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IFRS Developments

IASB proposes amendments to the equity method of accounting

What you need to know

- The IASB is proposing amendments to IAS 28 *Investments in Associates and Joint Ventures*.
- The objective of the proposed amendments is to develop answers to questions on how to apply the equity method.
- The comment period ends on 20 January 2025.

Highlights

On 19 September 2024, the International Accounting Standards Board (the IASB or Board) issued an Exposure Draft: *Equity Method of Accounting – IAS 28 Investments in Associates and Joint Ventures* (the ED). The project aims to reduce diversity in practice by answering application questions about the equity method of accounting and to improve the understandability of IAS 28.

The proposed amendments aim to clarify and amend the requirements of IAS 28, with new disclosure requirements intended to enhance the information companies provide about equity accounted investments. In addition, to improve the understandability of IAS 28, a reordering of the requirements is being proposed. The proposed amendments would affect any entity applying the equity method of accounting, in their consolidated financial statements, to investments in associates and joint ventures. They would also apply to entities that use the equity method in their separate financial statements for investments in subsidiaries, joint ventures or associates.

The IASB welcomes comments from stakeholders. Comments are due by 20 January 2025.

Building a better working world

Background

The IASB added a research project on the equity method to its work programme following the 2011 Agenda Consultation, after receiving stakeholder feedback that suggested the need for a fundamental review of the equity method. Subsequently, the IASB decided to instead focus on developing answers to application questions about the equity method, as this would more quickly provide preparers with solutions to application difficulties and reduce diversity in practice. Therefore, the project focused on addressing application questions by identifying and applying the principles that underlie IAS 28.

The project is not a fundamental review of IAS 28 and does not address topics such as: whether the equity method is a one-line consolidation methodology or a measurement method; the scope of application of the equity method; the definition of significant influence; or how to assess whether an entity has significant influence.

Proposed amendments

The proposed amendments clarify or amend the requirements of IAS 28 with respect to the application of the equity method. In particular:

- On initial recognition, the investor or joint venturer would:
  - Measure the cost of an associate or joint venture at the fair value of the consideration transferred, including the fair value of any previously held ownership interest
  - Recognise contingent consideration as part of the consideration transferred, measured at fair value. Contingent consideration classified as a liability would be remeasured at each reporting date with changes recognised in profit or loss
  - Include in the notional purchase price allocation the deferred tax effects related to the share of the fair value of the identifiable assets and liabilities
- If an investor or joint venturer subsequently purchases an additional ownership interest, while retaining significant influence or joint control, it would:
  - Recognise the additional ownership interest at the fair value of consideration transferred
  - Add the additional share of the fair value of the associate's or joint venture's identifiable assets and liabilities at the date of purchase, including the related deferred tax effects, in the notional purchase price allocation
  - Account for the difference between the fair value of the consideration transferred and the additional share of the fair value of the identifiable assets and liabilities as goodwill or a bargain purchase
- If an investor disposes of a portion of its investment while retaining significant influence or joint control, it would measure the disposed portion as a percentage of the carrying amount of the investment at the date of disposal and recognise the difference between the consideration received and the disposed portion as a gain or loss in profit or loss.
- If an investor or joint venturer has recognised its share of losses and reduced its investment in an associate or joint venture to nil, the investor or joint venturer:
  - Would not 'catch-up' losses not recognised if it purchases an additional ownership interest
  - Would recognise separately its share of profit or loss and its share of other comprehensive income
- An investor or joint venturer would recognise in full any gains or losses from all transactions with its associates and joint ventures. This proposal would supersede the requirements introduced by *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*[1], the effective date of which was deferred indefinitely.

[1] IASB, *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28)*

Other proposals include:

- Clarification of the impairment assessment requirements, in particular, when considering whether a decline in fair value is an indicator of impairment, the ED proposes replacing the reference to 'cost' with 'carrying amount'; and the removal of a reference to 'a significant or prolonged decline' in the fair value of an investment.
- Additional disclosures, such as a reconciliation between the opening and closing carrying amount of investments in associates and joint ventures.

The ED also includes proposed Illustrative Examples to illustrate:

- The application of the equity method on obtaining significant influence and purchasing an additional interest
- Other changes in an investor's ownership interest
- Recognising an investor's share of losses

The ED proposes that, on transition, an investor or joint venturer shall apply the proposed amendments prospectively, except in limited circumstances, including:

- Where an investor or joint venturer has historical transactions with an associate or joint venture, it shall recognise the previously restricted portion of gains or losses from such transactions as an adjustment to the carrying amount of the investment and the retained earnings at the transition date
- Where contingent consideration with respect to an associate or joint venture exists at the transition date, the contingent consideration shall be recognised and measured at fair value at the transition date, with any change recognised as an adjustment to the carrying amount of the investment.

Next Steps

The comment period ends on 20 January 2025. The IASB will consider comment letters and other feedback from its consultations on the proposals in the ED and will then decide whether to issue the proposed amendments.

How we see it

We support the IASB's efforts to resolve a number of the application questions that arise when using the equity method of accounting.

We encourage stakeholders to provide feedback to the IASB on the proposed amendments.

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ED None