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Equity Method – the IASB project
Issues Paper

Objective

1 The reason for the session is to update the EFRAG FR TEG members on the recent developments in the IASB project on the equity method of accounting, and to receive EFRAG FR TEG members comments on the IASB's tentative decision in regard to amending IAS 28 *Investments in Associates and Joint Ventures.*

2 The EFRAG Secretariat also seeks EFRAG FR TEG initial views on a potential exposure draft.

Background and history of the IASB project

3 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.

4 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.*

5 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.

6 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).

7 Following the discussions **in April 2023**, the IASB members decided to:

(a) move the Equity Method research project to the standard-setting work plan;

(b) work towards publishing an exposure draft; and

(c) to further consult its consultative groups.

8 The IASB also decided to re-phrase the project objective and clarify that the project is to:

develop answers to application questions about the equity method, as set out in IAS 28 Investments in Associates and Joint Ventures, using the principles derived from IAS 28 where possible.

9 A summary of all the tentative decisions of the IASB is provided in Appendix to this paper.

Recent developments

10 Since the recent EFRAG FR TEG and CFSS discussion in March 2023, the IASB has discussed and made tentative decisions in regard to:

March 2023 discussion

11 In regard to purchase of an additional interest in an associate while retaining significant influence, the IASB tentatively decided to propose that:

(a) when applying IAS 28, an investor purchasing an additional interest in an associate while retaining significant influence would recognise 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 either as goodwill, or as a gain from a bargain purchase.

12 On the perceived conflict between IFRS 10 *Consolidated Financial Statements* and IAS 28 Investments in Associates and Joint Ventures the IASN tentatively decided to propose:

(a) that, in applying IAS 28, an investor would recognise the full gain or loss on all transactions with its associate.

(b) some improvements in the disclosure requirements when an investor recognises the full gain or loss on transactions with its associate.

EFRAG Secretariat comment

13 EFRAG Secretariat notes that in regard to the perceived conflict between IFRS 10 and IAS 28 requirements, the EFRAG TEG and CFSS already discussion the topics at their March 2023 meeting. Following that meeting, the IASB tentatively decided to clarify accounting for profits or losses on upward and downward transactions.

14 We concur the IASB Staff arguments that it is unclear whether restricting gains or losses was intended to apply to the equity method. This is because the rationale that underlies proportionate consolidation, and its mechanism, assumes that such a transaction is conducted with the other venturers, and that each venturer controls its share the assets, liabilities, income, and expenses of a joint controlled entity.

15 We also think that such an approach would reduce the accounting burden required to present the investment in an associate in accordance with IAS 28.

April 2023 discussion

16 In April 2023, the IASB discussed the approaches to recognition of deferred tax related to investments in associates.

17 The IASB tentatively decided to propose that an investor would:

(a) recognise deferred tax asset (or liability) on the difference between its share of the fair value and the tax base of the associate's identifiable assets and liabilities; and

(b) present that deferred tax asset (or liability) in the carrying amount of its investment in the associate.

EFRAG Secretariat initial analysis

18 On obtaining significant influence, an investor applies paragraph 32 of IAS 28 and recognises its share of the net fair value of the investee's identifiable assets and liabilities.

This may require the investor to adjust the carrying amounts of investee's assets and liabilities (referred to as fair value adjustments).

19 Under IAS 12 requirements, the investor should consider whether the acquisition of the investment in an associate gives rise to deductible and temporary taxable differences; and whether the initial recognition exemption applies to the transaction.

20 Three views can be identified:

(a) An investor should recognise deferred tax on the fair value adjustments and the deferred tax is presented in the carrying amount of the investment in the associate.

This view applies a concept similar to one applied under business combination. It includes both the fair value remeasurement, and recognition of the deferred tax asset/liability on fair value adjustments.

(b) An investor should not recognise the deferred tax on the fair value adjustments because the fair value adjustments do not give rise to temporary differences (refer to paragraph 5 of IAS 12)

Under this view, the investor does not recognise the associate's individual assets and liabilities but a single investment in the associate. Consequently, there cannot be a temporary difference between the carrying amount and the tax base of an asset or liability as required by IAS 12.

(c) An investor should not recognise the deferred tax on the fair value adjustments because it applies the initial recognition exemption in IAS 12.

Under this view, the deferred tax is not recognised because the initial recognition exemption applies to the purchase of an investment in an associate, as the transaction: is not a business combination; and at the date of the transaction affects neither accounting profit nor taxable profit.

21 In view of EFRAG Secretariat, the recognition of a deferred tax liability provides a faithful representation of the transaction. Not recognising a deferred tax liability on the fair value adjustment would result in the investor recognising its share of the associate's tax profit without a corresponding deferred tax on the fair value adjustment.

22 To support our view, we would like to point to that the principal issue in accounting for income taxes is how to account for the current and future consequences of:

(a) the future recovery of assets and settlement of the carrying amount of assets (liabilities) that are recognised in an entity's statement of financial position; and

(b) transactions and other events of the current period that are recognised in an entity's financial statements.

23 IAS 12 requires an entity to recognise deferred tax, if it is probable that recovery of the carrying amount of an asset, or settlement of the carrying amount of a liability, will make future tax payments larger or smaller than they would be if such recovery or settlement were to have no tax consequence.

24 We also support aligning the concept of recognising deferred tax asset/liability in the equity method accounting with the analogical concept applicable to business combinations.

Information for EFRAG FR TEG

25 The IASB will continue the discussion on the application issues at its future meeting.

26 The IASB has not decided about the timing of the publication of exposure draft.

Questions for EFRAG FR TEG members

27 Do you have comments on the recent developments and the IASB tentative decisions summarised in the section ***Recent developments***.

28 Do you have suggestions for the EFRAG Secretariat on how to proceed towards EFRAG's comment letter on the expected IASB's exposure draft?

Summary of the past EFRAG discussions

29 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;

(h) EFRAG FR TEG and CFSS meeting on 15 March 2023 - changes in an investor's interest while retaining significant influence and recognition of losses.

Appendix: The summary of the IASB tentative decisions in the project

Application questions	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** **March 2023**	1. 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. 2. The IASB tentatively decided that an investor purchasing an additional interest in an associate while retaining significant influence would recognise 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 either as goodwill, or as a gain from a bargain purchase.
	June 2022	3. The IASB tentatively decided that an investor purchasing an additional interest in an associate (that is a bargain purchase), while retaining significant influence, would recognise a gain from a bargain purchase 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: • increases and retains significant influence, an investor would recognise that increase as a purchase of an additional interest. • decreases and retains significant influence, an investor would recognise that decrease as a partial disposal.
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. Accordingly, 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 associate to nil is required to 'catch up' unrecognised losses if it purchases an additional interest in the associate?	**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 nil 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 associate to nil recognises each component of comprehensive income separately?	**December 2022**	7. The IASB tentatively decided: • to clarify that an investor would recognise its share of an associate's comprehensive income until its interest in the associate is reduced to nil. • that when an investor has reduced the carrying amount of its investment in an associate to nil the investor would recognise separately its share of each component of the associate's comprehensive income. • 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.

Transactions between an investor and its 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 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*?	**March 2023**	8. The IASB tentatively decided: • that an investor would recognise the full gain or loss on all transactions with its associate. • to propose improvements for the disclosure requirements when an investor recognises the full gain or loss on transactions with its associate.
Initial recognition of an investment in an associate–Deferred taxes		
Does an investor account for a deferred tax asset (or liability) arising from recognising its share of the associate's net identifiable assets and liabilities at fair value?	**April 2023**	9. The IASB tentatively decided that an investor would account for, and include in the carrying amount of its investment in an associate, a deferred tax asset (or liability) arising from recognising its share of the associate's net identifiable assets and liabilities at fair value.