Staff paper

Agenda reference: 13

IASB® meeting

Date	**December 2022**
Project	**Equity Method**
Topic	**Cover paper**
Contacts	**Filippo Poli (fpoli@ifrs.org)** **Mostafa Mouit (mmouit@ifrs.org)**

Introduction and purpose of this meeting

1. The objective of the Equity Method 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.

2. The purpose of this meeting is to:

   (a) present the staff analysis on how an investor would apply the International Accounting Standards Board (IASB)'s preferred approach from the purchase of an additional interest in the associate until the equity method is discontinued, and ask the IASB to decide on how an investor measures the portion of the carrying amount of an investment in an associate to be derecognised in a partial disposal; and

   (b) ask the IASB to decide on two application questions on the recognition of an investor's share of the associate's losses.

Structure of this paper

3. The paper is structured as follows:

   (a) project background;

   (b) papers for this meeting;

   (c) next steps;

   (d) Appendix A—principles identified as underlying IAS 28;

   (e) Appendix B—summary of the IASB's tentative decisions, including application questions discussed; and

   (f) Appendix C—application questions within the scope of the project yet to be discussed.

Project background

4. At its October 2020 meeting, the IASB decided on the objective and approach of the Equity Method project and moved the project from the research pipeline to its research programme. The IASB decided that to achieve the objective, it would apply the following approach:

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

   (b) address the application questions by identifying and explaining the principles in IAS 28. This would allow the IASB to develop new requirements (or application guidance), which will amend the Standard.

5. Some application questions cannot be addressed by the principles identified in IAS 28. The IASB decided it will develop the principles needed to address these application questions by analogising to the principles identified and apply the judgment required when developing an accounting policy applying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*—that is considering the applicability of the requirements in IFRS Accounting Standards dealing with similar and related issues and the definitions, recognition criteria and measurement concepts in the *Conceptual Framework*[1].

6. At its October 2021 meeting, the IASB received an update on the application questions within the scope of the project; these application questions are set out in Appendix B and C to this paper.

7. At its October 2022 meeting, the IASB reviewed the progress of its Equity Method research project and decided to retain the project's objective and approach[2].

Papers for this meeting

8. Agenda papers for discussion at this meeting include:

   (a) Agenda Paper 13A *Applying the preferred approach after the purchase of an additional interest in an associate*—the Agenda Paper analyses how an investor would apply the IASB's preferred approach to transactions and events after the investor has obtained significant influence. The analysis in the agenda paper supports the staff recommendation on how to measure the portion of the carrying amount of an investment in an associate to be derecognised in a partial disposal;

   (b) Agenda Paper 13B *Purchase of additional interest in an associate and share of unrecognised losses*—the Agenda Paper discusses whether an investor that has reduced its interest in an associate to nil is required to 'catch up' unrecognised losses if it purchases an additional interest in the associate; and

[1] See AP13 of the June 2021 IASB Meeting and the IASB Update June 2021

[2] See AP13 of the October 2022 IASB Meeting and the IASB Update October 2022

(c) Agenda Paper 13C *Recognition of losses and components of comprehensive income*—the Agenda Paper discusses whether an investor that has reduced its interest in an associate to nil and the associate subsequently reports a loss (or a profit) in profit or loss, and an income (or an expense) in other comprehensive income, with the loss exceeding the income, recognises each component of comprehensive income separately.

Summary of the staff recommendations

9. The staff is recommending in Agenda Paper 13A, that an investor applying the equity method:

   (a) is measuring a single investment in the associate; and

   (b) measures the portion of the investment in the associate to be derecognised in a partial disposal as a proportion of the carrying amount of the investment at the date of the disposal.

10. The staff is recommending in Agenda Paper 13B, that an investor that has reduced its interest in an associate to zero does not recognise unrecognised losses from the cost of the additional interest in the associate.

11. The staff is recommending in Agenda Paper 13C that:

   (a) an investor recognises its share of comprehensive income until its interest in the associate is reduced to zero. Additional losses are provided for, and a liability is recognised, only to the extent that the investor has incurred a legal or constructive obligation or made payments on behalf of the associate.

   (b) an investor that has reduced its interest in an associate to zero recognises its share of each component of comprehensive income separately. That is an investor recognises and presents in accordance with IAS 1 *Presentation of Financial Statements* two items of the same amount (one positive and one negative).

   (c) in the circumstance an investor's share of comprehensive income in an associate is negative and it exceeds the carrying amount of the investment, the investor recognises first its share of the associate's profit and loss; and second its share of the associate's other comprehensive income until its interest in the associate is reduced to zero.

Next steps

12. At future meetings, the staff plans to ask the IASB to discuss other application questions within the scope of the project.

Appendix A—Principles identified as underlying IAS 28

	Principles Identified	Paragraph
Classification		
A	Power to participate is an investor's shared power to affect changes in, and to access net assets.	IAS 28.3 *Definition* IAS 28.5-9 IAS 28.12–14
Boundary of the reporting entity		
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.	IAS 28.3 *Definition* 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
Measurement on initial recognition		
D	Fair value at the date that significant influence or joint control is obtained provides the most relevant information and faithful representation of an associate's or joint venture's identifiable net assets.	IAS 28.30–31B IAS 28.32 IFRS 3.BC25/198
Subsequent measurement		
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 *Definition* IAS 28.10–13 IAS 28.26 IAS 28.28 IAS 28.30–31B IAS 28.33–36 (includes 35) IAS 28.37
F	An investor's maximum exposure is the gross interest in an associate or joint venture.	IAS 28.14A/29/38–43
G	When an investor has a decrease in its ownership interest in an associate or joint venture and continues to apply the equity method, it reclassifies amounts previously recognised in other comprehensive income.	IAS 28.24–25
Derecognition		
H	An investor: (a) applies IFRS 3 *Business Combinations* and IFRS 10 *Consolidated Financial Statements* if it obtains control of an associate or joint venture; (b) applies IFRS 9 *Financial Instruments* 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
Unallocated (not being addressed in the project)		
Presentation		IAS 28.15/20–21
Exceptions to the application of the equity method		IAS 28.16–19 IAS 28.27 IAS 28.36A

Appendix B—Summary of the IASB's tentative decisions, including application questions discussed

Table B1—Summary of IASB's tentative decisions

IASB Meeting	Topic	Staff condensed summary of the IASB's tentative decisions
October 2020	Objective and approach	1. The IASB decided on the objective and approach of the Equity Method project and moved the project from the research pipeline to its research programme.
March 2021	Scope—application questions	2. The IASB discussed the process for selecting application questions to be addressed by the project.
June 2021	Approach—principles underlying IAS 28	3. The IASB discussed: (a) the principles identified as underlying IAS 28; and (b) how to develop additional principles to guide how an entity applies the equity method in situations to which none of these underlying principles apply.
October 2021	Scope—application questions	4. The IASB received an update on application questions within the scope of the project—identified applying the process that the IASB discussed at its March 2021 meeting. 5. The IASB tentatively decided the staff should undertake research before considering the application questions within the scope of the project.
April 2022	Approach—identify principles in IFRS Accounting Standards	6. The IASB reviewed the research findings on changes made to IFRS Accounting Standards arising from the *Conceptual Framework*, Business Combinations and Joint Arrangements projects.
October 2022	Objective and approach	7. The IASB decided to retain the project's objective and approach.

Table B2—Summary of IASB's tentative decisions on application questions

Application question(s)	IASB Meeting	IASB's tentative decisions
Changes in an investor's interest while retaining significant influence		
How does an investor apply the equity method when purchasing an additional interest in an associate while retaining significant influence?	April 2022	1. The IASB tentatively decided to consult with stakeholders on measuring the cost of an investment, when an investor obtains significant influence, as the fair value of the consideration transferred, including the fair value of any previously held interest in the investee. 2. The IASB considered three approaches to applying the equity method when an investor purchases an additional interest in an associate while retaining significant influence. The IASB instructed the staff to continue exploring: (a) a preferred approach whereby an investor, after obtaining significant influence, would measure the investment in the associate as an accumulation of purchases. (b) an alternative approach whereby an investor would measure the investment as a single asset at its fair value at the date of the purchase of an additional interest.
	June 2022	3. The IASB tentatively decided that an investor applying the preferred approach to a bargain purchase of an additional interest, while retaining significant influence, would recognise a bargain purchase gain in profit or loss.
How does an investor apply the equity method when disposing of an interest in an associate while retaining significant influence?	June 2022	4. The IASB tentatively decided that an investor applying the preferred approach to a partial disposal, while retaining significant influence, would measure the portion of the carrying amount of an investment in an associate to be derecognised using: (a) a specific identification method, if the investor can identify the specific portion of the investment being disposed of and its cost; and (b) the last-in, first-out method, if the specific portion of the investment being disposed of cannot be identified. 5. The IASB decided to explore practical methods of measuring the portion of the carrying amount of an investment in an associate to be derecognised when an investor applies the preferred approach to a partial disposal while retaining significant influence.

Application question(s)	IASB Meeting	IASB's tentative decisions
	September 2022	6. The IASB asked the staff to consider further how its preferred approach for applying the equity method to acquisitions and disposals while retaining significant influence would be applied on initial recognition and on subsequent measurement of the investment in the associate.
Whether an investor recognises its share of other changes in an associate's net assets, and if so, how is the change presented?	September 2022	7. The IASB tentatively decided that when the investor's ownership interest increases and retains significant influence, an investor applying the preferred approach would recognise that increase as a purchase of an additional interest. 8. The IASB tentatively decided that when the investor's ownership interest decreases and retains significant influence, an investor applying the preferred approach would recognise that decrease as a partial disposal.
Transactions between investor and associate		
How should an investor recognise gains and losses that arise from the sale of a subsidiary to its associate, applying the requirements in IFRS 10 and IAS 28? In a transaction where an investor sells a subsidiary to its associate: (a) paragraph 25 and B97–B99 of IFRS 10 requires the investor to recognise in full the gain or loss on the loss of control of a subsidiary, remeasuring any retained interest, if any, at fair value; whereas (b) paragraphs 28 and 30 of IAS 28 require an investor to restrict the gain or loss recognised to the extent of the unrelated investors' interests in its associate.	September 2022	9. The IASB discussed four alternatives for how an investor recognises gains and losses that arise on the sale of a subsidiary to its associate.

Appendix C —Application questions within the scope of the project not yet discussed

Application question(s)
Recognition of losses
Whether an investor that has reduced its interest in an investee to nil is required to 'catch up' unrecognised losses if it purchases an additional interest in the investee?
Whether an investor that has reduced its interest in an investee to nil continues eliminating its share of gains arising from a downstream transaction?
Whether an investor that has reduced its interest in an investee to nil 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
Whether to recognise the portion of the investor's share of gain that exceeds the carrying amount of its investment in the investee in a downstream 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 in an upstream transaction?
Whether the provision of service and transactions that are not transfer of assets are upstream or downstream transaction?
Transactions between two associates
Whether the requirement for adjustment of gains and losses in intra-group transactions between subsidiaries should be applied by analogy to transactions between investees that are accounted for applying the equity method?
Impairment
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
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
How to initially and subsequently account for contingent consideration in the acquisition of an investee applying IAS 28?