EFRAG Secretariat: Didrik Thrane-Nielsen (Project Director), Robert Stojek

Equity Method of Accounting
Issues Paper

Objective

1 The objective of this paper is to facilitate the discussion on three alternatives on applying the equity method to the purchase of an additional interest in an associate without a change in significant influence, presented by the IFRS Staff at the April 2022 IASB meeting.

Approaches to accounting for purchasing of an additional interest under the equity method

2 In April 2022, the IASB discussed the research findings on changes made to IFRS Standards arising from the *Conceptual Framework*, and Business Combinations and Joint Arrangements projects. For reference, the detailed finding are available in the April 2022 IASB meeting agenda paper here.

3 At this meeting, the IASB discussed three approaches to applying the equity method when an investor purchases an additional ownership interest in an associate without a change in significant influence.

4 The approaches consider measurement of the cost of the investment both at the date the investor obtains significant influence, and when the investor purchases an additional interest in the investee without a change in significant influence.

5 Based on the research analysis of the approaches taken in other IFRS Standards, the IASB Staff has identified three approaches for acquisition of an additional interest in an associate without a change in significant influence:

(a) Approach A - continue to measure the investment as a single asset; the approach would remeasure both the investor's share of the associate's net assets at fair value and measure the aggregate cost of the investment at fair value at the date of acquiring the additional interest.

(b) Approach B - measure the interest as an accumulation of purchases. The investor would recognise its additional share of the associate's net assets with the cost (being the fair value of the consideration transferred) for the additional interest.

(c) Approach C - continue to measure the interest as a single asset but based on the investor's share of the associate's net assets at their carrying amounts for the investment, with the cost (being the fair value of the consideration transferred) for the additional interest.

6 The three approaches have the following features, as explained by the IASB Staff:

	Approach A	Approach B	Approach C
Investment cost	Measured as a single asset at fair value at the date of acquiring the additional interest. Previously held interests are remeasured to fair value and the difference with the carrying amount is recognised in comprehensive income	Measured as the aggregate of (a) cost (defined as fair value at the date the investor obtained significant influence); and (b) the fair value of the consideration paid for the additional share.	As in B

	Approach A	Approach B	Approach C
Investor's share of the associate's net assets	Measured as a single asset based on the fair value of the associate's net assets at the date of acquiring the additional interest.	Measured based on the aggregate of the fair value of the associate's net assets at the date the investor obtained significant influence, plus post-acquisition changes (carrying amounts for the investment); and for the additional share, based on the fair value of the associate's net assets at the date of acquiring the additional interest	Measured as a single asset based on the associate's net assets at their carrying amounts for the investment.
Difference between the consideration paid and the value attributed to the investor's share of the associate's net assets.	Goodwill or bargain purchase gain.	Goodwill or bargain purchase gain.	Positive difference as goodwill for an amount proportionate to the goodwill recognised when significant influence was obtained, with any residual recognised as an expense. Negative difference as a bargain purchase gain.

7 A numerical example that illustrates the approaches is provided in Appendix to this paper.

Tentative IASB decisions

8 Following the discussion, the IASB tentatively decided to consult with stakeholders, through a discussion paper or exposure draft, 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.

9 The IASB also requested their staff to proceed with an approach whereby an investor that has obtained significant influence would measure the investment in the associate as an accumulation of purchases (Approach A and B). At the future meetings, the IASB will discuss how the approach applies to other application questions.

Questions for EFRAG FR TEG members

10 Do you have comments on the three approaches discussed by the IASB on accounting for a purchase of additional interest in an associate without a change in significant influence?

11 Would you propose a different approach?

12 Do you have a comment on the tentative IASB decision to consult Approach A and B through a discussion paper or exposure draft?

Appendix 1: Illustrative Example A

1 In this example, we following data is considered (it follows the example presented at the April 2022 IASB meeting):

(a) On 1/1/20X1, Investor acquires a 5% share in Investee for a consideration of 200CU. This investment does not provide significant influence. It is accounted for under IFRS 9 *Financial Instruments* and measured at fair value. At 31/12/20X1 the fair value of the interest is 275CU.

(b) On 1/1/20X2, Investor acquires an additional share of 15% in Investee for an amount of 825CU. The entire share gives Investor significant influence over Investee. At that date, the fair value of the net assets of the investee is 4,400CU.

(c) The profit or loss of the investee for the year ending on 31/12/20X2 is 700CU, including the effects of the adjustments based on the fair values of the investee's net assets at the date significant influence is obtained.

(d) Finally, Investor acquires an additional share of 10% in Investee B at 1/1/20X3 for an amount of 700CU without a change in significant influence. At that date, the fair value of the net assets of the investee is 5,400CU.

2 The values may be summarised as follows:

	Acquisition cost	Accumulated share (%)	FV of acquired shares	FV of net assets	Investee's profit
1/01/x1	200	5%	200	NA	--
31/12/x1	--	5%	275	NA	NA
1/01/x2	825	20%	**1100**	**4400**	--
31/12/x2	--	20%	1400		700
1/01/x3	700	30%	**2100**	**1620**	--

Approach A

3 Investor would apply Approach A as follows:

31/12/20x2

4 The reported values for the financial year ended on 31/12/20x2 would therefore show:

Carrying amount of the investment:

Carrying amount of financial instrument	1100
Share of profit	140
	1240

The carrying amount compromises:

Share of net assets:	1020
Goodwill	220
	1240

1/01/20x3

5 The third acquisition at 1/01/20x3, would be accounted for as follows:

Carrying amount of the investment:

Opening balance	1240
Remeasurement of previous holding	**160**
Carrying amount of additional investment	700
	2100

This would comprise:

Share of net assets:	1620
Goodwill (220 + 480)	480
	2100

6 Under Approach A, the carrying amount of the investment should be understood as a sum of Investor's share of fair value of Investee's net assets measured at the date of last acquisition, and any changes to Investee's equity (profit or loss, OCI) from that date. For the interpretation in more complex circumstances, see paragraph 4 and 5 of Appendix 2.

7 Moreover, any share of Investee's comprehensive income, recognised in Investor's statements, should be understood as share of Investee's profits during the period, corrected for fair value adjustments, supplemented with any fair value adjustments recognised on existing holdings during the period.

Approach B

8 Investor would apply Approach B as follows:

31/12/20x2

9 As in Approach A.

1/01/20x3

10 The third acquisition at 1/01/20x3, would be accounted for as follows:

Carrying amount of the investment:

Opening balance	1240
Carrying amount of additional investment	700
	1940

This would comprise:

Share of net assets (1020+10% x 5400)	1560
Goodwill (220 + [700-10% x 5400])	380
	1940

11 Under Approach B, there is no remeasurement of the previous holding, so the share in assets constitute mixed asset measurement based on net assets' value at the initial recognition, and net assets' value at acquisition date of additional share.

12 At year end, the carrying amount of the investment should therefore be understood as a mixed measure of share in Investee's net assets, where each particular share acquisition provides its own fair value basis. The carrying amount is further supplemented by share in changes in Investee's equity (profit or loss, OCI) corrected for the mixed basis of fair value adjustments of net assets, as explained above. The complexity increases significantly with any sales or disposals of the

shareholding in Investee. For instance, entities may apply different approaches to identifying the measurement basis of the net assets, which the disposal or sale applies to. The possible approaches include FIFO or LIFO selection of the share acquisitions. A more complex example presenting this complexity is provided in Appendix 2 of this paper, where the disposal value bases on weighted average.

13 Moreover, any share of Investee's comprehensive income, recognised in Investor's statements, should be understood as a mix measure of shares in Investee's profits, for each particular share acquisitions, corrected for fair value adjustments performed for each particular share acquisition. Shareholdings are not remeasured under this approach; therefore, no fair value adjustments are recognised on share acquisitions.

<u>Approach C</u>

14 Investor would apply Approach B as follows:

31/12/20x2

15 As in Approach A.

1/01/20x3

16 The third acquisition at 1/01/20x3, would be accounted for as follows:

Carrying amount of the investment:

Opening balance	1240
Carrying amount of additional investment	620
	1860

This would comprise:

Share of net assets (1020+10% x [4400+700])	1530
Goodwill (220 + 110)	330
	1860

17 Under Approach C, there is no remeasurement of the previous holding.

18 Regarding the goodwill recognised, any positive difference should be recognised as additional amount of goodwill in a proportion to the goodwill recognised when significant influence was obtained. Any residual (excess) is recognised as an expense.

19 Consequently, the acquisition at 1/01/20x2 would be recognised as 620CU – increase in carrying amount of the investment, and the residual (700CU-620CU) = **80CU** in profit or loss (as an expense).

Appendix 2: Illustrative Example B

1 In this example, we following data is considered for **Scenario A**:

(a) On 1/1/20X1, Investor acquired a 30% share in Investee for a consideration of 3000CU. This investment gave Investor significant influence over Investee. Fair value of Investee's net assets was 8000CU at that date.

(b) Annual 20x1 profit of Investee was 1010CU. This value is corrected to 1000CU for any fair value adjustments. In 20x1, the fair value adjustments are the same for both Approach A and B.

(c) On 31/12/20x1, Investor acquired an additional 15% share of Investee's shareholding for 1800CU. The fair value of Investee's net assets was 9200CU at that date.

(d) Annual 20x2 profit of Investee was 1000CU. The profit under Approach A is corrected to 990CU for the fair value adjustments and, under Approach B. to 970CU. The difference in two approaches results from different fair value bases used to measure net assets of Investee.

(e) On 31/12/20x2, Investor sold a 5% share of Investee's shareholding for 750CU. Fair value of Investee's net assets is 10200CU at that date.

2 Alternatively we will consider the following **Scenario B**:

(a) On 1/1/20X1, Investor acquired a 30% share in Investee for a consideration of 3000CU. This investment gave Investor significant influence over Investee. Fair value of Investee's net assets was 8000CU at that date.

(b) Annual 20x1 profit of Investee was 1000CU. This value is corrected for any fair value adjustments.

(c) On 31/12/20x1, Investor acquired an additional 5% share of Investee's shareholding for 600CU. The fair value of Investee's net assets was 9200CU at that date.

(d) Annual 20x2 profit of Investee was 1000CU. The profit under Approach A is corrected to 990CU for the fair value adjustments and, under Approach B, to 980CU. The difference in two approaches results from different fair value bases used to measure net assets of Investee.

(e) On 31/12/20x2, Investor acquired an additional 5% share of Investee's shareholding for 750CU. Fair value of Investee's net assets is 10200CU at that date.

3 These two alternative scenarios are presented on the next page to illustrate Investor's accounting for the investment in Investee under Approaches A and B.

	Carrying amount						Notes:
	Scenario A			Scenario B			
Approach	**A**	**B**		**A**	**B**		
1/1/x1 - 1st acquisition	3000.0	3000.0	30%	3000.0	3000.0	30%	Goodwill of 3000-2400 = 600
Profit for 20x1	300.0	300.0		300.0	300.0		
	3300.0	3300.0		3300.0	3300.0		
31/12/x1 - 2nd acquisition	1800.0	1800.0	+15%	600.0	600.0	+5%	
Fair value adjustment (30%x12000CU-3300CU)	300.0			300.0			Approach A only: remeasurement of previous holding and goodwill Adjustment recognised in profit or loss
31/12/x1 Year end figures	5400.0	5100.0	45%	4200.0	3900.0	35%	
Profit for 20x2	445.5	436.5		346.5	343.0		
	5845.5	5536.5		4546.5	4243.0		
31/12/x2 - sale	-649.5	-615.2	-5%				Disposed 5% of the carrying amount
31/12/x2 - 3rd acquisition				750.0	750.0	+5%	
Fair value adjustment (35%x15000CU-4550CU)				703.5			Approach A only: remeasurement of previous holding and goodwill Adjustment recognised in profit or loss
31/12/x2 Year end figures	5196.0	4921.3	40%	6000.0	4993.0	40%	
sale proceeds	750.0	750.0					
carrying amount sold	-649.5	-615.2					
Profit on sale	100.5	134.8					

Additional notes

4 While accounting for the acquisitions of additional shares, under Approach A, is clear and requires remeasurement of any previous holdings to their fair value, the disposal does not require remeasuring. Consequently, under Approach A, the ultimate result of the two Scenarios is not comparable despite of such expectations.

5 Under Approach B, Scenario B results in mixed asset measurement based on different fair values and is becoming increasingly complex with each further sale or acquisition transaction.