

EFRAG FR TEG and CFSS meeting 15 March 2023 Paper 10-01

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Equity Method of Accounting Cover Note

Objective

- The objective of the session is to obtain views from EFRAG FR TEG and EFRAG CFSS members on the IASB's tentative decisions taken in the IASB's project Equity Method (the Project).
- This is to prepare EFRAG's response at the ASAF meeting that will take place on 27-28 March 2023.
- The tentative decisions of the IASB relate to the following aspects of the equity method:
 - (a) Changes in an investor's interest while retaining significant influence;
 - (b) Recognition of losses.
- 4 The details of the IASB tentative decisions are provided in Appendix to this paper.
- 5 Further details are provided in IASB's Agenda Paper 10.02 ASAF Paper AP2, prepared for discussion at the coming ASAF meeting in March 2023.

Background and history of the IASB Project

- Following the Feedback Statement to the 2011 Agenda Consultation, the IASB decided to add a project on equity method of accounting to the research programme. The IASB justified its decision using the feedback from constituents what included the criticisms related to application of the equity method, its complexities, and inconsistencies. The research was intended to involve a fundamental assessment of the equity method in terms of usefulness and difficulties for preparers.
- 7 In October 2020, the IASB reconsidered the scope of project and decided that its objective is to:

Assess whether application questions with the equity method, as set out in IAS 28, can be addressed in consolidated and individual financial statements by identifying and explaining principles in IAS 28.

- Accordingly, the IASB decided not to fundamentally reconsider IAS 28 guidance. Consequently, some of the application issues would be excluded from the scope of *the Project*.
- Please refer to Appendix 1 and 2 of November 2022 FR TEG and CFSS meeting agenda paper for the list of principles underlying IAS 28 requirements, identified by the IASB, and a list of issues/questions that satisfied the IASB selection criteria (i.e. whether application questions were not-yet-solved, possible to solve without fundamentally rewriting IAS 28, possible to solve without amending other IFRS Standards, and important frequent, widespread, material, and affecting consistent application of IAS 28).

Past EFRAG discussions on the Project

- 10 The progress in this IASB project was discussed at the following EFRAG meetings:
 - (a) EFRAG TEG and CFSS meeting on 15 September 2021 application questions that have recurrent themes but are outside the scope of the Project, the alternatives for addressing the application questions on changes in an investor's interest in an associate without change in significant influence, and ASBJ Perspectives of Equity Method of Accounting and related ASBJ presentation;
 - (b) EFRAG IAWG meeting on 23 September 2021 to the areas excluded from the scope of the IASB Research Project Equity Method of Accounting, and the principles proposed by the ASBJ Perspectives of Equity Method of Accounting related to hybrid approach to the equity method;
 - (c) EFRAG IAWG meeting on 12 May 2022 three alternatives on applying the equity method to the purchase of an additional interest in an associate without a change in significant influence;
 - (d) EFRA FR TEG meeting on 29 June 2022 three alternatives on applying the equity method to the purchase of an additional interest in an associate without a change in significant influence;
 - (e) EFRAG FIWG meeting on 21 June 2022 three alternatives on applying the equity method to the purchase of an additional interest in an associate without a change in significant influence;
 - (f) EFRAG User Panel meeting on 7 July 2022 three alternatives on applying the equity method to the purchase of an additional interest in an associate without a change in significant influence;
 - (g) EFRAG FR TEG and CFSS meeting on 30 November 2022 accounting for transactions between an investor and its associate:

Questions for EFRAG FR TEG and CFSS members

- Do you have any comments on the IASB's tentative answers to the application questions listed in Appendix?
- What are your views on potential effects (costs and benefits) of the tentative answers to the application questions?

Next steps

13 The IASB is expected to discuss the remining selected application issues.

Agenda Papers

14 In addition to this cover note, Agenda Paper 10-02 – ASAF paper AP2 Project Update – has been provided for the session.

Appendix - Summary of the IASB tentative decisions

The table below provides an overview of IASB discussions and tentative decisions so far. This table was prepared based on the condensed summary of the IASB decisions prepared by the IASB Staff.

Topic	Decisions reached	IASB Meeting Date		
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?	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. (Ref: page 10 of Agenda Paper 10-02)	April 2022		
	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 <u>preferred approach</u> whereby an investor, after obtaining significant influence, would measure the investment in the associate as an accumulation of purchases. 			
	 (Ref: page 11 of Agenda Paper 10-02) 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. 			
	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. (Ref: page 13 of Agenda Paper 10-02)	June 2022		
Whether an investor recognises its share of other changes in an associate's net assets, and if so, how is the change presented?	4 The IASB tentatively decided that when the investor's ownership interest:	September 2022		
	 increases and retains significant influence, an investor applying the preferred approach would recognise that increase as a purchase of an additional interest. 			
	 decreases and retains significant influence, an investor applying the preferred approach would recognise that decrease as a partial disposal. (Ref: page 15 of Agenda Paper 10-02) 			
How does an investor apply the equity method when disposing of an interest in an associate while retaining significant influence?	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. (Ref: page 14 of Agenda Paper 10-02)	December 2022		

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?	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. (Ref: page 18 of Agenda Paper 10-02)	December 2022	
Whether an investor that has reduced its interest in an investee to nil recognises each component of comprehensive income separately?	7	 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. (Ref: page 19 of Agenda Paper 10-02) 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. (Ref: page 20 of Agenda Paper 10-02) 	December 2022	
		• 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. (Ref: page 21 of Agenda Paper 10-02)		