

IFRS in Focus

Proposals for limited amendments to the equity method

Contents

Introduction

The proposals

Effective date and comment period

The Bottom Line

- An investor would recognise directly in equity its share of the changes in the net assets of an investee that are neither recognised in profit or loss or other comprehensive income of the investee nor distributions received from the investee.
- An investor would reclassify to profit or loss the cumulative amount of equity that it had previously recognised when it loses significant influence over or gains control of the investee and hence discontinues the use of the equity method.
- Comments on the proposals are due by 22 March 2013.

Introduction

In November 2012, the International Accounting Standards Board (IASB or the Board) published exposure draft ED/2012/3 *Equity Method: Share of Other Net Asset Changes* (Proposed amendments to IAS 28) ('the ED') that specifies the accounting for an investor's share of changes in an investee's net assets that are not recognised in the investee's profit or loss or other comprehensive income and are not distributions received ('other net asset changes').

The proposals

The ED proposes amendments to IAS 28 *Investments in Associates and Joint Ventures* (revised 2011) to specify the application of the equity method for other net asset changes. In doing so, paragraph 10 of IAS 28 (revised 2011) has been significantly restructured to provide a step-by-step guide on application of the equity method. An investor would apply the equity method by initially measuring its investment in an associate or a joint venture at cost. The subsequent accounting for changes in its share of the investee's net assets would then vary in accordance with the nature of the change.

For more information please see the following websites:

www.iasplus.com

www.deloitte.com

Equity method for other net asset changes

The ED proposes that other net asset changes should be recognised in the investor's equity. Examples of other net asset changes in respect to investments in associates and joint ventures include:

- issues of additional share capital to parties other than the investor;
- buy-backs of equity instruments from shareholders other than the investor;
- writing of a put option over the investee's own equity instruments to other shareholders;
- purchase or sale of non-controlling interests in the investee's subsidiaries; and
- equity-settled share-based payments.

Example

The ED proposes an example illustrating the accounting for other net asset changes.

An investor has a 30 per cent investment in an investee with net assets of CU1,000 and has significant influence over that investee. The investee issues additional shares to a third party for CU500 of cash. As a result, the investor's share decreases from 30 per cent to 25 per cent but the investor maintains significant influence over the investee.

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 in its investment and a CU75 increase in its shareholder's equity.

Observation

The issue of accounting for other net asset changes was initially considered by the IFRS Interpretations Committee ('the Committee'), who recommended that the IASB make limited scope amendments to IAS 28 (revised 2011) to address the accounting for increases (recognise as an incremental purchase at cost) and reductions (recognise in profit or loss) in an investor's ownership interest in an investment, with a corresponding adjustment to equity.

However, the IASB disagreed with the recommendations of the Committee given that it did not address all types of other net asset changes that might occur in practice (e.g., equity-settled share-based payments) and did not provide symmetry between a reduction and an increase in the investor's ownership interest in an investment.

The IASB preferred the approach described in this ED in that it addressed all types of other net asset changes and was consistent with the accounting treatment in IAS 28 *Investments in Associates* prior to a consequential amendment made as part of the 2007 revision to IAS 1 *Presentation of Financial Statements*. The Board acknowledged conceptual concerns with its proposals (i.e., that an investee is not part of the consolidated group as defined in IFRS 10 *Consolidated Financial Statements*, and thus, the investee's other net asset changes should be excluded from 'owner's transactions' that are presented within equity under IAS 1). However, the Board believed its proposed solution to be the most reasonable and expeditious approach to address diversity in practice until such time that it gives broader consideration to the equity method.

Discontinuing the use of the equity method

The ED notes that an investor may discontinue the use of the equity method for various reasons including where the investment in the investee becomes a subsidiary (investor gains control) or a financial asset (investor loses significant influence). The ED proposes that an investor should reclassify to profit or loss the cumulative amount of other net asset changes previously recognised in the investor's equity when an investor discontinues the use of the equity method for any reason.

Other changes in ownership interest

The ED proposes that reclassification to profit or loss only occurs when the investor discontinues the use of the equity method. If the investor's ownership interest in an investee is reduced, but the investor continues to apply the equity method, there is no reclassification of the cumulative amount of other net asset changes previously recognised in the investor's equity.

Proposed amendments to terminology

The ED also proposes changes to the terminology within IAS 28 (revised 2011) – changing 'entity' to 'investor' for consistency with the terminology in IFRS 11 *Joint Arrangements*.

Effective date and comment period

The ED does not specify an effective date. The Board will determine the effective date after considering the comments they receive on the ED.

Entities would be required to apply the proposals retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Comments on the ED are due by 22 March 2013.

Observation

The IASB tentatively decided not to amend the currently mandatorily effective IAS 28 given that this standard would be superseded by IAS 28 (revised 2011) before any proposed amendments became effective.

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