Equity Method of Accounting
Cover Note

Objective

1 The objective of the session is to obtain EFRAG CFSS and EFRAG FR TEG members views on whether the IASB should publish:

(a) an exposure draft of amendments to IAS 28 *Investments in Associates and Joint Ventures*; or

(b) an exposure draft of IAS 28 revised (i.e. an ED revising the entire standard)

2 To clarify:

(a) An exposure draft of amendments to IAS 28 would add, delete, or amend paragraphs in IAS 28 but would not change the order, re-number paragraphs or change the structure of IAS 28.

(b) An exposure draft IAS 28 Revised would allow to reorder, rearrange or change the structure of the Standard even for requirements that are unchanged.

3 The EFRAG CFSS- FR TEG discussion will provide input for the ASAF meeting discussion on the same topic on 10-11 July. The question to be addressed is exclusively about the form that the exposure draft should take.

4 A summary of the IASB tentative decisions is provided for background in the Appendix to this cover note.

Background and history of the IASB Project

5 EFRAG CFSS and FR TEG were last updated on the IASB project at their joint meeting in March 2023. Please refer to the meeting cover note for the complete background of the project since its inception.

6 The following paragraphs focus on the most recent developments since March 2023.

7 At its **April 2023 meeting,** the IASB tentatively decided:

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

(b) to work towards publishing an exposure draft as the next due process step; and

(c) to continue to use the expertise of its advisory bodies instead of establishing a consultative group.

8 The IASB also discussed the approaches to recognition of deferred tax related to investments in associates. The IASB tentatively decided 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.

9 At its June 2023 meeting, the IASB discussed:

(a) whether it should develop proposals on how an investor applies the equity method when an associate issues an equity-settled share-based payment or a share warrant; and

(b) how to, initially and subsequently, recognise and measure contingent consideration on acquisition of an investment in an associate applying IAS 28.

10 The IASB tentatively decided:

(a) That on acquisition of an investment in an associate, an entity recognises contingent consideration as part of the cost of the investment and measures that contingent consideration at fair value. After the acquisition date, it measures contingent consideration at fair value at each reporting date and recognises changes in fair value in profit or loss.

(b) To not to develop proposals on how an investor applies the equity method when an associate issues an equity-settled share-based payment or a share warrant.

11 In reaching its decision on (b) the IASB noted that research conducted by its Staff had not indicated that an associate's issuing of share-based payments has a pervasive and material effect on an investor. Also, there is a wide range of potentially dilutive instruments and transactions and trying to provide requirements for all possible fact patterns is not the objective of the project. The matter could involve the consideration of a wide range of possible equity settled acquisitions and would create complexity.

12 Appendix 1 contains a full summary of all the tentative decisions taken by the IASB to date; including at its June 2023 meeting (these decisions are not included in the ASAF paper 08 which was uploaded before the IASB meeting has taken place).

Remaining steps in the project before and ED can be issued

13 The remaining steps in the project include:

(a) Discussing one remaining application issue concerning impairment: whether the decline in fair value is assessed in relation to the original purchase price or the carrying amount at the reporting date;

(b) Deciding whether to add any additional application questions other than the ones already identified to the scope of the project;

(c) Discussing any implications of applying the IASB's tentative decisions to investments other than those in associates accounted for using the equity method (e.g. application to joint ventures or to subsidiaries accounted under the equity method in separate financial statements); and

(d) Discussing possible improvements for the disclosure requirements to accompany the IASB's tentative decisions and transition requirements.

Format of the Exposure draft

14 The IFRS Due Process Handbook is not specific in prescribing when an exposure draft should be published as an amendment to an IFRS Standard or as a revised Standard. In deciding the format, the IASB normally considers:

(a) Its aim of developing IFRS Accounting Standards that are clear, and enforceable; and

(b) The extent of the changes proposed and how these changes interact with requirements unchanged in IAS 28.

15 Based on the IASB's tentative decisions, it is anticipated that at least 10 paragraphs will be either added, amended, or deleted from IAS 28. However, the number could be even higher depending on the remaining topics to be discussed by the IASB (see remaining steps paragraph 13, above) in particular regarding possible improvements to the disclosure requirements to accompany the IASB's tentative decisions.

16 As noted in the ASAF paper; there would be several advantages in publishing an exposure draft of amendments rather than a Revised IAS 38 ED:

(a) Communicate better what the boundary of the project is and what areas of IAS 28 are not affected by the project;

(b) Encourage stakeholders to focus and provide comments only on the proposed amendments, and not on other requirements in IAS 28;

(c) Require less time and resources from the IASB than publishing an exposure draft of IAS 28 revised; and

(d) Minimise effects on Stakeholders who may have developed internal guidelines and publications that reference the existing paragraph numbers in IAS 28. Changes in the numbering of the paragraphs would require a revision of these materials.

17 Conversely publishing an exposure draft of IAS 28 revised could:

(a) Offer an opportunity to improve and clarify the wording and ordering in IAS 28 which was issued in 2011, does not follow the structure of more recent IFRS Standards and was subsequently amended on a piecemeal basis. For instance, the IASB could rearrange the order of the Standard and group requirements on scope, exemptions from the use of the equity method, recognition and measurement requirements. This would improve the understandability of IAS 28 by making it clearly articulated and using consistent terminology and structure.

(b) Make it easier for stakeholders to assess how the amendments interact with requirements unchanged in IAS 28 if a relatively large number of amendments are envisaged.

EFRAG Secretariat's preliminary views

18 The EFRAG Secretariat considers that an ED amending IAS 28 (rather than a Revised IAS 28 ED) would better reflects the objective assigned to the project which is to answer identified application questions by amending IAS 28 (or adding application guidance) applying core principles that already in the Standards.

19 The project does not aim at changing the basis for the recognition of investments in associates and joint ventures (significant influence and joint control, respectively); or replace the equity method with method of accounting or introduce a new measurement basis for these investments.

20 We also believe that the burden for stakeholders would be alleviated (both in responding to the public consultation and subsequently implementing the changes) in the case of amendments to IAS 28 that are limited to the proposed added or deleted paragraphs. This would also be the case for the IASB itself as an IAS 28 Revised ED is likely to require more time and resources from the IASB than publishing an exposure draft of amendments to IAS 28.

Questions for EFRAG FR TEG and CFSS members

21 What are members' views on whether the IASB should issue an exposure draft of amendments to IAS 28 or an exposure draft of IAS 28 revised?

22 Do members have other comments that they would like EFRAG to convey at the ASAF meeting?

Agenda Papers

23 In addition to this cover note, Agenda Paper 11-02 – *ASAF paper AP8 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.

Questions for EFRAG FR TEG members

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

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

Appendix 1: Summary of the IASB tentative decisions made to date (up to the June 2023 IASB meeting)

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**	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. 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	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**	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**	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? - Recognises each component of comprehensive income separately - Continues eliminating its share of gains arising from a downstream transaction	**December 2022**	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. 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. The IASB tentative decision, at its March 2023 meeting, on the perceived conflict between IFRS 10 Consolidated Financial Statements and IAS 28 on downstream transactions concluded the discussions on this application question.
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**	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.
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? 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? Whether the provision of service and transactions that are not transfer of assets are upstream or downstream transaction? 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?	**March 2023**	The tentative decision #9 described above on the perceived conflict between IFRS 10 and IAS 28 concluded the discussions on these application questions as they were no longer relevant (no elimination of the gain or loss).
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**	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.

Contingent consideration		
How to recognise and measure contingent consideration on acquisition of an investment in an associate, including the subsequent measurement of that contingent consideration. Whether the IASB should develop proposals on how an investor applies the equity method when an associate issues an equity-settled share-based payment or a share warrant.	**June 2023**	The IASB tentatively decided that, on acquisition of an investment in an associate, an entity recognises contingent consideration as part of the cost of the investment and measures that contingent consideration at fair value. After the acquisition date it measures contingent consideration at fair value at each reporting date and recognises changes in fair value in profit or loss. Lastly the IASB decided not to develop proposals on how an investor applies the equity method when an associate issues an equity-settled share-based payment or a share warrant.