Staff paper

Agenda reference: 13

IASB® meeting

Date	**April 2023**
Project	**Equity Method**
Topic	**Cover paper**
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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.[1]

2. The purpose of this meeting is to ask the International Accounting Standards Board (IASB) to:

   (a) decide how to answer the application question: *Does an investor recognise a deferred tax asset (or liability) on the difference between its share of the fair value and the tax base of the associate's identifiable assets and liabilities?*

   (b) decide whether to move the Equity Method research project to its standard-setting work plan and work towards publishing an exposure draft as the next due process step?

[1] See paragraphs 2(d) and 62 of Agenda Paper 13B of this meeting for the staff recommendation to the IASB to update the project's objective to reflect progress made on the project.

Structure of this paper

3. This paper is structured as follows:

   (a) project background (paragraphs 4–10 of this paper);

   (b) papers for this meeting (paragraph 11 of this paper);

   (c) next steps (paragraphs 12–13 of this paper);

   (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 to be discussed (or in discussion).

Project background

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

5. 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]

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

Step 1: Identify application questions

6. At its March 2021 meeting, the IASB agreed the process for selecting application questions to be answered by the project.[3] Subsequently, 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 Appendices B–C to this paper.[4]

7. The IASB decided the selection of application questions is an iterative process. As the project progresses, solutions can be found to application questions that were not selected or conversely solutions found could raise new application questions. The staff will therefore assess the effect of any proposed solutions on the application questions that have not been selected.

Step 2: Identify the principles

8. At its June 2021 meeting, the IASB discussed the principles identified as underlying IAS 28; these principles are set out in Appendix A to this paper. The objective of identifying the principles is to provide the IASB with a toolbox that can help the IASB to answer the selected application questions.[5]

9. Some application questions cannot be answered by the principles identified in IAS 28. The IASB decided it will develop answers to 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 Error*s—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 for Financial Reporting*.

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[3] See AP13 of the March 2021 IASB Meeting and the IASB Update March 2021

[4] See AP13 of the October 2021 IASB Meeting and the IASB Update October 2021

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

Step 3: Apply the principles to the application questions

10. The IASB began discussing and developing answers to the application questions in April 2022. As at 31 March 2023 the IASB:

    (a) has concluded discussions on three significant categories of the application questions for investments in associate entities, see IASB's tentative decisions in Table B2 of Appendix B to this paper.

    (b) is developing answers to the remaining application questions within the scope of the project, see Appendix C of this paper.

Papers for this meeting

11. Agenda papers for discussion at this meeting include:

    (a) Agenda Paper 13A *Initial recognition of an investment in an associate–deferred taxes*—the agenda paper includes the staff analysis on three views identified to answer the application question in paragraph 2(a) of this paper and recommends the IASB proposes:

    An investor recognises a deferred tax asset (or liability) on the difference between its share of the fair value and the tax base of the associate's identifiable assets and liabilities; and presents that deferred tax asset (or liability) in the carrying amount of its investment in the associate.

    (b) Agenda Paper 13B *Moving the research project to the standard-setting work plan*—the agenda paper includes the staff analysis on the *Due Process Handbook* criteria and recommends the IASB:

        (i) moves the Equity Method research project to its standard-setting work plan;

        (ii) works towards publishing an exposure draft as the next due process step;

(iii) continues to use the expertise of its advisory bodies instead of establishing a consultative group; and

(iv) updates the project's objective.

Next steps

12. At future meetings, the staff plan to ask the IASB to:

(a) discuss remaining application questions within the scope of the project, see Appendix C of this paper.

(b) explore further whether its tentative decision, to recognise an investor's share of other changes in an associate's net assets that affect its ownership interest as a purchase of an additional interest or a partial disposal, should also be applied to other transactions such as an associate's equity-settled share-based payment.

(c) decide whether to add application questions to the scope of the project.

(d) discuss any implications of applying its tentative decisions to investments other than associate entities that are accounted for applying the equity method.

13. Once the IASB has made tentative decisions on all aspects set out in paragraph 12 of this paper, the staff plan also to ask the IASB to:

(a) discuss possible improvements for the disclosure requirements to accompany its tentative decisions.

(b) discuss transition requirements for the proposals to revise IAS 28.

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	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 answered in 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 received an update on the project and decided to retain the project's objective and approach.

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

<table>
<tr><th>Application question(s)</th><th>IASB Meeting</th><th>IASB's tentative decisions</th></tr>
<tr><td colspan="3">Changes in an investor's interest while retaining significant influence</td></tr>
<tr><td rowspan="2">How does an investor apply the equity method when purchasing an additional interest in an associate while retaining significant influence?</td><td>April 2022
March 2023</td><td>1. The IASB tentatively decided that an investor would measure the cost of an investment, when an investor obtains significant influence, at the fair value of the consideration transferred, including the fair value of any previously held interest in the associate.
2. The IASB tentatively decided that an investor purchasing an additional interest in an associate while retaining significant influence would recognise any difference between the cost of the additional interest and its additional share in the net fair value of the associate's identifiable assets and liabilities either as goodwill, or as a gain from a bargain purchase.</td></tr>
<tr><td>June 2022</td><td>3. The IASB tentatively decided that an investor purchasing an additional interest in an associate (that is a bargain purchase), while retaining significant influence, would recognise a gain from a bargain purchase in profit or loss.</td></tr>
<tr><td>Whether an investor recognises its share of other changes in an associate's net assets, and if so, how is the change presented?</td><td>September 2022</td><td>4. The IASB tentatively decided that when the investor's ownership interest:
(a) increases and retains significant influence, an investor would recognise that increase as a purchase of an additional interest.
(b) decreases and retains significant influence, an investor would recognise that decrease as a partial disposal.</td></tr>
<tr><td>How does an investor apply the equity method when disposing of an interest in an associate while retaining significant influence?</td><td>December 2022</td><td>5. The IASB tentatively decided that an investor applying the equity method is measuring a single investment in an associate. Accordingly, in a partial disposal, an investor would be required to measure the portion of the investment in the associate to be derecognised as a proportion of the carrying amount of the investment at the date of the disposal.</td></tr>
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Application question(s)	IASB Meeting	IASB's tentative decisions
Recognition of losses		
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?	December 2022	6. The IASB tentatively decided that an investor applying the equity method that has reduced the carrying amount of its investment in an associate to nil and has therefore stopped recognising its share of an associate's losses would not recognise any unrecognised losses on purchasing an additional interest in the associate.
Whether an investor that has reduced its interest in an associate to nil recognises each component of comprehensive income separately?	December 2022	7. The IASB tentatively decided: (a) to clarify that an investor would recognise its share of an associate's comprehensive income until its interest in the associate is reduced to nil. (b) that when an investor has reduced the carrying amount of its investment in an associate to nil the investor would recognise separately its share of each component of the associate's comprehensive income. (c) if an investor's share of an associate's comprehensive income is a loss that is larger than that carrying amount of its investment in the associate, an investor would recognise in order its share of the associate's profit or loss, and its share of the associate's other comprehensive income.
Whether an investor that has reduced its interest in an associate to nil continues eliminating its share of gains arising from a downstream transaction?	March 2023	8. The IASB tentative decision, at its March 2023 meeting, on the perceived conflict between IFRS 10 and IAS 28 concluded the discussions on this application question.

Application question(s)	IASB Meeting	IASB's tentative decisions
Transactions with (and between) equity accounted investments		
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?	March 2023	9. The IASB tentatively decided: (a) that an investor would recognise the full gain or loss on all transactions with its associate. (b) to propose improvements for the disclosure requirements when an investor recognises the full gain or loss on transactions with its 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?	March 2023	10. The IASB tentative decision, at its March 2023 meeting, on the perceived conflict between IFRS 10 and IAS 28 concluded the discussions on these application questions.
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?		
Whether the requirement for adjustment of gains or losses in intra-group transactions between subsidiaries should be applied by analogy to transactions between investees that are accounted for applying the equity method?		

Appendix C—Application questions within the scope of the project to be discussed (or in discussion)

Application question(s)	Status
Impairment	
Whether the decline in fair value is assessed in relation to the original purchase price or the carrying amount at the reporting date?	To be discussed
Initial recognition	
Whether the investor recognises a deferred tax asset (or liability) on the difference between its share of the fair value and the tax base of the associate's identifiable assets and liabilities?	Agenda Paper 13A of this meeting
Contingent consideration	
How to initially and subsequently account for contingent consideration in the acquisition of an associate applying IAS 28?	To be discussed