



**IFRS<sup>®</sup>**

Accounting

September 2024

# Exposure Draft

IFRS<sup>®</sup> Accounting Standard

## **Basis for Conclusions on Equity Method of Accounting**

*IAS 28 Investments in Associates and Joint Ventures*  
(revised 202x)

Comments to be received by 20 January 2025

Basis for Conclusions on the Exposure  
Draft

*Equity Method of Accounting*

IAS 28 Investments in Associates and Joint  
Ventures (*revised 202x*)

*Comments to be received by 20 January 2025*

This Basis for Conclusions accompanies the Exposure Draft IASB/ED/2024/7 Equity Method of Accounting—IAS 28 *Investments in Associates and Joint Ventures* (revised 202x) (published September 2024; see separate booklet). It is published by the International Accounting Standards Board (IASB) for comment only. Comments need to be received by **20 January 2025** and should be submitted by email to [commentletters@ifrs.org](mailto:commentletters@ifrs.org) or online at <https://www.ifrs.org/projects/open-for-comment/>.

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## **Basis for Conclusions on Exposure Draft *Equity Method of Accounting—IAS 28 Investments in Associates and Joint Ventures (revised 202x)***

*This Basis for Conclusions accompanies, but is not part of, the Exposure Draft Equity Method of Accounting—IAS 28 Investments in Associates and Joint Ventures (revised 202x). It summarises the considerations of the International Accounting Standards Board (IASB) in developing the Exposure Draft. Individual IASB members gave greater weight to some factors than to others.*

### **Background**

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- BC1 IFRS Accounting Standards require entities to use the equity method in their consolidated financial statements for investments in associates and joint ventures (unless exempt from doing so). Entities are permitted to use the equity method in separate financial statements for investments in subsidiaries, joint ventures and associates. IAS 28 *Investments in Associates and Joint Ventures* sets out how to apply the equity method.<sup>1</sup>
- BC2 The IASB added a research project on the equity method to its work programme following its 2011 Agenda Consultation. Stakeholder feedback at that time suggested the need for a fundamental review of the equity method. Some stakeholders questioned its usefulness to users of financial statements (users) and others identified application questions faced by preparers of financial statements (preparers). In June 2015, the IASB started work on a limited-scope research project on the equity method.
- BC3 In May 2016, after reviewing progress on the research project and feedback on the 2015 Agenda Consultation, the IASB decided to stop working on the project until it assessed feedback from the Post-implementation Review of IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities* (Post-implementation Review).
- BC4 In April 2020, the IASB considered the findings from the first phase of the Post-implementation Review and decided to focus on specific matters in the next phase. Those matters did not relate to the requirement introduced by IFRS 11 for a joint venturer to account for its interests in joint ventures using the equity method and generally did not relate to the application of the equity method.
- BC5 Therefore, in October 2020, the IASB decided that it need not complete the Post-implementation Review before restarting work on the research project on the equity method. The IASB considered the scope of the project, including whether to undertake a fundamental review of the equity method or focus on application questions. The IASB decided not to undertake a fundamental review of the equity method, which:

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<sup>1</sup> All references to IAS 28 *Investments in Associates and Joint Ventures* in this Basis for Conclusions relate to the issued version of IAS 28, not to the [Draft] IAS 28 *Investments in Associates and Joint Ventures (revised 202x)* set out in the Exposure Draft *Equity Method of Accounting—IAS 28 Investments in Associates and Joint Ventures (revised 202x)*. The Table of Concordance shows how the contents of IAS 28 (issued version) and [Draft] IAS 28 (revised 202x) correspond.

- (a) would have required the IASB to consider whether the equity method should continue to be used and, if so, for which types of investments in other entities. The IASB noted that in developing the *Conceptual Framework for Financial Reporting (Conceptual Framework)*, it did not consider whether and how the economic entity perspective or the reporting entity concept could affect the use of the equity method.
  - (b) might have resulted in fundamental changes to the equity method. The IASB noted that the equity method is well established and fundamental changes would require significant stakeholder support.
- BC6 The IASB decided instead to focus on developing answers to application questions. This approach would, in a shorter time, provide preparers with solutions to long-standing application difficulties, reduce diversity in practice and lead to more comparable and understandable information for users.
- BC7 The IASB also decided to assess whether application questions could be answered using the principles that underlie IAS 28. Therefore, the project focused on:
- (a) identifying application questions and deciding which of these questions to answer;
  - (b) identifying the principles that underlie IAS 28; and
  - (c) answering the applications questions by applying those principles.
- BC8 In April 2023, the IASB decided to move the research project to its standard-setting work plan. Because of the project's focus on answering application questions, rather than a fundamental review, the IASB decided to work towards publishing an exposure draft, rather than first publishing a discussion paper. The scope of the project excludes, for example:
- (a) whether the equity method is a one-line consolidation or a measurement method;
  - (b) the scope of application of the equity method;
  - (c) the definition of significant influence; and
  - (d) how to assess whether an entity has significant influence.
- BC9 The IASB also noted that, compared with a discussion paper, an exposure draft would provide a more effective and timely way of obtaining stakeholder feedback on its proposed answers to application questions.

### Identifying the application questions

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- BC10 The IASB developed an initial list of application questions about the equity method from various sources, including:
- (a) its past work;
  - (b) submissions to the IFRS Interpretations Committee;
  - (c) feedback from the Global Preparers Forum;

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- (d) the research report *The Equity Method* published by the Korea Accounting Standards Board in September 2014; and
  - (e) outreach with national standard-setters, accounting firms and regulators.
- BC11 The IASB selected application questions to include in the scope of the project based on whether the question:
- (a) had not already been resolved;
  - (b) could be resolved efficiently and effectively without:
    - (i) fundamentally revising IAS 28; or
    - (ii) amending other IFRS Accounting Standards (other than by making consequential amendments);
  - (c) affected the consistent application of IAS 28; or
  - (d) involved a matter that was widespread or occurred frequently.
- BC12 The IASB selected an initial list of application questions to answer, then added other application questions as the project progressed. These additional questions were added if they were resolved by the proposed solution to a question from the initial list.
- BC13 Table 1 sets out the application questions the proposals in the Exposure Draft aim to answer. The IASB first developed proposed solutions to the application questions in the context of applying the equity method as set out in IAS 28 to investments in associates, so the questions in Table 1 are expressed in those terms. The IASB later considered whether these proposed solutions should also apply to other types of investments to which the equity method is applied (see paragraphs BC107–BC133).

**Table 1—Application questions in the scope of the project**

Application question topic	From paragraph
<b>Changes in an investor's ownership interest on obtaining significant influence</b>	BC17
How does an investor initially measure the carrying amount of an investment in an associate?	
If an investor with a previously held interest in an entity acquires an additional interest and obtains significant influence, does the initial measurement of the investment in an associate include the original purchase cost of the previously held interest or the carrying amount of that interest applying IFRS 9 <i>Financial Instruments</i> ?	

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<b>Changes in an investor's ownership interest while retaining significant influence</b>	BC20
How does an investor apply the equity method when purchasing an additional interest in an associate while retaining significant influence?	
How does an investor apply the equity method when disposing of an interest in an associate while retaining significant influence?	
Does an investor recognise its share of other changes in an associate's net assets that change the investor's ownership interest while retaining significant influence, and, if so, how is the change presented?	
How does an investor account for the associate's issue of shares while retaining significant influence?	
<b>Recognition of losses</b>	BC47
Is an investor that has reduced its interest in an associate to nil required to 'catch up' losses not recognised if it purchases an additional interest in the associate?	
Does an investor that has reduced its interest in an associate to nil recognise each component of comprehensive income separately?	
Does an investor that has reduced its interest in an associate to nil continue eliminating its share of gains arising from a downstream transaction?	
<b>Transactions with associates</b>	BC63
How should an investor recognise gains or losses that arise from the sale of a subsidiary to its associate, applying the requirements in IFRS 10 and IAS 28?	
Does an investor recognise the portion of its share of the gain in a downstream transaction that exceeds the carrying amount of its investment in the associate?	
Does an investor eliminate its share of a gain or loss in an upstream transaction from the carrying amount of the investment in the associate or the acquired asset?	
Is the provision of services and transactions that are not transfers of assets an upstream or downstream transaction?	
Should the requirement for the adjustment of gains or losses in intra-group transactions between subsidiaries apply by analogy to transactions between investees that are accounted for applying the equity method?	

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Does an investor eliminate its share of a gain or loss in a downstream transaction against the transaction gain or loss or the share of the associate's profit or loss?	
When an investor sells an item of property, plant or equipment to an associate and leases it back:  (a) IFRS 16 <i>Leases</i> requires an entity to recognise only the amount of gain or loss that relates to the rights transferred; whereas  (b) IAS 28 requires an investor to adjust its share of the gain or loss.  Does applying both requirements 'double-count' the elimination of the investor's share of the gain or loss?	
<b>Deferred taxes</b>	BC85
Does an investor include in the carrying amount of an investment in an associate the deferred tax effects related to measuring at fair value its share of the associate's identifiable assets and liabilities on initial recognition of the investment?	
<b>Contingent consideration</b>	BC89
How does an investor, initially and subsequently, recognise and measure contingent consideration for an investment in an associate?	
<b>Impairment of the investment</b>	BC94
Does an investor assess a decline in fair value in relation to the original purchase cost or the carrying amount at the reporting date?	

BC14 In selecting the application questions set out in Table 1, the IASB acknowledged that stakeholders had raised other application questions. The IASB decided to exclude application questions that did not meet the selection criteria (see paragraph BC11) or that were related to matters outside the scope of the project (see paragraph BC8).

## Identifying the principles underlying IAS 28

BC15 As explained in paragraph BC7, the IASB identified the principles underlying IAS 28 to help it to develop proposed answers to the application questions set out in Table 1. The IASB first reviewed the Standard's requirements and the related paragraphs in its Basis for Conclusions. The requirements were then grouped by topic and, for each group, the IASB identified an underlying principle (see Table 2). The IASB also considered the *Conceptual Framework* and requirements in other IFRS Accounting Standards in some cases.

Table 2—Principles identified as underlying IAS 28

Group	Category of principles Principles identified	Paragraph(s)
	<b>Classification</b>	
A	Power to participate is an investor's shared power to affect changes in, and to access, net assets.	IAS 28.3 <i>Definition</i> IAS 28.5–9 IAS 28.12–14
	<b>Boundary of the reporting entity</b>	
B	Application of the equity method includes an investor's share in the associate's or joint venture's net asset changes in the investor's statement of financial position.	IAS 28.3 <i>(Definition)</i> IAS 28.10–11 IAS 28.35
C	An investor's share of an associate's or joint venture's net assets is part of the reporting entity.	IAS 28.28
	<b>Measurement on initial recognition</b>	
D	Fair value at the date an investor obtains significant influence or joint control provides the most relevant information about, and faithful representation of, an associate's or joint venture's identifiable assets and liabilities.	IAS 28.30–31B IAS 28.32 IFRS 3.BC25 IFRS 3.BC198
	<b>Subsequent measurement</b>	
E	An investor recognises changes in an associate's or joint venture's net assets. An investor recognises the share of changes in net assets that it can currently access.	IAS 28.3 <i>(Definition)</i> IAS 28.10–13 IAS 28.26 IAS 28.28 IAS 28.30–31B IAS 28.33–36 IAS 28.37
F	An investor's maximum exposure is its gross interest in an associate or joint venture.	IAS 28.14A IAS 28.29 IAS 28.38–43
G	If an investor's ownership interest in an associate or joint venture decreases and the investor continues to apply the equity method, it reclassifies amounts previously recognised in other comprehensive income.	IAS 28.24–25

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	Derecognition	
H	An investor: (a) applies IFRS 3 <i>Business Combinations</i> and IFRS 10 if it obtains control of a former associate or joint venture; (b) applies IFRS 9 if it no longer has significant influence or joint control, but retains an interest in a former associate or joint venture; and (c) recognises a gain or loss and reclassifies amounts recognised in other comprehensive income on the date that significant influence or joint control is lost.	IAS 28.22–23 IFRS 3.41–42
	<b>Unallocated (not in the project's scope)</b>	
N/A	Presentation	IAS 28.15 IAS 28.20–21
N/A	Exceptions to the application of the equity method	IAS 28.16–19 IAS 28.27 IAS 28.36A

BC16 Some application questions do not relate directly to the principles identified. The IASB decided to develop proposed answers to those application questions by analogising to the principles where possible and by considering the requirements in IAS 8 *Basis of Preparation of Financial Statements* for developing an accounting policy, including:

- (a) the requirements in IFRS Accounting Standards dealing with similar and related issues; and
- (b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the *Conceptual Framework*.

## Answering the application questions—Proposed amendments to IAS 28

### Changes in an investor's ownership interest on obtaining significant influence

BC17 Paragraph 32 of IAS 28 requires an investor, on obtaining significant influence of an associate, to account for the difference between the cost of the investment and the investor's share of the net fair value of the associate's identifiable assets and liabilities as goodwill (or a bargain purchase gain). However, IAS 28 does not specify how to measure the cost of the investment

when obtaining significant influence, resulting in diversity in practice. Application questions include:

- (a) how an investor initially measures the carrying amount of an investment in an associate; and
- (b) if an investor with a previously held interest in an entity acquires an additional interest and obtains significant influence, whether the initial measurement of the investment in an associate includes the original purchase cost of the previously held interest or the carrying amount of that interest applying IFRS 9.

BC18 The IASB decided to propose requiring the cost of an associate on obtaining significant influence to be measured at the fair value of the consideration transferred, including the fair value of any previously held ownership interest. In reaching this decision, the IASB considered that:

- (a) obtaining significant influence changes both the relationship between the investor and the investee, and the accounting method used by the investor. In effect, the investor exchanges its previously held financial asset for an investment in an associate. Therefore, the fair value of the financial asset given up at the date of obtaining significant influence represents part of the consideration transferred for the investment in an associate.
- (b) measuring the cost of the investment at fair value would align with Principle D (see Table 2), which measures the associate's identifiable assets and liabilities at fair value on obtaining significant influence.
- (c) measuring the previously held interest at fair value would not be overly costly for entities to apply because before obtaining significant influence, the previously held interest would have been measured at fair value in accordance with IFRS 9.

BC19 The IASB also decided to remove the presentation requirement in paragraph 32 of IAS 28 to include a bargain purchase gain in the determination of the investor's share of the associate's profit or loss. The IASB considered that:

- (a) IFRS 18 *Presentation and Disclosure in Financial Statements* specifies requirements on presenting income and expenses in an investor's statement of profit or loss, including requirements on aggregating and disaggregating income and expenses when presenting line items.
- (b) retaining a requirement on presenting a bargain purchase gain might suggest the IASB should also develop requirements on presenting other types of income and expenses recognised when applying the equity method. The IASB's view is that such requirements are unnecessary, given the requirements in IFRS 18.

### **Changes in an investor's ownership interest while retaining significant influence**

- BC20 After initial recognition of an investment in an associate, the investor's ownership interest in the associate might change, while the investor retains significant influence. Application questions about such changes include:
- (a) how an investor applies the equity method when purchasing an additional ownership interest in an associate while retaining significant influence (paragraphs BC21–BC27);
  - (b) how an investor applies the equity method when disposing of an ownership interest in an associate while retaining significant influence (paragraphs BC28–BC35); and
  - (c) whether an investor recognises its share of other changes in an associate's net assets that change the investor's ownership interest while retaining significant influence and, if so, how any resulting gain or loss is presented—for example, how an investor accounts for an associate's issue of shares while the investor retains significant influence (paragraphs BC36–BC46).

### **Purchase of an additional ownership interest**

- BC21 IAS 28 does not specify how an investor is required to account for the purchase of an additional interest in an associate while retaining significant influence. In practice, approaches vary as to how the investor measures its additional share of the associate's identifiable assets and liabilities, and how the investor recognises the difference between the cost of the additional interest and the additional share of the associate's identifiable assets and liabilities.
- BC22 The IASB decided to propose requiring the investor, at the date of purchase:
- (a) to recognise that additional ownership interest and measure it at the fair value of the consideration transferred;
  - (b) to include in the carrying amount of that additional ownership interest the investor's share of the fair value of the associate's identifiable assets and liabilities; and
  - (c) to account for any difference between (a) and (b) either as goodwill included as part of the carrying amount of the investment or as a gain from a bargain purchase in profit or loss.<sup>2</sup>

- BC23 In reaching the decision in paragraph BC22(a), the IASB considered whether to require an investor to remeasure the carrying amount of the previously held interest when it purchases an additional interest in an associate. The IASB decided to use an approach that would result in the investor measuring its additional interests in an associate after obtaining significant influence as an accumulation of purchases, so the investor would not remeasure the carrying amount of its previously held interest in its associate, because:

<sup>2</sup> See paragraphs BC89–BC93 and BC85–BC88 for additional points on contingent consideration and deferred taxes on the purchase of an additional ownership interest in an associate.

- (a) in this circumstance, the purchase of an additional interest would not change the relationship between an investor and an investee, or the accounting method an investor applies. Therefore, the rationale for the IASB's decision on remeasuring the previously held interest on obtaining significant influence (see paragraphs BC17–BC18) does not apply to the purchase of an additional interest.
- (b) the proposed approach is consistent with the requirements in IFRS 11. If a joint operator purchases an additional interest in a joint operation while retaining joint control, its previously held interest in the joint operation is not remeasured.
- (c) if an investor remeasured the previously held interest when it purchased an additional interest, that would result in the investor measuring an investment in an associate at its fair value intermittently—only when it purchased an additional interest in the associate—which would be unlikely to provide useful information to users, particularly in the statement of profit or loss.

BC24 In reaching the decision in paragraph BC22(b), the IASB considered that measuring the investor's additional share of the associate's identifiable assets and liabilities at their fair value at the date of purchasing the additional interest would:

- (a) be consistent with Principle D (see Table 2), providing relevant information about the investor's additional share of the associate's identifiable assets and liabilities, and consistent with the IASB's view when developing IFRS 3 that measuring the acquiree's identifiable assets and liabilities at fair value provides relevant information.
- (b) be consistent with the requirements in IFRS 11 that an entity applies when it acquires an interest in a joint operation in which the activity of the joint operation constitutes a business. IFRS 11 requires the entity to apply all the principles on business combinations accounting in IFRS 3 that do not conflict with the guidance in IFRS 11, including measuring identifiable assets and liabilities at fair value.
- (c) faithfully represent any additional goodwill included in the investment, as the additional goodwill would be measured in the same way as the initial goodwill included in the investment on obtaining significant influence.

BC25 In reaching the decision in paragraph BC22(c), the IASB considered whether to require an investor:

- (a) to offset the gain from a bargain purchase against the goodwill previously included in the carrying amount of the investment when the investor obtained significant influence; or
- (b) to recognise the gain from a bargain purchase in profit or loss.

- BC26 The IASB decided to propose requiring an investor to recognise the gain in profit or loss. The IASB noted that its approach to accounting for a purchase of an additional interest in an associate would result in the investor's interest in the associate being measured as an accumulation of purchases (see paragraph BC23). The purchase of that additional interest would not result in the remeasurement of the previously held interest. The proposed requirement would, therefore, measure the purchase of the initial interest and each additional interest separately. Given this approach, it would not be appropriate to offset a gain from the purchase of an additional interest against goodwill previously included in the carrying amount of the investment on the purchase of the initial interest.
- BC27 The IASB also decided that a bargain purchase gain could be an indication of impairment and considered the matter further as part of addressing a related application question about impairment (see paragraphs BC94–BC106).

#### **Disposal of an ownership interest**

- BC28 IAS 28 does not include requirements on how an investor accounts for a disposal of a portion of its investment in an associate while retaining significant influence (a partial disposal), resulting in diversity in practice.
- BC29 The IASB decided to propose requiring the investor at the date of the disposal:
- (a) to derecognise the disposed portion of its investment in the associate;
  - (b) to measure the disposed portion of its investment as a percentage of the carrying amount of the investment (that percentage is calculated as the disposed ownership interest divided by the total ownership interest); and
  - (c) to recognise any difference between the consideration received and the disposed portion as a gain or loss in profit or loss.
- BC30 In reaching the decision in paragraph BC29, the IASB considered its proposed approach for when an investor purchases an additional ownership interest while retaining significant influence. The IASB's proposed approach would result in the investor measuring its additional interests as an accumulation of purchases (see paragraph BC23). The IASB considered whether that approach would have any implications for subsequent measurement and derecognition of the investment, that is, whether the investment should be viewed as:
- (a) a single unit of account—applying this view, the investment would subsequently be measured as a single investment in an associate; or
  - (b) comprising multiple components—applying this view, the investment would comprise multiple individual layers (the initial layer when obtaining significant influence and an additional layer for each additional interest purchased after obtaining significant influence), each measured separately.



- BC31 Differences between the two views described in paragraph BC30 include the measurement of impairment losses and the measurement of the derecognised portion of the investment in a partial disposal. If the investment is viewed as a single unit of account, an investor would:
- (a) test the entire carrying amount of the investment for impairment, which is consistent with the requirements in paragraph 42 of IAS 28; and
  - (b) measure the derecognised portion of the investment in a partial disposal as a percentage of the carrying amount of the investment.
- BC32 However, if the investment is viewed as comprising multiple layers, the investor would test each layer of the investment for impairment individually, potentially resulting in an impairment loss recognised on some layers but not others. That outcome could arise because:
- (a) the recoverable amount of each layer would be proportionate to the total recoverable amount of the investment (if all the instruments held in the associate have the same economic rights); but
  - (b) the carrying amount of each layer would not be proportionate to the total carrying amount of the investment.
- BC33 Also, if the investment is viewed as comprising multiple layers, the investor would need to determine which layer of the investment to derecognise in a partial disposal. Possible approaches include:
- (a) specific identification, if the investor is able to determine which specific layer has been disposed of; and
  - (b) the use of a cost formula, such as first in, first out (FIFO), or last in, first out (LIFO), or weighted average.
- BC34 The IASB noted that viewing the investment as a single unit of account would be more consistent with the principles underlying IAS 28, in particular, Principles B and E (see Table 2). Applying those principles, an investor recognises amounts based on its share of changes in the associate's net assets, which suggests that the investment should be measured as a single unit and not separately for each layer.
- BC35 The IASB also considered that viewing the investment as a single unit of account instead of comprising multiple layers would:
- (a) provide a more faithful representation of an investment that comprises instruments with the same economic rights, because each instrument is fungible;
  - (b) reflect that an investment in an associate is usually managed as a single asset;
  - (c) be more understandable (for example, the measurement of the amount derecognised in a partial disposal would be easier to understand); and
  - (d) be less complex and, therefore, less costly for entities to apply.

**Other changes in the investor's ownership interest**

- BC36 Paragraph 10 of IAS 28 requires that when applying the equity method, the carrying amount of an investment in an associate is increased or decreased to recognise:
- (a) the investor's share of the associate's profit or loss and other comprehensive income; and
  - (b) distributions received from the associate.
- BC37 IAS 28 does not specify whether or how an investor is required to recognise other changes in its ownership interest arising from transactions in which the associate:
- (a) issues or redeems its shares (paragraphs BC39–BC44); or
  - (b) grants an equity-settled share-based payment or issues a share warrant (paragraphs BC45–BC46).
- BC38 The approaches applied in practice vary. For example, some investors recognise the dilution of their ownership interest arising from an associate's issue of shares to other parties, but other investors do not. Investors that recognise the dilution present the resulting dilution gain or loss in various ways.
- Issue or redemption of shares by an associate*
- BC39 An associate's net assets might increase or decrease because of the issue or redemption of its shares. If all existing shareholders take part in the share issue or redemption in proportion to their existing ownership interests, the investor's ownership interest and, therefore, its share of the associate's net assets would not change.
- BC40 However, a share issue or redemption by an associate sometimes changes the investor's ownership interest and, therefore, the investor's share of the associate's net assets. Such transactions include:
- (a) transactions in which the investor exchanges consideration with the associate. For example, an investor could be the only shareholder that subscribes to newly-issued shares in the associate.
  - (b) transactions in which the investor does not exchange consideration with the associate. For example, if other parties subscribe to new shares issued by the associate, but the investor does not, the investor's ownership interest would be diluted, decreasing its share in the associate's net assets.
- BC41 For the transactions described in paragraph BC40, the IASB decided to propose requiring an investor that retains significant influence to:
- (a) recognise an increase in its ownership interest, as if purchasing an additional ownership interest (see paragraphs BC21–BC27); and
  - (b) recognise a decrease in its ownership interest, as if disposing of an ownership interest (see paragraphs BC28–BC35).

- BC42 In reaching this decision, the IASB considered that, regardless of whether an investor exchanges consideration with an associate in such transactions, the investor should reflect the effect of those transactions on its investment in the associate. As illustrated by paragraph BC40(b), the investor does not need to be a party to the transaction for the investor's ownership interest (and, therefore, its share of the associate's net assets) to be affected by the associate's share issue or redemption. Paragraph 1.12 of the *Conceptual Framework* explains that general purpose financial statements provide information about the effects of transactions and other events that change a reporting entity's economic resources and claims. The dilution of the investor's ownership interest is an event that changes the investor's economic resources, because the investor has a smaller share of a larger pool of the investee's net assets. Such a change could affect, for example, the investor's cash inflows from distributions received from the associate.
- BC43 The IASB also noted that its proposed approach would be consistent with the definition of the equity method in paragraph 3 of IAS 28, which states that the investment is adjusted for the post-acquisition change in the investor's share of the investee's net assets. Therefore, aligning the requirements in paragraph 10 of IAS 28 with the definition of the equity method would resolve a perceived internal inconsistency within IAS 28.
- BC44 The IASB also considered whether to require an investor to present a dilution gain or loss in profit or loss or in other comprehensive income. The gain or loss arises from a change in the investor's assets (the investment in the associate) and is, therefore, an item of income or expense. In principle, all income and expenses are included in the statement of profit or loss. The IASB did not identify any reason to require an investor to present the dilution gain or loss in other comprehensive income instead of in profit or loss. Also, requiring an investor to present the gain or loss in other comprehensive income would raise a further question about whether and when to require the investor to reclassify the gain or loss to profit or loss. Furthermore, requiring an investor to present that gain or loss in profit or loss would be consistent with the IASB's proposed approach for other gains or losses arising from the disposal of an interest in an associate.

*Equity-settled share-based payments and share warrants*

- BC45 In an equity-settled share-based payment arrangement in which an associate grants share options to its employees, the grant is typically subject to vesting conditions, such as the employee completing a specified period of service. Applying IFRS 2 *Share-based Payment*, the associate would recognise the employee services received over the vesting period, with a corresponding increase in equity. Subsequently, if the employee exercised the option, the associate would recognise the proceeds received (from the employee's payment of the exercise price) and the issue of shares. That share issue would dilute the investor's ownership interest in the associate. The IASB's proposed requirements for recognising the dilution of an investor's ownership interest in a partial disposal (see paragraphs BC39–BC44) do not address all aspects of accounting for these transactions, such as when the investor should recognise that dilution (or potential dilution)—over the vesting period or on the exercise

date. A similar question arises when an associate issues a share warrant to another party.

- BC46 Stakeholder feedback indicated that, in practice, there are many types of transactions in which entities issue potentially dilutive instruments, particularly in employee share-based payment arrangements. The IASB, therefore, considered that developing requirements to address such transactions when applying the equity method would have been time consuming and would probably delay the project considerably. Stakeholder feedback also suggested that such transactions typically do not have a pervasive or significant effect for investors. Therefore, in the IASB's view, the costs of developing requirements to address these transactions when applying the equity method were likely to outweigh the benefits, and so it did not address them.

### **Recognition of losses**

- BC47 Paragraph 38 of IAS 28 requires that if an investor's share of losses equals or exceeds its interest in the associate, the investor discontinues recognising its share of further losses. Paragraph 39 of IAS 28 requires that, after the carrying amount of the investor's interest is reduced to nil, additional losses are provided, and a liability is recognised, only to the extent that the investor has incurred legal or constructive obligations or made payments on behalf of the associate. If the associate subsequently reports profits, the investor resumes recognising its share of those profits only after its share of profits equals the share of losses not recognised.

- BC48 Application questions relating to an investor that has reduced its interest in an associate to nil include:

- (a) whether the investor is required to 'catch up' unrecognised losses if it purchases an additional interest in the associate (paragraphs BC50–BC55); and
- (b) whether the investor recognises each component of comprehensive income separately (paragraphs BC56–BC62).

- BC49 The application questions on the recognition of losses in the project's scope (see Table 1) also include a third application question, about whether an investor that has reduced its interest in an associate to nil is required to continue to eliminate its share of gains arising from downstream transactions. However, the IASB's proposed requirement for an investor to recognise such gains in full (see paragraphs BC63–BC84) would resolve this application question.

### **Losses not recognised and purchase of an additional interest**

- BC50 IAS 28 does not specify whether an investor that has reduced its investment in an associate to nil should, at the date of purchasing an additional ownership interest, recognise its share of any previous losses not recognised as a deduction from the cost of the additional interest. This application question is related to Principle F (see Table 2)—an investor's maximum exposure is its

gross interest in the associate—but applying that principle is not enough by itself to answer the application question.

- BC51 The IASB decided to propose that, in the situation described in paragraph BC50, an investor would not deduct its share of any losses not recognised from the cost of the additional ownership interest. The IASB noted that an investor would apply paragraph 39 of IAS 28, recognising its share of any subsequent profits of the associate only when its share of those profits—including the share attributable to the additional interest—exceeds the share of the losses not recognised.
- BC52 In reaching its decision, the IASB considered that the approach described in paragraph BC51 would be consistent with its proposed approach to the purchase of an additional ownership interest. That proposed approach would result in the investor measuring the purchase of an additional interest in an associate after obtaining significant influence as an accumulation of purchases (see paragraph BC23). An investor would, therefore, not remeasure the previously held interest in an associate when recognising the additional interest. In the IASB’s view, requiring an investor to deduct any losses not recognised relating to the previously held interest from the cost of an additional interest would be inconsistent with its proposed approach to the purchase of the additional interest.
- BC53 Also, in the IASB’s view, the approach described in paragraph BC51 would faithfully represent the purchase of the additional interest, because deducting the investor’s share of losses not recognised from the cost of the additional investment could imply that the investment is impaired. However, the IASB noted that the presence of unrecognised losses does not necessarily mean the investment is impaired. An investor could invest further in the associate with the expectation that the associate’s financial performance would improve in the future. For example, a start-up entity could incur losses initially and subsequently generate profits sufficient for its investors to recover their investments and earn a positive return. Therefore, the recoverable amount of the investment at the date of purchasing the additional interest might exceed the cost of that additional interest.
- BC54 The IASB also noted that if an impairment exists, an investor would be required to apply the requirements in IAS 28 and IAS 36 *Impairment of Assets* on impairment. Recognition of an impairment loss immediately following the recognition of a purchase of an additional interest in the associate would provide relevant information to users of the investor’s financial statements. That information might include, for example, an explanation of the investor’s rationale for investing additional funds in the associate.
- BC55 Furthermore, the IASB considered whether a transaction, in which the investor purchased an additional interest in a loss-making associate by providing additional funds to the associate, might suggest that the investor has a constructive obligation to fund those losses. However, whether such an obligation exists would depend on the circumstances. If the investor determined that it had incurred an obligation to fund the associate’s losses, it

would be required by paragraph 39 of IAS 28 to recognise a liability for those losses.

**Recognition of each component of comprehensive income**

- BC56 IFRS 18 (and its predecessor, IAS 1 *Presentation of Financial Statements*) requires an investor to present:
- (a) its share of the profit or loss from associates accounted for using the equity method in the statement of profit or loss; and
  - (b) its share of other comprehensive income of associates accounted for using the equity method in other comprehensive income.
- BC57 An associate might report a loss in its statement of profit or loss and a loss in its other comprehensive income. If the investor's share of those losses, in total, exceeds the carrying amount of its investment, an application question arises about the amount of losses it should recognise in profit or loss and in other comprehensive income. Various approaches are applied in practice. For example, an investor might recognise its share of the associate's total losses in profit or loss and other comprehensive income proportionately—or it might first recognise the full amount of its share of the associate's loss in profit or loss and then recognise the remaining balance of its share of the associate's total losses in other comprehensive income.
- BC58 Another application question arises once the investor has reduced the carrying amount of its investment to nil and an associate subsequently reports a loss in its statement of profit or loss and income in its other comprehensive income (or vice versa). In this situation, the question arises as to whether the investor should recognise any amounts for its share of the associate's loss (or profit) and other comprehensive income.
- BC59 The IASB first decided to propose a clarification to the requirement in paragraph 38 of IAS 28 for the investor to discontinue recognising its share of an associate's losses when the investment in the associate has been reduced to nil. The IASB noted that it might be unclear whether the requirement in paragraph 38 of IAS 28 applies to the investor's share of a loss reported in the associate's other comprehensive income. The IASB, therefore, decided to propose requiring an investor to recognise its share of an associate's total comprehensive income (which, therefore, would include a loss reported in an associate's other comprehensive income) until the investor's investment in the associate is reduced to nil.
- BC60 The IASB also decided to propose requiring the investor to recognise separately its share of the associate's profit or loss and its share of the associate's other comprehensive income. Furthermore:
- (a) if the investor's share of profit or loss and its share of other comprehensive income are both losses that in aggregate equal or exceed its net investment in the associate, an investor would first recognise its share of profit or loss and then its share of other comprehensive income.

- (b) after an investor has reduced its investment to nil, the investor would continue to recognise separately its share of profit or loss and its share of other comprehensive income. For example, if an investor's share of profit or loss is a loss of CU250 and its share of other comprehensive income is a profit of CU100, the investor would recognise a loss of CU100 in profit or loss and a profit of CU100 in other comprehensive income. The carrying amount of the investor's investment would remain at nil.

BC61 In reaching the decisions discussed in paragraph BC60, the IASB considered that the proposed approach would be consistent with:

- (a) Principles E and F (see Table 2)—when considered together, these principles suggest that an investor recognises its share of the changes in the associate's net assets, unless doing so would result in recognising losses that exceeded the investor's investment in the associate.
- (b) the requirements in IFRS 18 (and IAS 1) for an investor to recognise its share of an associate's profit or loss separately from its share of an associate's other comprehensive income.
- (c) the *Conceptual Framework*, which states that the statement of profit or loss is the primary source of information about an entity's financial performance. That concept suggests that the investor should prioritise recognising an amount reported in the statement of profit or loss over an amount reported in other comprehensive income. The proposed approach would enable an investor to recognise in its statement of profit or loss some or all of its share of an associate's profit or loss.

BC62 The IASB decided not to develop proposed answers for other related application questions, such as the order of recognising profits in profit or loss and in other comprehensive income when an investor resumes recognising its share of the associate's profits. Those questions do not commonly arise in practice and, therefore, were not on the list of application questions selected for the project (see paragraphs BC10–BC14).

### Transactions with associates

BC63 Paragraph 28 of IAS 28 requires an investor to recognise gains or losses resulting from transactions with an associate only to the extent of the unrelated investors' interests in the associate.<sup>3</sup> That requirement applies to both downstream transactions (such as a sale or contribution of assets from an investor to an associate) and upstream transactions (such as a sale of assets from an associate to an investor). Various application questions relating to that requirement have arisen, as described in Table 1.

<sup>3</sup> Paragraph BC63 describes a requirement in paragraph 28 of IAS 28 that is currently in effect. The IASB amended that requirement when it issued *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (Amendments to IFRS 10 and IAS 28) in 2014, but the effective date of those amendments has been deferred indefinitely.

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- BC64 The IASB first considered the application question about how an investor recognises gains or losses arising from the sale of a subsidiary to its associate, applying the requirements in IFRS 10 and IAS 28, and decided to propose revised requirements on transactions with associates to answer that question. Those proposed requirements would, if finalised, resolve the other application questions described in Table 1 relating to transactions with associates.
- BC65 The application question described in paragraph BC64 relates to an inconsistency between the requirements in IFRS 10 and IAS 28:
- (a) paragraphs 25 and B97–B99 of IFRS 10 require an investor to recognise, in full, the gains or losses on the loss of control of a subsidiary, remeasuring any retained interest at fair value; whereas
  - (b) paragraph 28 of IAS 28 requires an investor to restrict the gains or losses recognised to the extent of the unrelated investors' interests in an associate, by eliminating the investor's share of the gain or loss arising from the transaction.
- BC66 The IASB noted that the requirement in IFRS 10 specifically relates to transactions in which an investor loses control of a subsidiary, whereas the requirement in IAS 28 relates to all transactions between an investor and its associate. Therefore, the IASB took into account the wider application of the IAS 28 requirement when considering how to resolve the inconsistency between the requirements in IFRS 10 and IAS 28. The IASB decided to propose requiring an investor:
- (a) to recognise in full gains and losses resulting from all upstream and downstream transactions with its associate (paragraphs BC67–BC84); and
  - (b) to disclose information about the gains or losses recognised by the investor from downstream transactions with an associate (paragraphs BC142–BC146).
- BC67 In reaching this decision, the IASB considered various approaches. The two main approaches considered were:
- (a) Alternative 1—to apply the approach used in IFRS 10 to all transactions. As a result, an investor would recognise in full the gains and losses on all transactions with an associate.
  - (b) Alternative 2—to apply the approach used in IFRS 10 first in a transaction involving the loss of control of a subsidiary and then overlay this with the approach used in IAS 28 to restrict the gains or losses recognised to the extent of the unrelated investors' interests in an associate. As a result, an investor would recognise only partial gains or losses on all transactions with an associate.
- BC68 The IASB also considered two other approaches:



- (a) Alternative 3—to apply the approach used in IAS 28 (partial gain or loss) or IFRS 10 (full gain or loss), depending on whether the transaction involved the transfer of an output of the entity’s ordinary activities. This approach would require an entity to consider whether the transaction is within the scope of IFRS 15 *Revenue from Contracts with Customers*.
- (b) Alternative 4—to apply the approach used in IFRS 10 (full gain or loss) or in IAS 28 (partial gain or loss), depending on whether the transaction involved the transfer of a business. This approach is based on the requirements in *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*, which the IASB issued in 2014 and later deferred indefinitely.

BC69 Following feedback from stakeholders on the four alternatives, the IASB focused on Alternatives 1 and 2. The feedback suggested that Alternatives 3 and 4 would introduce unnecessary complexity because of the judgement needed to determine which requirements to apply to a transaction. Stakeholders also raised concerns about the conceptual rationale for distinguishing between types of transactions in Alternatives 3 and 4, including whether doing so would be consistent with the IASB’s thinking when developing IFRS 15 (for Alternative 3) and IFRS 10 (for Alternative 4).

BC70 The IASB decided to propose requirements based on Alternative 1 instead of Alternative 2, having considered:

- (a) user information needs (paragraphs BC72–BC74);
- (b) costs to preparers (paragraph BC75);
- (c) the objective of eliminating the investor’s portion of the gain or loss (paragraphs BC76–BC80); and
- (d) the requirements in other IFRS Accounting Standards dealing with similar matters (paragraphs BC81–BC83).

BC71 Consequently, the IASB also decided to propose amendments to IFRS 10 to remove the requirements introduced by *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*.

#### **User information needs**

BC72 Stakeholder outreach with users about Alternative 1 (full gain or loss) and Alternative 2 (partial gain or loss) suggested that, when evaluating the financial statements of an investor with investments in equity-accounted associates, users’ approaches vary depending on how they assess the significance of the associate’s contribution to an investor’s earnings:

- (a) if users assess the associate’s contribution as significant, users generally evaluate the associate separately. Valuation will be based on the associate’s financial statements, if available, which do not restrict gains or losses for transactions between an investor and its associate.

- (b) if users assess the associate's contribution as insignificant, users will often rely on information about the associate's earnings as reported in the investor's financial statements. These earnings will, when applicable, restrict gains or losses for transactions between an investor and its associate.

BC73 Overall, most users supported Alternative 1 and said it would provide them with the most useful information, for example, to help estimate future cash flows and analyse the associate's performance, particularly when the associate's financial statements are not available and users rely on information about the associate's earnings as reported in the investor's financial statements.

BC74 Users also supported enhanced disclosures about these gains or losses, regardless of whether the investor recognises the full gain or loss or only a partial gain or loss (see paragraphs BC142–BC146).

#### **Costs to preparers of financial statements**

BC75 Stakeholder outreach about the implementation and application costs of Alternative 1 and Alternative 2 suggested that:

- (a) some implementation costs would arise if the IASB were to develop requirements based on Alternative 1, because it would require a change to current practice for some types of transactions (particularly for transactions involving the sale or contribution of an asset that is not housed in a subsidiary).
- (b) once implemented, Alternative 1 would be simpler and, therefore, less costly to apply than Alternative 2. For example, applying Alternative 1, an entity with an investment in an associate would no longer be required:
  - (i) to gather the information required for elimination entries (which would also resolve difficulties in accessing information that sometimes arise when accounting for upstream transactions);
  - (ii) to exercise judgement when allocating the restricted gain or loss if the transaction involves the transfer of a business; or
  - (iii) to track the restricted gain or loss in future periods to determine when it should be recognised in the investor's financial statements (for example, on the sale of an item of inventory to a third party or over the useful life of an item of property, plant or equipment).

**The objective of eliminating the investor's portion of the gain or loss**

- BC76 The IASB noted that the key difference between Alternative 1 and Alternative 2 is that, unlike IAS 28, Alternative 1 would not require an investor to eliminate its portion of the gain or loss in a transaction with an associate. The IASB, therefore, considered the objective of the elimination requirement in IAS 28.
- BC77 In a group, the parent controls its subsidiaries and, therefore, their assets and liabilities. In accordance with IFRS 10, a parent cannot recognise gains or losses on transactions with its subsidiaries because consolidated financial statements report the parent and its subsidiaries as a single economic entity. As such, in consolidated financial statements, subsidiaries are within the boundary of the reporting entity. Therefore, such gains or losses are eliminated in consolidated financial statements.
- BC78 The requirement in paragraph 28 of IAS 28 to eliminate the investor's portion of the gain or loss in a transaction with an associate could be viewed as implying that, in applying the equity method, the boundary of the reporting entity is extended to include the associate (or the investor's share of the associate). This view is consistent with two of the principles identified as underlying IAS 28 (see Table 2) that are relevant to the boundary of the reporting entity and the objective of the elimination requirement:
- (a) Principle B—application of the equity method includes an investor's share in the associate's or joint venture's net asset changes in an investor's statement of financial position; and
  - (b) Principle C—an investor's share of an associate's or joint venture's net assets is part of the reporting entity.
- BC79 In contrast, in both the *Conceptual Framework* and other IFRS Accounting Standards, an associate is not within the definition of a group. For example, the *Conceptual Framework* explains that control over another entity determines the boundary of the reporting entity when preparing consolidated financial statements.
- BC80 The IASB observed that it is unclear why IAS 28 requires the investor's share of a gain or loss on a transaction with an associate to be eliminated. Also, although paragraph 26 of IAS 28 states that many of the procedures that are appropriate for the application of the equity method are similar to the consolidation procedures described in IFRS 10, that does not mean that all equity method procedures need to be aligned with consolidation procedures.

**Other requirements in IFRS Accounting Standards**

- BC81 When an investor loses control of a subsidiary, IFRS 10 requires the group to derecognise the subsidiary's assets and liabilities and measure any investment retained in the former subsidiary at fair value. The group, therefore, recognises the full gain or loss on loss of control of a subsidiary. When developing those requirements, the IASB concluded that:

- (a) the loss of control of a subsidiary is, from the group's perspective, the loss of control of the subsidiary's individual assets and liabilities and, therefore, those assets and liabilities should be derecognised; and
- (b) the retained interest should be measured at fair value because the loss of control of a subsidiary is a significant economic event—the parent–subsidiary relationship ceases to exist and an investor–investee relationship begins that differs significantly from the former parent–subsidiary relationship.

BC82 When an entity disposes of an item of property, plant or equipment, IAS 16 *Property, Plant and Equipment* requires the entity to derecognise the asset. The entity recognises the full gain or loss on disposal of the asset.

BC83 Therefore, regardless of whether an entity loses control of a subsidiary or a non-monetary asset, other IFRS Accounting Standards require the entity to recognise, in full, the resulting gain or loss. The IASB noted that it would be consistent with the requirements discussed in paragraphs BC81–BC82 to require an investor to recognise the full gain or loss on the sale or contribution of assets to an associate (Alternative 1). For example, if an investor contributed an item of property, plant or equipment to an associate in exchange for an additional interest in the associate, that exchange would be a significant economic event. The entity would no longer control the item of property, plant or equipment, and the nature of the asset the investor controlled would change.

#### **The IASB's decision on Alternatives 1 and 2**

BC84 After considering the matters summarised in paragraphs BC72–BC83, the IASB decided to propose requiring investors to recognise the full gains or losses resulting from all transactions with associates, which would change the requirement in paragraph 28 of IAS 28. The proposal is based on Alternative 1, that is applying the approach used in IFRS 10 to all transactions with an associate. The IASB is consequently proposing to remove the requirements in paragraph 29 of IAS 28.

#### **Deferred taxes**

BC85 Paragraph 32 of IAS 28 requires an investment to be accounted for using the equity method from the date on which the investee becomes an associate. On initial recognition of the investment, an investor determines its share of the net fair value of the associate's identifiable assets and liabilities, which includes adjustments to the carrying amounts of the assets and liabilities as reported in the associate's financial statements (referred to as 'fair value adjustments').

BC86 An application question arises about whether the investor is required to include the deferred tax effects related to those fair value adjustments in the carrying amount of an investment in an associate on initial recognition of the investment. The IASB understands that various approaches are applied in practice. The most common practice is to include those deferred tax effects in the carrying amount of the investment. A similar question arises when an

investor accounts for the purchase of an additional interest. If included in the investment, the deferred tax effects are subsequently reversed, as and when the related fair value adjustments reverse, as part of the adjustments made to the investor's share of the associate's profit or loss after the date of obtaining significant influence. For example, adjustments are made to account for depreciation of the associate's depreciable assets based on their fair values at the date of obtaining significant influence.

BC87 The IASB decided to propose requiring an investor to include in the carrying amount of its investment the deferred tax effects related to measuring its share of the associate's identifiable assets and liabilities at fair value. The IASB considered that the proposed approach would:

- (a) be consistent with paragraph 26 of IAS 28, which states that the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for the acquisition of an investment in an associate. IFRS 3 requires an acquirer to recognise and measure a deferred tax asset or liability arising from the assets acquired and liabilities assumed in a business combination in accordance with IAS 12 *Income Taxes*.
- (b) provide a faithful representation of the financial effects of obtaining an investment in an associate, by reflecting the future tax consequences related to the fair value adjustments.
- (c) provide useful information to users. For example, the adjustments to the investor's share of the associate's profit or loss in subsequent reporting periods would include both the reversal of the fair value adjustments and the reversal of the related deferred tax effects.
- (d) align with Principles D and E (see Table 2). The deferred tax effects relate to measuring the associate's identifiable assets and liabilities at fair value at the date of obtaining significant influence (Principle D) and the subsequent reversal of the deferred tax effects relates to recognising the investor's share of changes in the associate's net assets (Principle E).

BC88 The IASB acknowledged that applying the proposed approach would result in some costs and complexity for preparers, but took the view that the benefits to users of the proposed approach would outweigh the costs to preparers. The IASB also understands that the proposed approach is commonly applied in practice.

### **Contingent consideration**

BC89 Paragraph 32 of IAS 28 requires an investment to be accounted for using the equity method from the date on which it becomes an associate. It also sets out requirements relating to the initial recognition of the investment. However, IAS 28 does not specify requirements for recognising and measuring contingent consideration. An application question, therefore, arises about how an investor should recognise and measure contingent consideration on obtaining an investment in an associate, both initially and subsequently. A

similar question arises when an investor accounts for contingent consideration on the purchase of an additional interest.

- BC90 The IASB decided to propose requiring an investor:
- (a) on initial recognition of an investment in an associate or on purchase of an additional interest, to recognise contingent consideration as part of the consideration transferred and measure it at fair value; and
  - (b) subsequently:
    - (i) not to remeasure contingent consideration classified as an equity instrument and to recognise its subsequent settlement in equity; and
    - (ii) to measure other contingent consideration at fair value at each reporting date and recognise changes in fair value in profit or loss.
- BC91 In reaching this decision, the IASB considered that the proposed requirements outlined in paragraph BC90 would be similar to those in IFRS 3 for contingent consideration on the acquisition of a subsidiary. Applying IFRS 3, an acquirer recognises the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree. IFRS 3 also specifies requirements similar to those set out in paragraph BC90(b) for how to account for contingent consideration after the acquisition date.
- BC92 The IASB also understands that the proposed requirements set out in paragraph BC90 are consistent with the approach frequently applied in practice when accounting for contingent consideration on initial recognition of an investment in an associate or on purchase of an additional interest. Therefore, in most cases, the IASB expects that the proposed requirements would not impose significant additional costs on preparers.
- BC93 Furthermore, the IASB considered that:
- (a) the proposed requirement to measure contingent consideration at its fair value is consistent with the proposed requirement to measure the consideration transferred at its fair value when measuring the cost of the investment (see paragraph BC18).
  - (b) the proposed requirement to account for the settlement of contingent consideration classified as an equity instrument within equity is consistent with the accounting for the settlement of equity instruments within the scope of IAS 32 *Financial Instruments: Presentation* and equity-settled share-based payment arrangements within the scope of IFRS 2.
  - (c) the proposed requirement to subsequently measure other contingent consideration at fair value at each reporting date is consistent with the requirements in IFRS 9 for the subsequent measurement of derivatives. When developing IFRS 3, the IASB observed that many obligations for contingent consideration in a business combination that are classified as liabilities meet the definition of derivatives. The IASB considered

that similar considerations apply in the context of contingent consideration on obtaining significant influence of an associate or on purchase of an additional interest.

- (d) the proposed requirement to recognise the changes in the fair value of liabilities for contingent consideration in profit or loss is consistent with the IASB's conclusions when developing IFRS 3. When developing IFRS 3, the IASB concluded that such changes should not be reflected as adjustments to the consideration transferred (usually in goodwill) because those subsequent changes in fair value are generally directly related to post-combination events. Furthermore, it would be difficult for the IASB to develop requirements that differentiate between changes in fair value that relate to events that occurred before the date of obtaining significant influence and those that relate to subsequent events. Such requirements would also add costs and complexity for preparers.

### **Impairment of the investment**

BC94 Paragraph 40 of IAS 28 requires an investor to apply paragraphs 41A–41C of IAS 28 to determine whether there is any objective evidence indicating that its net investment in an associate might be impaired. If an indication of impairment exists, an investor tests its net investment in an associate for impairment in accordance with IAS 36.

BC95 Paragraphs 41A–41C of IAS 28 describe various events that are indications of impairment. Paragraph 41C of IAS 28 states that a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is objective evidence of impairment. An application question arises about whether an investor should assess a decline in the fair value of an investment by comparing that fair value to the carrying amount of the net investment in the associate at the reporting date or to the cost of the investment on initial recognition. Approaches applied in practice vary, but it is common for entities to compare the fair value of the investment with its carrying amount at the reporting date.

BC96 When considering that application question, the IASB also considered whether:

- (a) to remove from paragraph 41C of IAS 28 the reference to 'a significant or prolonged' decline in fair value; and
- (b) to add further guidance to IAS 28 on assessing whether a decline in fair value of the investment indicates it might be impaired.

### **Cost or carrying amount**

BC97 The IASB decided to propose replacing 'cost' in paragraph 41C of IAS 28 with 'carrying amount'—to require the investor to compare the fair value of the investment to its carrying amount, not its cost on initial recognition, when determining whether a decline in fair value indicates that an investment in an associate might be impaired.

BC98 The IASB considered the history of the requirement in paragraph 41C of IAS 28. Paragraphs 41A–41C were added to IAS 28 as part of consequential amendments made on issuing IFRS 9 in 2014, to replace a reference in IAS 28 to IAS 39 *Financial Instruments: Recognition and Measurement*. Paragraph 41C of IAS 28 replicated requirements in IAS 39 relating to the impairment of equity instruments classified as available-for-sale.<sup>4</sup> IAS 39 required those equity instruments to be measured at fair value with changes in fair value recognised in other comprehensive income. IAS 39 also required entities to assess an available-for-sale equity instrument for impairment by comparing its fair value with its original cost. That comparison was used to determine when to reclassify a loss from a decline in fair value of the instrument from other comprehensive income to profit or loss.

BC99 The IASB noted that the rationale for assessing and measuring the impairment of an available-for-sale equity instrument by comparing its fair value with its original cost does not apply to investments in associates accounted for using the equity method. IFRS Accounting Standards generally require an investor to recognise changes in the carrying amount of an investment in an associate in profit or loss, not in other comprehensive income (except for the investor's share of the associate's other comprehensive income). Also, IAS 28 requires an investor to test the investment for impairment and measure any impairment loss in accordance with IAS 36. When applying IAS 36, the investor measures the impairment of an investment in an associate by comparing the investment's recoverable amount with its carrying amount, not its original cost. In the IASB's view, it would be consistent with IAS 36 to assess whether a decline in the fair value of an investment in an associate indicates that the investment might be impaired by comparing the fair value of the investment with its carrying amount, not its original cost.

#### **A significant or prolonged decline in fair value**

BC100 Paragraph 41C of IAS 28 states that a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is objective evidence of impairment. When deciding to propose replacing 'cost' with 'carrying amount' (see paragraphs BC97–BC99), the IASB also decided to propose removing 'significant or prolonged'.

BC101 The IASB noted that, as discussed in paragraph BC98, paragraph 41C of IAS 28 replicates the requirements in IAS 39 for assessing and measuring impairment losses on equity instruments classified as available-for-sale. In addition to those requirements, IAS 39 did not permit an entity to subsequently recognise the reversal of an impairment loss on an available-for-sale equity instrument (for example, if the fair value of the asset is subsequently recovered). Therefore, when applying IAS 39, an entity recognised an impairment loss on an available-for-sale equity instrument in profit or loss only when the decline in the fair value of the instrument below its cost was significant or prolonged.

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<sup>4</sup> The term 'available-for-sale' refers to one of the measurement categories into which financial assets were classified when applying IAS 39 *Financial Instruments: Recognition and Measurement*. That measurement category was eliminated when the classification requirements in IFRS 9 *Financial Instruments* replaced those in IAS 39.



- BC102 However, the impairment requirements in IAS 36 are not the same as those in IAS 39. If an investor recognises an impairment of an investment in an associate, it subsequently recognises a reversal of that impairment loss if the impairment no longer exists or decreases. The IASB, therefore, considered that the rationale for referring to a ‘significant or prolonged’ decline in fair value in IAS 39 did not apply in the context of an investment in an associate accounted for using the equity method.
- BC103 The IASB also noted that application difficulties had arisen in the past about how entities assessed whether a decline in the fair value of an available-for-sale equity instrument was significant or prolonged.

#### **Additional impairment guidance**

- BC104 Paragraphs 41A–41C of IAS 28 describe various events that are indications of impairment. When developing the proposed requirements on accounting for the purchase of an additional ownership interest in an associate, the IASB noted that a bargain purchase gain might be an indication of impairment (see paragraph BC27).
- BC105 The IASB decided to propose adding further guidance on the impairment requirements in IAS 28 to explain that information about the fair value of an investment might be observed from the price paid to purchase an additional ownership interest in an associate or the price received to sell an ownership interest.
- BC106 The IASB found it reasonable to assume that a transaction in which an investor purchases an additional interest in an associate or sells such an interest is conducted at fair value, because these types of transactions often occur between independent parties. The transaction price paid or received therefore provides observable information about the fair value of the investment.

### **Implications of applying the proposals developed for investments in associates to other types of investments**

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- BC107 As noted in paragraph BC13, the IASB first developed proposed answers to the application questions set out in Table 1 in the context of accounting for investments in associates. Subsequently, the IASB considered the implications of applying those proposed solutions to other types of investments accounted for using the equity method, namely:
- (a) investments in joint ventures (paragraphs BC108–BC111); and
  - (b) investments in subsidiaries in separate financial statements (paragraphs BC112–BC127).

#### **Investments in joint ventures**

- BC108 IAS 28 sets out requirements on how to apply the equity method to both investments in associates and investments in joint ventures—those requirements apply to all entities that are investors with joint control of, or significant influence over, an investee (unless exempt from doing so).

- BC109 The IASB decided that its proposed solutions to the application questions set out in Table 1 would also apply to investments in joint ventures. The IASB observed that the alternative could result in two versions of the equity method in IAS 28—one for investments in associates and another for investments in joint ventures. Such an outcome would require the IASB to reconsider:
- (a) its decision when developing IFRS 11 to require the equity method to be applied to investments in joint ventures. When reaching that decision, the IASB acknowledged that significant influence and joint control are different. However, it 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.
  - (b) the requirement in paragraph 24 of IAS 28 that if an investment in an associate becomes an investment in a joint venture (or vice versa), the entity continues to apply the equity method and does not remeasure the retained interest. When developing that requirement, the IASB acknowledged that in such situations, the nature of the investment changes. However, both types of investment continue to be accounted for using the equity method. Therefore, if the IASB were to develop new requirements for investments in joint ventures, it would need to reconsider how an investor accounts for a change in the nature of the investment from an investment in an associate to an investment in a joint venture (or vice versa). That could introduce new complexities into IFRS Accounting Standards and could lead to new application questions.
- BC110 The IASB also noted that its rationale for the proposed solutions to the application questions also applies to investments in joint ventures. For example, the IASB decided:
- (a) to require an investor not to remeasure any previously held interest in an associate when accounting for the purchase of an additional interest in an associate while retaining significant influence. The IASB's rationale for that decision also applies to the purchase of an additional interest in a joint venture while retaining joint control (see paragraph BC23).
  - (b) to require an investor to recognise the full gain or loss on all transactions with an associate. The rationale for that decision also applies to transactions with a joint venture (see paragraphs BC63–BC84).
- BC111 Some stakeholders cautioned about requiring a joint venturer to recognise the full gain or loss on transactions with a joint venture, because such a requirement could potentially allow a venturer to manage its earnings. The nature of the relationship between a joint venturer and the joint venture (joint control rather than significant influence) could increase the risk that transactions are made on terms that are not equivalent to those in arm's length transactions. The IASB noted that its proposed requirement to disclose

any gains or losses arising from downstream transactions would provide information to help users to understand how the joint venturer's financial performance might be affected by such transactions (see paragraphs BC142–BC146).

### **Investments in subsidiaries in separate financial statements**

- BC112 IAS 27 *Separate Financial Statements* requires an entity that prepares separate financial statements to account for investments in subsidiaries, joint ventures and associates:
- (a) at cost;
  - (b) in accordance with IFRS 9; or
  - (c) using the equity method as described in IAS 28.
- BC113 The IASB decided that its proposed solutions to the application questions set out in Table 1 would also apply to a parent that chose to use the equity method to account for investments in subsidiaries in its separate financial statements.
- BC114 The IASB observed that the alternative would mean two versions of the equity method—one for investments in subsidiaries, if a parent chose to use the equity method to account for its investments in subsidiaries in its separate financial statements, and another for investments in associates and joint ventures. Some stakeholders argued that having two versions of the equity method would be reasonable, if necessary, to help parents to align the amounts reported in their separate financial statements with those in their consolidated financial statements. Stakeholders in favour of two versions of the equity method noted that a parent controls its subsidiaries, but does not control its associates or joint ventures.
- BC115 The IASB reached the decision described in paragraph BC113 after considering:
- (a) the types of financial statements and the concept of control in IAS 27 (paragraph BC117);
  - (b) the history of the equity method as a measurement option in IAS 27 (paragraphs BC118–BC120); and
  - (c) the application of the equity method, in practice, to investments in subsidiaries in separate financial statements and the implications for that practice of applying the IASB's proposed solutions to the application questions (paragraphs BC121–BC126).
- BC116 The IASB also decided to clarify how to apply the equity method to a step acquisition of a subsidiary and the loss of control of a subsidiary, while continuing to apply the equity method in separate financial statements (paragraphs BC128–BC133).

### **Types of financial statements and the concept of control in IAS 27**

- BC117 Paragraph BC7 of the Basis for Conclusions on IAS 27 explains that the IASB drew a distinction between accounting for investments in subsidiaries as equity instruments and accounting for the economic entity that a parent controls. Therefore:
- (a) in separate financial statements, an investment in a subsidiary is accounted for as an asset under the parent's control (similar to an investment in an associate or joint venture), using one of the measurement options in IAS 27; whereas
  - (b) in consolidated financial statements, a subsidiary is accounted for as an entity under the parent's control, so that the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity.

### **History of the equity method as a measurement option in IAS 27**

- BC118 In 2003, the IASB removed the equity method as a measurement option for investments in subsidiaries, joint ventures and associates in separate financial statements because it concluded that in separate financial statements, the focus is on the performance of the assets as investments.
- BC119 In 2014, the IASB decided to restore the equity method as a measurement option for investments in subsidiaries, joint ventures and associates in separate financial statements because the law in some jurisdictions requires listed companies to present separate financial statements using the equity method for investments in subsidiaries, joint ventures and associates.
- BC120 Paragraph BC10G of the Basis for Conclusions on IAS 27 explains that there could be situations in which applying the equity method to investments in subsidiaries in separate financial statements would give a different result compared to consolidated financial statements.

### **Applying the equity method, in practice, to investments in subsidiaries in separate financial statements and the implications of the proposals**

- BC121 Feedback from outreach with stakeholders suggests that use of the equity method to account for investments in subsidiaries in separate financial statements is prevalent in only a few jurisdictions. In other jurisdictions in which separate financial statements are prepared, the cost option in IAS 27 is typically used.
- BC122 Stakeholder feedback also suggested there is diversity in practice when the equity method is applied to investments in subsidiaries in separate financial statements. For example, when a parent entity applies the equity method to an investment in a subsidiary:
- (a) some parent entities aim to align the amounts reported in separate financial statements with those reported in consolidated financial statements, by analogising to IFRS 3 and IFRS 10; whereas
  - (b) other parent entities do not aim to achieve that alignment.

- BC123 Hence, the effects, in practice, of applying the IASB’s proposed solutions to the application questions to investments in subsidiaries in separate financial statements will vary depending on a parent entity’s existing accounting policies.
- BC124 In some cases, new or increased differences between separate and consolidated financial statements could arise. For example, applying the proposed requirements, the parent would recognise, in full, gains or losses on transactions with subsidiaries in its separate financial statements. However, in its consolidated financial statements, it would eliminate, in full, such gains or losses.
- BC125 Stakeholders in the jurisdictions described in paragraph BC122(a) raised concerns about applying the proposals to investments in subsidiaries in separate financial statements, particularly the matter discussed in paragraph BC124. The IASB acknowledged those concerns, but noted that the matter is neither new, nor limited to the proposed requirements—other requirements in IAS 28 can also result in differences between separate and consolidated financial statements.
- BC126 Moreover, stakeholder feedback suggests that the objective of preparing separate financial statements, and the purpose for which they are used, varies by jurisdiction. Also, broader questions arise about the relationship between the purpose of general purpose financial statements prepared applying IFRS Accounting Standards and jurisdictional requirements on dividend distributions and income tax calculations.<sup>5</sup> The IASB observed that considering whether and how to respond to the jurisdictional differences in the objective and use of separate financial statements would involve a comprehensive review of IAS 27. However, a comprehensive review of IAS 27, or considering broader issues about the objective and use of separate financial statements, is outside the scope of the Equity Method project, which is focused on answering application questions about the requirements in IAS 28 on how to apply the equity method (see paragraphs BC1–BC9).

### **The IASB’s decision**

- BC127 After considering the matters in paragraphs BC117–BC126, the IASB decided that its proposed solutions to the application questions set out in Table 1 would also apply to a parent that chose to use the equity method to account for its investments in subsidiaries in its separate financial statements.

### **Step acquisition (or loss of control) of a subsidiary**

- BC128 The IASB first considered the combined effects of its decisions:
- (a) to propose requiring the investor to include, in the cost of an investment in an associate on obtaining significant influence over the associate, the fair value of any previously held ownership interest (see paragraphs BC17–BC18); and

<sup>5</sup> For example, see the IFRS Foundation’s Feature: *Returns, reinvestment opportunities and dividend distribution*.

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- (b) to apply its proposed solutions to the application questions set out in Table 1 to investments in subsidiaries to which the equity method is applied in separate financial statements (see paragraphs BC112–BC127).
- BC129 The IASB considered a situation in which:
  - (a) the parent held an ownership interest in an entity prior to obtaining control of that entity;
  - (b) that previously held ownership interest was accounted for as an investment in an associate (or joint venture); and
  - (c) the parent has chosen to apply the equity method to both its investments in associates (or joint ventures) and its investments in subsidiaries in its separate financial statements.
- BC130 The IASB also considered the reverse situation, in which a parent loses control of a subsidiary and continues to account for any retained investment in the former subsidiary using the equity method.
- BC131 The IASB decided to propose requiring a parent that obtains control of an associate or a joint venture and continues to account for the investment in the subsidiary using the equity method in its separate financial statements not to remeasure its previously held interest. The IASB also decided to propose the same approach for the reverse situation.
- BC132 The IASB considered that in the situations described in paragraphs BC129–BC130:
  - (a) although obtaining control of a subsidiary changes the relationship between the parent and its former associate or joint venture, the parent does not change its accounting method. The absence of a change to its accounting method suggests the parent should not remeasure its previously held interest. The same rationale applies in the reverse situation.
  - (b) paragraph 24 of IAS 28 requires that if an associate becomes a joint venture (or vice versa), the entity continues to apply the equity method and does not remeasure the retained interest. Therefore, applying the same approach in the situations described in paragraphs BC129–BC130 would be consistent with IAS 28.
- BC133 The IASB acknowledged that its proposal could affect current practice for some entities that remeasure the previously held (or retained) interest at fair value in the situations described in paragraphs BC129–BC130. The IASB considered whether to permit entities an accounting policy choice of whether to remeasure the previously held (or retained) interest at fair value. The IASB decided not to do so, because permitting an accounting policy choice would result in continued diversity in practice.

## Disclosure—Proposed amendments to IFRS 12, IAS 27 and IFRS 19

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- BC134 The IASB decided to propose improved disclosure requirements in IFRS Accounting Standards to complement its proposed amendments to IAS 28, with proposed amendments to:
- (a) IFRS 12 (paragraphs BC137–BC165); and
  - (b) IAS 27 (paragraphs BC166–BC171).
- BC135 The IASB first considered amendments to disclosure requirements for investments in associates to which the equity method is applied. It later considered whether to propose the same disclosure requirements for investments in joint ventures and for investments in subsidiaries in separate financial statements to which the equity method is applied.
- BC136 The IASB also decided to propose related amendments to IFRS 19 *Subsidiaries without Public Accountability: Disclosures* (paragraphs BC172–BC177).

### Proposed amendments to IFRS 12 *Disclosure of Interests in Other Entities*

- BC137 The IASB decided to propose amendments to IFRS 12 relating to:
- (a) changes in an investor’s ownership interest while retaining significant influence (paragraphs BC139–BC141);
  - (b) transactions with associates (paragraphs BC142–BC146);
  - (c) contingent consideration (paragraphs BC147–BC149); and
  - (d) other matters raised by users (paragraphs BC150–BC158).
- BC138 When developing the proposed amendments, the IASB considered:
- (a) the existing disclosure requirements in IFRS 12;
  - (b) findings from the Post-implementation Review of IFRS 12;
  - (c) disclosure requirements in other IFRS Accounting Standards that apply to investments in associates, such as IAS 24 *Related Party Disclosures*;
  - (d) feedback from users; and
  - (e) expected costs to preparers.

### Changes in an investor’s ownership interest while retaining significant influence

- BC139 As discussed in paragraphs BC20–BC44, the IASB decided to propose requirements for how an investor would account for changes in its ownership interest in an associate while retaining significant influence. The IASB decided not to propose new disclosure requirements for the purchase or the disposal of an ownership interest in an associate, while retaining significant influence, to be consistent with existing disclosure requirements in IFRS Accounting Standards applying to investments in associates. For example, investors are

not required to disclose the amount of a bargain purchase gain recognised on obtaining significant influence over an associate. Therefore, it would be inconsistent to propose requiring investors to disclose a bargain purchase gain recognised on the purchase of an additional ownership interest after obtaining significant influence.

BC140 The proposals also include proposed requirements relating to an issue or redemption of equity instruments by an associate that results in an increase or decrease of the investor's ownership interest. Applying the proposed requirements, an investor would recognise any gains or losses resulting from those changes in ownership interest in profit or loss, for example, dilution gains or losses arising from the associate's issue of equity instruments to other parties. The IASB decided to propose requiring the investor to disclose those gains and losses.

BC141 In the IASB's view, disclosing the information in paragraph BC140 is unlikely to be costly for preparers of financial statements and would provide useful information to users of financial statements. For example, dilution gains or losses are different in nature from other income and expenses arising from an investor's interest in its associate and occur infrequently. If not presented separately in the investor's statement of profit or loss, separate disclosure of the gains or losses would also help users understand the composition of the line item(s) presented in the investor's statement of profit or loss for income and expenses from investments in associates to which the equity method is applied.

#### **Transactions with associates**

BC142 As discussed in paragraphs BC63–BC84, the IASB decided to propose requiring an investor to recognise the full gain or loss on all transactions with an associate. That proposed requirement would apply to both downstream and upstream transactions.

BC143 The IASB noted that paragraph 18 of IAS 24 specifically requires disclosure of the amounts of related party transactions and any outstanding balances, but not disclosure of any gains or losses arising from such transactions.

BC144 The IASB decided to propose requiring an investor to disclose any gains or losses from downstream transactions with its associates. The proposal responds to feedback from users that they would find such information useful because it would:

- (a) help users to assess earnings quality—users said that insufficient disaggregation of earnings in the investor's financial statements often restricts their ability to assess earnings quality;
- (b) allow users to adjust the recognised gain or loss, if desired, in their analysis; and
- (c) allow users to assess the reasonableness and sustainability of these transactions and their pricing for benchmarking against market terms.



- BC145 Although users suggested that information about the investor's share of the gains or losses recognised by an associate in upstream transactions would also be useful, the IASB decided not to propose a similar disclosure requirement for those gains or losses. Requiring disclosure of such information could be costly and require information that might not be readily available to the investor.
- BC146 The IASB proposed adding the proposed requirement described in paragraph BC144 to IFRS 12 rather than IAS 24, because IAS 24 applies to all transactions with related parties, not only to transactions with associates.

### **Contingent consideration**

- BC147 As discussed in paragraphs BC89–BC93, the IASB decided to propose requirements for how an investor would recognise and measure contingent consideration on obtaining significant influence of an associate or on the purchase of an additional ownership interest.
- BC148 The IASB decided to propose requiring an investor that enters into a contingent consideration arrangement to disclose:
- (a) for the period in which it obtains significant influence over an associate or purchases an additional ownership interest:
    - (i) the amount recognised as at the date the entity obtains significant influence or purchases an additional ownership interest.
    - (ii) a description of the arrangement and the basis for determining the amount of the payment.
    - (iii) an estimate of the range of outcomes (undiscounted) or, if a range cannot be estimated, that fact, and the reasons why a range cannot be estimated. If the maximum amount of the payment is unlimited, the investor would be required to disclose that fact.
  - (b) for each subsequent reporting period until the investor collects or settles the contingent consideration or it is cancelled or expires:
    - (i) any changes in the amounts recognised, including any differences arising upon settlement.
    - (ii) any changes in the range of outcomes (undiscounted) and the reasons for those changes.
    - (iii) the valuation techniques and key model inputs used to measure the contingent consideration.
- BC149 The proposed disclosure requirements set out in paragraph BC148 are based on the disclosure requirements in IFRS 3 relating to contingent consideration in a business combination. In the IASB's view, similar information about contingent consideration arrangements on obtaining an investment in an associate would help users assess the amount, timing and uncertainty of an entity's future cash flows. The proposed disclosure requirements are also

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 interests in associates.

**Other matters raised by users**

- BC150 The IASB completed its Post-implementation Review of IFRS 12 in 2022. Some of the Post-implementation Review respondents said while the information required by IFRS 12 is useful, they need additional information, such as information about associates (and joint ventures) by operating segment.
- BC151 When responding to that feedback during the Post-implementation Review of IFRS 12, the IASB 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 in IFRS 12, it assessed the matter to be of low priority. If identified as a priority in the next agenda consultation, the IASB could assess whether to take action.<sup>6</sup>
- BC152 In general, the IASB received no new information during its Equity Method project that suggested a need to reconsider the decision made during the Post-implementation Review of IFRS 12.
- BC153 However, in response to requests from users during the Equity Method project, the IASB decided to propose:
- (a) a disclosure objective requiring an investor to disclose information that enables users of its financial statements to evaluate the changes in the carrying amount of investments in associates; and
  - (b) a reconciliation between the opening and closing carrying amount of its investments in associates, to meet the new disclosure objective.
- BC154 The IASB observed that a reconciliation between the opening and closing amount of particular types of assets and liabilities is often required in other IFRS Accounting Standards, for example:
- (a) IFRS 13 *Fair Value Measurement*, for recurring fair value measurements categorised in Level 3 of the fair value hierarchy;
  - (b) IAS 16, 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.

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<sup>6</sup> For more information see page 21 of the *Project Report and Feedback Statement on the Post-implementation Review of IFRS 12 Disclosure of Interests in Other Entities*, which was issued in June 2022.

- BC155 Users said that reconciliations help them understand the effects of changes in assets and liabilities on the entity's financial performance and cash flows in the period.
- BC156 In the IASB's view, a reconciliation between the opening and closing balance of the carrying amount of an investor's investments in associates would help users of the investor's financial statements understand the changes in that balance. For example, it would help users to distinguish between changes arising from cash transactions (such as dividends received) and changes arising from non-cash transactions (such as impairment losses). It would also help users understand how the carrying amount of the investment has been affected by, for example, the purchase of an additional interest in an associate or a partial disposal. Such a reconciliation would, therefore, complement the proposed recognition and measurement requirements relating to such transactions.
- BC157 The IASB does not expect the proposed requirement to disclose such a reconciliation to be overly costly for preparers, because the information needed to apply the proposed requirement is held by entities and is, in some cases, already required to be presented or disclosed (for example, the investor's share of its associate's profit or loss).
- BC158 The IASB also decided to propose the disclosure objective described in paragraph BC153(a). In the IASB's view, the proposed disclosure objective is consistent with—and would add more detail to—the existing disclosure requirement in paragraph 20 of IFRS 12, which requires an investor to disclose information that enables users of its financial statements to evaluate the nature, extent, financial effects and risks associated with its interests in associates.

### **Applying the proposed disclosure requirements to investments in joint ventures**

- BC159 The IASB developed the proposed improved disclosure requirements discussed in paragraphs BC137–BC158 in the context of investments in associates to which the equity method is applied.
- BC160 The IASB decided to propose the same improved disclosure requirements for investments in joint ventures. In the IASB's view:
- (a) proposing the same disclosure requirements for investments in joint ventures as proposed for investments in associates would be consistent with IFRS 12, which generally requires the same information to be disclosed for the two categories of investments.
  - (b) the proposed requirements would result in the disclosure of useful information about investments in joint ventures. For example, information about contingent consideration arrangements entered into on obtaining an investment in a joint venture would help users to assess the amount, timing and uncertainty of the entity's future cash flows.

- (c) the expected costs for preparers to provide the information are likely to be similar for both types of investments.
- BC161 In relation to the proposed requirement to disclose a reconciliation between the opening and closing carrying amount of an investment in an associate (see paragraphs BC150–BC158), the IASB considered whether to specifically require an investor with investments in both associates and joint ventures to disclose:
  - (a) a single reconciliation; or
  - (b) two separate reconciliations—one for its investments in associates and another for its investments in joint ventures.
- BC162 The IASB noted that the general aggregation and disaggregation requirements in IFRS 18 (or its predecessor, IAS 1) would apply to investors with investments in associates and joint ventures. For example, applying IFRS 18, an investor with investments in both associates and joint ventures would need to consider how to disaggregate information about those investments to fulfil the role of the notes to the financial statements in providing material information. The IASB decided that the general requirements were enough and that it need not develop a specific requirement on this matter because whether two separate reconciliations provide useful information would depend on the entity's specific circumstances.
- BC163 The IASB also considered whether to propose any additional disclosure requirements relating to the application questions in the scope of the project for investments in joint ventures. Although IFRS 12 generally requires the same information for the two categories of investments, in some cases it requires additional information about joint ventures.
- BC164 In particular, the IASB considered whether to extend the proposed disclosure requirement relating to downstream transactions to gains or losses from upstream transactions with joint ventures, but decided not to do so. For transactions with associates, the IASB decided not to propose such a requirement because it could be costly to apply and entities sometimes experience difficulties with accessing information about gains or losses recognised by an associate in upstream transactions (see paragraph BC145). For transactions with joint ventures, the IASB observed that difficulties with accessing information are less likely to arise because the joint venturer has joint control of the joint venture. However, requiring an investor to disclose this information could be costly, particularly if a joint venturer has many investments in joint ventures.
- BC165 Therefore, in the IASB's view, although the cost–benefit balance of such a disclosure requirement differs for investments in joint ventures compared with investments in associates, the costs are likely to outweigh the benefits.

### **Proposed amendments to IAS 27 *Separate Financial Statements***

- BC166 As discussed in paragraphs BC112–BC127, the IASB decided that its proposed solutions to the application questions in the scope of the project, which were developed in the context of investments in associates, would also apply to a parent that chose to use the equity method to account for its investments in subsidiaries in its separate financial statements.
- BC167 The IASB, therefore, considered whether to propose requiring such a parent to disclose the same information as proposed for investments in associates.
- BC168 The IASB decided, with one exception (discussed in paragraph BC169), not to require the same information to be disclosed; this is consistent with the disclosure requirements in IFRS Accounting Standards applying to separate financial statements. The IASB noted that:
- (a) the disclosure requirements in IFRS 12 generally do not apply to separate financial statements; and
  - (b) the disclosure requirements in IAS 27 or other IFRS Accounting Standards do not require the disclosure of quantitative information in separate financial statements about investments in subsidiaries to which the equity method is applied.
- BC169 However, the IASB decided to propose requiring a parent that chose to use the equity method to account for investments in subsidiaries in its separate financial statements to disclose gains or losses from downstream transactions with its subsidiaries. In the IASB’s view, the information would help users of a parent’s separate financial statements to understand how much of the parent’s profit or loss was generated from such transactions. That information would complement the information about such transactions required by IAS 24, which applies to a parent’s separate financial statements.
- BC170 The IASB also decided to propose adding the disclosure requirement described in paragraph BC169 to IAS 27 rather than IAS 24, because IAS 24 applies to all transactions with related parties, not only to transactions with subsidiaries.
- BC171 The IASB considered whether to propose a similar disclosure requirement, as described in paragraph BC169, about gains or losses recognised by the parent’s subsidiaries in upstream transactions, but decided not to do so. In the IASB’s view, the benefits of disclosing the information are likely to be outweighed by the costs because:
- (a) information about gains or losses from upstream transactions is likely to be less useful to users of the parent’s separate financial statements than information about gains or losses from downstream transactions; and
  - (b) although a parent would be able to access information about upstream transactions because of its control over its subsidiaries, such information could be costly to gather, especially if a parent has many subsidiaries and its consolidation process results in these gains or

losses being eliminated in a sub-group consolidation, and, therefore, not tracked at the ultimate parent level.

**Proposed amendments to IFRS 19 *Subsidiaries without Public Accountability: Disclosures***

- BC172 IFRS 19 permits subsidiaries that do not have public accountability and meet other specified criteria (eligible subsidiaries) to apply IFRS Accounting Standards with reduced disclosure requirements. It also specifies the disclosure requirements an eligible subsidiary is permitted to apply instead of the disclosure requirements in other IFRS Accounting Standards.
- BC173 The IASB decided to propose amendments to IFRS 19 to require an eligible subsidiary:
- (a) to disclose gains or losses resulting from downstream transactions with its associates or joint ventures;
  - (b) to disclose, in the period in which the entity obtains significant influence or joint control or purchases an additional ownership interest, for contingent consideration arrangements:
    - (i) the amount recognised at the date it obtains significant influence or joint control, or at the date it purchases that additional ownership interest;
    - (ii) a description of the arrangement; and
    - (iii) the basis for determining the amount of the payment;
  - (c) to disclose, for each subsequent reporting period until the entity collects or settles that contingent consideration or it is cancelled or expires:
    - (i) any changes in the recognised amounts, including any differences arising upon settlement; and
    - (ii) the valuation techniques and key model inputs used to measure contingent consideration; and
  - (d) to disclose gains or losses resulting from downstream transactions with its subsidiaries if the entity is a parent that uses the equity method to account for its investments in subsidiaries in its separate financial statements.
- BC174 In reaching this decision, the IASB assessed the proposed amendments to the disclosure requirements in IFRS 12 and IAS 27 (see paragraphs BC137–BC171) both:
- (a) individually, based on the IASB's agreed principles for reducing disclosures (see paragraph BC175); and
  - (b) as a group, to ensure that the effect of making the amendments is proportionate and preserves the goal of maintaining the usefulness of financial statements of eligible subsidiaries with reduced disclosure requirements.

- BC175 In developing IFRS 19, the IASB was guided by six broad principles:
- (a) users of the financial statements of eligible subsidiaries are particularly interested in information about short-term cash flows and about obligations, commitments or contingencies, whether or not they are recognised as liabilities;
  - (b) users of the financial statements of eligible subsidiaries are particularly interested in information about liquidity and solvency;
  - (c) information on measurement uncertainties is important for eligible subsidiaries;
  - (d) information about an entity's accounting policy choices is important for eligible subsidiaries;
  - (e) disaggregations of amounts presented in eligible subsidiaries' financial statements are important for an understanding of those statements; and
  - (f) some disclosures in IFRS Accounting Standards are more relevant to investment decisions in public capital markets than to the transactions and other events and conditions encountered by typical eligible subsidiaries.
- BC176 Based on these principles, in the IASB's view:
- (a) the information about contingent consideration would provide users with useful information about cash flows and commitments. Also, the proposed disclosure requirements are consistent with the disclosure requirements in IFRS 19 for contingent consideration in business combinations.
  - (b) the information about gains or losses from downstream transactions would help users disaggregate those gains or losses from gains or losses from transactions with third parties, and is, therefore, consistent with the disaggregation principle.
- BC177 The IASB also decided not to propose amendments to IFRS 19 for the other proposed amendments to IFRS 12. For example, the IASB decided not to propose requiring an eligible subsidiary to disclose a reconciliation between the opening and closing carrying amount of its interests in joint ventures and associates (see paragraphs BC150–BC158). In the IASB's view, although such a requirement is consistent with the disaggregation principle in paragraph BC175(e), the resulting information might not be sufficiently useful to users of eligible subsidiaries' financial statements to outweigh the costs of providing the information.

## Transition

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- BC178 The proposed requirements would require some entities to change their accounting policies when using the equity method to account for an investment in an associate or joint venture.<sup>7</sup> The IASB decided to propose requiring an entity:
- (a) to apply retrospectively, in accordance with IAS 8, the requirement to recognise the full gain or loss from all transactions with its associates or joint ventures (paragraphs BC182–BC186);
  - (b) to apply the requirements on contingent consideration by:
    - (i) recognising and measuring contingent consideration at fair value at the transition date, with a corresponding adjustment to the carrying amount of its investments in associates or joint ventures (paragraphs BC187–BC192); and
    - (ii) not remeasuring contingent consideration that an investor had classified as an equity instrument and measured at fair value at the date it obtained significant influence (paragraph BC193); and
  - (c) to apply prospectively all the other requirements from the transition date (paragraphs BC194–BC199).
- BC179 The IASB also decided:
- (a) to propose that for the purpose of the transition requirements:
    - (i) the date of initial application is the beginning of the annual reporting period in which an investor or joint venturer first applies the proposed requirements; and
    - (ii) the transition date is the beginning of the annual period immediately preceding the date of initial application, except for entities that present more than one period of comparative information (paragraphs BC206–BC210);
  - (b) to propose that if an investor or joint venturer estimated at the transition date the recoverable amount of an investment in an associate or joint venture, requiring the investor to reduce the carrying amount to that recoverable amount (if applicable) and recognise any impairment loss in the opening balance of retained earnings (paragraphs BC200–BC205); and
  - (c) not to propose an investor or joint venturer disclose the information required by paragraph 28(f) of IAS 8 for the current period and for any prior period that the investor or joint venturer presents unadjusted (paragraphs BC211–BC216).

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<sup>7</sup> Paragraphs BC178–BC216 refer to associates and joint ventures because IAS 28 sets out requirements for applying the equity method to investments in associates and joint ventures. However, the proposed transitional provisions would also apply to a parent that chose to use the equity method as described in IAS 28 to account for its investments in subsidiaries in separate financial statements.



BC180 In the IASB's view, retrospective application in accordance with IAS 8 would result in the most useful information for users. An entity would be required to present its financial statements as if the proposed requirements had always been effective. Therefore, information presented for prior periods would be comparable.

BC181 However, in some cases, retrospective application might be complex, costly or involve the use of hindsight. The IASB, therefore, considered each of the proposed requirements to determine whether the benefits of retrospective application would outweigh the costs.

### **Gains and losses on transactions with associates or joint ventures**

BC182 As discussed in paragraphs BC63–BC84, the IASB decided to propose requiring an investor to recognise in full the gains or losses on transactions with its associates or joint ventures. That proposed requirement would change the existing requirements in IAS 28, whereby an investor:

- (a) recognises the gain or loss from such transactions at the transaction date only to the extent of the unrelated investors' interests in the associate or joint venture; and
- (b) subsequently recognises the restricted portion of the gain or loss when the transferred asset is sold to third parties or consumed over time.

BC183 Therefore, when first applying the new requirements, an investor might not have yet recognised all the restricted portion of a gain or loss from previous transactions with an associate or joint venture. Retrospective application would, therefore, require an investor to recognise any remaining portion of the previously restricted gain or loss:

- (a) in the opening balance of retained earnings for transactions that occurred before the transition date; and
- (b) in profit or loss in the comparative period for transactions that occurred in the comparative period.

BC184 The IASB observed that, in general, information about the remaining balance of the restricted portion of the gain or loss as at the transition date should be available to preparers because that information is necessary to apply the existing requirements in IAS 28. Therefore, while retrospective application could involve some costs, the IASB's view was that, on balance, the benefits of retrospective application are likely to outweigh them.

BC185 The IASB also observed that IAS 8 includes requirements to limit retrospective application if it is impracticable for an entity to determine the effects of a change in accounting policy.

BC186 After considering the matters discussed in paragraphs BC184–BC185, the IASB decided to propose requiring an investor or joint venturer to apply retrospectively, in accordance with IAS 8, the requirement to recognise the full gain or loss on all transactions with its associates or joint ventures.

### Contingent consideration

- BC187 As discussed in paragraphs BC89–BC93, the IASB decided to propose requiring an investor:
- (a) on initial recognition of an investment in an associate or joint venture, to recognise contingent consideration as part of the consideration transferred and measure it at fair value; and
  - (b) subsequently:
    - (i) not to remeasure contingent consideration classified as equity and recognise its subsequent settlement within equity; and
    - (ii) to measure other contingent consideration at fair value at each reporting date and recognise changes in fair value in profit or loss.
- BC188 The proposed requirements are similar to those in IFRS 3 for contingent consideration in a business combination. In some cases, entities applying the equity method to an investment in an associate or joint venture may already apply, by analogy, the requirements for contingent consideration in IFRS 3. In such cases, retrospective application would not require any adjustment to the amounts recognised in the investor's financial statements.
- BC189 However, in other cases, an investor might not have recognised contingent consideration, or might have measured it on a different basis. In such cases, retrospective application would require the investor to measure the fair value of the contingent consideration:
- (a) at the date of obtaining significant influence or joint control; and
  - (b) at the transition date for contingent consideration recognised as a liability.
- BC190 An investor could have obtained significant influence or joint control before the transition date. Requiring the investor to measure the fair value of contingent consideration at the date of obtaining significant influence or joint control would likely involve the use of hindsight, especially for any unobservable inputs included in the fair value measurement.
- BC191 The IASB noted, however, that prospective application of the proposed requirements—only to contingent consideration arrangements entered after the date of transition—would result in a lack of comparability between an entity's reporting periods and between one entity and another.
- BC192 After considering the matters discussed in paragraphs BC187–BC191, the IASB decided to propose requiring an investor to recognise and measure contingent consideration at fair value at the transition date and recognise a corresponding adjustment to the carrying amount of an investment in an associate or joint venture.

- BC193 The IASB also decided to propose requiring an investor, that on obtaining significant influence had classified contingent consideration as an equity instrument and measured that contingent consideration at fair value, not to remeasure that contingent consideration at the transition date. The IASB noted that the proposed requirement would avoid remeasuring an equity instrument, consistent with the requirements in other IFRS Accounting Standards.

### **Indications of impairment**

- BC194 As discussed in paragraphs BC94–BC106, the IASB decided to propose amendments to the impairment requirements in IAS 28, which are:
- (a) to replace ‘cost’ with ‘carrying amount’ and remove ‘significant or prolonged’ from the requirement in the last sentence of paragraph 41C of IAS 28; and
  - (b) to add guidance explaining that information on the fair value of an investment might be observed from the price paid to purchase an additional interest in an associate or joint venture and received to sell part of the interest.

- BC195 The proposals would change the conditions under which an investor tests its investment in an associate or joint venture for impairment, but would not change how the investor determines the recoverable amount of the investment.

- BC196 The IASB decided to propose requiring an entity to apply the amended requirements prospectively because retrospective application would result in the use of hindsight to assess whether the amended requirements would have triggered the need to test the investment in an associate or joint venture for impairment and, if so, determine the recoverable amount of the investment.

### **Other proposed requirements**

- BC197 The IASB decided to propose requirements relating to:
- (a) the initial recognition of an investment in an associate or joint venture (see paragraphs BC17–BC18 and paragraphs BC85–BC88);
  - (b) the purchase of an additional ownership interest in an associate or joint venture (see paragraphs BC21–BC27);
  - (c) the disposal of an ownership interest in an associate or joint venture (see paragraphs BC28–BC35);
  - (d) other changes in ownership interests (see paragraphs BC36–BC44);
  - (e) unrecognised losses and purchase of an additional interest (see paragraphs BC50–BC55); and
  - (f) the recognition of each component of comprehensive income (see paragraphs BC56–BC61).

- BC198 The IASB decided to propose requiring an investor or joint venturer to apply the requirements listed in paragraph BC197 prospectively, that is, only to transactions occurring after the transition date.
- BC199 The IASB considered that the proposed requirements would apply when an investor initially obtains significant influence or joint control of an associate or joint venture, or when the investor's ownership interest in the associate or joint venture changes after obtaining significant influence or joint control. The proposed requirements would require an investor to use information at the date of the transaction, such as the fair value of the consideration paid or received and the investor's share of the fair value of the associate's or joint venture's identifiable assets and liabilities. Retrospective application of the proposed requirements could, therefore, require the use of hindsight. Retrospective application could also be complex and costly because of the adjustments it would require to the carrying amount of the investment at the transition date, including the share of net assets of the associate or joint venture and goodwill included in the carrying amount of the investment.

### **Impairment at the transition date**

- BC200 When first applying the new requirements, an investor or joint venturer might be required to increase the carrying amount of its investment in an associate or joint venture at the transition date, for example, when recognising:
- (a) the remaining portion of a previously unrecognised gain from a transaction with an associate or joint venture; or
  - (b) contingent consideration for an investment in an associate or joint venture made prior to the transition date.<sup>8</sup>
- BC201 If, on first applying the new requirements, an investor or joint venturer determined that the increased carrying amount of the investment exceeded its recoverable amount, that impairment loss could relate to a period before the transition date. If so, it could be appropriate for an investor or joint venturer to recognise the impairment loss as an adjustment to the opening balance of retained earnings at the transition date.
- BC202 The IASB, therefore, considered, but decided not to propose, requiring an investor or joint venturer to test its investments in associates and joint ventures for impairment at the transition date. The IASB considered that if there was no indication of impairment at that date, such a requirement would impose costs on preparers without any benefit for users.
- BC203 The IASB also considered, but decided not to propose, allowing an investor or joint venturer to retrospectively test an investment in an associate or joint venture for impairment at the transition date, when first applying the new requirements. The IASB noted that for many investments in associates and joint ventures, an observable market price might not be available at the

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<sup>8</sup> The transition date is the beginning of the annual reporting period immediately preceding the date of initial application, except for some entities that present more than one period of comparative information (see paragraphs BC206–BC210).

transition date. Also, even if an observable market price were to be available at that date, the investor or joint venturer might need to estimate the value in use of the investment when estimating its recoverable amount. Therefore, allowing the investor or joint venturer to retrospectively test the investment for impairment at the transition date would often involve the use of hindsight to estimate the recoverable amount of the investment at that date.

- BC204 However, in some cases, an investor or joint venturer might have previously estimated the recoverable amount of an investment in an associate or joint venture at the transition date. In those cases, when first applying the new requirements, the investor or joint venturer could use its previous estimate of the recoverable amount of the investment, without using hindsight.
- BC205 Therefore, the IASB decided to require that if an investor or joint venturer had estimated the recoverable amount of an investment in an associate or joint venture at the transition date, the investor would reduce the carrying amount to that recoverable amount (if applicable) and recognise any impairment loss in the opening balance of retained earnings.

### **Entities that present more than one period of comparative information**

- BC206 IFRS Accounting Standards require an entity to provide comparative information for all amounts reported in the current period's financial statements. However, an entity might present more than one period of comparative information, either voluntarily or because of a reporting requirement in its jurisdiction.
- BC207 The IASB, therefore, considered the implications of the decisions in paragraph BC178 for entities that present more than one period of comparative information. For example, one of those decisions is to require an investor or joint venturer to recognise and measure contingent consideration at fair value at the transition date and make a corresponding adjustment to the carrying amount of its investments in associates or joint ventures. The IASB considered whether it should require the transition date to be the beginning of the earliest period presented or the beginning of the preceding period.
- BC208 The IASB acknowledged that requiring the transition date to be the beginning of the earliest period presented would provide more useful information to users, because all information in the financial statements would be provided on a comparable basis. However, such a requirement could be complex to apply and might require the use of hindsight. That concern also arises for many of the other proposed requirements, including the proposed requirements for which the IASB is proposing to require prospective application from the transition date.

- BC209 The IASB also noted that in some other standard-setting projects, it had developed transition requirements for entities providing more than one period of comparative information that did not require all comparative information to be adjusted.<sup>9</sup>
- BC210 The IASB decided to propose permitting an investor or joint venturer that presents more than one period of comparative information to present comparative information for any additional prior periods either:
- (a) adjusted for the effects of the proposed requirements, in which case the transition date would be the beginning of the earliest adjusted comparative period presented; or
  - (b) unadjusted for the effects of the proposed requirements, in which case the investor or joint venturer would label the comparative information as unadjusted, and disclose that the comparative information has been prepared on a different basis and explain that basis.

### **Disclosure of the effects of initial application of the proposed requirements**

- BC211 When initial application of an IFRS Accounting Standard has an effect on any period presented, paragraph 28(f) of IAS 8 requires an entity to disclose, for the current period and each prior period presented, to the extent practicable, the amount of the adjustment for each financial statement line item affected and, if IAS 33 *Earnings per Share* applies to the entity, for basic and diluted earnings per share.
- BC212 The IASB does not expect that it would be costly for preparers to apply the requirement in paragraph 28(f) of IAS 8 for the immediately preceding period, because an investor or joint venturer would have the necessary information from its restatement of comparative information for that period.
- BC213 However, the IASB considered that it could be costly for preparers to apply the requirement in paragraph 28(f) of IAS 8 for the current period. For example, to disclose information about the effects on the current period of recognising the full gain or loss arising from transactions with its associates or joint ventures, an investor or joint venturer would need to:
- (a) determine the portion of those gains or losses that it would have restricted on transactions occurring during the current period, had the entity applied the requirement in paragraph 28 of IAS 28 to restrict the gains or losses on such transactions; and
  - (b) determine the portion of unrecognised gains or losses from prior periods that would have been recognised in the current period.
- BC214 Overall, in the IASB's view, the costs for preparers of providing the information required by paragraph 28(f) of IAS 8 for the current period are likely to exceed the benefits for users.

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<sup>9</sup> For example, see paragraphs C25–C27 of IFRS 17 *Insurance Contracts*.

- BC215 The IASB also noted that requiring an investor or joint venturer to apply paragraph 28(f) of IAS 8 for any additional comparative periods presented would be inconsistent with its decision to permit the investor or joint venturer to present unadjusted comparative information for those additional comparative periods (see paragraph BC210(b)).
- BC216 Therefore, the IASB decided to propose not requiring an investor or joint venturer to disclose the information required by paragraph 28(f) of IAS 8 for the current period and for any prior period that the investor or joint venturer presents unadjusted.

### Expected effects of the proposals

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- BC217 The IASB is committed to assessing, and explaining its views about, the likely benefits and costs of implementing its proposals, and the likely ongoing benefits and application costs of those proposals – these benefits and costs are collectively referred to as ‘effects’. The IASB expects to gain further insight into the likely effects of its proposals from responses to the Exposure Draft and through analysis and outreach with stakeholders.
- BC218 Paragraphs BC219–BC229 discuss:
- (a) entities affected by the proposals (paragraphs BC219–BC220);
  - (b) the expected effects on information reported in financial statements (paragraph BC221);
  - (c) the expected effects on the quality of financial reporting (paragraphs BC222–BC223); and
  - (d) the expected costs of implementing and applying the proposals (paragraphs BC224–BC229).

### Entities affected by the proposals

- BC219 The proposals would affect entities that:
- (a) when required by IAS 28, use the equity method to account for investments in associates or joint ventures in consolidated financial statements or in individual financial statements;<sup>10</sup> and
  - (b) as permitted by IAS 27, choose to use the equity method as described in IAS 28 to account for investments in associates, joint ventures or subsidiaries in separate financial statements.
- BC220 For affected entities, the magnitude of change introduced by the proposals would vary depending on:
- (a) the significance to the entity’s financial position and financial performance of its investments in, and income and expenses from, associates, joint ventures and subsidiaries to which the equity method is applied;

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<sup>10</sup> The term ‘individual financial statements’ is sometimes used to describe the financial statements of an entity with no subsidiaries.

- (b) whether and how much the entity engages in (or is affected by) the types of transactions and other events to which the proposed requirements relate; and
- (c) how different the entity's existing accounting policies are to the proposed requirements for those transactions and other events.

### Expected effects on information reported in financial statements

BC221 Table 3 summarises the expected effects of the IASB's proposals on how information is reported in the financial statements of affected entities. For simplicity, Table 3 mostly refers to investments in associates. However, the expected effects of the proposals also relate to investments in joint ventures and to a parent that chose to use the equity method to account for its investments in subsidiaries in its separate financial statements, unless indicated otherwise.

**Table 3—Expected effects on information reported in financial statements**

Current situation	Expected effects
<b>Changes in an investor's ownership interest on obtaining significant influence</b>	
<p>IAS 28 does not specify how to measure the cost of the investment when obtaining significant influence, for example, whether to measure any previously held interest at its original purchase cost or carrying amount applying IFRS 9.</p> <p>Approaches applied in practice vary.</p>	<p>Some entities might need to change their accounting policy.</p> <p>The cost of investment would be measured at the fair value of the consideration transferred, including the fair value of any previously held interest in the associate.</p>
<b>Changes in an investor's ownership interest while retaining significant influence</b>	
<p>IAS 28 does not specify how an investor, while retaining significant influence, accounts for:</p> <ul style="list-style-type: none"> <li>• the purchase of an additional interest;</li> <li>• the disposal of an interest; or</li> <li>• changes in the investor's interest resulting from an associate's issue or redemption of shares.</li> </ul>	<p>Some entities might need to change their accounting policies.</p> <p>For example, an investor purchasing an additional interest would:</p> <ul style="list-style-type: none"> <li>• measure its additional share of the associate's identifiable assets and liabilities at their net fair value at the date of purchasing the additional interest;</li> </ul>

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<p>Approaches in practice vary. For example, an investor purchasing an additional interest, might:</p> <ul style="list-style-type: none"> <li>• measure its additional share of the associate's identifiable assets and liabilities at their net book value or their net fair value;</li> <li>• remeasure or not remeasure its existing interest in the associate to its fair value; or</li> <li>• recognise a bargain purchase gain as a deduction from the carrying amount of the investment or as a gain in profit or loss.</li> </ul>	<ul style="list-style-type: none"> <li>• measure the cost of the additional interest at the fair value of the consideration transferred for that additional interest, without remeasuring the existing interest; and</li> <li>• account for any difference between those amounts either as goodwill (included in the carrying amount of the investment) or as a gain in profit or loss.</li> </ul>
<b>Recognition of losses</b>	
<p>IAS 28 does not specify whether an investor that has reduced its investment in an associate to nil is required:</p> <ul style="list-style-type: none"> <li>• upon purchase of an additional interest, to recognise its share of any previously unrecognised losses as a deduction from the cost of the additional interest; or</li> <li>• to recognise separately each component of the associate's total comprehensive income.</li> </ul> <p>IAS 28 also does not specify the order in which losses are recognised, for example, if the investor's share of the associate's total comprehensive income is a loss that is higher than the carrying amount of the investment.</p> <p>Approaches applied in practice vary.</p>	<p>Some entities might need to change their accounting policies.</p> <p>An investor that has reduced its investment in an associate to nil would:</p> <ul style="list-style-type: none"> <li>• not recognise any previously unrecognised losses as a deduction from the cost of an additional interest purchased in the associate; and</li> <li>• recognise separately its share of the associate's profit or loss and its share of the associate's other comprehensive income.</li> </ul> <p>An investor would also recognise its share of the associate's profit or loss and then its share of the associate's other comprehensive income.</p>

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EQUITY METHOD OF ACCOUNTING—IAS 28 INVESTMENTS IN ASSOCIATES AND JOINT VENTURES  
(REVISED 202x)

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<b>Transactions with associates</b>	
<p>Paragraph 28 of IAS 28 requires an investor to restrict the gain or loss recognised in a transaction with an associate to the extent of the unrelated investors' interests in the associate. That requirement applies to both downstream and upstream transactions. The portion of the gain or loss that is not recognised at the date of the transaction is recognised subsequently, when the transferred asset is sold to unrelated third parties or consumed over time.</p> <p>However, paragraphs 25 and B97–B99 of IFRS 10 require an investor to recognise in full the gains or losses on the loss of control of a subsidiary.</p> <p>An inconsistency, therefore, arises between the requirements in IAS 28 and IFRS 10 when an investor accounts for the sale or contribution of a subsidiary to an associate.</p>	<p>Entities would need to change their accounting policies.</p> <p>An investor would recognise in full the gain or loss on all transactions with associates, including:</p> <ul style="list-style-type: none"> <li>• sales or contributions of a subsidiary to an associate; and</li> <li>• all other transactions with an associate.</li> </ul> <p>For a parent entity that chose to apply the equity method to its investments in subsidiaries in separate financial statements, the proposal could increase the differences between the amounts reported in a parent's separate financial statements and consolidated financial statements.</p>
<b>Deferred taxes</b>	
<p>IAS 28 does not specify whether an investor is required to include, in the carrying amount of the investment in an associate, the deferred tax effects related to measuring its share of the associate's identifiable assets and liabilities at fair value.</p> <p>Different approaches are applied in practice, with the inclusion of such deferred tax effects being common.</p>	<p>Most entities would not need to change their accounting policy.</p> <p>An investor would include, in the carrying amount of the investment, the deferred tax effects related to measuring its share of the associate's identifiable assets and liabilities at fair value.</p>

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<b>Contingent consideration</b>	
<p>IAS 28 does not specify how an investor is required to recognise or measure contingent consideration on obtaining an investment in an associate, either on initial recognition or subsequently. A similar issue arises for contingent consideration on purchase of an additional interest.</p> <p>Although approaches applied in practice vary, it is common for entities to apply a similar approach, to that required by IFRS 3 to recognise and measure contingent consideration in a business combination.</p>	<p>Most entities would not need to change their accounting policies.</p> <p>An investor would recognise and measure contingent consideration on obtaining an investment in an associate (or on purchase of an additional interest) in a similar way as is required by IFRS 3 for contingent consideration in a business combination.</p>
<b>Impairment</b>	
<p>IAS 28 states that a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is objective evidence of impairment, but is unclear as to whether an investor is required to compare that fair value with the investment's carrying amount at the reporting date or its cost on initial recognition.</p> <p>Although approaches applied in practice vary, it is common for entities to compare the fair value of the investment with its carrying amount at the reporting date.</p>	<p>Most entities would not need to change how they assess whether an indicator of impairment exists. The proposals do not change how an investor tests an investment in an associate for impairment.</p> <p>An investor would assess whether a decline in the fair value of an investment in an associate indicates that the investment might be impaired by comparing its fair value with its carrying amount at the reporting date. The proposed amendments would:</p> <ul style="list-style-type: none"> <li>• replace 'cost' with 'carrying amount';</li> <li>• remove the phrase 'significant or prolonged'; and</li> <li>• add guidance on how information about the fair value of an investment might be observed.</li> </ul>

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<b>Disclosures</b>	
<p>IFRS 12 specifies disclosure requirements for an investor with an investment in an associate or joint venture. Those disclosure requirements generally do not apply to a parent's separate financial statements.</p> <p>IAS 27 specifies disclosure requirements for separate financial statements.</p> <p>In addition, IAS 24 specifies disclosure requirements for related party transactions, which apply to consolidated, separate and individual financial statements.</p>	<p>Entities with investments in an associate or joint venture accounted for using the equity method would need to disclose additional information about any:</p> <ul style="list-style-type: none"> <li>• changes in the carrying amount of an investment in an associate or joint venture;</li> <li>• gains or losses from other changes in its ownership interest;</li> <li>• gains or losses from downstream transactions with its associates or joint ventures; and</li> <li>• contingent consideration arrangements.</li> </ul>

### **Expected effects on the quality of financial reporting**

- BC222 The proposed amendments would provide users with more comparable information by reducing diversity in practice. The proposals answer application questions that arise in practice when preparers use the equity method to account for investments in associates and joint ventures (or for investments in subsidiaries in separate financial statements). There is diversity in practice in accounting for the transactions and other events to which the proposals relate, because IAS 28 either does not specify requirements or specifies requirements inconsistent with those in other IFRS Accounting Standards. The proposed requirements are expected to eliminate that diversity and, therefore, result in more comparable information.
- BC223 The proposals would also provide users with more relevant information. One example is the proposed requirement for entities to disclose a reconciliation between the opening and closing balance of the carrying amount of an investor's investments in associates and joint ventures. This proposal would help users of the investor's financial statements understand the changes in that balance (see paragraph BC156).

### **Expected costs of implementing and applying the proposals**

- BC224 Currently, preparers incur costs to develop their own accounting policies to answer the application questions in Table 1, including researching potential accounting policies and engaging in discussions with auditors and regulators, who also incur costs to review those accounting policies. The proposals would reduce some costs to preparers, auditors and regulators by providing answers

to application questions arising in practice for entities applying the equity method.

- BC225 As shown in Table 3, some entities may need to change their accounting policies to implement the proposals. In many cases, the IASB does not expect the specific proposals to be costly for preparers to implement and apply, such as the proposal to remeasure any previously held investment in an associate at its fair value on obtaining significant influence (see paragraph BC18(c)).<sup>11</sup> In some cases, an entity's new accounting policy may be less costly to apply than its existing one. In particular, the proposed requirement to recognise, in full, the gain or loss from transactions with associates would mean that preparers would not need:
- (a) to track when an asset transferred to or from an associate in such transactions is subsequently sold to unrelated parties or consumed over time; or
  - (b) to gather information about gains or losses from upstream transactions.
- BC226 Although the IASB expects preparers to incur some costs to implement and apply the proposed requirement to disclose the amount of any gains or losses recognised by an investor on downstream transactions, the IASB expects applying the proposed disclosure requirement to be less costly than applying the current requirements in IAS 28 for those transactions. In particular, an investor would no longer need to track when an asset transferred to an associate is subsequently sold to unrelated parties or consumed over time.
- BC227 In some jurisdictions in which the equity method is required (or otherwise frequently used) to account for a parent's investments in its subsidiaries in separate financial statements, the proposal for the parent to recognise in full any gains or losses from transactions with its subsidiaries may result in some additional costs for preparers. The proposal could increase the differences between the amounts reported in separate and consolidated financial statements (see paragraph BC124). When entities need to provide information that aligns the amounts reported in their separate and consolidated financial statements—for example, for the purposes of dividend distributions—the parent may need to provide additional information about any differences between its separate and consolidated financial statements to meet local requirements.
- BC228 In some cases, an entity's new accounting policy may be more costly to apply than its existing accounting policy, such as the proposal to measure the investor's additional share of the associate's identifiable assets and liabilities at their net fair value, and include the related deferred tax effects, when purchasing an additional interest in an associate. Some entities' existing accounting policy might be to measure the investor's additional share of the associate's identifiable assets and liabilities at their net book value.

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<sup>11</sup> For simplicity, in most cases paragraphs BC225–BC229 discuss the proposals in the context of investments in associates. However, the proposals would also apply to investments in joint ventures and to a parent that chose to use the equity method as described in IAS 28 to account for its investments in subsidiaries in its separate financial statements.

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- BC229 Entities may incur some other costs to implement and apply the other proposed new disclosure requirements, such as the proposal for an investor to disclose a reconciliation between the opening and closing carrying amount of its investments in associates.

## **Alternative view of Mr Tadeu Cendon on the Exposure Draft *Equity Method of Accounting—IAS 28 Investments in Associates and Joint Ventures (revised 202x)***

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AV1 Mr Cendon voted against the proposals in the Exposure Draft *Equity Method of Accounting—IAS 28 Investments in Associates and Joint Ventures (revised 202x)*. Mr Cendon supports the proposals in the Exposure Draft amending the equity method requirements in IAS 28 *Investments in Associates and Joint Ventures*. However, in his opinion, IAS 27 *Separate Financial Statements* should have been amended to include an option to apply the equity method of accounting differently when the parent has control of the investee (that is, when the investee is a subsidiary) and the entity elects to apply the equity method.

### **Use of the equity method in separate financial statements**

AV2 In 2003, the IASB amended IAS 27 to require the use of cost or fair value for investments in subsidiaries, associates and joint ventures. At that time, the IASB stated that, for separate financial statements, the focus was on the performance of the asset as an investment. The IASB also explained that although the equity method of accounting 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 the investee's individual financial statements and does not need to be provided to the users of its separate financial statements.

AV3 In its 2011 Agenda Consultation, the IASB was asked to restore the option to permit investments in subsidiaries, joint ventures or associates to be accounted for using the equity method in the separate financial statements. Some jurisdictions that permit or require entities to prepare separate financial statements in accordance with IFRS Accounting Standards also require the use of the equity method for investments in subsidiaries, associates and joint ventures. In those jurisdictions the use of the equity method may have been the only difference between separate financial statements prepared in accordance with IFRS Accounting Standards and those prepared in accordance with any local regulations.

AV4 As a result of the 2011 Agenda Consultation, the IASB undertook a narrow-scope project that culminated in the 2014 amendments to IAS 27 (*Equity Method in Separate Financial Statements (Amendments to IAS 27)*). The amendments restored the option to use the equity method in separate financial statements for investments in subsidiaries, associates and joint ventures. In the Exposure Draft: *ED/2013/10 - Equity Method in Separate Financial Statements*, which preceded the 2014 amendments, the IASB noted that the proposals would facilitate convergence of local GAAP with IFRS Accounting Standards when preparing separate financial statements, and that would help to reduce compliance costs for some entities without the loss of information.

### **Recognition in full of gains and losses in transactions with associates or joint ventures**

- AV5 Mr Cendon agrees with the proposed amendment that would require an investor or joint venturer to recognise, in full, the gains and losses resulting from all its upstream and downstream transactions with its associates or joint ventures. However, Mr Cendon does not agree that these amendments should be made to IAS 28 without amending IAS 27. Associates and joint ventures share a characteristic—they are not part of the reporting entity in consolidated financial statements, as the parent does not control the assets and liabilities of these investees. Mr Cendon's view is that this characteristic is an important reason to support the proposed requirement (that is, recognition in full of gains or losses). However, this characteristic is not present when the investee is a subsidiary. Subsidiaries are part of the reporting entity because the parent controls the individual assets and liabilities of the subsidiary.
- AV6 The aim of the Equity Method project is to answer application questions, and not to examine the purpose and nature of the equity method, including whether it is a one-line consolidation or a measurement basis. However, Mr Cendon believes that the proposed amendments, in practice, assume that the equity method is a measurement basis because they disregard the existence of control and will require the same treatment in separate financial statements for subsidiaries as for associates and joint ventures. Because of the notion of control, a subsidiary is fundamentally different from an associate or joint venture.
- AV7 IAS 27 acknowledges that entities might prepare separate financial statements on a voluntary basis or because laws or regulations require entities to publish them. However, IAS 27 does not provide much insight into the purpose of separate financial statements or the principles behind the accounting options for investments in subsidiaries, joint ventures or associates.
- AV8 The proposed amendments address application questions on applying the equity method, but do not address the two topics above – the purpose and nature of the equity method, and the purpose of separate financial statements (including the rationale for the accounting options for investments in subsidiaries, joint ventures or associates).
- AV9 The amendment to IAS 28 will require a parent that prepares separate financial statements and accounts for its investment in subsidiaries applying the equity method to recognise, in full, the gains or losses resulting from all its upstream and downstream transactions with these subsidiaries. In practice it will, in many cases, if not in all, have the effect of reversing the main benefits of the 2014 amendments, when the equity method option was restored.
- AV10 As these gains or losses are eliminated in the consolidated financial statements, differences between shareholders' equity or the net profit attributable to the owners of the parent in the consolidated financial statements, and the equivalent in the separate financial statements, will arise. For the same reason, the proposed requirement prohibiting remeasurement in the separate financial statements of the previously held interest when an



entity obtains control of an associate or joint venture, or of the retained investment when an entity loses control of a subsidiary and retains an investment in that former subsidiary as an investment in an associate or joint venture, will result in an additional difference between the consolidated and separate financial statements.<sup>12</sup>

AV11 In many jurisdictions, the separate financial statements play an important role. They are more clearly linked with the legal entity, while the consolidated financial statements (although more relevant from the investors' perspective) provide a view of the group rather than of a legal entity. In many jurisdictions, separate financial statements are the starting point for compliance with legal requirements, for example, for taxation and capital maintenance, including paying dividends and assessing insolvency or bankruptcy.

AV12 In jurisdictions where separate financial statements are:

- (a) required or permitted to be prepared in accordance with IFRS Accounting Standards (or even in circumstances where they are prepared in accordance with local regulations); and
- (b) investments in subsidiaries, joint ventures and associates are accounted for using the equity method,

any difference between the shareholders' equity or net profit attributable to the owners of the parent in the consolidated financial statements, and the equivalent in the separate financial statements could increase the cost of compliance for preparers. Such differences would also add complexity for users because the users would need to understand the impact of these differences on all aspects of the entity.

AV13 Mr Cendon believes that, until the IASB addresses the conceptual questions about the nature and purpose of the equity method and of separate financial statements, an option should be added to IAS 27 to allow a parent to apply the equity method for investments in subsidiaries consistently with the procedures used when preparing consolidated financial statements. A parent choosing this option would eliminate gains or losses resulting from upstream and downstream transactions with its subsidiaries and remeasure the previously held interest when it obtains control of an associate or joint venture, or remeasure its retained investment when an entity loses control of a subsidiary and retains an investment in that former subsidiary as an investment in an associate or joint venture.

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12 The proposed requirements prohibiting the remeasurement of the previously held interest in an associate or joint venture when an entity obtains control are in paragraphs 10A and 10B of the [Draft] Amendments to IAS 27 in the Exposure Draft *Equity Method of Accounting—IAS 28 Investments in Associates and Joint Ventures (revised 202x)*.



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