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Equity Method of Accounting
Issues Paper

Objective

1 The objective of this paper is to facilitate the discussion on three alternatives on applying the equity method to the purchase of an additional interest in an associate without a change in significant influence, presented by the IFRS Staff at the April 2022 IASB meeting.

Approaches to accounting for acquisition of additional interest in an associate, under the equity method

2 In April 2022, the IASB discussed the research findings on changes made to IFRS Standards arising from the *Conceptual Framework*, and Business Combinations and Joint Arrangements projects. For reference, the detailed finding are available in the April 2022 IASB meeting agenda paper here.

3 At this meeting, the IASB discussed three approaches to applying the equity method when an investor purchases an additional ownership interest in an associate without a change in significant influence.

4 The approaches consider measurement of the cost of the investment both at the date the investor obtains significant influence, and when the investor purchases an additional interest in the investee without a change in significant influence.

5 Based on the research analysis of the approaches taken in other IFRS Standards, the IASB Staff has identified three approaches for acquisition of an additional interest in an associate without a change in significant influence:

(a) Approach A - continue to measure the investment as a single asset; the approach would remeasure both the investor's share of the associate's net assets at fair value and measure the aggregate cost of the investment at fair value at the date of acquiring the additional interest.

(b) Approach B - measure the interest as an accumulation of purchases. The investor would recognise its additional share of the associate's net assets with the cost (being the fair value of the consideration transferred) for the additional interest.

(c) Approach C - continue to measure the interest as a single asset but based on the investor's share of the associate's net assets at their carrying amounts for the investment, with the cost (being the fair value of the consideration transferred) for the additional interest.

6 The three approaches have the following features, as explained by the IASB Staff:

	Approach A	Approach B	Approach C
Investment cost	Measured as a single asset at fair value at the date of acquiring the additional interest. Previously held interests are remeasured to fair value and the difference with the carrying amount is recognised in comprehensive income	Measured as the aggregate of (a) cost (defined as fair value at the date the investor obtained significant influence); and (b) the fair value of the consideration paid for the additional share.	As in B
Investor's share of the associate's net assets	Measured as a single asset based on the fair value of the associate's net assets at the date of acquiring the additional interest.	Measured based on the aggregate of the fair value of the associate's net assets at the date the investor obtained significant influence, plus post-acquisition changes (carrying amounts for the investment); and for the additional share, based on the fair value of the associate's net assets at the date of acquiring the additional interest	Measured as a single asset based on the associate's net assets at their carrying amounts for the investment.
Difference between the consideration paid and the value attributed to the investor's share of the associate's net assets.	Goodwill or bargain purchase gain.	Goodwill or bargain purchase gain.	Positive difference as goodwill for an amount proportionate to the goodwill recognised when significant influence was obtained, with any residual recognised as an expense. Negative difference as a bargain purchase gain.

7 A numerical example which considers a simple piecemeal acquisition and illustrates the approaches is provided **in Appendix 1** to this paper.

8 In Appendix 2, the EFRAG Secretariat provided another numerical example to facilitate the discussion on accounting for an acquisition of additional interest in associate, without a change in significant influence of the associate.

Tentative IASB decisions

April 2022

9 Following the discussion in April 2022, the IASB tentatively decided to consult with stakeholders, through a discussion paper or exposure draft, 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.

10 The IASB also requested their staff to proceed with an approach whereby an investor that has obtained significant influence would measure the investment in the associate as an accumulation of purchases, and to consider Approach B as preferred approach. The IASB will also consider the implications of Approach A – called the alternative approach.

June 2022

11 At its June 2022 meeting, the IASB discussed how the preferred approach applies to other transactions and events that change the investor's ownership interest in an associate, including:

(a) an investor purchasing an additional interest that is a bargain, and making a partial disposal of the associate, while retaining significant influence; and

(b) changes arising from equity transactions of the associate.

12 Regarding the preferred approach, for the transactions that retain significant influence, it is proposed that:

(a) The investment would be carried in layer representing the initial layer (on obtaining significant influence) and any further not-linked acquisitions.

(b) On further bargain acquisitions, the investor would recognise the bargain purchase gain separately in profit or loss.
These situations differ from the approach to business combinations, because any goodwill or bargain profit is only recognised on obtaining the control over subsidiary.

(c) A partial disposal would require derecognising a part of the carrying amount of the investment using:

(i) A specific identification method; or

(ii) LIFO method.

A difference between derecognised carrying amount and fair value of the consideration received would be recognised in profit or loss.

13 Following the discussion the IASB tentatively decided that, on bargain acquisitions, the investor would recognise the bargain purchase gain separately in profit or loss.

14 However, the IASB has not reached a conclusion on the partial recognition approach, and asked their staff to provide further analysis.

The issues for the discussion

15 The application IASB preferred approach – Approach B

(a) It should be noted that Approach B seems easier to apply at acquisition of additional layers of investments. This is because the previous holdings would not to be remeasured.

(b) However, the application of Approach B results in the carrying amount of the investment being a mixed measure based on different fair value bases. Consequently, the share of total comprehensive income of the investee is adjusted for different fair value bases of investee's assets and liabilities. This results in:

(i) The carrying amount of the investment and the recognised share in TCI being complex to calculate and hard to explain;

(ii) The complexity of the calculations increasing with the further acquisitions and disposals.

(c) Furthermore, on derecognition, the suggested approach that requires specific identification or LIFO approaches does not seem to have benefits compared to weighted average, FIFO, or any other method. Instead:

(i) Unless the holding comprises clearly identifiable instruments, neither LIFO nor specific identification seem to provide more faithful representation what include the recognise profit/loss on sales, carrying amount, recycling of OCI etc.

(d) Approach B, does not clarify how to account for OCI elements, on derecognition when LIFO or specific identification is considered. Consequently, the OCI may become even harder to reconcile and explain.

16 The implications of the IASB's alternative Approach A

(a) Compared to Approach B, this approach would require remeasuring of the holding on additional acquisitions, disposals. In this respect, this approach seems to require more resources to perform.

(b) The goodwill recognised would be also remeasured at each particular acquisition following obtaining the significant influence. This would result in bargain acquisitions resulting in reducing recognised investee's goodwill. However, the situations when bargain purchases occur (as explained by IFRS 3 *Business Combinations* guidance) include a forced liquidation or distress sale (barring errors in measuring fair values of the net assets acquired). Since a forced liquidation or distress sale is not an orderly transaction, an investor applying the alternative approach to a bargain purchase may encounter complexity in determining the fair value of previously interests.

(c) The carrying amount and the adjusted profit would be much easier to explain and reconcile, because the investment carried in investor's accounts, would represent a single asset comprising the fair value of holding at recent acquisition, adjusted for any share in corrected TCI of the investee.

(d) The partial disposals would bring less complexity, compared to Approach B, as only one approach is applicable.

(e) Nevertheless, the IASB Staff proposes to consider that the retained interest should also be remeasured to fair value following the partial disposal. That brings another issue on how to account for any OCI elements recognised previously. Should it remain in OCI intact, be recycled, transferred etc.

(f) Finally it's not clear whether the carrying amount of the investment should be understood as having started from zero following each non-related acquisition or partial disposal, and to present the movements in TCI.

(g) It should finally be noted, that the approach that requires remeasurement of the holding, as explained above, would need to be considered in the context of paragraph 24 of IAS 28, which requires that an investor does not remeasure its interest when it loses joint control while acquiring significant influence or loses significant influence while acquiring joint control.

Questions for EFRAG FR TEG members

17 Do you have comments on the three approaches discussed by the IASB on accounting for a purchase of additional interest in an associate without a change in significant influence?

18 Do you have comments on the tentative IASB decision to consult constituents on proposed investor's accounting on obtaining significant influence over the investee and on separate recognition of bargain purchase under preferred approach?

19 Do you have comments on proposed accounting for other transactions, subsequent to obtaining significant influence? Would you propose any alternative approach?

Appendix 1: Illustrative Example A

1 In this example, we following data is considered (it follows the example presented at the April 2022 IASB meeting):

(a) On 1/1/20X1, Investor acquires a 5% share in Investee for a consideration of 200CU. This investment does not provide significant influence. It is accounted for under IFRS 9 *Financial Instruments* and measured at fair value. At 31/12/20X1 the fair value of the interest is 275CU.

(b) On 1/1/20X2, Investor acquires an additional share of 15% in Investee for an amount of 825CU. The entire share gives Investor significant influence over Investee. At that date, the fair value of the net assets of the investee is 4,400CU.

(c) The profit or loss of the investee for the year ending on 31/12/20X2 is 700CU, including the effects of the adjustments based on the fair values of the investee's net assets at the date significant influence is obtained.

(d) Finally, Investor acquires an additional share of 10% in Investee B at 1/1/20X3 for an amount of 700CU without a change in significant influence. At that date, the fair value of the net assets of the investee is 5,400CU.

2 The values may be summarised as follows:

	Acquisition cost	Accumulated share (%)	FV of acquired shares	FV of net assets	Investee's profit
1/01/x1	200	5%	200	NA	--
31/12/x1	--	5%	275	NA	NA
1/01/x2	825	20%	**1100**	**4400**	--
31/12/x2	--	20%	1400		700
1/01/x3	700	30%	**2100**	**1620**	--

<u>Approach A</u>

3 Investor would apply Approach A as follows:

31/12/20x2

4 The reported values for the financial year ended on 31/12/20x2 would therefore show:

Carrying amount of the investment:

Carrying amount of financial instrument	1100
Share of profit	<u>140</u>
	<u>1240</u>

The carrying amount compromises:

Share of net assets:	1020
Goodwill	<u>220</u>
	<u>1240</u>

1/01/20x3

5 The third acquisition at 1/01/20x3, would be accounted for as follows:

Carrying amount of the investment:

Opening balance	1240
Remeasurement of previous holding	**160**
Carrying amount of additional investment	700
	2100

This would comprise:

Share of net assets:	1620
Goodwill (220 + 480)	480
	2100

6 Under Approach A, the carrying amount of the investment should be understood as a sum of Investor's share of fair value of Investee's net assets measured at the date of last acquisition, and any changes to Investee's equity (profit or loss, OCI) from that date. For the interpretation in more complex circumstances, see paragraph 4 and 5 of Appendix 2.

7 Moreover, any share of Investee's comprehensive income, recognised in Investor's statements, should be understood as share of Investee's profits during the period, corrected for fair value adjustments, supplemented with any fair value adjustments recognised on existing holdings during the period.

Approach B

8 Investor would apply Approach B as follows:

31/12/20x2

9 As in Approach A.

1/01/20x3

10 The third acquisition at 1/01/20x3, would be accounted for as follows:

Carrying amount of the investment:

Opening balance	1240
Carrying amount of additional investment	700
	1940

This would comprise:

Share of net assets (1020+10% x 5400)	1560
Goodwill (220 + [700-10% x 5400])	380
	1940

11 Under Approach B, there is no remeasurement of the previous holding, so the share in assets constitute mixed asset measurement based on net assets' value at the initial recognition, and net assets' value at acquisition date of additional share.

12 At year end, the carrying amount of the investment should therefore be understood as a mixed measure of share in Investee's net assets, where each particular share acquisition provides its own fair value basis. The carrying amount is further supplemented by share in changes in Investee's equity (profit or loss, OCI) corrected for the mixed basis of fair value adjustments of net assets, as explained above. The complexity increases significantly with any sales or disposals of the shareholding in

Investee. For instance, entities may apply different approaches to identifying the measurement basis of the net assets, which the disposal or sale applies to. The possible approaches include FIFO or LIFO selection of the share acquisitions. A more complex example presenting this complexity is provided in Appendix 2 of this paper, where the disposal value bases on weighted average.

13 Moreover, any share of Investee's comprehensive income, recognised in Investor's statements, should be understood as a mix measure of shares in Investee's profits, for each particular share acquisitions, corrected for fair value adjustments performed for each particular share acquisition. Shareholdings are not remeasured under this approach; therefore, no fair value adjustments are recognised on share acquisitions.

<u>Approach C</u>

14 Investor would apply Approach B as follows:

31/12/20x2

15 As in Approach A.

1/01/20x3

16 The third acquisition at 1/01/20x3, would be accounted for as follows:

Carrying amount of the investment:

Opening balance	1240
Carrying amount of additional investment	620
	1860

This would comprise:

Share of net assets (1020+10% x [4400+700])	1530
Goodwill (220 + 110)	330
	1860

17 Under Approach C, there is no remeasurement of the previous holding.

18 Regarding the goodwill recognised, any positive difference should be recognised as additional amount of goodwill in a proportion to the goodwill recognised when significant influence was obtained. Any residual (excess) is recognised as an expense.

19 Consequently, the acquisition at 1/01/20x2 would be recognised as 620CU – increase in carrying amount of the investment, and the residual (700CU-620CU) = **80CU** in profit or loss (as an expense).

Appendix 2: Illustrative Example B

1 This example considers two scenarios to illustrate Investor's accounting for the investment in Investee under Approaches A and B. Additionally, the example illustrates the application of an approach (Approach A/FV) where on disposal or sales of an interest in associate, Investor remeasures the investment to fair value.

2 The following economic events and financial data are considered for **Scenario A**:

(a) On 1/1/20X1, Investor acquired a 30% share in Investee for a consideration of 3000CU. This investment gave Investor significant influence over Investee. Fair value of Investee's net assets was 8000CU at that date.

(b) Annual 20x1 profit of Investee was 1010CU. This value is corrected to 1000CU for any fair value adjustments. In 20x1, the fair value adjustments are the same for both Approach A and B.

(c) On 31/12/20x1, Investor acquired an additional 15% share of Investee's shareholding for 1800CU. The fair value of Investee's net assets was 9200CU at that date.

(d) Annual 20x2 total comprehensive income of Investee was 1000CU. Under Approach A, this was corrected to 970CU for the fair value adjustments and, under Approach B. to 990CU where, in both cases, OCI was measured at 200.. The difference in two approaches results from different fair value bases used to measure net assets of Investee.

(e) On 31/12/20x2, Investor sold a 5% share of Investee's shareholding for 750CU. Fair value of Investee's net assets is 10200CU at that date.

3 Alternatively in **Scenario B**, the following is considered.:

(a) On 1/1/20X1, Investor acquired a 30% share in Investee for a consideration of 3000CU. This investment gave Investor significant influence over Investee. Fair value of Investee's net assets was 8000CU at that date.

(b) Annual 20x1 profit of Investee was 1010CU. This value is corrected to 1000CU for any fair value adjustments. In 20x1, the fair value adjustments are the same for both Approach A and B.

(c) On 31/12/20x1, Investor acquired an additional 5% share of Investee's shareholding for 600CU. The fair value of Investee's net assets was 9200CU at that date.

(d) Annual 20x2 total comprehensive income of Investee was 1000CU. Under Approach A, this was corrected to 970CU for the fair value adjustments and, under Approach B, to 990CU where, in both cases, OCI was measured at 200. The difference in two approaches results from different fair value bases used to measure net assets of Investee.

(e) On 31/12/20x2, Investor acquired an additional 5% share of Investee's shareholding for 750CU. Fair value of Investee's net assets is 10200CU at that date.

	Carrying amount							Notes:
	Scenario A				Scenario B			
Approach	**A**	**A/FV**	**B**		**A**	**B**		
1/1/x1 - 1st acquisition	3000.0	3000.0	3000.0	30%	3000.0	3000.0	30%	Goodwill of 3000-2400 = 600
TCI for 20x1	300.0	300.0	300.0		300.0	300.0		
	3300.0	3300.0	3300.0		3300.0	3300.0		
31/12/x1 - 2nd acquisition	1800.0	1800.0	1800.0	15%	600.0	600.0	5%	
Fair value adjustment *)	300.0	300.0			300.0			Approach A & A/FV only: remeasurement of previous holding to FV (30%x12000CU), recognised in p&l
31/12/x1 Year end figures	5400.0	5400.0	5100.0	45%	4200.0	3900.0	35%	
TCI for 20x2	436.5	436.5	445.5		339.5	346.5		
	5836.5	5836.5	5545.5		4539.5	4246.5		
31/12/x2 - disposal	-648.5	-648.5	-616.2	-5%				Disposed 5% of the carrying amount
	5188.0	5188.0	4929.3					
Remeasurement		812.0						Approach A/FV only - remeasurement of the remaining holding to FV (40%*15000CU) in p&l
31/12/x2 - 3rd acquisition					750.0	750.0	5%	
Fair value adjustment					710.5			Approach A only: remeasurement of previous holding to FV (35%x15000CU), recognised in p&l
31/12/x2 Year end figures	5188.0	6000.0	4929.3	40%	6000.0	4996.5	40%	
sale proceeds	750	750	750					
carrying amount sold	-648.5	-648.5	-616.17					
Profit on sale	**101.5**	**101.5**	**133.83**					

Additional notes

Remeasurement

4 While accounting for the acquisitions of additional shares, under Approach A, is clear and, on additional acquisition, requires remeasurement of any previous holdings to fair value, the disposal does not require remeasuring. Consequently, under Approach A, the ultimate result of two scenarios is not comparable despite of such expectations.

5 This aspect has been considered in Approach A/FV where the remaining holding is remeasured to FV following the disposal.

Understanding measurement in statement of financial position

6 Under Approach A, the carrying amount represents the fair value of the holding at the date of recent acquisition, adjusted for any subsequent profits/losses/impairments. Approach A/FV introduces obligatory remeasurement on disposal, so the carrying amount would represent the fair value of the holding at the date of recent acquisition or disposal, adjusted for any subsequent profits/losses/impairments.

7 Under Approach B, the scenarios result in mixed asset measurement based on different fair values. The measurement becomes increasingly complex with each further acquisition or disposal transaction.

8 Moreover, under Approach B, the complexity increases significantly with any sales or disposals of the shareholding in Investee. This is because Investor may apply different approaches to identifying the measurement basis of the dispose share in net assets i.e. based on FIFO or LIFO selection of the share acquisitions, or weighted average.

Understanding total comprehensive income (TCI)

9 Under all approaches, the profit or loss and other comprehensive income are corrected to reflect net assets' fair value adjustments, at recent acquisition. It should be noted that, under approach B, the fair value adjustments base on mixed fair value measurements, what makes the calculations complex and less clear.

10 The share of TCI is recognised in equity of Investor and presented in statement of total comprehensive income, appropriately split into profit or loss, and other comprehensive income (OCI).

11 However, it's not clear how to proceed with the TCI recognised in equity, on remeasurement of previous holding or remaining holding. This is particularly important when the recognised OCI is considered on disposal, where the OCI could be transferred, recycled, or kept intact in equity.