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Staff paper

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Capital Markets Advisory Committee

Date	**9 March 2023**
Project	**Equity Method**
Topic	**Project overview**
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This paper has been prepared for discussion at a public meeting of the Capital Markets Advisory Committee (CMAC). This paper does not represent the views of the International Accounting Standards Board (IASB) or any individual IASB member. Any comments in the paper do not purport to set out what would be an acceptable or unacceptable application of IFRS® Accounting Standards. The IASB's technical decisions are made in public and are reported in the IASB *Update*.

Purpose of this session

- To ask CMAC members for views on whether gains and losses from transactions between an investor and its associate should be restricted or recognised in full, see Agenda Paper 4A.
- Seek feedback from CMAC members on the IASB's tentative decisions on the Equity Method project.

Information for CMAC members

Questions for CMAC members

Questions

1	Should gains and losses from transactions between an investor and its associate be restricted or recognised in full? (See Agenda Paper **4A** for related questions and background information on this question)
2	Do you have comments on the IASB's tentative decisions that: • an investor would measure the cost of an investment when an investor obtains significant influence at the fair value of the consideration transferred (slide 12). • an investor purchasing an additional interest would measure the investment in the associate as an accumulation of purchases (slides 13 to 14). • when the investor's ownership increases or decreases due to other changes in an associate's net assets the investor would recognise the change as a purchase of an additional interest or a partial disposal (slides 15 to 16). Is there information, in addition to what is already provided in accordance with IFRS 12 *Disclosure of Interests in Other Entities*, you need to understand the effects of these transactions? If so, how would you use this information?

Background

Users' comments on the equity method of accounting

While equity method of accounting has been in use for many years, we hear numerous practical issues and concerns

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)

Financial statement users want more information on the investee company as their job is to assess the value of, and return on, that investment

CFA Institute comment letter on the FASB's *Investments – Equity Method and Joint Ventures: Simplifying the Equity Method of Accounting* (2015)

Objective and approach of the Equity Method project*

Project objective

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

Project approach

Identify application questions → **Identify the principles** → **Apply the principles to the application questions**

* For more details about the project, please refer to the [project page] on the IFRS website

IASB’s tentative decisions

IASB's tentative decisions*

How does an investor apply the equity method to changes in its interest in an associate while retaining significant influence?

Sub-divide the question

(see next slide)

* The IASB's tentative decisions on the application questions are summarised here.

IASB's tentative decisions*

- How does an investor:
  - measure the cost of an investment in an associate when obtaining significant influence?
  - measure an additional interest in an associate while retaining significant influence?
  - measure an additional interest in an associate (that is a bargain) while retaining significant influence?
  - recognise other changes in ownership interest?
  - recognise partial disposal of an interest in an associate?
- The IASB has made tentative decisions on some application questions related to 'recognition of losses', for example the application question on 'catch up' unrecognised losses.

Slide 12
Slide 13
Slide 14
Slide 15
Slide 16
Slide 17

* The IASB's tentative decisions on the application questions are summarised here.

Purchase of an additional interest in an associate (1)

Application question

How does an investor apply the equity method when purchasing an additional interest in an associate while retaining significant influence?

Aspect 1—measuring the cost of an investment in an associate when obtaining significant influence

Background

IFRS Accounting Standards do not include requirements.

Current practices measure the cost of the investment at either:

- fair value on the date of obtaining significant influence; or
- an accumulation of costs, that is costs at the date of acquiring each interest and on obtaining significant influence.

Tentative decision

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.

Purchase of an additional interest in an associate (2)

Application question

How does an investor apply the equity method when purchasing an additional interest in an associate while retaining significant influence?

Aspect 2—purchasing an additional interest in an associate while retaining significant influence

Tentative decision

An investor would measure the investment in the associate as an accumulation of purchases.

The investors additional share in the associate's net assets would be measured at their fair value at the date of the purchasing the additional interest.

No remeasurement of previously held interest in an associate because no change in the relationship between an investor and its associate.

Purchase of an additional interest in an associate (3)

Application question

How does an investor apply the equity method when purchasing an additional interest in an associate while retaining significant influence?

Aspect 3—purchasing an additional interest in an associate (that is a bargain) *while retaining significant influence*

Tentative decision

An investor would recognise a bargain purchase gain in profit or loss.

Other changes in ownership interest

Application question

Does an investor recognise its share of other changes in an associate's net assets, and if so, how is the change presented?

For instance, an associate may issue or redeem shares with a change in the investor's ownership.

Tentative decision

The IASB tentatively decided that when the investor's ownership increases or decreases due to other changes in an associate's net assets the investor would recognise the change as a purchase of an additional interest or a partial disposal.

The investor therefore would recognise gains and losses in profit or loss.

IASB has yet to consider changes arising from associate's share-based payments.

Partial disposal of an interest in an associate

Application question

How does an investor apply the equity method when disposing of an interest in an associate while retaining significant influence?

Tentative decision

An investor would measure the portion to be derecognised as a proportion of the carrying amount of the investment at the date of disposal.

The difference between the fair value of the consideration received and the portion derecognised would be recognised as a gain or loss in profit or loss.

‘Catch up’ unrecognised losses

Application question

Is an investor, that has reduced its interest in an associate to nil, required to ‘catch up’ unrecognised losses if it purchases an additional interest in the investee?

Tentative decision

The IASB tentatively decided that an investor **would not ‘catch up’ for unrecognised losses** on purchasing an additional interest in the associate.

Appendix

Overview of IFRS Accounting Standards requirements for investments accounted for applying the equity method

The equity method of accounting

- The equity method of accounting applies in consolidated financial statements to investments in associates and joint ventures.
- An investor has significant influence over an associate or joint control over a joint venture.
- Initially an investor recognises its share of the fair value in the associate's or joint venture's net assets. Any difference between the cost and the investor's share in the fair value of the associates or joint venture's net assets is recognised as goodwill, or bargain purchase gain.
- The investor adjusts the cost of the investment for its share of post-acquisition changes in the investee's net assets. Dividends received are deducted from the carrying amount of the investment.
- The investor restricts gains/losses from transactions with associates and joint ventures.
- The investor stops recognising its share of losses when the carrying amount of the investment is reduced to zero.

Disclosures required for investment in associates

IFRS 12 requires an investor to disclose information on:

- nature, extent and financial of interests in associates; and
- risks associated with interests in associates.

Information includes the proportion of ownership interest, dividends received, summarised financial information for each material associate (and in aggregate for individually immaterial associates) and reconciliation of the carrying amount of the investment to the summarised financial information presented.

Example – Disclosure of material associate and JVs

US$ million	Associate A	Associate B	**Total material associates**	Joint Venture A	Joint Venture B	**Total material joint ventures**
Non-current assets	2,399	4,589	**6,988**	4,905	5,712	**10,617**
Current assets	630	1,276	**1,906**	1,306	7,363	**8,669**
Non-current liabilities	(768)	(1,170)	**(1,938)**	(1,207)	(3,855)	**(5,062)**
Current liabilities	(57)	(486)	**(543)**	(794)	(5,389)	**(6,183)**
The above assets and liabilities include the following:						
Cash and cash equivalents	157	55	**212**	163	184	**347**
Current financial liabilities[1]	(21)	(53)	**(74)**	(15)	(2,770)	**(2,785)**
Non-current financial liabilities[1]	(15)	(146)	**(161)**	(95)	(3,450)	**(3,545)**
Net assets 31 December 2019	**2,204**	**4,209**	**6,413**	**4,210**	**3,831**	**8,041**
Group 's ownership interest	33.3%	33.8%		44.0%	49.9%	
Acquisition fair value and other adjustments	409	1,872	**2,281**	1,116	1,246	**2,362**
Carrying value	1,143	3,295	**4,438**	2,968	3,158	**6,126**

Example – Disclosure of material associate and JVs

US$ million	Associate A	Associate B	**Total material associates**	Joint Venture A	Joint Venture B	**Total material joint ventures**
Revenue	1,483	3,038	**4,521**	3,147	25,057	**28,204**
(Loss)/income for the year	(1,440)	892	**(548)**	945	(29)	**916**
Other comprehensive loss	–	–	**–**	(23)	(3)	**(26)**
Total comprehensive (loss)/income	(1,440)	892	**(548)**	922	(32)	**890**
Group's share of dividends paid	66	243	**309**	467	–	**467**
The above (loss)/income for the year includes the following:						
Depreciation and amortisation	(565)	(811)	**(1,376)**	(640)	(524)	**(1,164)**
Interest income[1]	–	15	**15**	35	28	**63**
Interest expense[2]	(12)	(3)	**(15)**	(25)	(202)	**(227)**
Impairment, net of tax[3]	(1,305)	–	**(1,305)**	–	–	**–**
Income tax credit/(expense)	46	(489)	**(443)**	(437)	(40)	**(477)**

Disclosures required for investment in associates

IAS 24 ***Related Party Disclosures*** defines associates as related parties and requires disclosing information on

- amounts of transactions with associates;
- outstanding balances, including commitments;
- terms and conditions of outstanding balances (nature of consideration, guarantees given or received); and
- provisions for doubtful debts and expense in relation of bad or doubtful debts from associates.

There is no requirement to disclose recognised and unrecognised gains or losses from upstream and downstream transactions, see Agenda Paper 4A.

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