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Equity Method – Summary of tentative decisions

Objective

1 The objective of this paper is to update the EFRAG FR TEG members on the tentative decisions of the IASB on the equity method of accounting, and to receive the input in regard to the discussed potential amendments to equity method of accounting in IAS 28 *Investments in Associates and Joint Ventures* as applied to subsidiaries and joint-ventures.

2 The paper is structured in 5 major topics:

(a) Table 1 - IASB's tentative decisions on application questions for investments in associates

(b) Table 2 – IASB's tentative decisions on improvements to disclosure requirements for investments in associates

(c) Table 3 – IASB's tentative decisions for investments other than those in associates accounted for using the equity method

(d) Table 4 – IASB's tentative decisions on transitional requirements for the amendments to be proposed to IAS 28

(e) Table 5 – IASB's tentative decisions to propose amending the prospective Subsidiaries Standard

Table 1 – IASB's tentative decisions on application questions for investments in associates

	Application questions	IASB's tentative decisions
	Changes in an investor's interest on obtaining significant influence	
3	How does an investor determine the initial carrying amount of an investment in an associate?	The IASB tentatively decided to consult with stakeholders 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**. Therefore, the IASB's tentative decision, at its April 2022 meeting, resolves these application questions.
4	An investor, with a previously held meeting, acquires an additional interest and obtains significant influence. Does the initial measurement include the original purchase cost of the previously held interest or the carrying amount of that interest applying IFRS 9 *Financial Instruments*?	

	Changes in an investor's interest while retaining significant influence	
5	How does an investor apply the equity method when purchasing an additional interest in an associate while retaining significant influence?	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.** 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.
6	Whether an investor recognises its share of other changes in an associate's net assets while retaining significant influence, and if so, how is the change presented?	The IASB tentatively decided that when the investor's ownership interest: - increases and the investor retains significant influence, the investor would **recognise that increase as a purchase of an additional interest**. - decreases and the investor retains significant influence, the investor would **recognise that decrease as a partial disposal.** The IASB tentatively decided not to develop proposals on how an investor applies the equity method when an associate grants an equity-settled share-based payment or a share warrant. The IASB tentatively decided to amend paragraph 10 of IAS 28 Investments in Associates and Joint Ventures to refer to 'changes in the investor's share of the associate's net assets'.
8	How does an investor account for the associate's issuance of shares while retaining significant influence? Common transactions include the repurchase or issuance of shares by the associate.	In answering the application question(s) on applying the equity method to changes in ownership interests while retaining significant influence, the IASB tentatively decided how an investor accounts for changes in an associate's net assets that change the investor's ownership interest from the issue of equity instruments (para 6 above). Therefore, the IASB's tentative decision resolves this application question.
9	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. 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	
10	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?	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.**

11	Whether an investor that has reduced its interest in an associate to nil recognises each component of comprehensive income separately?	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**. - that 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**.
12	Whether an investor that has reduced its interest in an associate to nil continues eliminating its share of gains arising from a downstream transaction?	The IASB tentatively decided, at its March 2023 meeting, on the perceived conflict between IFRS 10 and IAS 28: - to propose that an investor, in applying IAS 28, 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.
	Transactions <u>with (and between)</u> equity accounted investments	
13	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?	The IASB tentatively decided: - to propose that an investor, in applying IAS 28, 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.
14	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?	The IASB's tentative decision, at its March 2023 meeting, on the perceived conflict between IFRS 10 and IAS 28 (paragraph 12 of this paper) resolves this application question.
15	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?	The IASB's tentative decision, at its March 2023 meeting, on the perceived conflict between IFRS 10 and IAS 28 (paragraph 12 of this paper) resolves this application question.
16	Whether the provision of service and transactions that are not transfer of assets are upstream or downstream transaction?	The IASB's tentative decision, at its March 2023 meeting, on the perceived conflict between IFRS 10 and IAS 28 (paragraph 12 of this paper) resolves this application question.
17	Whether the requirement for adjustment of gains or losses in intra-group transactions between subsidiaries should be applied by analogy to transactions between	The IASB's tentative decision, at its March 2023 meeting, on the perceived conflict between IFRS 10 and IAS 28 (paragraph 12 of this paper) resolves this application question.

	investees that are accounted for applying the equity method?	
18	Does an investor eliminate its portion of gain or loss in a downstream transaction against the transaction gain or loss or the share of the associate's profit or loss?	The IASB's tentative decision, at its March 2023 meeting, on the perceived conflict between IFRS 10 and IAS 28 (paragraph 12 of this paper) resolves this application question.
19	An investor sells an item of property, plant and equipment to an associate and leases it back: (a) IFRS 16 Leases requires to recognise only the amount of gain or loss that relates to the rights transferred; whereas (b) IAS 28 requires to adjust for the investor's portion of gain or loss. Concerns were expressed about possible double counting.	The IASB's tentative decision, at its March 2023 meeting, on the perceived conflict between IFRS 10 and IAS 28 (paragraph 12 of this paper) resolves this application question and any concern about possible double counting.
	Initial recognition of an investment in an associate – Deferred taxes	
20	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?	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. The IASB tentatively decided to clarify that if an investor purchases an additional interest in an associate, it would apply the IASB's tentative decisions to deferred taxes.
	Contingent consideration	
21	How to, initially and subsequently, recognise and measure contingent consideration on obtaining significant influence in an associate applying IAS 28?	The IASB tentatively decided that: - **on obtaining** significant influence in an associate, an investor would recognise contingent consideration **as part of the cost of the investment** and measure that contingent consideration **at fair value**; and - for each **subsequent** reporting period: o *for contingent consideration classified as equity*: an investor would **account for its subsequent settlement within equity.** o *for other contingent consideration*: an investor would measure it **at fair value at each reporting date and recognise changes in fair value in profit or loss.** The IASB tentatively decided to clarify that if an investor purchases an additional interest in an associate, it would apply the IASB's tentative decisions to contingent consideration arrangements.

	Impairment	
22	Does an investor assess a decline in fair value in relation to the original purchase price or the carrying amount at the reporting date?	The IASB tentatively decided to propose amendments to IAS 28: - to change the term 'cost' to 'carrying amount' in paragraph 41C of IAS 28. - to **add as objective evidence of impairment** a purchase price an investor pays for an additional interest in an associate, or a selling price for part of the interest, that is lower than the carrying amount of the investment in the associate at the date of the purchase or sale of that interest. - to remove the term 'significant or prolonged'.

Table 2 – IASB's tentative decisions on improvements to disclosure requirements for investments in associates

	Improvements to disclosure requirements	**IASB's tentative decisions**
23	A reconciliation between the opening and closing carrying amount of an investor's investments in associates.	The IASB tentatively decided to propose amendments to IFRS 12 *Disclosure of Interests in Other Entities*: - to add a disclosure objective requiring an investor to disclose information that enables users of its financial statements to **evaluate the changes** in the amounts in the financial statements arising from investments in associates; and - to meet that new disclosure objective, to require an investor to disclose a **reconciliation between the opening and closing carrying amount of its investments in associates**.
24	Other changes in the associate's net assets that change an investor's ownership interest.	The IASB tentatively decided to propose amendments to IFRS 12 to require an investor **to disclose the gain or loss from recognising its share of other changes in its associate's net assets that change its ownership interest**, while it retains significant influence.
25	Transactions with equity-accounted investments	The IASB tentatively decided to propose amendments to IFRS 12 to require an investor to **disclose its gains or losses on transactions <u>to</u> its associates**. The IASB tentatively decided **not** to propose amendments to IFRS 12 to require an investor to **disclose the gains or losses on transactions <u>from</u> its associates.**
26	Contingent consideration arrangements	The IASB tentatively decided to propose amendments to IFRS 12 to require an investor that has entered into a contingent consideration arrangement, **to disclose**: - ***on obtaining significant influence in an associate***: the amount recognised as part of the cost of the investment, a description of the arrangement and the basis for determining the amount of the payment, and an estimate of the range of outcomes (undiscounted) or, if a range cannot be estimated, that fact and the reasons why a range cannot be estimated. If the maximum amount of the payment is unlimited, the investor shall disclose that fact.

	- ***for each subsequent reporting period until the investor collects or settles the contingent consideration or it is cancelled or expire****s:* any changes in the recognised amounts, including any differences arising upon settlement, any changes in the range of outcomes (undiscounted) and the reasons for those changes, and the valuation techniques and key model inputs used to measure the contingent consideration.

Table 3 – IASB's tentative decisions for investments other than those in associates accounted for using the equity method

	Type of investments	IASB's tentative decisions
27	Investments in subsidiaries in separate financial statements	The IASB tentatively decided that its tentative decisions on application questions for investments in associates **apply when a parent elects to use the equity method to account for its investments in subsidiaries in separate financial statements**. The IASB tentatively decided to propose that a parent that elects to use the equity method to account for its investments in subsidiaries in separate financial statements **would disclose the gains or losses from the parent's transactions to its subsidiaries**. The IASB tentatively decided to clarify that if a parent entity applies the equity method to its investments in subsidiaries in its separate financial statements, it would apply paragraph 24 of IAS 28 to a step acquisition of a subsidiary.
28	Investments in joint ventures	The IASB tentatively decided that its tentative decisions on application questions for investments in associates apply to investments in joint ventures. The IASB tentatively decided to propose **the same improvements to the disclosure requirements** that it has tentatively decided to propose for investments in associates for investments in joint ventures.

Table 4 – IASB's tentative decisions on transitional requirements for the amendments to be proposed to IAS 28

	Transitional requirements	IASB's tentative decisions
29	Transitional requirements for the amendments to be proposed to IAS 28	The IASB tentatively decided to propose that an investor or a joint venturer would: - **retrospectively apply** the requirement to recognise the **full gain or loss** on all transactions with its associates or joint ventures. - **recognise and measure contingent consideration at fair value at the transition date** and recognise any corresponding adjustment to the carrying amount of its investments in associates or joint ventures.

	- **prospectively apply all the other requirements** from the transition date The IASB tentatively decided to clarify its tentative decision that an investor or joint venturer would retrospectively apply the requirement to recognise the full gain or loss on all transactions with its associates or joint ventures. An investor or joint venturer would **apply the proposed requirement by recognising the remaining portion of the restricted gain or loss. The cumulative effect of that gain or loss would be recognised as an adjustment to the opening balance of retained earnings at the transition date** in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. The IASB tentatively decided to propose that if, **on initial application of the proposed requirements**, an investor or joint venturer had estimated, at the transition date, the recoverable amount of an investment in an associate or joint venture, the investor or joint venturer would: - **reduce the carrying amount to that recoverable amount;** and - **recognise the impairment loss in the opening balance of retained earnings**. The IASB tentatively decided to propose that an investor or joint venturer that chooses (or is required by legislation) to present more than one period of comparative information may present comparative information for any additional prior periods: - **adjusted** for the effects of the proposed requirements: **the transition date would be the beginning of the earliest adjusted comparative period presented**; or - **unadjusted** for the effects of the proposed requirements: the investor or joint venturer would identify the comparative information as unadjusted **and disclose** that the comparative information has been prepared on a different basis, explaining that basis. The IASB tentatively decided to **propose an exemption** from disclosing the information required by paragraph 28(f) of IAS 8 for the current period and for any additional prior period that the investor or joint venturer presents unadjusted.

Table 5 – IASB's tentative decisions to propose amending the prospective Subsidiaries Standard

	Amendments to disclosure requirements	**IASB's tentative decisions**
30	Contingent consideration arrangements, under the subheading IFRS 12.	The IASB tentatively decided to propose amending the prospective Subsidiaries Standard to require that an eligible subsidiary discloses: - ***<u>on obtaining significant</u>*** influence in an associate or joint control in a joint venture: the amount of contingent consideration recognised as part of the cost of the investment; a description of the contingent consideration

		arrangement; and the basis for determining the amount of the payment. - ***for each subsequent reporting period until the subsidiary collects or settles the contingent consideration or until it is cancelled or expires:*** any changes in the recognised amounts, including any differences arising upon settlement; and the valuation techniques and key model inputs used to measure the contingent consideration.
31	Transactions with equity-accounted investments, under the subheading IFRS 12 and IAS 27, respectively.	The IASB tentatively decided to propose amending the prospective Subsidiaries Standard to require that an eligible subsidiary **disclose gains or losses on downstream transactions**: - to its associates and joint ventures; and - to its subsidiaries if it applies the equity method to its investments in subsidiaries in separate financial statements, as permitted in IAS 27.
32	A reconciliation between the opening and closing carrying amount of an investor's investments in associates and joint ventures, under the subheading IFRS 12.	The IASB tentatively decided **not** to propose amendments to the prospective Subsidiaries Standard to require an eligible subsidiary to **disclose a reconciliation between the opening and closing carrying amount of its investments in associates and joint ventures.**

Questions for EFRAG FR TEG:

33 Do you have any questions or comments on the tentative decisions outlined above?

34 Do you foresee any application issues with the proposed amendments?