Staff paper

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IASB® meeting

Date	**April 2023**
Project	**Equity Method**
Topic	**Moving the research project to the standard-setting work plan**
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Purpose of the paper

1. The purpose of this paper is to ask the International Accounting Standards Board (IASB) whether to:
   (a) move the Equity Method research project to its standard-setting work plan;
   (b) work towards publishing an exposure draft as the next due process step;
   (c) set up a consultative group; and
   (d) update the project's objective to reflect the progress made on the project.

Staff recommendations

2. The staff recommend that the IASB:
   (a) moves the Equity Method research project to its standard-setting work plan;
   (b) works towards publishing an exposure draft as the next due process step;
   (c) continues to use the expertise of its advisory bodies instead of establishing a consultative group; and
   (d) updates the project's objective.

Structure of the paper

3. The paper is structured as follows:

   (a) background on the Equity Method project (paragraphs 4–10 of this paper);

   (b) staff analysis on:

      (i) moving the project to the standard-setting work plan (paragraphs 13–42 of this paper);

      (ii) type of consultation document (paragraphs 43–58 of this paper);

      (iii) consultative group for the project (paragraphs 59–61 of this paper); and

      (iv) updating the project's objective (paragraph 62 of this paper); and

   (c) questions for the IASB.

Background on the Equity Method project

4. IASB Work Plan *2017–2021 Feedback Statement on the 2015 Agenda Consultation* (Work Plan 2017—2021) noted that the IASB decided to create a research pipeline of future research projects, which will not start immediately but on which it expects to carry out work before the next agenda consultation. The IASB added to the research pipeline a project on equity method, noting[1]:

> 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.

[1] In adding a project on the equity method to the research pipeline, the IASB stopped work it had undertaken on a previous project on the equity method.

5. 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*.

6. In October 2020, the IASB decided to move the project on the equity method from the research pipeline to its research programme. In doing so the IASB defined the project's objective as:

> 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.

7. The IASB decided on the following approach to the project:

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

   (b) 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 amends the Standard.

8. In deciding on the Equity Method project objective and approach the IASB asked to receive regular updates on the project's progress. The IASB has received updates in March 2021[2] and October 2022[3].

9. The IASB started developing possible answers to the application questions in April 2022 and has now made tentative decisions on most of the application questions in the scope of the project for associate entities[4].

[2] March 2021-Project update and next steps
[3] October 2022 AP13-Project Direction
[4] See Appendices B–C of Agenda Paper 13 of this meeting, which include the list of application questions within the scope of the project.

10. The staff think that it is possible the IASB could complete the discussion of the application questions in the second half of 2023, although this will depend on the research on the outstanding application questions. See paragraphs 12–13 of Agenda Paper 13 of this meeting for further details on the next steps.

Staff analysis

11. The objective of this research project is to gather evidence about the application questions and assess whether it is feasible to develop solutions to the application questions in scope of the project. A research project is intended to provide the IASB with evidence to help decide whether to add a project to its standard-setting work plan.

12. In this section of the paper, the staff analyse if the Equity Method research project has met these objectives and the IASB can move the project to its standard-setting work plan.

Moving the project to the standard-setting work plan

13. Paragraph 4.9 of the *Due Process Handbook* explains that:

> The purpose of the Board's research programme is to analyse possible financial reporting problems by collecting evidence on the nature and extent of the perceived shortcoming and assessing potential ways to improve financial reporting or to remedy a deficiency. This analysis will help the Board decide whether it should undertake a standard-setting project to develop a proposal for a new IFRS Standard or to amend or replace a Standard…

14. Paragraph 5.1 of the *Due Process Handbook* states:

> In considering whether to add a standard-setting project to the work plan, the IASB or the Interpretations Committee requires the

development of a specific project proposal and an assessment against the project criteria outlined in paragraph 5.4…

15. Paragraph 5.4 of the *Due Process Handbook* states that when adding a standard-setting project to its agenda, the IASB evaluates the merits of adding the project primarily on the basis of the needs of users, while also taking into account the costs of preparing the information. When deciding whether a proposed agenda item will address users' needs, the IASB considers:

    (a) whether there is a deficiency in the way particular types of transactions or activities are reported in financial reports;

    (b) the importance of the matter to those who use financial reports;

    (c) the types of entities likely to be affected by any proposals, including whether the matter is more prevalent in some jurisdictions than others; and

    (d) how pervasive or acute a particular financial reporting issue is likely to be for entities.

16. Paragraph 5.7 of the *Due Process Handbook* also states that the IASB adds a standard-setting project to the work plan only if it concludes that the benefits of the improvements to financial reporting will outweigh the costs.

Are the criteria met?

Deficiencies in current financial reports

17. The feedback has provided evidence that there are application questions in applying the equity method. These application questions are set out in Appendices B–C of Agenda Paper 13 of this meeting. Evidence collected includes:

    (a) feedback on the IASB's agenda consultations, see paragraph 4 of this paper;

    (b) past work of the IASB, see paragraph 18 of this paper;

(c) the number of submissions received by the IFRS Interpretations Committee (Interpretations Committee);

(d) feedback from the IASB's consultative groups, including comments from the Global Preparers Forum (GPF) at the November 2014 meeting and the Accounting Standards Advisory Forum (ASAF) at the March 2015 meeting;

(e) work performed by other organisations, such as the research report published by the Korean Accounting Standards Board in September 2014; and

(f) outreach undertaken with national standard-setters, accounting firms and regulators to provide input to identify the application questions.

18. The IASB Work Plan 2017–2021 stated that a number of queries on equity method and its interaction with the accounting for other ways of holding interests in other entities have been raised with the Interpretations Committee. Application questions that have been the subject of IASB or Interpretations Committee's activities in the past include:[5]

(a) Exposure Draft—*Equity Method: Share of Other Net Asset Changes (proposed amendments to IAS 28 Investments in Associates and Joint Ventures)* – issued in November 2012. The IASB decided not to finalise the amendments proposed in that exposure draft.

(b) Amendment—*Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* – issued in September 2014. The effective date of that amendment has been indefinitely deferred.

(c) IFRIC Agenda Decision—*Investment in a subsidiary accounted for at cost: Step acquisition* – issued in January 2019. The Interpretations Committee concluded an entity may determine the cost of its investment in a subsidiary

[5] October 2022 AP13-Project Direction

using either fair value as deemed cost approach; or an accumulated cost approach.

19. Recent outreach on some of the application questions from the accounting firms (during October 2022), ASAF (December 2022 meeting) and GPF (November 2022 meeting) also provides evidence that diversity in practice exists, see Agenda Paper 13B of the January 2023 IASB meeting.

20. The IASB made tentative decisions on:

    (a) application questions that have been the subject of IASB or Interpretations Committee's activities in the past, paragraph 18 of this paper; and

    (b) other application questions within the scope of the project, see Table B2 of Appendix B of Agenda Paper 13 to this meeting.

21. In the staff's view the research summarised in paragraphs 17–20 of this paper provides sufficient evidence that there are deficiencies in current financial reports.

Importance of deficiencies to users

22. Users of financial statements (users) have said:

    (a) "…while equity-method accounting has been in practical use for many years, we hear numerous practical issues and concerns…".[6]

    (b) "…users want more information on the investee company as their job is to assess the value of, and return on, that investment each period…".[7]

23. Recent feedback from outreach with users and Capital Markets Advisory Committee (CMAC) members on some application questions provided evidence that, when evaluating the financial statements that include investments accounted for applying the equity method users:

[6] Corporate Reporting Users' Forum (CRUF) response to the *Request for Information on the post-implementation review of IFRS 10, IFRS 11 and IFRS 12* (2021).
[7] CFA Institute comment letter on the FASB's *Investments – Equity Method and Joint Ventures: Simplifying the Equity Method of Accounting* (2015).

(a) will evaluate the associate separately, if the associate is material. In analysing financial performance, users will prioritise the associate's earnings as reported in its financial statements.

(b) will rely on the associate's earnings as reported in the investor's financial statements, if the associate is not material.

24. Users noted that in practice most associates are unlisted entities and may be located in overseas jurisdictions. Consequently, it is not always easy to obtain the associate's financial statements, leaving them to rely only on the amounts reported in the investor's financial statements, see Agenda Paper 13C of the March 2023 IASB meeting.

25. Therefore, users are affected by the diversity in how the equity method is applied, which reduces the comparability and understandability of financial statements.

26. At March 2023 meeting, a few ASAF members said that users in their jurisdictions have stressed the need for disclosures to accompany the IASB's tentative decisions in answering the application questions. At a future meeting, the staff will ask the IASB to discuss possible improvements to the disclosure, see paragraph 13 of Agenda Paper 13 to this meeting.

27. Sometimes associates are purchased as an intermediate step to acquiring control at a later date (that is a business combinations achieved in stages). In the *Business Combinations—Disclosures, Goodwill and Impairment* project, the feedback from users indicates that improving the information about the business combination is important.[8] In the staff's view, improving the equity method by eliminating diversity in practice benefits users when they analyse changes in the carrying amount of an investment from a financial asset, to investment accounted for applying the equity method, to a subsidiary.

[8] See December 2022 IASB Meeting; AP18A.

Entities affected and pervasiveness of the application questions

28. IFRS Accounting Standards require the equity method for investments in associates and joint ventures, in addition they permit the equity method in separate financial statements for subsidiaries, joint ventures and associates.

29. The staff research provides evidence that entities in Africa and Middle East, Asia Pacific, Canada, Europe and Latin America are likely to have interests in associate and joint ventures. The average carrying value of investments accounted for using the equity method in 2020 financial statements amounted to 5.7% of the total assets. The share of profit or loss from associates and joint ventures amounted to 8.2% of the net income. [9]

30. Similarly, holding investments in associates and joint ventures is common in the following industries; energy, communication services, consumer discretionary, consumer staples, health care, industrials, information technology, materials, real estate and utilities.

31. Paragraph BC10A of the Basis for Conclusions on IAS 27 *Separate Financial Statements* explains that the laws of some countries require listed companies to present separate financial statements prepared in accordance with local regulations, and those local regulations require the use of the equity method to account for investments in subsidiaries, joint ventures and associates.

32. The IASB reached out to stakeholders to obtain advice on the selection of the application questions to be included in the project. The IASB in March 2021 agreed on a process for selecting application questions from the list of questions from stakeholders the IASB technical staff initial list.[10] Selection to applications questions considered the following criteria:

[9] Extraction criteria – public companies in the top 10% of market capitalisation, excluding entities based in US (presumably applying US GAAP); and entities in financial industry (given their large balance sheet).

[10] AP13: Project update and next steps (ifrs.org)

(a) is the application question unresolved?

(b) can the application question be solved without fundamentally rewriting IAS 28?

(c) can the application question be solved without amending other IFRS Accounting Standards?

(d) does the application question affect the consistent application of IAS 28?

(e) is the application question important?

33. To apply the last criterion, reference was made to paragraphs 5.4 and 5.16 of the *Due Process Handbook* and evidence was sought from:

(a) past activities of the Interpretations Committee;

(b) the prominence given to the question in the work performed by other organisations; and

(c) how often the same question occurred in the replies to the outreach request.

34. In October 2021 the IASB was provided with an update on the application questions in scope of the research project.

35. In the staff's view, many entities are likely to be affected by the IASB's tentative decisions, given that the use of the equity method is common in many jurisdictions and industries, and that the tentative decisions affect the accounting of commonly recurring transactions such as:

(a) acquisition of an associate in stages;

(b) purchase of an additional interest and partial disposal of an investment in associate, while retaining significant influence;

(c) dilution of an investor's interest in an associate; and

(d) transactions between an investor and its associates.

Costs and benefits of the IASB's tentative decisions on the application questions

36. The history of IAS 28 suggests that addressing application questions on a piecemeal basis is not effective and created inconsistencies that led to further questions. This equity method project is an opportunity to look at the application questions in a holistic way whilst maintaining consistency in answers to the application questions.

37. An effects analysis will be completed before publishing the consultation document. However, the staff preliminary analysis is that the benefits of the improvements to financial reporting from this project are likely to outweigh the costs.

38. At its March 2023 meeting, overall, ASAF members supported the IASB's tentative decisions to the following application questions:

    (a) changes in an investor's ownership interest while retaining significant influence; and

    (b) recognition of losses.

39. ASAF members generally agreed that the benefits of applying those tentative decisions would outweigh the implementation and ongoing costs and said the IASB's tentative decisions to the application questions would:

    (a) remove diversity in practice;

    (b) enhance comparability and provide better quality information to the users; and

    (c) not involve significant implementation costs to the preparers.

40. Also, the IASB tentative decision on how to answer the application question on the perceived conflict between IFRS 10 and IAS 28, will be a simplification in the equity method procedures and decreases costs and efforts. At the same time, it maximises the benefits that users receive. Feedback from outreach with users, CMAC and GPF supported this initial assessment of costs and benefits.

41. Overall, in the staff's view answering the application questions benefits users because it will reduce divergence in practice which improves comparability and understanding the effects of investments in associates.

Conclusion

42. Considering paragraphs 17–41 of this paper, the staff think that the criteria have been met and recommend that the IASB moves the Equity Method research project to its standard-setting work plan.

Type of consultation document

43. Paragraph 4.12 of the *Due Process Handbook* states:

> The main output of the research programme is expected to be discussion papers and research papers. Discussion papers and research papers are designed to elicit comments from interested parties that can help the Board decide whether to add a standard-setting project to the work plan...

44. Paragraph 5.5 of the *Due Process Handbook* states:

> The Board considers adding a standard-setting project to the work plan after considering any research it has undertaken on the topic. The Board would normally propose to develop a new IFRS Standard or to make major amendments to a Standard only after it has published a discussion paper and considered the comments it receives from that consultation. Publishing a discussion paper before adding a major standard-setting project to the work plan is not a requirement. However, to proceed without a discussion paper, the Board needs to be satisfied that it has sufficient information and understands the problem and the potential solutions well enough. The Board might conclude that a discussion paper is not necessary because it has sufficient input

from a research paper, request for information or other research to proceed directly to an exposure draft. The reasons for not publishing a discussion paper need to be set out by the Board and reported to the DPOC.[11]

45. The staff note that a discussion paper is generally published before starting a standard-setting project. Given the staff recommendation in paragraph 42 of this paper, that the IASB moves the project to its standard-setting work plan, the staff acknowledge that assessing whether it should publish a discussion paper or an exposure draft interacts with prior discussion set out in paragraphs 13–41 of this paper. The staff think that considering the next consultation document helps:

  (a) affirm the staff recommendation that the IASB moves the project to its standard-setting work-plan; and

  (b) structure future recommendations to the IASB.

46. In developing the recommendation on what the consultation document for the project should be, the staff considered the factors discussed in Agenda Paper 28 of the February 2018 IASB meeting[12]:

  (a) the need for formal consultation;

  (b) the stage of development;

  (c) the significance of change;

  (d) the effect on timelines; and

  (e) possible pitfalls – re-exposure.

[11] See AP1B: IASB Technical Activities of the Trustees of the IFRS Foundation March 2023 meeting.

[12] AP28: Discussion Papers and Exposure Drafts (ifrs.org)

Agenda Paper 28 of the February 2018 IASB meeting

47. Paragraphs 24–26 of the February 2018 Agenda Paper 28, explained that the nature of the information being sought should be considered in determining the type of consultation document to be published.

48. Paragraphs 27–29 of the February 2018 Agenda Paper 28, explained that an understanding and agreement on core topics, before a project is too far advanced, can help create consensus and gain acceptance of a potential new IFRS Accounting Standard or a major amendment even when some stakeholders disagree with particular decisions of the IASB.

49. Paragraphs 30–33 of the February 2018 Agenda Paper 28 explained that when new reporting requirements significantly affect current practice there is a greater need to consult.

50. Paragraphs 34–41 of the February 2018 Agenda Paper 28 explained the IASB needs to balance the time needed for consultation against the benefits of consultation. Failure to consult appropriately could result in insufficient information being obtained which means that a consultation might need to be repeated. A discussion paper would allow the IASB to obtain feedback from stakeholders and to refine its preliminary views, as needed, without being constrained to a particular approach. However, while allowing a longer time for consultation is consistent with the principle of full and fair consultation, there could be disadvantages to longer timelines when not needed.

Analysing the factors

51. The staff anticipate that the consultation document will seek views from stakeholders on targeted amendments to IAS 28 to remove diversity in practice that has been emerged.

52. The project is not reconsidering concepts of the equity method; in particular, the IASB is not expected to change or add requirements on:

(a) the objective of the equity method;

(b) the scope of application of the equity method; and

(c) the definition of significant influence or how to assess whether an entity has significant influence.

53. A discussion paper is useful for establishing a foundation for future proposals because it can explore a range of possible approaches and the limitations of each approach relative to the others. A discussion paper is particularly useful when there is a range of possible answers or several interrelated issues to explore. In contrast, when the IASB has already determined the approach it intends to pursue, and when that approach is generally understood and accepted by stakeholders, an exposure draft may be appropriate. An exposure draft is also effective when drafting is critical.

54. At this stage of the project, the IASB has reached tentative decisions on application questions and does not intend to consult on alternative answers to application questions. Those tentative decisions are generally understood by the IASB consultative groups, including user advisory committees from different jurisdictions.

55. The staff note that none of the tentative decisions so far change requirements in IAS 28 (except for the tentative decision that an investor would recognise a full gain or loss on all transactions with its associate, for which it would itself be a simplification in the equity method). The tentative decisions rather fill gaps on how to apply the equity method to specific transactions and events.

56. Publishing a discussion paper would add significant time to complete the project. It would also require more staff resources to prepare the document and analyse the comments and more IASB time to consider the comments. One of the reasons why the IASB decided not to undertake a fundamental review of the equity method was that it would have taken more time and resources and delayed providing constituents with solutions to long outstanding application questions.

Conclusion

57. Considering paragraphs 43–56 of this paper, the staff think that:

(a) the IASB has sufficient evidence from its past work, and research and outreach undertaken in this project to proceed directly to an exposure draft; and

(b) the proposals of targeted amendments for IAS 28 are best illustrated in an exposure draft as this would enable stakeholders to assess and provide feedback on the proposed new requirements.

58. The staff, therefore, recommend that the IASB works towards publishing an exposure draft as the next due process step.

Consultative group for the project

59. Paragraph 3.59 of the *Due Process Handbook* requires that once a project is added to the IASB's standard-setting work-plan, the IASB must consider whether it should establish a consultative group for the project. It is not mandatory to have a consultative group, but if the IASB decides not to do so it is required to explain on the project page why it decided not to do so, and the IASB is also required to inform the Due Process Oversight Committee.

60. The staff recommend that the IASB does not establish a consultative group for the project because:

(a) the equity method is general and affects many investors rather than being sector specific or specialised (see paragraphs 29–30 of this paper).

(b) the IASB's existing consultative groups have the necessary experience and expertise to advise on this project. The staff consulted with ASAF, GPF and CMAC during the research phase of this project and plans to continue using these groups to provide advice on the project.

(c) if necessary, it will be possible to undertake targeted outreach without the need for a specific consultative group (for example, outreach activities with accounting firms and user advisory committees from different jurisdictions/regions).

61. Consequently, the staff think the costs required to establish and co-ordinate a consultative group would exceed the benefit.

Updating the project's objective

62. As noted in paragraph 6 of this paper, the objective of the research project was to assess whether application questions can be addressed by identifying and explaining principles in IAS 28. The IASB has concluded discussions on significant categories of the application questions for investments in associate entities, reaching tentative decisions on them. The staff think that the objective of the project needs to be updated to reflect progress made on the project, as follows:

> To develop answers to application questions in consolidated and individual financial statements with the equity method as set out in IAS 28 *Investments in Associates and Joint Ventures*, using the principles in IAS 28 where possible.

Questions for the IASB

Questions for the IASB
1. Does the IASB agree: (a) to move the Equity Method research project to its standard-setting work plan? (b) to work towards publishing an exposure draft as the next due process step? (c) to continue to use the expertise of its advisory bodies instead of establishing a consultative group? (d) to update the project's objective?