
IASB® meeting

Date	July 2023
Project	Equity Method
Topic	Towards an Exposure Draft—Impairment of investments in associates
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Introduction and purpose of this paper

1. The purpose of this paper is to ask the International Accounting Standards Board (IASB) to consider how to resolve the application question relating to the assessment of impairment: *Does an investor assess a decline in fair value in relation to the original purchase price or the carrying amount at the reporting date?*
2. In developing its recommendation, the staff considered how the IASB discussed at its June 2022 meeting that a bargain purchase gain arising when an investor acquires an additional interest in an associate may indicate there is an impairment of the investment in that associate¹.

¹ See [AP13A: Purchase of an additional interest \(and disposal of an interest\) in an associate while retaining significant influence \(ifrs.org\)](#)

Staff recommendation

3. The staff recommend the IASB propose amendments to paragraph 41C of IAS 28 *Investments in Associates and Joint Ventures*:
- (a) to change the term ‘*cost*’ to ‘*carrying amount*’;
 - (b) to add an impairment indicator when a purchase price (per share) for an additional interest, or a selling price (per share) for part of the interest, is lower than the carrying amount (per share) of the net investment in the associate at the date of the purchase or sale of that interest; and
 - (c) to remove the term ‘*significant or prolonged*’.

Structure of this paper

4. This paper is structured as follows:
- (a) staff analysis:
 - (i) understanding the application question (paragraphs 5–13 of this paper);
 - (ii) history of paragraph 41C of IAS 28 (paragraphs 14–17 of this paper);
and
 - (iii) additional considerations (paragraphs 18–38 of this paper); and
 - (b) question for the IASB.

Staff analysis

Understanding the application question

5. Paragraph 40 of IAS 28 requires an investor to apply paragraphs 41A–41C of IAS 28 to determine whether there is objective evidence that its net investment in an associate or joint venture is impaired. An investor tests its net investment in an associate for impairment in accordance with IAS 36 *Impairment of Assets*.
6. The net investment in an associate is impaired if there is objective evidence of impairment from one or more events that occurred after the initial recognition of the net investment and that loss event has an impact on the estimated future cash flows from the net investment that can be reliably estimated.
7. Paragraphs 41A–41C of IAS 28 list the indicators that provide objective evidence of impairment. Paragraph 41C of IAS 28 states that a significant or prolonged decline in the fair value of an investment in an equity instrument below its *cost* is also objective evidence of impairment.
8. Paragraph 3 of IAS 28 requires that the investment in the associate is measured at cost at initial recognition, however cost is not defined. At its April 2022 meeting, 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.
9. The application question in paragraph 1 of this paper asks if an investor (applying paragraph 41C of IAS 28) should assess if there is objective evidence of impairment by comparing the fair value of an investment to the carrying amount of the net investment in the associate at the reporting date instead of the cost on obtaining significant influence.

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10. The application question can be illustrated by assuming:
- (a) the investor acquired a 25% interest for CU100 and obtained significant influence at 1/1/20X1;
 - (b) in the following years, the investor recognises its share of the associate's profit or loss, for a cumulative amount of CU80. At 31/12/20X3 the carrying amount of the investment is CU180; and
 - (c) at 31/12/20X3, the fair value of the associate is CU120.
11. Based on paragraph 41C of IAS 28, an investor might compare the fair value of CU120 to the cost on obtaining significant influence of CU100 and conclude there is no objective evidence of impairment, even if the net investment in the associate is higher than the fair value.
12. The staff considered the principles identified as underlying IAS 28, see Appendix A of Agenda Paper 13 of this meeting. Principle F states that:
- An investor's maximum exposure is the gross interest in an associate or joint venture.
13. Principle F is not directly related to the application question. However, Principle F links the measurement of an impairment loss to the carrying amount of the investment in the associate.

History of paragraph 41C of IAS 28

14. Paragraph 41C was added to IAS 28 as a consequential amendment on issuing IFRS 9 *Financial Instruments* in July 2014. Paragraph 41C in substance replicated the predecessor requirements of paragraph 61 of IAS 39 *Financial Instruments: Recognition and Measurement*. Paragraph 61 of IAS 39 set out requirements to assess objective evidence of impairment of equity instruments classified as available-for-sale². Available-for-sale equity instruments were carried at fair value with changes in fair value recognised in other comprehensive income.
15. Paragraph 67 of IAS 39 required that when a decline in fair value of an available-for-sale financial asset had been recognised in other comprehensive income and there was objective evidence that the asset was impaired, the cumulative loss was to be reclassified to profit or loss as a reclassification adjustment, even though the financial asset had not been derecognised.
16. Impairment of an available-for-sale financial asset could not be measured as the difference between the fair value and the carrying amount, because the carrying amount was fair value. Therefore, the fair value compared to the original cost was used to assess and measure impairment losses. Impairment losses were recognised as the difference between the fair value and the original cost at the reporting date.
17. Investments in associates are measured using the equity method. After obtaining significant influence, the investor adjusts the cost of the investment for its share of the changes in the associate's net assets. For investments in associates, the cost is only equal to the carrying amount of the net investment in the associate on the date of obtaining significant influence.

² IFRS 9 eliminated the category of available-for-sale financial assets.

Additional considerations

18. Due to the different measurement requirements for available-for-sale financial assets and investments in associates, and given that the change in fair value of available-for-sale financial assets was recognised in other comprehensive income with impairment losses reclassified to profit or loss whereas for the equity method the investor's share of the associate's profit or loss is presented in profit or loss, we think that the impairment indicator in paragraph 41C of IAS 28 should be amended as discussed in paragraphs 21–38 of this paper in addition to answering the application question in paragraph 1 of this paper.

Cost or carrying amount?

19. Based on the explanation in paragraphs 5–13 of this paper, cost on obtaining significant influence is not the correct comparator to fair value for investments in associates, therefore the staff support the view that it should be amended to the carrying amount of the net investment in the associate.
20. IAS 36 prescribes the procedures an entity applies to ensure its assets are carried at no more than their recoverable amount. For assets in the scope of IAS 36, an entity recognises an impairment loss when the carrying amount of an asset exceeds its recoverable amount. The recoverable amount is the higher of the fair value less cost of disposal and the value in use. Amending the reference to the carrying amount of the net investment would be consistent with the requirements in IAS 36, especially paragraph 12(d) of IAS 36 that lists the carrying amount of an entity being higher than the entity's market capitalisation (for example, fair value) as an indication of impairment.

The June 2022 IASB discussion

21. At its June 2022 meeting, the IASB discussed how an investor measures the purchase of an additional interest in associate while retaining significant influence. The IASB tentatively decided that an investor would recognise a bargain purchase gain in profit or loss. During this discussion, some IASB members noted the bargain purchase may provide evidence of impairment of the net investment in the associate.
22. In the staff's view, there is a connection between the IASB's discussion at its June 2022 meeting and the application question in this paper. As a working assumption, a transaction between independent parties is conducted at fair value; if an investor purchasing an additional interest whilst retaining significant influence pays a price (per share) lower than the carrying amount of its net investment, the transaction may provide evidence that the fair value is below the carrying amount. The same applies if in a partial disposal the investor receives a price (per share) lower than the carrying amount of its net investment.
23. Therefore, the staff recommend the IASB propose an additional impairment indicator when the price paid or received (per share) for the purchase of an additional interest or partial disposal whilst retaining significant influence is lower than the carrying amount of the net investment in the associate at the date of purchasing the additional interest or a partial disposal.
24. Assuming the IASB agrees with the staff recommendation, both the new impairment indicator and the indicator in the last sentence of paragraph 41C of IAS 28 would use the fair value of the investment in the associate as a trigger for the impairment assessment. However, the new impairment indicator would be applied whenever there is a transaction whereas at present paragraph 41C of IAS 28 states:

... A significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is also objective evidence of impairment.

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25. We think that there should be consistency in when the impairment indicators are applied.

Significant or prolonged criterion

26. Whilst the reference to *significant or prolonged* was justified for available-for-sale equity instruments it is difficult to understand why it should be applied to investments in associates.
27. Applying IAS 39, if the entity concluded that the decline in fair value below the cost at the reporting date was *significant or prolonged*, it would recognise the difference as an impairment loss and reclassify the amount to profit or loss. The entity did not subsequently apply IAS 36 and determine the value-in-use to assess the recoverable amount.
28. IAS 39 did not permit an entity to reverse impairment losses for equity instruments classified as available-for-sale financial assets. Therefore, without the *significant or prolonged* criterion, any decline in the fair value would have triggered the immediate recognition of an impairment loss that could not be reversed, even if the fair value of the equity instrument subsequently recovered.
29. In contrast, an investor applying IAS 28 first assesses if there is objective evidence of impairment in an associate. The investor then applies IAS 36 to determine the recoverable amount as the higher of fair value less costs of disposal and value in use. If the value in use is higher than the carrying amount of the investment, no impairment loss is recognised.
30. Paragraph 42 of IAS 28 notes that an impairment loss is not allocated to any asset, including goodwill, that forms part of the net investment; and any reversal of that impairment is recognised in accordance with IAS 36.
31. Although staff did not hear specific comments on operational difficulties in applying the *significant or prolonged* criterion during the initial outreach for the Equity Method project, the application of *significant or prolonged* has raised concerns in the past.

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32. In 2009, the IFRS Interpretations Committee (Committee) received questions on how to determine whether a decline in fair value is *significant or prolonged*. The Committee agreed with the submission that diversity exists in practice on this issue and also noted that determination of what constitutes a *significant or prolonged* decline is a matter of fact that requires the application of judgement. The Committee did not develop guidance on the question, noting that at that time the IASB had accelerated the project to replace IAS 39.
 33. When developing IFRS 9, the IASB did not introduce an available-for-sale category. The IASB decided to permit an entity to make an irrevocable election to present in other comprehensive income changes in the value of any equity instrument not held for trading; however, it did not permit recycling. Paragraph 5.25 of the Basis for Conclusions of IFRS 9 explains that recycling of gains and losses to profit or loss would create something similar to the available-for-sale category in IAS 39 and would create the requirement to assess the equity instrument for impairment, which had created application problems in the past.
 34. In the staff's view, the assessment of whether a decline in the fair value of an investment in an associate is *significant or prolonged* presents the same operational difficulties as those that arose in applying IAS 39.
 35. Although the staff think there should be consistency in when the two impairment indicators (a bargain gain or decline in fair value) are applied, we also acknowledge that removing *significant or prolonged* will mean that any decline in fair value compared to the carrying amount of the net investment in the associate will lead to testing for impairment. This is likely to increase costs to preparers and auditors, albeit it will remove the judgement required on when to apply the indicator, removing the operational difficulties.

36. Paragraph 41A of IAS 28 refers to loss event (or events) whereas paragraph 41C of IAS 28 refers to objective evidence of impairment for the net investment in the associate including information about significant changes with an adverse effect that have taken place. Therefore, it could be argued that there is not inconsistency between when the two impairment indicators would be applied because a bargain purchase is a transaction and therefore a loss event whereas a decline in fair value provides objective evidence that an impairment may have occurred.
37. Furthermore, some may argue that removing *significant or prolonged* moves the IASB towards a fair value model for investments in associates—this is not the intention as the investor would still be required to apply IAS 36 to determine if an impairment had occurred.
38. On balance the staff think that if the IASB proposes an additional impairment indicator that when the price paid or received (per share) for an additional interest whilst retaining significant influence or partial disposal is lower than the carrying amount of the net investment in the associate it should remove *significant and prolonged* otherwise the impairment indicators are inconsistent as to when they are applied.

Question for the IASB

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1. Does the IASB agree with the staff recommendation in paragraph 3 of this paper to propose amendments to paragraph 41C of IAS 28:
 - (a) to change the term '*cost*' to '*carrying amount*';
 - (b) to add an impairment indicator when a purchase price (per share) for an additional interest, or a selling price (per share) for part of the interest, is lower than the carrying amount (per share) of the net investment in the associate at the date of the purchase or sale of that interest; and
 - (c) to remove the term '*significant or prolonged*'.