Staff paper

Agenda reference: 13

IASB® meeting

Date	**March 2023**
Project	**Equity Method**
Topic	**Cover paper**
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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 this meeting is to ask the International Accounting Standards Board (IASB) to:

   (a) conclude its discussions on the application question: *How does an investor apply the equity method when purchasing an additional interest in an associate while retaining significant influence*?

   (b) decide which alternative (Alternative 1 'No elimination' with enhanced disclosure or Alternative 2 'Elimination') to propose to answer the application question: *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* Consolidated Financial Statements *and IAS 28?*

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

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 (paragraph 12 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 it 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.[1]

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

Step 1: Identify the application questions

6. At its March 2021 meeting, the IASB agreed the process for selecting application questions to be addressed by the project.[2] 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 Appendix B and C to this paper.[3]

7. The IASB decided the selection of application questions is an iterative process. As the project progresses, it may be that 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 applications 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 address the selected application questions.[4]

9. Some application questions cannot be addressed 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 (Conceptual Framework).*

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

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

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

Step 3: Apply the principles to the application questions

10. At its April 2022 meeting, the IASB began discussing and developing answers to the application questions identified. The IASB's tentative decisions are summarised in Table B2 of Appendix B to this paper.

Papers for this meeting

11. Agenda papers for discussion at this meeting include:

    (a) Agenda Paper 13A *Purchase of additional interest in an associate while retaining significant influence*—the paper summarises the IASB's discussions on application question in paragraph 2(a) of this paper and recommends the IASB proposes:

    An investor purchasing an additional interest in an associate, while retaining significant influence, recognises 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 as goodwill or as a bargain purchase.

    (b) Agenda Paper 13B *Perceived conflict between IFRS 10 and IAS 28*—the paper includes the staff analysis on how to answer the application question in paragraph 2(b) of this paper and recommends the IASB proposes amendments to IAS 28 and IAS 24 *Related Party Disclosures*:

    An investor recognises the full gain or loss on all transactions with its associate and discloses that gain or loss (collectively referred as Alternative 1 with enhanced disclosure). [5]

    (c) Agenda Paper 13C *Perceived conflict between IFRS 10 and IAS 28–feedback summary on outreach activities undertaken with users*—the agenda paper

[5] See paragraph 12(b) of this paper for the consequential impact on other application questions to be discussed if the IASB agrees with the staff recommendations set out in agenda paper 13B of this meeting.

summarises feedback from outreach with users of financial statements on the application question in paragraph 2(b) of this paper.

(d) Agenda Paper 13D *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(c) of this paper and recommends the IASB proposes:

An investor recognises deferred tax assets or liabilities on the differences between the fair value and the tax base of its share of the associate's identifiable assets and liabilities.

Next steps

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

(a) decide whether to publish an exposure draft or a discussion paper as the next step in this project.

(b) discuss other application questions within the scope of the project, see appendix C of this paper. If the IASB agrees with staff recommendations set out in Agenda Paper 13B of this meeting, it would conclude discussion on application questions in the category of 'Transactions between investor and associate' voiding the application questions on the 'recognition of losses' and 'transactions between two associates' category.

(c) decide whether to add application questions to the scope of the project, see paragraph 7 of this paper.

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 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 June 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. 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: (a) increases and retains significant influence, an investor applying the preferred approach would recognise that increase as a purchase of an additional interest. (b) decreases and retains significant influence, an investor applying the preferred approach would recognise that decrease as a partial disposal.

Application question(s)	IASB Meeting	IASB's tentative decisions
How does an investor apply the equity method when disposing of an interest in an associate while retaining significant influence?	December 2022	5. 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.
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	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 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	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 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)	Status
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?	To be discussed, see paragraph 12(b) of this paper.
Transactions between investor and associate	
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? 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.	In discussion
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?	To be discussed, see paragraph 12(b) of this paper.
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?	To be discussed, see paragraph 12(b) of this paper.
Whether the provision of service and transactions that are not transfer of assets are upstream or downstream transaction?	To be discussed, see paragraph 12(b) of this paper.

Application question(s)	Status
Transactions between two associates	
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?	To be discussed, see paragraph 12(b) of this paper.
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 deferred tax assets or liabilities on the differences between the fair value and the tax base of its share of the associate's identifiable assets and liabilities?	In discussion
Contingent consideration	
How to initially and subsequently account for contingent consideration in the acquisition of an investee applying IAS 28?	To be discussed