STAFF PAPER

October 2020

IASB® Meeting

Project	**Equity Method of Accounting**		
Paper topic	Project objective and approach		
CONTACT	Filippo Poli	fpoli@ifrs.org	+44 (0)20 7246 6959
	Zhen Xu	zxu@ifrs.org	+44 (0)20 7246 6477

Purpose of the paper

1. This paper asks the International Accounting Standards Board (Board) to:

   (a) confirm the objective of the research project on the equity method of accounting; and

   (b) agree the approach to the research project.

Background

2. The *IASB Work Plan 2017–2021 Feedback Statement on the 2015 Agenda Consultation*, states:

   > A number of queries on equity accounting and its interaction with the accounting for other ways of holding interests in other entities have been raised with the Interpretations Committee. The Board thinks that it will be able to consider this topic most effectively and efficiently after it has assessed feedback from the forthcoming Post-implementation Review of IFRS 11 *Joint Arrangements*.

3. In September 2019, the Board began the Post-implementation Review of IFRS 10 *Consolidated Financial Statements*, IFRS 11 and IFRS 12 *Disclosure of Interests in Other Entities*.

4. In April 2020, the Board approved the matters to be examined in a Request for Information. Because of the covid-19 pandemic, the Board has decided to delay publication of the Request for Information to the fourth quarter of 2020.

Structure of this paper

5. This paper sets out:

   (a) staff recommendations (paragraph 6);

   (b) objective of the research project (paragraphs 7–15);

   (c) recommended approach to the research project (paragraphs 16–31);

   (d) alternative approach not recommended (paragraphs 32–34);

   (e) timing of the research project (paragraphs 35–38);

   (f) questions to the Board members;

   (g) Appendix A – History of the equity method project; and

   (h) Appendix B – Illustrative list of identified application problems.

Staff recommendations

6. The staff recommends that:

   (a) the Board confirms the objective of the research as being:

   To assess whether application problems with the equity method as set out in IAS 28 *Investments in Associates and Joint Ventures*, can be addressed in consolidated and individual financial statements by identifying and explaining the principles of IAS 28.

   (b) the project approach be to:

      (i) identify application problems and decide which problems the project will address;

(ii) address the application problems by identifying and explaining the principles that underlie IAS 28. Identifying and explaining the principles that underlie IAS 28 will allow the Board to develop new requirements (or application guidance) which will amend the Standard.

Objective of the research project

Defining the problem

7. The *Due Process Handbook* states that the first step in developing a new financial reporting requirement is to assess and define the problem within the existing reporting practice.

8. The Board had started a research project on the equity method but following the 2015 Agenda Consultation decided to defer work on the project. Appendix A summarises the Board's previous work, including the Board's tentative decisions.

9. The Board had decided to undertake a limited-scope research project addressing application problems with the aim of reducing the need for continued narrow-scope amendments to IAS 28.

10. The Board reached this decision because:

    (a) it needs to address application problems that had been referred to the IFRS Interpretations Committee (Interpretations Committee) and highlighted by the Global Preparers Forum;

    (b) stakeholders expressed different views— between 2014 and 2015 two views emerged regarding how the Board should approach the project:

    View 1—aim to resolve application problems;

    View 2—determine the objective of the equity method, because application problems can only be solved if the objective of the equity method is clarified.

(c) a wide-scope research project addressing the objective of the equity method:

(i) would be better undertaken following the Post-implementation Review of IFRS 10, IFRS 11 and IFRS 12 because feedback from the Post-implementation Review could inform the equity method project; and

(ii) could result in significant changes to financial reporting (see paragraph 34).

Scope of the research project

11. IAS 27 *Separate Financial Statements* permits an entity to account for investments in subsidiaries, associates and joint ventures at cost, or applying the equity method as described in IAS 28, or in accordance with IFRS 9 *Financial Instruments* (at fair value).

12. As part of its previous work the Board decided to assess separately the equity method of accounting as applied to subsidiaries in separate financial statements. The staff recommendation to do so was based on research which led the staff to believe the application of the equity method of accounting in separate financial statements for investments in subsidiaries was a one-line consolidation method.

13. The staff recommends that the project initially focuses on the equity method applied in consolidated and individual financial statements[1] because most of the application problems identified relate to transactions between an investor and an associate or joint venture rather than transactions between an investor and a subsidiary.

14. At a later stage of the project, the Board will assess whether and how it can apply any proposed solutions to investments in subsidiaries when an entity applies the equity method in separate financial statements.

[1] In this paper, individual financial statements are those presented by an entity that does not have subsidiaries but has investments in associates and/or joint ventures that are accounted for using the equity method.

Summary

15. Paragraphs 7–14 summarise the Board's decisions from its previous work. The staff considers that these points are still relevant and therefore ask the Board to confirm that the objective of the research is:

> To assess whether application problems with the equity method as set out in IAS 28, *Investments in Associates and Joint Ventures* can be addressed in consolidated and individual financial statements by identifying and explaining the principles of IAS 28.

Recommended approach to the research project

Identification of application problems

16. To achieve the project objective, it will be necessary to identify the application problems to be addressed. For illustration purposes only, Appendix B includes a list of known application problems. At this meeting, the staff is not asking the Board's views on the list of application problems.

17. The staff's view is that the project should address application problems based on:

    (a) whether they can be resolved efficiently and effectively without:

        (i) fundamentally rewriting IAS 28; or

        (ii) amending other IFRS Standards (except for consequential amendments);

    (b) whether they affect consistent application of IAS 28; and

    (c) the importance of the matter, including whether addressing the problem would improve the usefulness of financial information.

18. The staff will ask the Board to decide which application problems to address in the project at a future meeting.

Approach to resolving application problems

19. The staff has also considered different approaches to resolve the application problems. The staff recommends resolving the application problems by amending IAS 28 or adding application guidance that improves the usefulness of financial information.

20. To resolve the application problems within the confines of IAS 28, it will be necessary to apply the principles underlying IAS 28. However, IAS 28 has no clearly defined principles therefore it will be necessary to identify and explain the principles.

21. The Board has acknowledged that equity accounting as set out in IAS 28, has problems[2]. Paragraph 3 of IAS 28 defines the equity method as:

> A method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee net assets. The investor's profit or loss includes its share of the investee's profit or loss and the investor's other comprehensive income includes its share of the investee's other comprehensive income.

22. IAS 28 was initially issued in December 2003 and does not include a Basis for Conclusions. Furthermore, the Board did not address the equity method of accounting when it developed the *Conceptual Framework for Financial Reporting (Conceptual Framework)*.

23. It is recognised that identifying and explaining the principles of IAS 28 will be challenging. The staff has identified resources that may help to provide insight into the principles that underlie IAS 28. These resources are:

    (a) the requirements of IAS 28 itself;

    (b) the Interpretations Committee's agenda decisions, including the working papers;

    (c) the Board's narrow-scope amendments to IAS 28, including the working papers; and

[2] See IASB Work plan 2017-2021 Feedback Statement on 2015 Agenda consultation

(d) the Board's discussions in projects such as Joint Arrangements and Primary Financial Statements.

24. The staff will aim to identify the underlying principles that set out how to apply the equity method. The scope of IAS 28 and the definition of significant influence will not be addressed.

25. Amending or providing application guidance to IAS 28 will lead to implementation costs. Identifying and explaining the principles in IAS 28 should lead to lower implementation costs than would developing new principles. Doing so would also lead to a smaller potential to create inconsistencies than adding or modifying requirements in IAS 28 for specific fact patterns or transactions.

26. The staff will address costs and benefits during the research project by:

(a) applying the criteria to identify which application problems the project should address; and

(b) evaluating how possible solutions to application problems interact with the requirements of IAS 28.

Summary

27. The project would be within the confines of IAS 28 and a focus solely on solving the identified application problems.

28. The Board is applying a similar approach in its Financial Instruments with Characteristics of Equity project. As noted, this approach goes further than the work of the Interpretations Committee, because it intends to build on principles in the Standard and develop new requirements or application guidance.

29. The staff suggests that such an approach is advantageous because if a step cannot be achieved, the Board could either stop the project or amend the project approach.

30. Another advantage is that by identifying and explaining the principles in IAS 28, the project would provide a basis to address emerging application problems.

31. The staff does not recommend that the project attempts to develop solutions by looking at each application problem individually. A piecemeal approach risks creating inconsistencies and conflicts with existing requirements of IAS 28 and other IFRS Standards.

Alternative approach not recommended

32. Some stakeholders hold the view a fundamental review of the equity method is required. A fundamental review could include assessing:

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

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

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

33. A fundamental review of the equity method would require more time and resources than the recommended approach, and the Board would need to decide the priority for such a project. A fundamental review could lead the Board to conclude that fundamental changes are required to when and how the equity method is applied, or even whether the equity method is required at all.

34. Such a fundamental review could result in substantive changes to financial statements and stakeholders would need more time and effort to implement the new requirements. The equity method is well-established and such changes would require significant stakeholder support. Therefore, the staff is not recommending such an approach.

Timing of the research project

35. After the 2015 Agenda Consultation, the Board moved the equity method project to the research pipeline. The Board stated it would defer work on the equity method project until after it had assessed feedback from the Post-implementation Review of IFRS 11.

36. The equity method is related to both IFRS 11 and IFRS 12. IFRS 11 requires an investor to apply the equity method when a joint arrangement is classified as a joint venture, and IFRS 12 requires disclosing financial information about investments in joint ventures and associates.

37. The first phase of the Post-implementation Review of IFRS 11 is complete. The Request for Information will not examine matters related to the application of the equity method. Only one of the matters the Board has decided to examine further is relevant to the application of the equity method— how to account for certain transactions that result in changes in ownership interest that alter the relationship between an investor and an investee.

38. The staff suggests that starting work on the equity method project now will allow the staff to simultaneously conduct outreach on the equity method and on the Request for Information on the Post-implementation Review. Combining the two projects should also be time-effective for stakeholders who can express views on these interrelated topics simultaneously.

Questions to the Board members

Questions for Board members
1 Do the Board members confirm the objective of the research project is: To assess whether application problems with the equity method as set out in IAS 28 *Investments in Associates and Joint Ventures*, can be addressed in consolidated and individual financial statements by identifying and explaining the principles of IAS 28.

2 Do Board members agree with the recommended project approach to:

(i) identify application problems and decide which problems to consider in the project; and

(ii) address the application problems by identifying and explaining the principles that underlie IAS 28. Identifying and explaining the principles that underlie IAS 28 will allow new requirements (or application guidance) to be developed which amend the Standard.

Appendix A – History of the equity method project

Work undertaken by the International Accounting Standards Board

A1 The Feedback Statement: 2011 Agenda Consultation stated:

> The equity method of accounting for some investments is often criticised. Some question whether it provides helpful information to users, while others note the complexities and inconsistencies it creates when it interacts with other requirements in IFRS–such as goodwill impairment, share based payments and joint arrangements. The research project will involve a fundamental assessment of the equity method in terms of its usefulness to investors and problems for preparers.

A2 At its meeting in May 2014 the International Accounting Standard Board (Board) considered the scope of, and approach to, to its research project on the equity method of accounting. The Board decided to review the circumstances in which the equity method is applied in IFRS Standards, with the objective of identifying the financial reporting problem or problems in the application of the equity method. The Board emphasised that it intends to focus on identifying problems related to the equity method, to ensure that it does not attempt to resolve problems that are not clearly identified.

A3 Between May 2014 and June 2015, the Board:

(a) consulted its consultative bodies, including the Capital Markets Advisory Committee, Global Preparers Forum and Accounting Standards Advisory Forum;

(b) reviewed the work undertaken by the Interpretations Committee; and

(c) reviewed the work of national standard-setters.

A4 In June 2015, the Board consider the planned scope of, and approach to the research project. The Board decided:

(a) to undertake a limited-scope research project that seeks to address application problems with the equity method as set out in IAS 28;

(b) the limited-scope project should seek to address the matters currently being considered by the Interpretations Committee on developing a narrow-scope amendment to IAS 28;

(c) to assess separately the equity method of accounting as applied to subsidiaries in separate financial statements; and

(d) to consider the need for a wider research project after the completion of the Post-implementation Review of IFRS 10, IFRS 11 and IFRS 12.

A5 The Board made this decision based on feedback from its consultations groups and work undertaken by the Interpretations Committee. The Board considered a limited-scope project should focus on application of the equity method as set out in IAS 28. The aim is to address application problems that have either been considered by the Interpretations Committee or that have been highlighted by the Global Preparers Forum.

A6 Following the 2015 Agenda Consultation, the Board decided to defer work on the equity method project until after it had assessed feedback from the Post-implementation Review of IFRS 11. It therefore removed the project from its research programme and added it to the research pipeline.

Work done by others

European Financial Reporting Group—The Equity Method: A Measurement Basis or One-line Consolidation?

A7 In January 2014, the European Financial Reporting Group published a Discussion Paper *The Equity Method: A Measurement Basis or One-line Consolidation?* [3] The objective of the Discussion Paper was to debate the nature of the equity method, that is whether it is a one-line consolidation or a measurement method (or possibly a hybrid). The Discussion Paper noted that one argument against the equity method as a one-line consolidation is that

[3] The discussion paper can be found here.

control is the basis for consolidation in IFRS 10, and joint ventures and associates are not controlled by an investor. Responses to the Discussion Paper showed a diversity of views, indicating that there is no common understanding of the purpose or use of the equity method.

Korea Accounting Standards Board –The Equity Method.[4]

A8 In September 2014, the Korea Accounting Standards Board (KASB) published a research report *The Equity Method*.[5] The research report noted the cause of problems related to the equity method stems from IAS 28 not clarifying the underlying concept of the equity method.

A9 The KASB illustrated the three following alternative approaches to define a 'scope of the equity-accounted group' and explained how each approach would be applied to address the application problems:

(a) the equity-accounted investment is part of the group;

(b) the equity-accounted group includes the investor's share of the equity-accounted investment; or

(c) the scope of the equity-accounted group is confined only to an investor and its subsidiaries—equity-accounted investments are not part of the group.

Financial Accounting Standards Board proposal to simplify the equity accounting

A10 In June 2015 Financial Accounting Standards Board (FASB) published a proposal to simplify the equity accounting. The proposed simplifications would eliminate the requirements to:

[4] The research report can be found here.

[5] The research report can be found here.

(a) account for the basis difference (the difference between the cost of the investment and the investor's proportionate share of the net assets of the investee) as if the investment were a consolidated subsidiary; and

(b) retroactively adopt the equity method of accounting if an investment qualifies for use of the equity method as a result of an increase in ownership or influence.

A11 After considering feedback to the proposal, the FASB concluded that there was insufficient support to change the equity method of accounting and thus voted to remove the project from its agenda.

Appendix B–Illustrative list of identified application problems

B1 This appendix includes a list of known application problems. This list was developed from the following sources:

(a) submissions to the IFRS Interpretations Committee (Interpretations Committee);

(b) recent work from the International Accounting Standards Board (Board);

(c) comments from the Global Preparers Forum members at the November 2014 meeting; and

(d) research report published by the Korea Accounting Standards Board.

B2 As noted above, the list is for illustration purposes only.

	Application difficulty	Description	Status
1	**Reciprocal interests** *The Interpretations Committee published its decision in April 2003*	This difficult is how to account for the parent's (or investor's) shares that are held by a subsidiary (or associate).	The Interpretations Committee suspended work because the Board had a project to review IAS 27.
2	**Impairment of an intangible asset with indefinite life held by an associate** *The Interpretations Committee published its decision in March 2009*	The difficulty was originated by the FASB's issuance of EITF 08-6 addressing several problems on the equity method.	IAS 28.42 specifies that the implicit goodwill is not subject to mandatory annual impairment testing. The investment is assessed for impairment as a single asset.
3	**Change in an investment from equity method to cost method** *The Interpretations Committee published its decision in March 2009*	The difficulty was originated by the FASB's issuance of EITF 08-6 addressing several problems on the equity method.	IAS 28.22(c) requires that, when an investor discontinues the use of the equity method, any retained interest in the former associate is remeasured at fair value. The request for information on the Post-implementation Review of IFRS 10, 11 and 12 will include a question on the remeasurement of

	Application difficulty	Description	Status
			retained interests after the parent loses control of a subsidiary.
4	**Partial use of fair value through profit and loss**	The difficulty was whether a parent entity with an associate that is partially held by a venture capital firm (that carries its portion at fair value through profit and loss) can maintain both measurement basis in its consolidated financial statements.	The Board amended IAS 28 to allow the parent to maintain the two measurement bases (paragraph 19 of IAS 28).
5	**Measurement of the initial carrying amount** *The Interpretations Committee published its decision in July 2009*	The difficulty was originated by the FASB's issuance of EITF 08-6 addressing several problems on the equity method.	IAS 28.10 specifies that the investment in an associate is initially recognised at cost.
6	**Investee's issue of shares** *The Interpretations Committee published its decision in July 2009*	The difficulty is originated by the FASB's issuance of EITF 08-6 addressing several problems on the equity method.	IAS 28.25 includes requirements on how to account for a decrease in the investor's ownership interest that does not result in a loss of significant influence.
7	**Impairment of associates in separate financial statements** *The Interpretations Committee published its decision in January 2013*	The difficulty was which impairment requirements apply in the separate financial statements of the investor when investments are carried at cost.	IAS 36.4 indicates that the IAS 36 requirements apply to investment in associates carried at cost.
8	**Fund manager's assessment of significant influence** *The Interpretations Committee published its decision in March 2017*	The difficulty is what factors may indicate that a fund manager has significant influence over a fund that it manages and has a direct holding in.	The Interpretations Committee noted that it would be unable to address the difficulty without a comprehensive review of the notion of significant influence.
9	**Contribution of PPE to an associate** *The Interpretations Committee published its decision in January 2018*	The problems concern the accounting of a transaction where different investors contribute property, plant and equipment (PPE) to a newly formed associate.	The Interpretations Committee noted that each investor recognises any gain or loss related to other investors' interests in the associate; and that the initial cost of the investment is based on the fair value of the PPE. If the fair value of the

	Application difficulty	Description	Status
			PPE is higher than the fair value of the received interest, this is an indication that the interest may be impaired.
10	**Equity method in the separate financial statements**	The difficulty was whether to allow the use of the equity method of accounting in a parent entity's separate financial statements for its subsidiaries, joint ventures and associates.	In August 2014, the Board amended IAS 27 to allow investors to use the equity method in their separate financial statements.
11	**Sale or Contribution of Assets between an Investor and its Associate or Joint Venture**	The difficulty is an inconsistency between the requirements in • IFRS 10, that requires recognition of the full gain (and remeasurement of any retained interest) in case of loss of control of a subsidiary. • IAS 28, that requires an investor to limit recognition of gain from a transaction with an investee to the extent of the interest of other investors.	In September 2014, the Board issued amendments to require that: • a full gain or loss is recognised when a transaction involves a business (whether it is housed in a subsidiary or not). • a partial gain or loss is recognised when a transaction involves assets that do not constitute a business, even if these assets are housed in a subsidiary. In December 2015, the Board indefinitely deferred the effective date of the amendments.
12	**Elimination of gains from downstream transactions**	The difficulty is about how an investor presents the portion of gain from a 'downstream' transaction that exceeds the carrying amount of the entity's interest in the associate. An additional difficulty concerned the interaction between the partial recognition of a gain/loss and the initial measurement of the investment in the associate as per IAS 28.32	Following the decision to defer indefinitely the amendments to IAS 28 and IFRS 10, the Board never issued the amendment on elimination of gains from downstream transactions.

	Application difficulty	Description	Status
		In January 2014, the IASB agreed to amend IAS 28 to require presenting that portion as a deferred revenue.	
13	**Equity method: share of other net assets changes**	The difficulty is whether and how an investor would recognise its share of the investee's other net asset changes, that are not distributions received.	The Board published an Exposure Draft in November 2012.The Exposure Draft did not proceed to a Standard, because the Board raised concerns of a perceived conflict with IAS 1 *Presentation of Financial Statements.*
14	**Impairment of long-term interests in associates**	The difficulty was whether an investor would test other long interests in an associate in accordance with IFRS 9 *Financial Instruments* or together with the investment in the associate.	In October 2017, the Board issued amendments to IAS 28 to specify that IFRS 9 requirements apply to long-term interests in associate, to which the equity method is not applied.
15	**Associates and common control**	The difficulty considered is whether it is appropriate to apply the scope exemption for business combinations under common control, by analogy to the acquisition of an interest in an associate or joint venture under common control.	The Interpretations Committee noted that an entity is required to apply Standards unless there are explicit exemptions. The project on Business Combinations under Common Control does not address acquisitions of interests in associates.
16	**Limitation in obtaining information**	The difficulty is about the investor's ability to obtain the information needed to apply uniform accounting policies and consolidation entries.	
17	**Presumption of significant influence**	The difficulty is about the investor's ability to obtain the information needed to apply the equity method, when the investor is presumed to have significant influence by holding more than 20% of the voting power.	

	Application difficulty	Description	Status
18	**Allocation of impairment loss**	The difficulty concerns the lack of recycling of the share of other comprehensive income when the investor fully impairs the investment in the associate.	
19	**Associates' issue of preference shares**	The difficulty is about how to calculate the investors share of profit or loss when the associate has outstanding cumulative preference shares.	IAS 28.37 requires adjusting the associate's profit or loss for the dividends attributable to preference shares held by third parties.