Staff paper

Agenda reference: 13

IASB® meeting

Date	**January 2023**
Project	**Equity Method**
Topic	**Cover paper**
Contacts	**Filippo Poli (fpoli@ifrs.org)** **Mostafa Mouit (mmouit@ifrs.org)**

Introduction

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 the agenda papers for this meeting is to continue the discussion on possible alternatives to solve the application question:

> 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 *Consolidated Financial Statements* and IAS 28?[1]

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 to be discussed or in discussion.

[1] See AP 13C of the September 2022 IASB Meeting

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*[2].

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[3].

Papers for this meeting

8. Agenda papers for discussion at this meeting include:

   (a) Agenda Paper 13A *Perceived conflict between IFRS 10 and IAS 28–further considerations of applying the four alternatives*—the agenda paper discusses further considerations on applying the four alternatives, in particular whether:

      (i) 'upstream' and 'downstream' transactions should be affected in the same way when applying any of the alternatives; and

      (ii) the disclosure requirements in IAS 24 *Related Party Disclosures* provide users with sufficient useful information about the gain or loss arising from transactions in the application question, particularly if Alternative 1 is pursued.

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

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

(b) Agenda Paper 13B *Perceived conflict between IFRS 10 and IAS 28–feedback summary of the outreach activities undertaken*—the agenda paper summarises the feedback on the four alternatives. It also includes the staff preliminary analysis on some of the feedback, including:

(i) Alternative 1—is not requiring elimination entries a move away from the equity method viewed as a one-line consolidation method?

(ii) Alternative 2—are there new structuring opportunities associated with this alternative?

(iii) Alternative 3—is it justifiable to introduce different requirements for sales to customers and to those that are not customers?

(iv) Alternative 4—is it justifiable to introduce a distinction between the sale of an asset and of a business?

Next steps

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

(a) decide which alternative it prefers to address the application question in paragraph 2 of this paper;

(b) confirm how its preferred approach would be applied to address the application question: how does an investor apply the equity method when purchasing an additional interest in an associate while retaining significant influence;

(c) discuss other application questions within the scope of the project, see appendix C of this paper;

(d) decide whether to add application questions to the scope of the project; and

(e) decide whether to publish an exposure draft or a discussion paper as the outcome to this 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	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 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

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 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.
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	4. 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. 5. 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.
How does an investor apply the equity method when disposing of an interest in an associate while retaining significant influence?	December 2022	6. The IASB tentatively decided that an investor applying the equity method is measuring a single investment in an associate when applying the IASB's preferred approach. Accordingly, when applying the preferred approach 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.

Application question(s)	IASB Meeting	IASB's tentative decisions
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?	December 2022	7. The IASB tentatively decided that an investor applying the equity method that has reduced the carrying amount of its investment in an associate to zero 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 investee to nil recognises each component of comprehensive income separately?	December 2022	8. 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 zero. (b) that when an investor has reduced the carrying amount of its investment in an associate to zero 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.

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

Application question(s)
Recognition of losses
Whether an investor that has reduced its interest in an investee to nil continues eliminating its share of gains arising from a downstream transaction?
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.
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?