
IASB[®] meeting

Date	October 2025
Project	Equity Method
Topic	Transactions with associates—consideration of possible earnings management and enhancing disclosures (or guidance)
Contact	Mostafa Mouit (mmouit@ifrs.org)

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

Purpose of this paper

1. The purpose of this paper is for the International Accounting Standards Board (IASB) to consider:
 - (a) the feedback on the proposal in the Exposure Draft *Equity Method of Accounting—IAS 28 Investments in Associates and Joint Ventures (revised 202x)* (the Exposure Draft) to require an investor to recognise gains and losses in full resulting from all transactions with its associates from some respondents who raised concerns about possible earnings management and suggested enhancing disclosures or guidance.
 - (b) the staff's initial analysis on how to address that feedback.
2. This paper is a supporting paper for, and should be read in conjunction with, Agenda Paper 13B *Transactions with associates* of this meeting. This paper does not include staff recommendations or questions for the IASB, which are included in Agenda Paper 13B of this meeting.
3. References to 'investor', 'associate' and 'significant influence' should be read as also referring to 'joint venturer', 'joint venture' and 'joint control' in relation to

investments in joint ventures in consolidated financial statements, unless indicated otherwise.¹

Structure of this paper

4. This paper is structured as follows:
 - (a) scope of the analysis (paragraphs 6–8 of this paper);
 - (b) feedback on possible earnings management and suggestions for enhanced disclosures or guidance (paragraphs 9–11 of this paper); and
 - (c) staff's initial analysis (paragraphs 12–33 of this paper):
 - (i) opportunity to manage earnings (paragraphs 14–25 of this paper).
 - (ii) suggestions for enhanced disclosures or additional guidance (paragraphs 26–33 of this paper).
5. There is an appendix to this paper: Appendix A—Illustrative examples: Transactions between an investor and its associate.

Scope of the analysis

6. This paper does not consider the feedback on the related proposal to require an investor to disclose gains or losses resulting from 'downstream' transactions with its associates.
7. The staff acknowledge that concerns about possible earnings management were raised alongside suggestions to enhance disclosures or add guidance. Hence, there is a link between that feedback and the proposed disclosure requirement on downstream transactions. This paper is focused on those suggestions to enhance disclosures or add guidance to alleviate concerns about possible earnings management. A complete

¹ Entities are permitted to use the equity method in separate financial statements for investments in subsidiaries, joint ventures and associates.

discussion of the feedback on the proposed disclosure requirement will be presented in a future agenda paper.

8. To facilitate the discussions, the staff have developed illustrative examples, set out in Appendix A of this paper. The examples demonstrate how the proposal to recognise gains and losses in full resulting from all transactions with associates affect the investor's financial statements, compared to the requirements in paragraph 28 of IAS 28. Three examples are provided:
- (a) a downstream sale of inventory transaction;
 - (b) a downstream render of service transaction; and
 - (c) an upstream sale of equipment transaction.

Feedback on possible earnings management and suggestions for enhanced disclosures or guidance

9. As noted in paragraphs 23, 25(c), 30(c) and 32 of Agenda Paper 13B of this meeting, some respondents cautioned about possible earnings management or structuring opportunities, mainly for investments in joint ventures.² Not all these respondents provided fact patterns or circumstances in which the proposal would facilitate earnings management; however, a few of them said:
- (a) an investor with a business that is not performing well could have an incentive to conduct transactions with associates that are not on arm's length terms, for example, an investor might:
 - (i) structure a transaction that lacks commercial substance; or
 - (ii) manipulate transaction prices; and
 - (b) the potential risk of earnings management could be higher in the context of investments in joint ventures than for investments in associates.

² In this paper, the term 'earnings management' also includes references by respondents to 'structuring opportunities'.

-
10. Some of these respondents suggested enhanced disclosures or adding guidance to mitigate this potential risk of earnings management. These respondents made different suggestions, which can be grouped into the following categories:
- (a) introducing a requirement to disclose gains or losses from ‘upstream’ transactions, as this information is needed for users, similar to the proposal on ‘downstream’ transactions.
 - (b) introducing disclosures to improve transparency for users, for example, by disclosing the rationale for transactions and their pricing.
 - (c) introducing guidance on how the proposal applies to transactions that lack commercial substance, or creating an exception to the proposal if transactions lack commercial substance.
11. A few of these respondents suggested, in enhancing the disclosure requirements, disclosures only be required on aggregated information, particularly for transactions that are within the ordinary course of business, and ensuring that entities are not required to disclose commercially sensitive information.

Staff’s initial analysis

12. In the following paragraphs, the staff have initially analysed the feedback summarised in paragraphs 9–10 of this paper using the illustrative examples in Appendix A. That analysis includes:
- (a) opportunity to manage earnings; and
 - (b) suggestions to enhance disclosures or additional guidance.
13. For ease of comparison in the rest of this paper, the reference:
- (a) to ‘full gains and losses’ means the proposal in the Exposure Draft; that is, recognising gains and losses in full resulting from all ‘upstream’ and ‘downstream’ transactions with associates.

-
- (b) to ‘partial gains and losses’ means the requirements in paragraph 28 of IAS 28; that is, restricting gains or losses to the extent of the unrelated investors’ interests in an associate and recognising that restricted gains or losses in future periods when the asset is sold to a third party or over the useful life of the asset.

Opportunity to manage earnings

14. The concerns about possible earnings management are described in paragraph 9 of this paper. The term ‘earnings management’ is sometimes used to refer to the deliberate use of accounting techniques to manipulate reported earnings, for example, to match a pre-determined target.³
15. The staff, therefore, think that the concern raised by respondents can be stated as:
- “If an investor has the desire to manipulate reported earnings, for example, to match a pre-determined target, and is able to conduct transactions with associates that lack commercial substance or are not on arm’s length terms, the concern is whether ‘full gains and losses’ could be used as an earnings management tool, compared to ‘partial gains and losses’.”*
16. The concerns described in paragraph 9 of this paper are considered:
- (a) firstly in the context of transactions with associates (see paragraphs 17–23 of this paper); and
 - (b) secondly in the context of transactions with joint ventures (paragraphs 24–25 of this paper).

³ For example, see the Investopedia definition: [Earnings Management: Definition and Examples](#).

Investments in associates—transactions that lack commercial substance

17. As noted in paragraph 9(a)(i) of this paper, these stakeholders provided an example of an investor that could have an incentive to conduct transactions with associates that lack commercial substance.
18. Requirements in other IFRS Accounting Standards seek to mitigate the risk of this type of earnings management. For example, IFRS 15 *Revenue from Contracts with Customers* includes:
- (a) criteria for a contract to be within the scope of IFRS 15, including a criterion that the contract has commercial substance (that is, the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract), see paragraph 9(d) of IFRS 15.⁴
 - (b) a number of indicators of the transfer of control and provides guidance on assessing whether control has been transferred, such as on sales with a right of return, consignment arrangements and bill-and-hold arrangements.
19. Also, the disclosure requirements in IFRS Accounting Standards may draw users' attention to those transactions, for example:
- (a) the Basis for Conclusions on IFRS 18 *Presentation and Disclosure in Financial Statements* explains that the IASB expects that the disclosure of information about unusual (or similarly described) income and expenses will be improved by other requirements in IFRS 18, particularly the requirements relating to:
 - (i) the disaggregation of items with dissimilar characteristics—for example, if an item of income or expense lacks persistence, an entity would need to consider whether information about the lack of persistence of the item is material and needs to be disclosed; and

⁴ Paragraph BC40 of the Basis for Conclusions on IFRS 15 explains that the requirement was included when considering whether revenue should be recognised in contracts with customers that include non-monetary exchanges. The IASB noted that, without that requirement, entities might transfer goods or services back and forth to each other (often for little or no cash consideration) to artificially inflate their revenue.

-
- (ii) the description of items using labels that faithfully represent the characteristics of those items—for example, if an entity discloses an item because it lacks persistence, or is identified as unusual, it would be described as such.⁵
 - (b) the objective of IAS 24 *Related Party Disclosures* is to ensure that an entity's financial statements contain the disclosures necessary to draw users' attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions with such parties. Paragraph 18 of IAS 24 requires an entity to disclose the nature of the related party relationship, as well as information about transactions and outstanding balances, including commitments, necessary for users to understand the potential impact of the relationship on the financial statements.
20. Considering the illustrative examples in Appendix A of this paper, the staff note that:
- (a) for transactions that are transfers of assets, such as a downstream sale of inventory, to the extent that there is a risk an investor conducts a transaction with its associate in a manner that lacks commercial substance:
 - (i) applying 'partial gains and losses' could help to mitigate that existing risk of earnings management but only to some extent in downstream transactions, because the investor recognises 80% (and restricts only 20%) of the gain from that transaction in Year 1 and recognises that restricted 20% of the gain in Year 2.
 - (ii) applying 'full gains and losses' accelerates the recognition pattern of the gain from that transaction. In other words, the investor recognises 100% of the total gain described in (i) in Year 1.
 - (b) for downstream render of service transactions—as outlined in paragraph A6 of Appendix A to this paper, feedback is that, generally, preparers do not apply the requirements in paragraph 28 of IAS 28 to transactions that are not

⁵ For further details, please see paragraphs BC407–BC413 of the Basis for Conclusions on IFRS 18 *Presentation and Disclosure in Financial Statements*.

transfers of assets. If so, there will be no differences between ‘full gains and losses’ compared to ‘partial gains and losses’.

Investments in associates—manipulate transaction prices

21. As noted in paragraph 9(a)(ii) of this paper, these stakeholders provided examples of a situation in which an investor could manipulate transaction prices with associates.
22. Requirements in other IFRS Accounting Standards that could help to mitigate the risk of this type of earnings management include:
 - (a) as outlined in paragraph 19(b) of this paper, the disclosure requirements in paragraph 18 of IAS 24 may draw users’ attention to these transactions, such as requirements to disclose the nature of the related party relationship, as well as information about transactions and outstanding balances, including commitments, necessary for users to understand the potential impact of the relationship on the financial statements.
 - (b) for the counterparty of a transaction, for example, in the associate’s financial statements in a downstream transaction, IAS 2 *Inventories* and IAS 36 *Impairment of Assets* include requirements to assess impairment.
23. It could also be argued that:
 - (a) since the investor has only significant influence, transaction prices with its associate are likely to be negotiated on arm’s length terms and, therefore, the investor’s ability to manipulate prices is likely to be limited, particularly if any such manipulation would disadvantage the associate and its other investors.⁶
 - (b) any risk of manipulating transaction prices could exist regardless of whether ‘full gains and losses’ or ‘partial gains and losses’ is applied. In other words, if an investor is able to manipulate transaction prices and wishes to do so to achieve a desired accounting outcome, then ‘full gains and losses’ does not

⁶ For example, it would not be in the interests of the associate (or its other investors) if the associate were to pay above-market prices to the investor.

necessarily change that. For example, it results in a different pattern of transaction amounts to achieve that desired outcome.

Investments in joint ventures

24. As noted in paragraph 9(b) of this paper, these stakeholders said that the potential earnings management risk could be higher in the context of investments in joint ventures than for investments in associates. This is mainly because, in the circumstances of joint control, transaction prices between parties could be jointly negotiated on terms that are not arm's-length.
25. The staff think that much of the analysis outlined in paragraphs 17–23 of this paper also applies to transactions with joint ventures, for example:
- (a) the requirements in other IFRS Accounting Standards, as discussed in paragraphs 18–19 and 22(b) of this paper, help to mitigate the risk of earnings management.
 - (b) the risk of manipulating transaction prices, as discussed in 23(b) of this paper, could exist regardless of whether ‘full gains and losses’ or ‘partial gains and losses’ is applied.

Suggestions for enhanced disclosures or additional guidance

26. As noted in paragraph 7 of this paper, a complete discussion of the feedback on the proposed disclosure requirement on downstream transactions will be presented in a future agenda paper. In this section of the paper (paragraphs 27–33 of this paper), the staff outline some background information relating to some of the enhanced disclosures or additional guidance suggested by respondents in paragraph 10 of this paper. This background information is provided to acknowledge previous discussions by the IASB and the IFRS Interpretations Committee, and requirements in IFRS Accounting Standards, that could be relevant to considering these suggestions further, as recommended in Agenda Paper 13B.

Disclosing gains or losses from 'upstream' transactions

27. To mitigate the risk of earnings management, a few respondents suggested introducing a requirement to disclose gains or losses from 'upstream' transactions.
28. The IASB considered proposing such a disclosure requirement in developing the Exposure Draft. Paragraph BC145 of the Basis for Conclusions on the Exposure Draft explains that the IASB decided not to do so in the context of investments in associates because requiring disclosure of such information could be costly and require information that might not be readily available to the investor. In paragraphs BC164–BC165 of the Basis for Conclusions, the IASB observed that difficulties with accessing information are less likely to arise for joint venturers compared to investors. However, the IASB considered that requiring disclosure of gains or losses from 'upstream' transactions could still be costly, particularly if a joint venturer has many investments in joint ventures.

Disclosing the rationale for transactions and their pricing

29. To mitigate the risk of earnings management, a few respondents suggested introducing additional disclosures to improve transparency for users, for example, by disclosing the rationale for transactions and their pricing.
30. In September 2004, the IFRS Interpretations Committee (Committee) discussed an issue on '[*IAS 24: Interpretation of the term "information" in IAS 24 paragraph 18*](#)'. The Committee:
- (a) was asked to supplement the minimum disclosures in paragraph 17 of IAS 24 (the equivalent requirement is now in paragraph 18 of IAS 24). For example, it was suggested that an interpretation of paragraph 18 should specifically require disclosure of the purpose and economic substance of transactions, identity of related parties, extent of management involvement, special risks and the effect of such transactions on the financial statements; and

- (b) decided not to add this issue to its agenda, noting that the IASB, in its revisions to IAS 24 in 2003, debated the extent of specific minimum disclosure requirements and the suggested items were not included. The Committee agreed that, because of wider policy considerations, this issue might be appropriate for discussion by the IASB and, perhaps, the Standards Advisory Council.

Additional guidance on transactions that lack commercial substance

31. To mitigate the risk of earnings management, a few respondents suggested introducing additional guidance on how the proposal applies to transactions that lack commercial substance.
32. Requirements in IFRS Accounting Standards on transactions that lack commercial substance include the IFRS 15 criterion regarding ‘commercial substance’, as outlined in paragraph 18(a) of this paper. In addition, paragraph 54 of the Exposure Draft (carried forward from paragraphs 30–31 of IAS 28) specifies the accounting requirements for contributions of non-monetary assets to associates or joint ventures that lack ‘commercial substance’, as described in IAS 16 *Property, Plant and Equipment*, and are made in exchange for an equity interest in those associates or joint ventures.
33. Paragraph 54 of the Exposure Draft requires gains or losses on those contributions to be regarded as unrealised and eliminate it against the carrying amount of the investment. If, in addition to receiving an equity interest in the associate or joint venture, an investor or joint venturer receives monetary or non-monetary assets, the investor or joint venturer shall recognise in full in profit or loss the portion of the gain or loss on the non-monetary contribution relating to the monetary and non-monetary assets received.

Appendix A—Illustrative examples: Transactions between an investor and its associate

Illustrative example 1 — 'Downstream' transaction—Sale of inventory

- A1. A downstream sale of inventory transaction in which:
- (a) investor XYZ owns a 20% share in associate ABC.
 - (b) at Year 1, XYZ sells inventory to ABC for CU2,000 (transaction price is the same as in an arm's length transaction); XYZ's cost of sales is CU1,800. XYZ applies IFRS 15.
 - (c) as of the reporting date of Year 1, inventory remains in ABC stocks (that is, not yet sold to a third party). ABC sells inventory to a third party in March of Year 2.
 - (d) these types of transaction, as in (b) and (c), are recurring transactions for the following years.
 - (e) profit of ABC for Years 1 to 0x is CU500 each.
- A2. Table 1 sets out the result of applying the proposal in the Exposure Draft to the fact pattern in paragraph A1 of this Appendix.

Table 1: Extract | XYZ – Statement of profit or loss

Applying the proposal in the Exposure Draft				
	Year 1	Year 2	Year 3	Years 4 to 0x
Revenue	2,000	2,000	2,000	
Cost of sales	(1,800)	(1,800)	(1,800)	
Gross profit	200	200	200	Same as years 2–3
Share of ABC's profit	100	100	100	
Profit before tax	300	300	300	

- A3. Tables 2 and 3 set out the result of applying the requirements in paragraph 28 of IAS 28 to the fact pattern in paragraph A1 of this Appendix. It should be noted that

paragraph 28 of IAS 28 does not specify how to apply the requirement. Possible alternative approaches are:

- (a) a portion of the entire transaction is eliminated from both revenue and cost of sales and is recognised later as part of both revenue and cost of sales when ABC sells the inventory to a third party.

Table 2: Extract | XYZ – Statement of profit or loss

Applying the requirements in paragraph 28 of IAS 28 (revenue/cost of sales)				
	Year 1	Year 2	Year 3	Years 4 to 0x
Revenue	1,600	2,000	2,000	Same as years 2–3
Cost of sales	(1,440)	(1,800)	(1,800)	
Gross profit	160 ⁷	200 ⁸	200	
Share of ABC's profit	100	100	100	
Profit before tax	260	300	300	

- (b) eliminating only a portion of the gain (that is, CU40) against revenue, with the CU40 flowing through later as part of the share of ABC's profit when ABC sells the inventory to a third party.

Table 3: Extract | XYZ – Statement of profit or loss

Applying the requirements in paragraph 28 of IAS 28 (revenue/Share of profit)				
	Year 1	Year 2	Year 3	Years 4 to 0x
Revenue	1,960 ⁹	1,960	1,960	Same as years 2–3
Cost of sales	(1,800)	(1,800)	(1,800)	
Gross profit	160	160	160	
Share of ABC's profit	100	140 ¹⁰	140	
Profit before tax	260	300	300	

⁷ CU160 = CU1,600 {CU2,000 (full revenue) - CU400 (CU2,000 x 20% (restricting XYZ's portion of revenue))} - CU1,440 {CU1,800 (full cost of sales) - CU360 (CU1,800 x 20% (restricting XYZ's portion of cost of sales))}.

⁸ Same as in Year 1 as described in footnote 7 above, that is CU160 + CU40 {CU400 (CU2,000 x 20% (recognising restricted XYZ's portion of revenue from Year 1) - CU360 (CU1,800 x 20% (recognising restricted XYZ's portion of cost of sales from Year 1))}.

⁹ CU1,960 = CU2,000 (full revenue) - CU40 {(CU2,000 x 20% (restricting XYZ's portion of revenue) - (CU1,800 x 20% (restricting XYZ's portion of cost of sales))}.

¹⁰ CU140 = CU100 + CU40 (recognising restricted XYZ's portion of revenue from Year 1).

Illustrative example 2 — 'Downstream' transaction—Render of service

- A4. A downstream render of service transaction in which:
- (a) investor XYZ owns a 20% share in associate ABC.
 - (b) at Year 1, XYZ renders service to ABC for CU2,000 (transaction price is the same as in an arm's length transaction); XYZ's cost of sales is CU1,800. XYZ applies IFRS 15.
 - (c) this type of transaction is a recurring transaction for the following years.
 - (d) profit of ABC for Years 1 to 0x is CU500 each.
- A5. Table 4 sets out the result of applying the proposal in the Exposure Draft to the fact pattern in paragraph A4 of this Appendix.

Table 4: Extract | XYZ – Statement of profit or loss

Applying the proposal in the Exposure Draft				
	Year 1	Year 2	Year 3	Years 4 to 0x
Revenue	2,000	2,000	2,000	
Cost of sales	(1,800)	(1,800)	(1,800)	
Gross profit	200	200	200	Same as years 1–3
Share of ABC's profit	100	100	100	
Profit before tax	300	300	300	

- A6. As noted in paragraph 28 of Agenda Paper 13B of this paper, the feedback indicated that, generally, preparers do not currently apply the requirements in paragraph 28 of IAS 28 on transactions that are not transfers of assets.

- A7. Table 5 sets out the result of applying the current practice outlined in paragraph A6 of this Appendix to the fact pattern in paragraph A4 of this Appendix.

Table 5: Extract | XYZ – Statement of profit or loss

Applying current practice outlined in paragraph A6 of this Appendix				
	Year 1	Year 2	Year 3	Years 4 to 0x
Revenue	2,000	2,000	2,000	
Cost of sales	(1,800)	(1,800)	(1,800)	
Gross profit	200	200	200	Same as years 1–3
Share of ABC's profit	100	100	100	
Profit before tax	300	300	300	

Illustrative example 3 — 'Upstream' transaction—Sale of equipment

- A8. An upstream sale of equipment transaction in which:
- (a) investor XYZ owns a 20% share in associate ABC.
 - (b) at the beginning of Year 1, ABC sells to XYZ equipment for a consideration of CU1,500. At that date, the net book value of such equipment in ABC's financial statements is CU1,200 and therefore ABC recognises a profit of CU300.
 - (c) XYZ estimates that the equipment has a 3-year life, a residual value of zero and plans to depreciate it on a straight-line basis.
 - (d) profit of ABC for Year 1 is CU800 and for Years 2 to 4 is CU500 each.
- A9. Table 6 sets out the result of applying the proposal in the Exposure Draft to the fact pattern in paragraph A1 of this Appendix.

Table 6: Extract | XYZ – Statement of profit or loss

Applying the proposal in the Exposure Draft				
	Year 1	Year 2	Year 3	Year 4
Revenue (ordinary activities)	1,000	1,000	1,000	1,000
Depreciation	(500)	(500)	(500)	-
Share of ABC's profit	160	100	100	100
Profit before tax	660	600	600	1,100

A10. Table 7 sets out the result of applying the requirements in paragraph 28 of IAS 28 to the fact pattern in paragraph A1 of this Appendix.

Table 7: Extract | XYZ – Statement of profit or loss

Applying the requirements in paragraph 28 of IAS 28				
	Year 1	Year 2	Year 3	Year 4
Revenue (ordinary activities)	1,000	1,000	1,000	1,000
Depreciation	(500)	(500)	(500)	-
Share of ABC's profit	120 ¹¹	120	120	100
Profit before tax	620	620	620	1,100

¹¹ CU120 = CU160 (share of ABC's profit) – CU60 {CU300 x 20% (restricting XYZ's portion of ABC's earning of disposing the equipment)} + CU20 (recognising the restricted proportion of the gain over the useful life of the equipment; CU60 / 3 years). However, other possible alternative approach could be adjusting the equipment (not the carrying amount of the investment), meaning that the share of ABC's profit would be CU100 each year while the depreciation would be CU480.