IFRS

STAFF PAPER

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IASB® meeting

Project	**Equity Method**
Paper topic	Application questions selected and proposed next steps

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Purpose of meeting

1. At this meeting the International Accounting Standards Board (Board) is:

   (a) provided with an update on the application questions identified as within the scope of the Equity Method research project; and

   (b) asked whether the staff should first perform research to understand the implications of differences between the principles in IAS 28 *Investments in Associates and Joint Ventures* and other Standards arising from the Board's Business Combinations and Consolidation projects before addressing the application questions within the scope of this project.

Structure of the paper

2. This paper presents to the Board application questions identified as within the scope of the project using the selection process discussed in March 2021 and staff's initial findings on the interaction of IAS 28 with other IFRS Standards. The paper is structured as follows:

   (a) project background and update;

   (b) application questions selected;

(c) interaction of IAS 28 with other IFRS Standards;

(d) proposed next steps; and

(e) Appendix—criteria and process for selecting application questions.

Project background and update

3. At its October 2020 meeting, the Board approved the approach to the Equity Method research project. The Board decided that the objective of the Equity Method research project is:

> To assess whether application questions 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 principles in IAS 28.[1]

4. The Board decided that to achieve the objective, it would apply the following approach:

   (a) identify application questions and decide which of these questions to address; and

   (b) address the application questions by identifying and explaining the principles in IAS 28.

5. At its March 2021 meeting, the Board discussed the process of selecting application questions for consideration in the project.[2] Paragraphs 10–17 of this paper present the list of application questions selected applying this process.

6. As mentioned during previous meetings, the staff consider the selection of application questions to be an iterative process. As the project progresses, it may be that solutions can be found to application questions that have been removed or conversely solutions found could raise new questions. The staff will therefore need to assess the effect of any proposed solutions on the questions that have been excluded.

[1] October 2020 IASB Board meeting AP13: Project objective and approach (ifrs.org)
[2] March 2021 IASB Board meeting AP13: Project update and next steps (ifrs.org)

7. At its June 2021 meeting, the Board discussed principles identified as underlying IAS 28 and the approach to develop additional principles in situations to which none of these underlying principles apply.[3]

Application questions selected

8. Applying the criteria agreed with the Board the staff have identified and grouped the application questions by topic in paragraphs 10–17 of this paper.

9. For simplicity, the application questions refer to associates and joint ventures accounted for applying IAS 28 as "investees" when describing the application question.

Increases and decreases in an investor's interest without a change in significant influence

10. There are two application questions in the scope of the project for this topic:

 (a) Paragraph 32 of IAS 28 requires an investor to measure its share of the investee's identifiable assets and liabilities at their fair value at the date significant influence is obtained. The application question arising is when the investor increases its interest in the investee without a change in significant influence:

  (i) if and how to measure the investor's additional share of the investee's net assets; and

  (ii) if the investor's additional share of the investee's identifiable net assets is measured at an amount different from the consideration paid, how to account for the difference.

 (b) An investee may issue shares to other investors resulting in a dilution of the investor's interest. The application question is how to present the change in the measurement of the investor's interest from various events that do not affect significant influence.

[3] June 2021 IASB Board Meeting [AP13: Identifying the principles in IAS 28 Investments in Associates and Joint Ventures (ifrs.org)]

Recognition of losses

11. Applying paragraphs 38 and 39 of IAS 28, when an investor's interest in its investee is reduced to zero, the investor discontinues recognising its share of further losses. It resumes recognising its share of profit only after its share of profit equals the share of losses not recognised. The following application questions are related to paragraphs 38 and 39 of IAS 28:

Whether an investor that has reduced its interest in an investee to nil:

(a) is required to 'catch up' unrecognised losses if it purchases an additional interest in the investee. The staff note that to address this question, the Board will need to address how to account for increases in an investor's interest without a change in significant influence (see paragraph 10).

(b) continues eliminating its share of gains arising from a downstream transaction.

(c) recognises each component of comprehensive income separately. For example, in a financial year, an investee recognises a loss in comprehensive income that includes, a profit in its statement of profit and loss, and a loss in its statement of other comprehensive income.

Transactions between investor and associate

12. Applying paragraph 28 of IAS 28, an investor is required to eliminate its share of gain or loss in an upstream and downstream transaction with an investee. The following application questions are related to paragraph 28:

(a) in a downstream transaction, whether to recognise the portion of the investor's share of gain that exceeds the carrying amount of its investment in the investee.

(b) in an upstream transaction, whether the investor's share of gain or loss is eliminated from the carrying amount of the investment in the investee or the acquired asset.

(c) if the provision of service and transactions that are not transfer of assets are upstream or downstream transaction.

(d) how should an investor account for gains and losses that arise from the sale of a subsidiary to an investee given the conflicting requirements between IFRS 10 *Consolidated Financial Statement* and IAS 28. In a transaction where an investor sells a subsidiary to its investee, paragraph 25 of IFRS 10 requires the investor to recognise in full the gain or loss from the sale of a subsidiary, remeasuring any retained interest whereas paragraph 28 of IAS 28 requires an investor to eliminate the gain or loss to the extent of the retained interest in the former subsidiary.

Transactions between two associates

13. Paragraph 26 of IAS 28 states that procedures appropriate for the application of the equity method are similar to the consolidation procedures described in IFRS 10. The application question is whether the adjustment of gains and losses in intra-group transactions between subsidiaries should be applied by analogy to transactions between investees under the equity method.

Share of other changes in net assets

14. The application question is whether an investor recognises its share of the investee's other changes in net asset as result of transactions other than distributions received, and if so, how the investor's share of other changes in net assets is presented.

Impairment

15. According to paragraph 41B of IAS 28, in assessing impairment of the net investment in an investee, a decline in fair value of the investee may be evidence of impairment when considered with other available information. The application question seeks clarification as to whether the decline in fair value is assessed in relation to the original purchase price or the carrying amount at the reporting date.

Initial recognition

16. Paragraph 32 of IAS 28 requires an investor to recognise its share of the fair value of the investee's net assets at the date significant influence is obtained. The application question is whether the investor recognises deferred tax assets and liabilities on the differences between the fair value and the tax base of its share of the investee's net assets.

Contingent consideration

17. IAS 28 does not provide specific guidance in accounting for contingent consideration arising on the acquisition of an investee. The application question seeks clarification on the initial and subsequent accounting for contingent consideration in the acquisition of an investee applying IAS 28. In practice, paragraph 39 of IFRS 3 *Business Combinations* is commonly referenced as paragraph 26 of IAS 28 states that the application of the equity method is similar to the consolidation procedures, and IFRS 3 provides guidance on the initial recognition and subsequent measurement for contingent consideration arising on the acquisition of subsidiaries.

Interaction of IAS 28 with other IFRS Standards

18. Paragraph 26 of IAS 28 states:

> Many of the procedures that are appropriate for the application of the equity method are similar to the consolidation procedures described in IFRS 10. Furthermore, 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 or a joint venture.

19. The staff have encountered difficulties in identifying underlying principles when the application problems in this paper involve the application of this paragraph and therefore the interaction of the principles in IAS 28 with other IFRS Standards, such as IFRS 3 and IFRS 10. Our initial research has indicated that this may be because significant changes were made to accounting for the acquisition of a subsidiary and consolidation procedures by the Board's Business Combinations project completed in 2008 and Consolidation project completed in 2011. For example, remeasurement of a retained or existing interest

in an investee at fair value is a fundamental principle in IFRS 3 and IFRS 10, but it is not clear how this principle is applied to equity method investments in the scope of IAS 28.

20. Given the requirement in paragraph 26 of IAS 28 pre-dates issuance of IFRS 3 and IFRS 10, the staff would like to perform research to understand the implications of differences between the principles in IAS 28 and other IFRS Standards arising from the Board's Business Combinations and Consolidation projects before addressing the application questions within the scope of the project.

Proposed next steps

21. At future Board meetings, the staff would:

(a) present to the Board our research on the implications of differences between the principles in IAS 28 and other Standards, including the implications for this project, if any.

(b) present to the Board the staff analysis on the application questions in paragraph 10–17 of this paper.

(c) highlight to the Board other application questions that, based on the selection process, would not be addressed in the project. The Board will be asked to consider whether these questions warrant extending the scope of the project.

Questions for the Board	
1	Does the Board agree that the staff should first perform research to understand the implications of differences between the principles in IAS 28 and other IFRS Standards arising from the Board's Business Combinations and Consolidation projects before considering the application questions within the scope of the project?
2	Does the Board have any other comments on the direction of the project or proposed next steps?

Appendix—Criteria and process for selecting application questions