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Exposure Draft ED/2012/3

Equity Method: Share of Other Net Asset Changes

Proposed amendments to IAS 28

Comments to be received by 22 March 2013

IFRS®

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Exposure Draft ED/2012/3 *Equity Method: Share of Other Net Asset Changes* is published by the International Accounting Standards Board (IASB) for comment only. The proposals may be modified in the light of the comments received before being issued in final form as amendments to IFRSs. Comments on the Exposure Draft and the Basis for Conclusions should be submitted in writing so as to be received by **22 March 2013**. Respondents are asked to send their comments electronically to the IASB website (www.ifrs.org), using the 'Comment on a proposal' page.

All responses will be put on the public record unless the respondent requests confidentiality. However, such requests will not normally be granted unless supported by good reason, such as commercial confidence.

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Introduction and invitation to comment

Introduction

The International Accounting Standards Board (IASB) has published this Exposure Draft of the proposed amendments to IAS 28 *Investments in Associates and Joint Ventures* to specify that an investor should recognise, in the investor's equity, its share of the changes in the net assets of the investee that are not recognised in profit or loss or other comprehensive income (OCI) of the investee, and that are not distributions received ('other net asset changes').

Paragraph 3 of IAS 28 defines the equity method to be a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets. In other words, under the equity method, all post-acquisition changes in the net assets of an investee should be recognised by the investor. However, as a result of a consequential amendment made as part of the 2007 revision to IAS 1 *Presentation of Financial Statements*, paragraph 10 of IAS 28 no longer states whether, and if so, where, the investor should account for other net asset changes of the investee. As a result, some view paragraphs 3 and 10 as being inconsistent with each other, or at least unclear.

Invitation to comment

The IASB invites comments on the proposals in this Exposure Draft, particularly on the questions set out below. Comments are most helpful if they:

(a) comment on the questions as stated;

(b) indicate the specific paragraph or group of paragraphs to which they relate;

(c) contain a clear rationale; and

(d) include any alternative that the IASB should consider, if applicable.

The IASB is not requesting comments on matters in IAS 28 that are not addressed in this Exposure Draft.

Comments should be submitted in writing so as to be received no later than **22 March 2013**.

Questions for respondents

Question 1

The IASB proposes to amend IAS 28 so that an investor should recognise in the investor's equity its share of the changes in the net assets of the investee that are not recognised in profit or loss or OCI of the investee, and that are not distributions received. Do you agree? Why or why not?

Question 2

The IASB also proposes that an investor shall reclassify to profit or loss the cumulative amount of equity that the investor had previously recognised when the investor discontinues the use of the equity method. Do you agree? Why or why not?

Question 3

Do you have any other comments on the proposals?

[Draft] Amendments to IAS 28 *Investments in Associates and Joint Ventures*

Paragraphs 10, 22, 23, 25 and the heading before paragraph 25 are amended. Paragraph 45A is added. New text is underlined and deleted text is struck through

Equity method

10 Under the equity method, an investor initially recognises its ~~on initial recognition the~~ investment in an associate or a joint venture at cost. Thereafter, ~~and~~ the carrying amount is increased or decreased to recognise changes in the investor's share of the investee's net assets ~~share of the profit or loss of the investee after the date of acquisition.~~ in the following manner:

(a) The investor's share of the investee's profit or loss is recognised in the investor's profit or loss.

(b) The investor's share of the investee's components of other comprehensive income is recognised in the investor's other comprehensive income (see IAS 1 *Presentation of Financial Statements*). Such changes include those arising from the remeasurements of the net defined benefit liability (asset), from the revaluation of property, plant and equipment and from foreign exchange translation differences.

(c) Distributions received from an investee reduce the carrying amount of the investment. Such distributions include dividends in cash or other assets and returns of invested capital.

(d) The investor's share of the investee's net asset changes, other than profit or loss or other comprehensive income and distributions received, is recognised in the investor's equity. Examples of such changes include those arising from movements in the share capital of the investee (for example, when an investee issues additional shares to third parties or buys back shares from third parties) and movements in other components of the investee's equity (for example, when an investee accounts for an equity-settled share-based payment transaction). ~~Adjustments to the carrying amount 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. Such changes include those arising from the revaluation of property, plant and equipment and from foreign exchange translation differences. The investor's share of those changes is recognised in the investor's other comprehensive income (see IAS 1~~ ~~*Presentation of Financial Statements*).~~

Example illustrating paragraph 10(d)
An investor has a 30 per cent investment in an investee and has significant influence over that investee. The investee issues additional shares to a third party for cash. As a result, the investor's share decreases from 30 per cent to 25 per cent, while the investee's net assets increase from CU1,000[a] to CU1,500. The investor maintains significant influence over the investee. The investor's share of the investee's pre-existing net assets is diluted by CU50 (CU1,000 x 30% - CU1,000 x 25%). On the other hand, the investor's share of the investee's net assets increases by CU125 (CU500 x 25%) because of the additional funds raised by the investee. In other words, the investor's share of the investee's net assets increases from CU300 (CU1,000 x 30%) to CU375 (CU1,500 x 25%). Consequently, the investor records a CU75 increase to its investment and a CU75 increase to its shareholder's equity.

[a] In this Standard monetary amounts are denominated in 'currency units (CU)'.

Discontinuing the use of the equity method

22 An investor ~~entity~~ shall discontinue the use of the equity method from the date when its investment ceases to be an associate or a joint venture as follows:

(a) If the investment becomes a subsidiary, the ~~entity~~ investor shall account for its investment in accordance with IFRS 3 *Business Combinations* and IFRS 10.

(b) If the retained interest in the former associate or joint venture is a financial asset, the ~~entity~~ investor shall measure the retained interest at fair value. The fair value of the retained interest shall be regarded as its fair value on initial recognition as a financial asset in accordance with IFRS 9. The ~~entity~~ investor shall recognise in profit or loss any difference between:

(i) the fair value of any retained interest and any proceeds from disposing of a part interest in the associate or joint venture; and

(ii) the carrying amount of the investment at the date the equity method was discontinued.

(c) When an ~~entity~~ investor discontinues the use of the equity method, the ~~entity~~ investor shall:

(i) account for all amounts previously recognised in the investor's other comprehensive income in relation to that investment on the same basis as would have been required if the investee had directly disposed of the related assets or liabilities~~.~~; and

(ii) reclassify to profit or loss the cumulative amount of equity that had previously been recognised in accordance with paragraph 10(d).

23 ~~Therefore, if a gain or loss previously recognised in other comprehensive income by the investee would be reclassified to profit or loss on the disposal of the related assets or liabilities, the entity reclassifies the gain or loss from equity to profit or loss (as a reclassification adjustment) when the equity method is discontinued.~~ For example, if an investee ~~associate or a joint venture~~ has cumulative exchange differences relating to a foreign operation and the investor ~~entity~~ discontinues the use of the equity method, the investor ~~entity~~ shall reclassify to profit or loss the gain or loss that had previously been recognised in its other comprehensive

income in relation to the foreign operation. As another example, an investee had previously issued additional shares to third parties other than the investor, which had resulted in a change of the investor's share of the investee's other net assets, and the investor had recognised the change in its equity. When at a later date the investor discontinues the use of the equity method because the investment becomes a subsidiary or a financial asset, the investor shall reclassify to profit or loss the amount that it had previously recognised in equity in relation to the investee's issue of additional shares.

Other ~~C~~changes in ownership interest

25 If an ~~entity's~~ investor's ownership interest in an associate or a joint venture is reduced, but the ~~entity~~ investor continues to apply the equity method, the investor ~~entity~~ shall reclassify to profit or loss the proportion of the gain or loss ~~that had~~ previously ~~been~~ recognised in accumulated other comprehensive income relating to that reduction in ownership interest if that gain or loss would be required to be reclassified to profit or loss on the disposal of the related assets or liabilities. The investor shall not reclassify to profit or loss the amount that it had previously recognised in equity in accordance with paragraph 10(d), until the investor discontinues the use of the equity method.

Effective date and transition

45A *Equity Method: Share of Other Net Asset Changes* (Amendments to IAS 28), issued in [date to be inserted after exposure], amended paragraphs 10, 22, 23 and 25. An entity shall apply those paragraphs for annual periods beginning on or after [date to be inserted after exposure] retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Earlier application is permitted.

Approval by the Board of *Equity Method: Share of Other Net Asset Changes* (Proposed amendments to IAS 28) published in November 2012

The Exposure Draft *Equity Method: Share of Other Net Asset Changes* was approved for publication by fourteen of the fifteen members of the International Accounting Standards Board. Mr Ochi voted against its publication. His alternative view is set out after the Basis for Conclusions.

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Takatsugu Ochi	
Paul Pacter	
Darrel Scott	
Chungwoo Suh	
Wei-Guo Zhang	

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the proposed amendments.

Application of the equity method

Share of other net asset changes

Recognition in equity

BC1 Paragraph 3 of IAS 28 defines the equity method as a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets. In other words, under the equity method, all post-acquisition changes in the net assets of an investee should be recognised by the investor. However, as a result of a consequential amendment made by the 2007 revision to IAS 1 *Presentation of Financial Statements*, paragraph 10 of IAS 28 no longer states whether, and if so, where, the investor should account for its share of other net asset changes of the investee that are not recognised in profit or loss or other comprehensive income (OCI) of the investee, or that are not distributions received ('other net asset changes'). As a result of that consequential amendment, some view paragraphs 3 and 10 as being inconsistent with each other, or at least unclear.

BC2 This issue was brought to the attention of the IFRS Interpretations Committee (the Interpretations Committee) in March 2011 because there was diversity in practice. Following several discussions by both the IASB and the Interpretations Committee, the IASB asked the Interpretations Committee to propose a narrow-scope amendment that would address the observed diversity in practice in the short term. In responding to the IASB's request, the Interpretations Committee tentatively agreed on the following principles:

(a) where an investor's ownership interest in the investment is reduced, whether directly or indirectly, the impact of the change should be accounted for as a partial disposal and recognised in profit or loss of the investor; and

(b) where an investor's ownership interest in the investment increases, whether directly or indirectly, the impact of the change should be accounted for as an incremental purchase of the investment and recognised at cost.

The Interpretations Committee also considered how an investor should account for call option transactions entered into by an investee over its own equity (including share-based payments). However, the Interpretations Committee could not reach a consensus because it was concerned about the complexity that would need to be introduced into IAS 28 to reflect the accounting for the call-option transactions. Consequently, the Interpretations Committee decided to recommend to the IASB that IAS 28 should be amended to incorporate the tentative decisions above but that call-option transactions would not be considered in the amendments to IAS 28.

BC3 The IASB discussed, but disagreed with, the proposed amendment because it would not address all types of other net asset changes that might occur in practice—in particular, share-based payment transactions in an investee. In addition, the IASB was concerned that the proposed accounting did not provide symmetry between a reduction and an increase in the investor's ownership interest in the investment and would cause complexity as a result. Consequently, the IASB's preference was for a more generalised approach that would address all types of other net asset changes. The IASB noted three possible areas where such changes could be recognised by an investor: investor's equity, investor's OCI or investor's profit or loss.

BC4 The IASB noted that including the investor's share of the investee's equity transactions in profit or loss risks giving a misleading representation of the investee's performance, because such equity transactions do not reflect performance. For example, when an investee issues additional shares to third parties for cash, the investee records cash received and the corresponding equity. This transaction does not involve recognition of income and expenses and, therefore, does not represent a performance of the investee.

BC5 In addition, the IASB observed that recognising these other net asset changes in profit or loss can cause anomalous results. For example, with regard to a share-based payments transaction, the 'debit' part of the associate's transaction is already included in the investor's share of the associate's profit. Recording the investor's share of the 'credit' part of the transaction in profit as well will result in a net nil impact on the investor's profit or loss, which is not a fair presentation of the transaction.

BC6 Furthermore, some IASB members noted that the application of the equity method is consistent with the view held by some interested parties that equity method accounting is a one-line consolidation and including the investor's share of the investee's equity transactions in profit or loss would be inconsistent with that view. Some IASB members also noted that paragraph 26 of IAS 28 states that many of the procedures that are appropriate for the application of the equity method are similar to the consolidation procedures described in IFRS 10.

BC7 The IASB noted that IAS 28 requires that an investor's share of an investee's profit or loss is recognised in the investor's profit or loss. It also requires that the investor's share of the investee's OCI is recognised in the investor's OCI. Other net asset changes of the investee result from transactions that are neither profit or loss nor OCI but, rather, are the investee's equity transactions. Accordingly, the IASB concluded that it is appropriate that such changes are recognised in the investor's equity.

BC8 The IASB acknowledged that an investee is not part of the consolidated group as defined in Appendix A of IFRS 10 *Consolidated Financial Statements* and thus the investee's other net asset changes are excluded from 'owner's transactions' that are presented within equity under IAS 1. However, the IASB noted that, before the revision in 2007, IAS 28 required these types of changes to be recognised in the investor's equity. Because of its desire to address diversity in practice, the IASB concluded that returning to the previous requirements would be the most reasonable and expeditious approach as a short-term solution. Consequently, the IASB is proposing to amend IAS 28 so that an investor should account for other net asset changes of the investee in the investor's equity.

Presentation and disclosure

BC9 The IASB considered whether an entity should reclassify the amount that had previously been recognised in equity to profit or loss. The IASB noted that paragraph B98 of IFRS 10 requires that, if a parent loses control of a subsidiary, the parent shall derecognise the carrying amount of the assets, liabilities and non-controlling interests in the former subsidiary (including any components of the investor's accumulated OCI attributable to them) at the date when control is lost. This is because the loss of control of a subsidiary is a significant economic event to a parent (BCZ182 of IFRS 10). The IASB acknowledged that, in its redeliberation of the Exposure Draft *Joint Arrangements*, it concluded that loss of joint control or loss of significant influence, although significant, is fundamentally different from loss of control of a subsidiary (BC28 of IAS 28). It also acknowledged that retaining the characterisation of 'significant economic event' in the case of loss of joint control or significant influence when the retained interest is a financial asset is unnecessary, because IFRS 9 already requires that in such cases the retained interest (which is a financial asset) must be measured at fair value (BC29 of IAS 28).

BC10 However, the IASB made the observation in these proposed amendments to IAS 28 that the cumulative amount of equity that an investor had previously recognised in relation to the investee's other net asset changes will remain in the investor's shareholder's equity even after the investor loses significant influence over the investee, unless the investor reclassifies the amount recognised in equity to profit or loss. The IASB does not regard this as a fair presentation of loss of significant influence. The IASB thinks that the cumulative amount of equity that the investor had previously recognised should move to retained earnings if the investor loses significant influence over the investee and discontinues the use of the equity method. The IASB noted that paragraph 22 of IAS 28 requires that, when an investor discontinues the use of the equity method, the investor shall account for all amounts previously recognised in OCI in relation to that investment on the same basis as would have been required if the investee had directly disposed of the related assets or liabilities. Accordingly, the IASB proposes that, when an investor discontinues the use of the equity method, it shall reclassify to profit or loss the cumulative amount of equity that it had previously recognised, in relation to the investee's other net asset changes.

BC11 The IASB also considered whether it should require disclosure of the amount recognised in equity by an investor resulting from an investee's equity transactions, but decided that it should not do so. It noted that paragraph 106 of IAS 1 already requires that an entity should provide a reconciliation of components of equity separately if they are material and also noted that the amount recognised in equity by an investor in respect of its share of the investee's other net asset changes would form part of such a disclosure.

Effective date and transition

BC12 The IASB decided that the amendments should apply retrospectively (which is the general approach to transition set out in IAS 8) and that no additional amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards* should be required. This is because, as set out in C5 of IFRS 1, the exemption for business combinations already applies to investments in associates and joint ventures at the date of transition.

Alternative view of Takatsugu Ochi

AV1 Mr Ochi voted against the publication of the Exposure Draft *Equity Method: Share of Other Net Asset Changes* because he believes that the amendment is inconsistent with concepts of other IFRSs, and would cause serious conceptual confusion. Mr Ochi recognises that the proposal is intended to be an expeditious short-term solution to address current diversity in practice. However, he believes that such a short-term solution would not improve financial reporting but would instead undermine a basic concept of consolidated financial statements.

AV2 If a short-term solution is really necessary, Mr Ochi prefers an investor to recognise its share of other net asset changes in the investor's profit or loss rather than in equity. This is because recognising this amount in profit or loss is more consistent with other IFRSs and would not taint the amounts included in equity. Paragraphs AV3–AV11 set out Mr Ochi's alternative views.

Inconsistency with the concept of IAS 1

AV3 Paragraph IN2 of IAS 1 *Presentation of Financial Statements* states that the main objective of revising IAS 1 was to separate changes in equity (net assets) of an entity during a period arising from transactions with owners in their capacity as owners from other changes in equity. Consequently, IAS 1 requires an entity to present all owner changes in equity within a statement of changes in equity. All non-owner changes in equity are required to be presented in the statement of comprehensive income.

AV4 Although the purpose of this Exposure Draft is to follow up on matters arising from the 2007 revision of IAS 1, the proposal would mix transactions with owners together with transactions with non-owners (as pointed out in paragraph BC8). In Mr Ochi's view, this is contrary to the objective of the revision of IAS 1 made in 2007.

Inconsistency with the concept of IFRS 10

AV5 Mr Ochi also believes that the proposal made in this Exposure Draft would be inconsistent with paragraph 25 of IFRS 10 *Consolidated Financial Statements*. Paragraph 25 of IFRS 10 requires that if a parent loses control of a subsidiary, the parent recognises the gain or loss associated with the loss of control attributable to the former controlling interest. This requirement applies even in cases where the investor retains an interest in the investee, such as when the investment becomes an associate.

AV6 For example, if the investor's share of a completely owned subsidiary is reduced to 30 per cent as a consequence of other net asset changes of that subsidiary, the investor shall recognise, in profit or loss, the gain or loss associated with the whole transaction—that is, the effect of the loss of control attributable to the former controlling interest and the reduction in ownership interest to 30 per cent. However, if the transaction was made in two steps, the first step being loss of control only and the second step being the reduction in ownership to 30 per cent, the accounting treatment for each step would be different under this proposal. The gain or loss arising on the loss of control in the first step would be recognised in profit or loss in accordance with the guidance in IFRS 10, but the gain or loss arising from the reduction in ownership interest to 30 per cent as a result of the second step would be required to be recognised in equity by this proposed amendment. This example indicates that the proposal is inconsistent with IFRS 10.

Change in the nature of equity

AV7 Mr Ochi is particularly concerned that the proposal would change the nature of equity. According to the proposal, an associate's equity transaction would be recognised in the investor's equity. Theoretically, equity transactions made by an associate's associate, or even any further remote transactions, would be recognised in the consolidated financial statements, as if they were the investor's own equity transactions.

AV8 Mr Ochi also has a concern about the proposed amendments to paragraphs 22, 23, and 25. He thinks that the proposal to require the cumulative amount of equity to be 'recycled' to profit or loss when the equity method is discontinued will result in treating equity like other comprehensive income (OCI), which may introduce additional complexity. He believes that the proposal risks causing confusion about the distinction between OCI and equity. He thinks that, if the proposal is to use equity as a temporary 'home' for such other net asset changes, that 'home' should be OCI rather than equity. Nevertheless, he disagrees with such a notion in the first place.

Equity accounting versus one-line consolidation

AV9 Mr Ochi disagrees with the view presented in paragraph BC6 that the equity method of accounting can be viewed as a one-line consolidation. He believes that, under the equity method of accounting, the investment is only adjusted for the post-acquisition changes in the investor's share of the investee's net assets. In his view, the equity method of accounting does not represent a one-line consolidation at the time of acquisition or disposal of the investment. The example shown in paragraph 10(d) relates to a decrease in the investor's share over the investee's net assets. He believes that these types of transaction are more like the acquisition or disposal of the investment, rather than being subsequent changes in the investment after the acquisition. Consequently, the investee's net asset changes caused by its own capital transactions should not be elevated to the investor's consolidated financial statements as a one-line consolidation.

AV10 Mr Ochi disagrees with the reason given in paragraph BC5 against the investee's other net asset changes being recognised in the investor's profit or loss. He does not think that recognising a nil impact for a share-based payment transaction is an anomalous result. Instead, he believes that the nil impact is a better depiction of the transaction, because from the investor's perspective a share-based payment transaction has no economic impact on the value of the investment.

AV11 Mr Ochi disagrees with the reason given in paragraph BC4. He does not think that recognising an associate's equity transactions in profit or loss misleads outside investors. For example, if an associate made a successful capital increase, the value of the investment would increase and vice versa. Reflecting such an increase or decrease in value in the investor's profit or loss would provide better information than recognising it in equity.

