IFRS

STAFF PAPER

June 2022

IASB® meeting

Project	**Equity Method**	
Paper topic	Other changes in an associate's net assets	

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Purpose of this paper

1. At its April 2022 meeting, the International Accounting Standards Board (IASB) discussed the application question: *How does an investor apply the equity method when purchasing an additional interest in an associate while retaining significant influence.*

2. The IASB discussed possible approaches to the application question and asked the staff to continue its analysis of two approaches (a preferred and an alternative approach) [1].

3. Transactions and events other than purchases and disposals can also change an investor's ownership interest in an associate. This paper introduces how the equity method of accounting might be applied to these transactions and events.

4. At a future meeting, the staff will illustrate the application of the preferred and alternative approaches to these transactions and events.

5. This paper is for education purposes and the IASB is not asked to make any decision.

[1] More detail on the preferred and alternative approach can be found in AP13A of the June 2022 IASB meeting.

Structure of the paper

6. The paper is structured as follows:

   (a) transactions and other events that change an investor's ownership interest (paragraphs 7–11 of this paper);

   (b) transactions and other events that change an investor's ownership interest and an associate's net assets (paragraphs 12–24 of this paper);

   (c) other changes in an associate's net assets–initial considerations and next steps (paragraphs 25–31 of this paper); and

   (d) questions to the IASB.

Transactions and other events that change an investor's ownership interest

7. Transactions and other events that change an investor's ownership interest in an associate can be categorised based on whether:

   (a) the investor exchanges consideration (for example purchases and partial disposals); and

   (b) the transaction is an equity transaction of the associate; that is a transaction that changes the associate's net assets.

8. The purchase of an additional interest or a partial disposal of an interest in an associate with a counterparty meets condition (a) but not condition (b) in paragraph 7 of this paper. This is because consideration is exchanged between the investor and the counterparty. The associate neither receives nor distributes resources and thereby there is no change in the associate's net assets.

9. An example of a transaction that meets both conditions (a) and (b) in paragraph 7 of this paper is an associate's share issue or redemption in which the investor participates but not all other shareholders participate. In this transaction the investor's ownership interest changes and there is a change in the associate's net assets.

10. A transaction that changes the investor's ownership interest but does not meet either condition (a) or (b) in paragraph 7 of this paper is an equity–settled share–based payment

granted by the associate in exchange for employee service. The investor's ownership interest dilutes if the granted instruments vest and are exercised. There is no change in net assets as the share-based payments are granted in exchange for a service.

11. A share issue or redemption by an associate in which the investor does not participate meets only condition (b) of paragraph 7 of this paper. Condition (b) is met because the associate receives cash inflows from, or distributes cash outflows to, other shareholders but not the investor. The investor's ownership interest in the associate is changed because the investor does not participate in the share issue or the redemption; simultaneously there is a change in the net assets of the associate.

Transactions and other events that change investors' ownership interest and an associate's net assets

12. The transactions described in paragraphs 9 and 11 of this paper change the shareholdings of investors' and the associate's net assets.

13. Applying the equity method of accounting to transactions or other events that change an associate's net assets is a longstanding question for the equity method of accounting and is an application question within the scope of this project.

14. In the next paragraphs we introduce the analysis of applying the equity method to the application question: *Whether an investor recognises its share of other changes in an associate's net assets, and if so, how is the change presented*.

15. Applying the equity method on initial recognition the investment in an associate is recognised at cost, and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the acquisition date. The equity method of accounting therefore does not report the economic value or changes in the economic value of the investor's interest in an associate.

16. In economic terms a change in an investor's ownership interest arising from the issue or redemption of shares (an equity transaction by the associate) should not change the economic value of the investor's interest, assuming that the issue or redemption price is at fair value.

17. Assume a scenario where:

    (a) an investor holds 20% of an associate;

    (b) the associate has 1,000 outstanding ordinary shares;

    (c) the associate issues 100 additional ordinary shares; and

    (d) the investor does not take part in the share issue.

18. If the fair value of the associate before the share issue is 6,000CU, the entity subscribing the new shares should pay (6,000CU/1,000)*100 = 600CU. The economic value of the investor's interest before and after the transaction would be:

	Before the transaction	**After the transaction**
Investor's ownership interest	(200/1,000) = 20%	(200/1,100) =18.2%
Fair value of the associate	6,000	6,600
Investor's economic value	1,200	1,200
Book value of net assets	4,500	5,100

19. However, in this scenario, the investor's share of the associate's net assets will change as a result of the transaction[2] from (20%*4,500CU) = 900CU to (18.2%*5,100CU) = 927.3CU.

20. The application question in paragraph 14 of this paper asks whether an investor recognises this change in net assets. Paragraph 10 of IAS 28 requires the investor to recognise its share of the associate's profit or loss. It further states that adjustments to the carrying amount of the investee may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's other comprehensive income.

[2] In the context of the analysis, the carrying amount of the associate's net assets includes the appropriate adjustments (basis differences) made by the investor at the date significant influence was obtained.

IASB's previous discussions

21. In November 2012, the IASB published for comment the Exposure Draft *Equity Method: Share of Other Net Asset Changes* (proposed amendments to IAS 28 *Investments in Associates and Joint Ventures*). The proposed amendment aimed to respond to diversity in practice that had arisen on how to apply the equity method to certain transactions entered into by an equity-accounted investee.

22. The IASB proposed to address this diversity by requiring an investor to:

    (a) recognise, in the investor's equity, the investor's share of other changes in the investee's net assets; and

    (b) reclassify to profit or loss the cumulative amount of those other changes previously recognised in equity when the investor discontinued the use of the equity method.

23. All respondents agreed that the investor should recognise their share of the associate's net asset changes, but most disagreed that the recognition should occur in equity. Some respondents stated that indirect changes in the investor's ownership interest such as dilutions are economically similar to direct changes like purchases and disposals, and the reporting should be the same[3].

24. In May 2014 due to diversity in the views among IASB members, the IASB decided not to finalise the proposed amendments and defer work on the topic to a future research project on the equity method.

Other changes in an associate's net assets–initial considerations and next steps

25. Agenda Paper 13A for this meeting expands the application of the preferred and alternative approaches when applying the equity method to a purchase of an additional interest that is a bargain and a partial disposal of an interest in an associate, while retaining significant influence. The staff think once the IASB has made tentative decisions on these transactions it should discuss how the approaches can be applied to the

[3] For more details, see AP12C: Exposure Draft Equity Method: Share of Other Net Asset Changes (ifrs.org) of the October 2013 IASB meeting.

transactions in paragraphs 9 and 11 of this paper; that is transactions or events that change the investors' ownership interest and the associate's net assets.

26. The staff think that *all* changes in an investor's ownership interest can be seen as having similar economic outcomes for the investor. For example, a partial disposal and a dilution have similar economic outcomes because both transactions decrease the investor's ownership interest. In a partial disposal the investor exchanges consideration with the counterparty; in a dilution the investor is compensated for the dilution by the increase in the associate's net assets.

27. Consequently, the staff think that the financial reporting of the transactions in paragraphs 9 and 11 of this paper should be consistent with the reporting of a purchase of an additional interest or a partial disposal. It is helpful to think of how these transactions can be depicted in terms of purchases or disposals.

28. Assume a scenario where:

(a) an investor owns 20% of an associate;

(b) the associate has 1,000 issued ordinary shares;

(c) the associate issues 111 additional ordinary shares; and

(d) the investor subscribes for the newly issued shares in full.

29. The investor's ownership share before and after the transaction is:

	Before share issue	**After share issue**		
		Previously held interest	Additional interest	Total
Investor's shares	200	200	111	311
Total shares	1,000	1,111		
Ownership share	20%	18%	10%	28%

30. Application of the preferred approach to the scenario in paragraph 29 depends on how the transaction is viewed. There are two possible views on the transaction:

View A: a partial disposal of 2% and a purchase of an additional 10% share; or

View B: a purchase of an additional 8% share.

31. Whether View A or View B is adopted will affect the recognition and measurement of the investment in an associate. The staff plan to consider View B in a future paper for the IASB to consider. In the staff's view there is a single transaction or event that changes the investor's ownership interest and the associate's net assets.

Questions to the IASB
1. Do you have any comments on the staff analysis in paragraphs 25 to 31 of this paper?   2. Do you agree the staff should develop this analysis in this paper further as part of the equity method project?