an Exposure Draft—Cover paper* of this meeting for the IASB's tentative decisions on the Equity Method project.

(b) the IASB's tentative decision may require some investors to change accounting policies. The IASB's tentative decision will require gains and losses to be presented in profit and loss.

Contingent consideration

13. At its June 2023 meeting, the IASB tentatively decided how an investor would recognise and measure contingent consideration on obtaining significant influence in an associate. The IASB's tentative decision was derived from the recognition and measurement requirements for contingent consideration in IFRS 3 *Business Combinations*.

14. IFRS 3 includes the following disclosure requirements for contingent consideration:

(a) paragraph B64 requires an acquirer to disclose for each business combination that occurs during the reporting period:

(i) the amount recognised at the acquisition date for contingent consideration arrangements;

(ii) a description of the arrangement and the basis for determining the amount of the payment; and

(iii) an estimate of the range of outcome (undiscounted).

(b) paragraph B67 requires an acquirer to disclose for each reporting period after the acquisition date until the entity settles the contingent consideration or it is cancelled or expires:

(i) any changes in the recognised amounts, including any differences arising upon settlement;

(ii) any changes in the range of outcomes (undiscounted) and the reasons for those changes; and

(iii) the valuation techniques and key model inputs used to measure the contingent consideration.

15. The information required by paragraphs B64 and B67 of IFRS 3 is helpful in assessing the amount, timing and uncertainty of the entity's future cash flows. The staff think this is also true in the context of associates. In addition, we think the disclosures are consistent with the objective in paragraph 20(b) of IFRS 12—to disclose information that enables users to evaluate the nature of, and changes in, the risks associated with the interests in associates. Therefore, we recommend that the same disclosures are required for contingent consideration on obtaining significant influence in an associate.

Transactions with associates

16. At its March 2023 meeting, the IASB tentatively decided to propose that an investor should recognise the full gain or loss on all transactions with an associate. The IASB said it would consider improvements to the disclosure of these transactions. Paragraph 18 of IAS 24 requires disclosing the amount of these transactions and the amount of any outstanding balances.

17. Users' input confirmed that information on the financial impact of transactions between an investor and its associates is helpful because the terms of the transaction may be affected by the related party relationship. If an investor does not present the gain or loss on transactions with its associate as a separate item in its statement of comprehensive income, no information on the financial impact of these transactions will be available in the investor's financial statements. Consequently, the staff think that requiring an investor to disclose gains or losses result from transactions with its associates would be helpful to users.

18. Since IAS 24 applies to all transactions with related parties and not only associates, the staff recommend that the disclosure requirement is included in IFRS 12 and not in IAS 24.

Other topics

19. In the staff's view, the remaining IASB's tentative decisions (see paragraph 10 of this paper) do not trigger a need to improve in the disclosure requirements as they clarify how to apply the equity method in certain fact patterns.

Input from users of financial statements

20. The staff discussed with selected users of financial statements possible improvements to the disclosure requirements. One suggestion was to add a requirement to disclose a reconciliation between the opening and closing balance of investments in associates.

21. A reconciliation between the opening and closing balance of a line item is often required in IFRS Accounting Standards:

    (a) IFRS 13 *Fair Value Measurement*, for recurring fair value measurements categorised within Level 3 of the fair value hierarchy;

    (b) IAS 16 *Property, Plant and Equipment*, for each class of property, plant and equipment;

    (c) IAS 19 *Employee Benefits*, for defined benefit plans;

    (d) IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, for each class of provisions; and

    (e) IAS 38 *Intangible Assets*, for each class of intangible assets.

22. The staff reviewed these Standards for an explanation of why reconciliations provide useful information. In March 2021 the IASB issued the Exposure Draft *Disclosure Requirements in IFRS Standards—A Pilot Approach* (Exposure Draft) in which it proposed amendments to the disclosure requirements in IAS 19. In the Exposure Draft the IASB proposed to retain the requirement to provide a reconciliation of a defined benefit plan.

23. Paragraph BC144 of the Basis for Conclusions on IAS 19 explains that some users said that a complete numerical reconciliation from opening to closing amounts of the net defined benefit liability or asset provides useful information, whereas other users said they only use specific line items from such a reconciliation.

24. Reconciliations help in understanding the effects on the changes on the performance and cash flows in the period. During the development of the Exposure Draft, Capital Markets Advisory Committee (CMAC) members noted that a reconciliation of a defined benefit plan is useful to their analysis because it enables them to reconcile pension information to the statements of financial position and performance. CMAC members added that they would also like to be able to reconcile pension information to the statement of cash flows.

25. IAS 28 *Investments in Associates and Joint Ventures* has never included a requirement to disclose such a reconciliation of investments in associates. Staff acknowledge that as the scope of the project is to develop answers to application questions about the equity method, some could argue that proposing this requirement goes beyond the scope of the project.

26. However, in the staff's view, requiring a reconciliation between the opening and closing balance of the carrying amount of investments in associates would help users to understand the material changes in the balance. Especially as some changes arise from cash transactions (such as purchases, sales and dividends received), and some changes arise from non-cash transactions (such as the amount of the investor's share in the associate's profit or loss and other comprehensive income, and impairment losses).

27. A reconciliation in a tabular format is an effective way to explain changes in a balance over a reporting period. Some of the requirements in the IFRS Accounting Standards referenced in paragraph 21 of this paper specify the items to be shown in the reconciliation. We think that the IASB does not need to prescribe all the items for the reconciliation, but the reconciliation should disclose:

(a) the share of profit or loss and other comprehensive income;

(b) distributions received;

(c) increases and decreases for investments where the entity has started or discontinued applying the equity method. These would include changes arising from obtaining and losing significant influence; and

(d) impairment losses.

28. Separate disclosure of the amounts in paragraph 27 of this paper would allow users to assess the return on investments at the beginning of the period; how the change in the carrying amount is impacted by additions and disposals; and the risks associated with the investments.

29. In IAS 19, the reconciliation of a defined benefit plan is required to meet the disclosure objective in paragraph 135(b) of IAS 19—to identify and explain the amounts in an entity's financial statements arising from the entity's defined benefit plans. As noted in paragraph 5 of this paper, IFRS 12 requires an investor to disclose information on the nature, financial effects and risks associated with its interests in associates. Investors are not required to explain the amounts in its financial statements arising from its interests in associates, or any changes in these amounts. We think that if the IASB introduce a requirement for investors to disclose a reconciliation of investments in associates, it should also introduce a disclosure objective similar to the objective in paragraph 135(b) of IAS 19.

Post-implementation Review of IFRS 12

30. The IASB recently completed its Post-implementation Review (PIR) of IFRS 12. Some of the respondents said that whilst the information required by IFRS 12 is useful, additional information is needed for preparing valuation models for individually material joint ventures and associates. These respondents asked for more granular information, including interest-bearing borrowings, cash flow information, capital expenditure and total dividends received.

31. In some cases, it was unclear whether the perceived lack of information could be attributed to the requirements or to limited compliance with those requirements by entities.

32. In the IASB's response to the findings from its PIR of IFRS 12, it acknowledged users' requests for additional disclosure on interests in other entities. However, the IASB also noted that, in developing additional disclosure requirements, it would need to assess the costs of implementing the new requirements and the benefits of the additional information. Because the IASB concluded that entities can meet the disclosure objective of IFRS 12, it assessed the matter to be of low priority. Therefore, the IASB will consider the matter in the next agenda consultation to decide if it should take action. In the staff's view, no information received indicates that the IASB should review this decision.

Question for the IASB

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Does the IASB agree with the staff recommendation in paragraph 3 of this paper?