IASB PUBLISHES EXPOSURE DRAFT *EQUITY METHOD OF ACCOUNTING IAS 28* INVESTMENTS IN ASSOCIATES AND JOINT VENTURES *(REVISED 202X)*

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BACKGROUND

The International Accounting Standards Board (IASB) published Exposure Draft *Equity Method of Accounting IAS 28* Investments in Associates and Joint Ventures *(revised 202x)* (the Exposure Draft) on 19 September 2024.

IFRS® Accounting Standards require entities to use the equity method in their consolidated financial statements to account for investments in associates and joint ventures (unless exempt from doing so). Entities are permitted to use the equity method in separate financial statements for investments in subsidiaries, joint ventures and associates. IAS 28 *Investments in Associates and Joint Ventures* sets out how to apply the equity method.

STATUS

Exposure draft

ACCOUNTING IMPACT

The Exposure Draft proposes a revision to IAS 28, which might significantly affect entities that apply the equity method.

Entities with loss-making associates or joint ventures and entities with transactions with associates or joint ventures might be particularly affected due to the clarifications and measurement changes proposed by the Exposure Draft.

The IASB added a research project on the equity method to its work programme following its 2011 Agenda Consultation. The work on the research project commenced in June 2015. Subsequently, after further deliberations, the IASB decided not to undertake a fundamental review of the equity method. The IASB decided instead to focus on developing answers to certain application questions. The application questions related mainly to the following areas:

- Changes in an investor's ownership interest on obtaining significant influence
- Changes in an investor's ownership interest while retaining significant influence
- Recognition of share of losses by the investor of joint venturer
- Transactions with associates and joint ventures
- Deferred taxes
- Contingent consideration
- Impairment of the investment.

The Exposure Draft focusses on answering the selected application questions. The IASB has also regrouped the requirements of IAS 28 by topic, such as recognition and initial measurement, subsequent measurement, etc. The Exposure Draft includes a table of concordance between the currently effective IAS 28 and the draft IAS 28 (revised 202x).

The IASB has also released a 'Snapshot' that briefly explains the proposed requirements. The Exposure Draft, the Basis for Conclusions on the Exposure Draft and the Snapshot may be accessed on the Equity Method project page on the IFRS Foundation website. Comments on the Exposure Draft are due by 20 January 2025.

Following is a summary of the main proposals in the Exposure Draft, which are explained in detail in separate sections later in this publication:

INITIAL MEASUREMENT
▶ Introduction of the definition of the cost of the associate or joint venture, which includes fair value of any previously held interest.
▶ Clarification on accounting for contingent consideration and deferred tax effects.

CHANGES IN OWNERSHIP INTEREST WHILE RETAINING SIGNIFICANT INFLUENCE
▶ Purchase of additional ownership interest measured at fair value of consideration transferred.
▶ Partially disposed portion to be measured as a percentage of the carrying amount of the investment.
▶ Other increases or decreases in ownership interest to be accounted as purchase or disposal of ownership interest.

INVESTOR'S SHARE OF LOSSES
▶ No catch-up of unrecognised losses on purchase of an additional ownership interest.
▶ Losses (profit or loss and OCI) exceeding net investment: first the share of profit or losses to be recognised and then the share of OCI.
▶ Losses subsequent to the reduction of net investment to nil: Separate recognition of the share of profit or loss and OCI with a nil net investment.

TRANSACTIONS WITH AN ASSOCIATE / JOINT VENTURE	
▶ Recognition in full of the gains and losses resulting from all 'upstream' and 'downstream' transactions (including sale of subsidiary) with its associates or joint venture.	! **Important** This is a change in measurement requirements.

OTHER PROPOSALS
▶ Impairment - Clarifications on certain requirements.
▶ Additional disclosure requirements.

ENTITIES AFFECTED BY THE PROPOSED REQUIREMENTS

The proposals are expected to significantly affect entities that apply the equity method.

Entities that have upstream or downstream transactions with associates or joint ventures would be particularly affected due to the proposed requirement to recognise full gains and losses from all upstream and downstream transactions.

Currently there is lack of clarity on certain aspects related to recognition of investor's or joint venturer's share of losses, which the Exposure Draft proposes to address. As a result, entities with loss making associates or joint ventures might need to change the recognition of their share of losses depending on the accounting policy followed by them currently.

PROPOSALS RELATED TO INITIAL MEASUREMENT ON OBTAINING SIGNIFICANT INFLUENCE

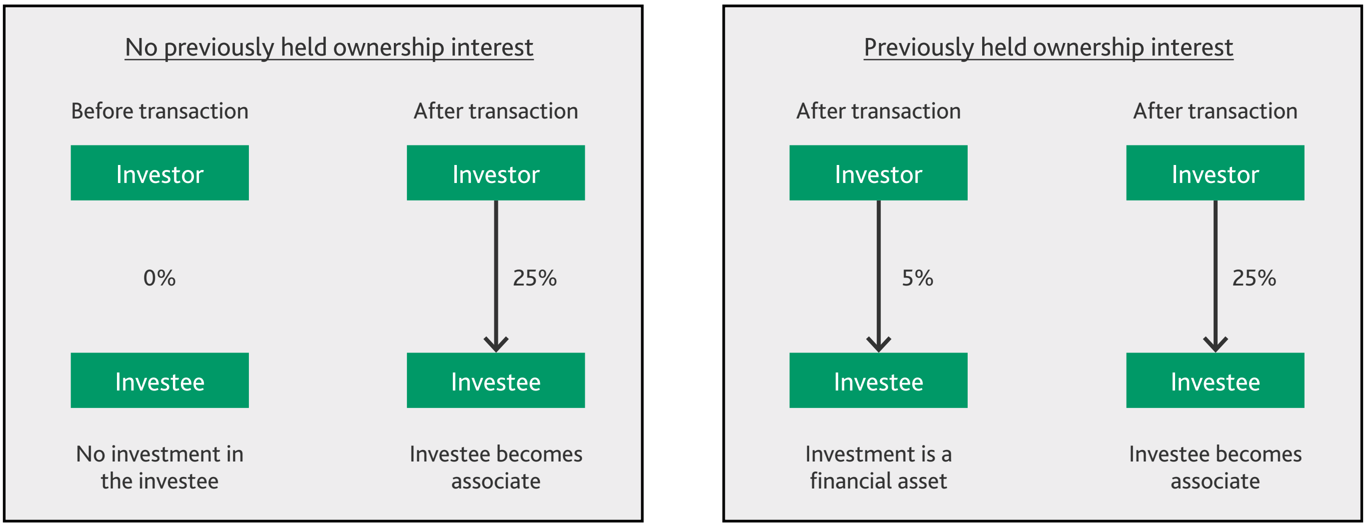
What is the issue?

IAS 28.10 requires an investment in an associate or a joint venture to be recognised at cost on initial recognition. However, IAS 28 does not currently specify how to measure the cost of the investment when obtaining significant influence. As a result, the following application questions arose, leading to diversity in practice:

- how an investor initially measures the carrying amount of an investment in an associate;
- if an investor with a previously held interest in an entity acquires an additional interest and obtains significant influence, whether the initial measurement of the investment in an associate includes the original purchase cost of the previously held interest or the carrying amount of that interest applying IFRS 9 *Financial Instruments*; and
- whether an investor or joint venturer includes in the consideration transferred any contingent consideration, and if so, how the contingent consideration is measured.

What do the proposals require?

The proposals explained below relate to situations where an investor obtains significant influence. The investor may or may not have previously held ownership interest in the investee, as shown in the diagram below:



Definition of the cost of the associate or joint venture

The Exposure Draft proposes to define the cost of the associate or joint venture as below:

Fair value of the consideration transferred, including the fair value of any previously held ownership interest (or any investment retained) in the associate or joint venture, measured at the date an investor obtains significant influence or a joint venturer obtains joint control.

Contingent consideration

The Exposure Draft also proposes the following with respect to contingent consideration:

- Recognition of contingent consideration as part of the consideration transferred, to be measured at fair value.
- Classification of contingent consideration as a financial liability or equity in accordance with the requirements of IAS 32 *Financial Instruments: Presentation*.
- Classification of a right to the return of previously transferred consideration as an asset.
- Subsequent measurement of contingent consideration classified as a liability at fair value at each reporting date, with changes in fair value recognised in profit or loss.

BDO Comment

It should be notes that the proposed requirement to measure the contingent consideration at fair value at each reporting date, with changes in fair value recognised in profit or loss applies to contingent consideration classified as liabilities, and not just financial liabilities. For example, if contingent consideration includes transfer of inventory or property, plant and equipment, such consideration would be classified as liabilities and not financial liabilities. Such consideration is proposed to be remeasured at fair value at each reporting date, with changes in fair value recognised in profit or loss.

- No subsequent remeasurement of contingent consideration classified as equity, with subsequent settlement recognised in equity.

The above proposals related to contingent consideration also apply when an investor purchases an additional ownership interest while retaining significant influence.

Deferred tax effects

The proposals also require inclusion in the carrying amount of the associate or joint venture the deferred tax effects related to the investor's share of the fair value of the associate's or joint venture's identifiable assets and liabilities. These deferred tax effects arise due to the difference between the tax bases and the fair value of the net assets of the associate or joint venture on the date the ownership interest giving significant influence is acquired. The deferred tax effects would be subsequently reversed, as and when the related fair value adjustments reverse, as part of the adjustments made to the investor's share of the associate's profit or loss after the date of obtaining significant influence. For example, adjustments are made to the investor's or joint venturer's share of the associate's or joint venture's profit or loss to account for depreciation of the associate's depreciable assets based on their fair values at the date of obtaining significant influence.

Presentation of bargain purchase gain

IAS 28.32(b) currently provides a presentation requirement to include a bargain purchase gain in the determination of the investor's share of the associate's profit or loss in the period in which the investment is acquired. This requirement is removed in the Exposure Draft since IFRS 18 *Presentation and Disclosure in Financial Statements* now specifies the requirements related to presenting income and expenses in an investor's statement of profit or loss (Basis for Conclusions on the Exposure Draft - BC19).

PROPOSALS RELATED TO CHANGES IN OWNERSHIP INTEREST WHILE RETAINING SIGNIFICANT INFLUENCE

What is the issue?

After initial recognition of an investment in an associate, the investor's ownership interest in the associate might change in the following ways, while the investor retains significant influence:

- Purchase of an additional ownership interest:

  For example, Entity A holds 25% interest in Entity B, which gives Entity A significant influence over Entity B. Entity A purchases an additional 10% interest, which results in Entity A continuing to have significant influence over Entity B, rather than obtaining control of Entity B.

- Disposal of an ownership interest:

  For example, Entity A holds 30% interest in Entity B, which gives Entity A significant influence over Entity B. Entity A sells 5% interest in Entity B, retaining 25% interest. Thus, Entity A continues to have significant influence over Entity B.

- Other reasons such as redemption or issue of equity investments by the associate or joint venture:

  For example, Entity A holds 30% interest in Entity B, which gives Entity A significant influence over Entity B. Entity B issues additional equity shares to Entity C, which results in dilution of the holding of Entity A to 25%. Entity A continues to have significant influence over Entity B after the dilution.

IAS 28 does not currently specify how to apply the equity method in the above circumstances, resulting in diversity in practice.

What do the proposals require?

Purchase of an additional ownership interest

The proposals require an investor or joint venturer purchasing an additional ownership interest while retaining significant influence or joint control:

a. to recognise that additional ownership interest and measure it at the fair value of the consideration transferred;

b. to include in the carrying amount of that additional ownership interest the investor's share of the fair value of the associate's identifiable assets and liabilities; and

c. to account for any difference between (a) and (b) either as goodwill included as part of the carrying amount of the investment or as a gain from a bargain purchase in profit or loss.

The proposed requirements related to contingent consideration and any related deferred tax would also apply to the purchase of an additional ownership interest.

BDO comment – Additional ownership interest while retaining significant influence measured as accumulation of purchases

It should be noted that in case of purchase of an additional ownership interest, while retaining significant influence or joint control; the previously held interest is not proposed to be remeasured at fair value.

However, when a purchase of an additional ownership interest results in the investor obtaining significant influence or joint control for the first time, the previously held interest is remeasured at fair value.

For example, Entity A holds 10% equity interest in Entity B and accounts for the interest as a financial asset measured at fair value through profit or loss in accordance with IFRS 9. On 1 June 20X1, Entity A purchases an additional ownership interest of 15%, giving it a total interest of 25% and a significant influence over Entity B. On 1 January 20X2, Entity A purchases an additional 5% interest in Entity B, giving it a total interest of 30%, whereby it continues to have significant influence over Entity B. Under the proposed requirements, the accounting by Entity A would be as below:

- At the time of applying equity method for the first time on 1 June 20X1, Entity A would remeasure at fair value the 10% interest in Entity B held originally. From 1 June 20X1, Entity A would apply equity method to the entire 25% interest.
- At the time of recognising the additional purchase of 5% interest, the previously held interest of 25% is not remeasured at fair value. The purchase of additional 5% interest is accounted for applying the proposed requirements related to a purchase of an additional ownership interest while retaining significant influence or joint control.

When an investor purchases an additional ownership interest in an associate or joint venture, while retaining significant influence, and such purchase results in a bargain purchase gain; under the proposed requirements, the bargain purchase gain would not be set off against any goodwill recognised as part of the investment on the previously held interest. The bargain purchase gain would be recognised in profit or loss. Such bargain purchase gain may be an indicator of impairment. (Basis for Conclusions on the Exposure Draft – BC25-27).

!

EXAMPLE (BASED ON ILLUSTRATIVE EXAMPLE 1 FROM THE EXPOSURE DRAFT)	
A.	***Initial investment*** *Fact pattern:* *On 1 January 20X1 Entity A (the investor) acquires a 5% ownership interest in Entity B for a consideration of CU1,200. In accordance with IFRS 9, Entity A measures the investment at fair value through profit or loss and recognises a financial asset of CU1,200.*
	Answer: On 31 December 20X1, the fair value of the 5% ownership interest in Entity B is CU1,500. Entity A recognises the change of CU300 in the fair value of the financial asset in profit or loss.

EXAMPLE (BASED ON ILLUSTRATIVE EXAMPLE 1 FROM THE EXPOSURE DRAFT)

B. ***Obtaining significant influence***

Fact pattern:

On 1 January 20X2, Entity A acquires an additional 20% ownership interest in Entity B (the associate). Entity A determines that it has obtained significant influence over Entity B.

Other details are as below:

- *Consideration: CU6,500, including an obligation for contingent consideration. The fair value of the contingent consideration is CU1,000.*
- *The carrying amount and the tax basis of Entity B's net assets on 1 January 20X2: CU20,000.*
- *The fair value of Entity B's net assets on 1 January 20X2: CU30,000, including the fair value of property, plant and equipment that is CU10,000 more than its carrying amount, with a remaining useful life of 10 years.*
- *Entity B's tax rate: 40%.*

Answer:

a. Cost of the associate Entity B

	CU
The fair value of the consideration transferred, including the contingent consideration	6,500
Add: The fair value of the previously held ownership interest	1,500
Cost of the associate	8,000

Entity A classifies the contingent consideration as a financial liability.

b. Entity A's share of the fair value of Entity B's identifiable assets and liabilities:

The fair value of Entity B's identifiable assets and liabilities on 1 January 20X2 is CU30,000.

Entity A's share, considering its total ownership interest on 1 January 20X2 is CU7,500 (i.e. CU30,000 * 25%).

c. Deferred tax effect on the fair value adjustment

Fair value adjustment (excess of fair value over the carrying amount of Entity B's net assets)	CU10,000
Entity B's tax rate	40%
Entity A's ownership interest in Entity B	25%
Deferred tax effect on the fair value adjustment (CU10,000 * 40% * 25%)	(1,000)

This deferred tax effect will reverse as and when the related fair value adjustments reverse.

d. Goodwill

	CU
Cost of the associate	8,000
Less: Entity A's share of the fair value of Entity B's identifiable assets and liabilities (net of deferred tax adjustment) (7,500 - 1,000)	6,500
Goodwill	1,500

EXAMPLE (BASED ON ILLUSTRATIVE EXAMPLE 1 FROM THE EXPOSURE DRAFT)

e. Investment in Associate B as at 1 January 20X2

	CU
Share of the fair value of net assets	7,500
Less: Deferred tax effect on fair value adjustments	(1,000)
Add: Goodwill	1,500
Cost of the associate Entity B	8,000

f. Entry

The following entry will be recorded on 1 January 20X2:

Dr Investment in Entity B - Associates	CU8,000	
Cr Cash		CU5,500
Cr Contingent Consideration		CU1,000
Cr Investment in Entity B (financial asset derecognised)		CU1,500

(Being investment in Entity B as associate recognised and previous investment in Entity B as a financial asset derecognised.)

C. ***Subsequent measurement – 31 December 20X2***

Fact pattern:

Entity B's profit for the year ending 31 December 20X2 is CU3,000. Entity A's share of Entity B's profit is CU750 (CU3,000 × 25%).

The fair value of the contingent consideration on 31 December 20X2 is CU1,200.

Answer:

Entity A adjusts its share of Entity B's profit for the depreciation of Entity B's property, plant and equipment based on its fair value on obtaining significant influence. The adjustment is:

	CU
Depreciation on the fair value adjustment of Entity B's property, plant and equipment (CU10,000/10)	1,000
Entity A's share in the above depreciation (CU1,000 *25%)	(250)
Deferred tax effect on fair value adjustment (CU250 * 40%)	100
Adjustment to Entity A's share of Entity B's profit or loss (CU250 – CU100)	(150)

Therefore, Entity A recognises (CU750 – CU150) = CU600 in its profit or loss, by recording the following entry:

Dr Investment in Entity B - Associates	CU600	
Cr Profit of loss		CU600

Entity A remeasures the contingent consideration and recognises the change in the fair value of CU200 as an expense in profit or loss.

The carrying amount of the investment on 31 December 20X2 is CU8,600.

EXAMPLE (BASED ON ILLUSTRATIVE EXAMPLE 1 FROM THE EXPOSURE DRAFT)

D. ***Purchase of additional ownership interest***

Fact pattern:

On 1 January 20X3 Entity A acquires an additional 15% ownership interest in Entity B. Entity A determines that it retains significant influence over Entity B.

Other details are as below:

- Consideration: CU5,600.
- The carrying amount of Entity B's net assets, on 1 January 20X3: CU23,000.
- The fair value of Entity B's net assets on 1 January 20X3: CU35,000, including the fair value of property, plant and equipment that is CU12,000 more than its carrying amount with a remaining useful life of 9 years.

Answer:

a. Entity A measures the additional ownership interest in Entity B at CU5,600. *(Note: the fair value of previously held ownership interest is not included in the consideration transferred.)*

b. Entity A's additional share of the fair value of Entity B's identifiable assets and liabilities:

The fair value of Entity B's identifiable assets and liabilities on 1 January 20X3 is CU35,000.

Entity A's additional share of the fair value of Entity B's identifiable assets and liabilities is CU5,250 (i.e CU35,000 * 15%)

c. Deferred tax effect on the fair value adjustment

Fair value adjustment (excess of fair value over the carrying amount of Entity B's net assets) (CU35,000 – CU23,000)	CU12,000
Entity B's tax rate	40%
Entity A's additional ownership interest in Entity B	15%
Deferred tax effect on the fair value adjustment (CU12,000 * 40% * 15%)	(720)

This deferred tax effect will reverse as and when the related fair value adjustments reverse.

d. Goodwill

	CU
Total cost of additional ownership interest	5,600
Less: Entity A's additional share of the fair value of Entity B's identifiable assets and liabilities (net of deferred tax adjustment) (5,250 - 720)	4,530
Goodwill	1,070

After the purchase of the additional ownership interest, the carrying amount of the investment in Entity B is (CU8,600 + CU5,600) = CU14,200.

EXAMPLE (BASED ON ILLUSTRATIVE EXAMPLE 1 FROM THE EXPOSURE DRAFT)

E. ***Subsequent measurement – 31 December 20X3***

Fact pattern:

Entity B's profit for the year ending 31 December 20X3 is CU4,000. Entity A's share of Entity B's profit is CU1,600 (CU4,000 × 40%).

Answer:

Entity A adjusts its share of Entity B's profit for the depreciation of Entity B's property, plant and equipment based on its fair value on obtaining significant influence and at the date of purchasing the additional ownership interest net of the reversal of the deferred tax effect. The adjustment is:

	CU
Depreciation of Entity B's property, plant and equipment for the ownership interest on obtaining significant influence (CU10,000/10 × 25%)	(250)
Depreciation of Entity B's property, plant and equipment for the additional ownership interest (CU12,000/9 × 15%)	(200)
Deferred tax effect on fair value adjustments ((CU250 + CU200) × 40%)	180
Adjustment to Entity A's share of Entity B's profit or loss	(270)

Therefore, Entity A recognises (CU1,600 – CU270) = CU1,330 in profit or loss.

The reconciliation between the opening and the closing carrying amounts of the investment in Entity B is as below:

	CU
Opening balance	8,600
Additional investment in Entity B	5,600
Share of Entity B' profit	1,330
Closing balance	15,530

Disposal of an ownership interest

The proposals require an investor or joint venturer disposing an ownership interest while retaining significant influence or joint control:

- to derecognise the disposed portion of its investment in the associate;
- to measure the disposed portion of its investment as a percentage of the carrying amount of the investment (that percentage is calculated as the disposed ownership interest divided by the total ownership interest); and
- to recognise any difference between the consideration received and the disposed portion as a gain or loss in profit or loss.

BDO comment – Unit of account

Under the proposed requirements, additional investments while retaining significant influence are recognised as an accumulation of purchases (see BDO comment above). In this situation, a question arises as to what the unit of measurement is i.e. whether the investment should be viewed as:

- a single unit of account; or
- comprising multiple components.

This question is particularly relevant for impairment testing, measurement of impairment losses and derecognition of investment in case of a partial disposal.

For example, Entity A holds a 25% interest in Entity B, which gives Entity A significant influence over Entity B. The carrying value of the investment applying the equity method on 31 December 20X1 is CU1,000. On 31 December 20X1, Entity A purchases an additional 10% interest in Entity B for a cash consideration of CU500. Assume that the fair value of consideration paid equals the fair value of net assets of Entity B on 31 December 20X1 and there is no goodwill or bargain purchase gain recognised. Deferred tax effects are ignored for this example. Therefore, the total carrying amount of the investment as at 31 December 20X1 is CU1,500, which would be accounted using the equity method.

Assume that during 20X2, Entity A's share of income of Entity B is Nil and the carrying value of the investment as on 31 December 20X2 continues to be CU1,500.

On 31 December 20X2, Entity A disposes 15% interest in Entity B, retaining 20% interest. Entity A continues to have significant influence over Entity B. The question arises as to whether the 15% interest disposed of should be viewed as:

- a single unit of account: In this case, 15% interest is considered to be disposed of out of the total 35% interest. Therefore, the carrying value of the portion disposed of would be CU643 (CU1,500 * 15/35); or
- comprising multiple components: In this case, 15% interest may be considered to be disposed of entirely out of the original investment of 25%, if a first-in, first-out (FIFO) approach is followed. The carrying value of the interest disposed of would be CU600 (CU1,000 * 15/25). If alternatively, last in, first out (LIFO) or weighted average approach is followed, the carrying value of the interest disposed of would change accordingly.

Similar considerations would arise for impairment testing and measurement of impairment losses.

On deliberations, the IASB noted that viewing the investment as a single unit of account would be more consistent with the principles underlying IAS 28 (Basis for Conclusions on the Exposure Draft – BC25-27). Therefore, under the proposed requirements, the investment would be required to be viewed as a single unit of account in case of partial disposal while retaining significant influence or joint control, although additional purchases while retaining significant influence or joint control are measured as accumulation of purchases.

In cases of disposal of ownership interest, while retaining significant influence or joint control, IAS 28.25 currently requires the investor or joint venturer to reclassify to profit or loss the proportion of the gain or loss that had previously been recognised in other comprehensive income relating to that decrease in ownership interest if that gain or loss would be required to be reclassified to profit or loss on disposal of the related assets or liabilities.

There is no change proposed for this requirement.

Other changes in ownership interest

If an investor's or joint venturer's ownership interest changes as a result of other reasons, such as issue or redemption of shares by the associate or joint venture and the investor retains significant influence over the associate or joint venture, the proposals require the investor to account for the change in ownership interest as below:

- Increase in ownership interest

  An increase in ownership interest would be accounted for similar to purchase of an additional ownership interest while retaining significant influence. As there is no consideration transferred, the additional ownership interest would be recognised at the investor's or joint venturer's share of the change in its associate's or joint venture's net assets arising from the associate's or joint venture's redemption of equity instruments.

EXAMPLE

Entity A holds 30% of Entity B's ordinary shares and has significant influence over Entity B.

On 31 December 20X1, the carrying amount of Entity A's investment in Entity B is CU9,000. On 1 January 20X2, Entity B redeems some shares held by a third party for CU3,000. Entity B's net assets are reduced by that amount. Entity A's ownership interest in Entity B increases from 30% to 40% as a result of the redemption. Entity A determines that it retains significant influence over Entity B.

The fair value of Entity B's net assets as at 1 January 20X2 is CU10,000.

Question: How will the increase in ownership interest be accounted under the proposed requirements (ignore deferred tax effects)?

Answer:

- The additional ownership interest would be recognised at Entity A's share of the change in Entity B's asset arising from the redemption of equity instruments. This share is CU900 (i.e. CU3,000 * 30%).
- Entity A's additional share in the fair value of Entity B's assets on 1 January 20X2 is CU700 (i.e. CU(10,000-3,000) * 10%).
- Entity A would be required to recognise goodwill of CU200 (i.e. CU900 – CU700) as part of the investment in Entity B.

  There is no Journal entry since this is a reclassification between Entity A's share in the equity of Entity B and goodwill that are both included within the investment.

- Decrease in ownership interest

  A decrease in ownership interest would be accounted for similarly to the disposal of an ownership interest while retaining significant influence. As there is no consideration received, gain or loss would be recognised as the difference between 'the investor's or joint venturer's share of the change in its associate's or joint venture's net assets arising from the associate's or joint venture's issue of equity instruments' and the disposed portion.

EXAMPLE (BASED ON ILLUSTRATIVE EXAMPLE 2 FROM THE EXPOSURE DRAFT)

Entity A holds 40% of Entity B's ordinary shares and has significant influence over Entity B.

On 31 December 20X1, the carrying amount of Entity A's investment in Entity B is CU3,200. On 1 January 20X2, Entity B issues new equity instruments to a third party for a consideration of CU3,000. Entity B's net assets increase by that amount. Entity A's ownership interest in Entity B decreases from 40% to 30%. Entity A determines that it retains significant influence over Entity B.

Question: How will the decrease in ownership interest be accounted under the proposed requirements?

EXAMPLE (BASED ON ILLUSTRATIVE EXAMPLE 2 FROM THE EXPOSURE DRAFT)

Answer:

- Entity A would be required to derecognise a portion of its investment, calculated as a percentage of the carrying amount of Entity A's investment in Entity B. Its ownership interest is reduced from 40% to 30%. Therefore, the derecognition of the carrying amount required is CU800 (i.e. CU3,200 *10%/40%).
- Entity A's share of the change (an increase) in Entity B's net assets arising from the issue of equity instruments is CU900 (i.e. CU3,000 * 30%).
- Therefore, the gain recognised in profit or loss is CU100 (i.e. CU900 – CU800).

  The following entry would be recorded to account for this gain:

Dr Investment in Entity B	CU900	
Cr Investment in Entity B		CU800
Cr Gain on change in ownership interest (profit or loss)		CU100

PROPOSALS RELATED TO INVESTOR'S SHARE OF LOSSES

What is the issue?

IAS 28.38 requires an investor or joint venturer to discontinue recognising its share of losses, if the carrying amount of its investment is reduced to nil. IAS 28.39 requires additional losses to be provided, and a liability recognised, only to the extent that the investor has incurred legal or constructive obligations or made payments on behalf of the associate or joint venture. If the associate or joint venture subsequently reports profits, the investor resumes recognising its share of those profits only after its share of profits equals the share of losses not recognised.

The application questions that arose with respect to recognition of losses when an investor's or joint venturer's interest in an associate or joint venture is reduced to nil included the following:

- 'Catch up' of unrecognised losses if the investor or joint venturer purchases an additional interest:

  When an investor or joint venturer purchases an additional ownership interest in the associate or joint venture, it is not clear whether the investor is required to recognise additional losses from the previously unrecognised losses when the original investment was reduced to nil.

- Separate recognition of each component of comprehensive income:

  IFRS 18 (and IAS 1 *Presentation of Financial Statements*) requires an investor or joint venturer to present its share of the profit or loss from the associate or joint venture in the statement of profit or loss and its share of other comprehensive income (OCI) of the associate or joint venture in its OCI. There was a lack of clarify with respect to the following issues leading to diversity in practice:

  - An associate or joint venture might report a loss in its statement of profit or loss and a loss in its OCI. If the investor's or joint venturer's share of those losses, in total, exceeds the carrying amount of its investment, IAS 28 does not specify the portion of the losses that should be recognised in profit or loss and in OCI by the investor or joint venturer.
  - Once the investor or joint venturer has reduced the carrying amount of its investment to nil, the associate or joint venture might subsequently report a loss in its statement of profit or loss and income in its OCI (or vice versa). In such situations, it is not clear whether the investor or joint venturer should recognise any amounts for its share of the associate's or joint venture's loss (or profit) and OCI.

What do the proposals require?

The proposals require the investor or joint venturer to recognise separately its share of the associate's or joint venture's profit or loss and its share of the associate's or joint venture's OCI.

The proposals also require the following:

- No catch-up of unrecognised losses on purchase of an additional ownership interest:

  On purchasing an additional ownership interest, the proposals require an investor or joint venturer that has not recognised its share of an associate's or joint venture's losses to not recognise those losses by reducing the carrying amount of the investment at the date of that purchase.

EXAMPLE
Entity A holds a 25% ownership interest in Entity B and has significant influence over Entity B. Entity B has been loss making for past few years. As at 31 December 20X4, Entity A's net investment in Entity B is reduced to nil. Entity A's share of loss of Entity B not recognised due to the investment being reduced to nil is CU1,000. On 1 January 20X5, Entity A purchases an additional 5% interest in Entity B for CU5,000. In this case, Entity A would not be required or permitted to recognise the previously unrecognised loss of CU1,000 against the additional ownership interest of CU5,000. The total ownership interest of Entity A for the year 20X5 is 30%. Entity A will account for 30% of profit or loss of Entity B for the year 20X5. If Entity B reports a loss for the year 20X5, Entity A's share of the loss will be recognised until the investment of CU5,000 is reduced to nil. If Entity B reports a profit, Entity A's share of the profit will be recognised only when it exceeds the previously unrecognised loss of CU1,000.

- Clarification of sequence of recognition of losses in profit or loss and OCI:

  If an investor's or joint venturer's share of profit or loss and share of OCI are both losses that in aggregate equal or exceed its net investment in the associate or joint venture, the proposals require the investor or joint venturer to recognise first its share of profit or loss and then its share of OCI.

EXAMPLE (BASED ON ILLUSTRATIVE EXAMPLE 3 FROM THE EXPOSURE DRAFT)
Entity A's carrying amount of its investment in Entity B, an associate, is CU5,000 as on 31 December 20X1 before recognising its share of Entity B's profit or loss and OCI for the year 20X1. Entity A's share of profit or loss of Entity B is a loss of CU4,000 and its share of OCI is a loss of CU3,000 for the year 20X1. The proposals require Entity A to recognise its share of loss of CU4,000 first and then its share of OCI to the extent of CU1,000 i.e. till the net investment of CU5,000 is reduced to nil. Thus, Entity A would have an unrecognised loss in OCI of CU2,000 (CU3,000 – CU1,000).

- Separate recognition of share of profit or loss and OCI with a nil net investment:

  The proposals require an investor or joint venturer that has reduced its net investment to nil to continue to recognise separately its share of an associate's or joint venture's profit or loss and its share of an associate's or joint venture's other comprehensive income, retaining a carrying amount in the net investment of nil. The Exposure Draft proposes to retain the existing requirement in IAS 28 that an investor or joint venturer only recognises a liability for additional losses to the extent that it has incurred legal or constructive obligations or made payments on behalf of the associate or joint venture.

EXAMPLE
Entity A has reduced its net investment in Entity B, an associate, to nil. Entity A's share of profit or loss of Entity B is a loss of CU250 and its share of OCI is a profit of CU100. The proposals require Entity A to recognise a loss of CU100 in profit or loss and a profit of CU100 in other comprehensive income, so that the net carrying amount of the net investment continues to be nil. Entity A would have an unrecognised loss of CU150 (CU250 – CU100).

PROPOSALS RELATED TO TRANSACTIONS WITH ASSOCIATES OR JOINT VENTURES

What is the issue?

IAS 28.28 currently requires an investor or joint venturer to recognise gains or losses resulting from transactions, both upstream and downstream, with an associate or joint venture only to the extent of the unrelated investors' interests in the associate or joint venture. A number of application questions arose related to this issue, which included the following:

- Recognition of gains or losses from the sale of a subsidiary to an associate:

  There is an inconsistency between the requirements of IFRS 10 and IAS 28. IFRS 10.25 and IFRS 10.B97-B99 require an investor to recognise, in full, the gains or losses on the loss of control of a subsidiary, remeasuring any retained interest at fair value. IAS 28.28 requires an investor to restrict the gains or losses recognised to the extent of the unrelated investors' interests in an associate, by eliminating the investor's share of the gain or loss arising from the transaction. Therefore, if an investor sells a subsidiary to an associate, it is unclear as to how much gain or loss from the transaction should be recognised.

- Recognition of gains or losses from other transactions with an associate or a joint venture:

  There were several application questions related to the gains or losses from upstream and downstream transactions such as the following:

  - Does an investor recognise the portion of its share of the gain in a downstream transaction that exceeds the carrying amount of its investment in the associate?
  - Does an investor eliminate its share of a gain or loss in an upstream transaction from the carrying amount of the investment in the associate or the acquired asset?
  - Does an investor eliminate its share of a gain or loss in a downstream transaction against the transaction gain or loss or the share of the associate's profit or loss?

What do the proposals require?

The proposals require an investor or joint venturer to recognise in full the gains and losses resulting from all 'upstream' and 'downstream' transactions with its associates or joint ventures. This includes transactions of sale of subsidiary to an associate.

While developing these proposals, the factors considered by the IASB included the boundary of the reporting entity. In consolidated financial statements, subsidiaries are within the boundary of the reporting entity. Therefore, gains and losses from transactions with subsidiaries are eliminated. In both *the Conceptual Framework* and other IFRS Accounting Standards, an associate is not within the definition of a group. *The Conceptual Framework* explains that control over another entity determines the boundary of the reporting entity when preparing consolidated financial statements. The IASB observed that eliminating the investor's portion of the gain or loss in a transaction with an associate could be viewed as implying that, in applying the equity method, the boundary of the reporting entity is extended to include the associate (or the investor's share of the associate). This is one of the main reasons for the IASB to propose full recognition of gains and losses from 'upstream' and 'downstream' transactions with associates or joint ventures (Basis for Conclusions on the Exposure Draft – BC76-80).

OTHER PROPOSALS

Impairment

IAS 28.41A-41C describe various indicators of impairment. IAS 28.41C states that '*a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is also objective evidence of impairment*'. Since IAS 28.41C refers to 'cost', an application question arose about whether an investor should test impairment by comparing the fair value of the investment with the carrying amount at the reporting date or with the cost on initial recognition. The IASB has proposed to replace the reference to 'cost' with 'carrying amount' and to eliminate 'significant and prolonged' in the Exposure Draft.

The amendments proposed related to impairment of an investment in an associate or joint venture include the following:

- substitution of the reference to 'cost' with 'carrying amount' and removal of the reference to 'significant and prolonged' in the paragraph corresponding to the existing paragraph 41C;
- addition of further guidance on how to gather information on fair value of the investment (price paid to purchase an additional ownership interest or to sell an ownership interest or quoted market price); and
- alignment of the wording for impairment indicators with that used in IAS 36 *Impairment of Assets*.

Proposed disclosure requirements

The Exposure Draft proposes amendments to IFRS 12 *Disclosure of Interests in Other Entities*.

The proposed disclosure requirements include the following:

- changes in the carrying amount of investments in joint ventures and associates
- gains or losses from other changes in its ownership interest of joint ventures or associates
- gains or losses from 'downstream' transactions with its joint ventures and associates
- disclosures for contingent consideration arrangements which include the nature of the contingent consideration arrangement, amounts recognised and changes in those amounts, and the range of possible outcomes
- reconciliation between the opening and closing carrying amount of investments accounted for using the equity method.

Proposed amendments to IAS 27

The Exposure Draft also proposes amendments to IAS 27 *Separate Financial Statements* as below:

- If an entity obtains control of an associate or joint venture and continues to account for the investment in the subsidiary using the equity method, the entity shall not remeasure its previously held equity interest.
- If an entity loses control of a subsidiary and continues to account for any investment retained in that former subsidiary using the equity method, the entity shall not remeasure the retained investment.

The proposals also introduce a requirement to disclose gains or losses from 'downstream' transactions with subsidiaries for a parent entity that uses the equity method to account for its investments in subsidiaries in its separate financial statements.

PROPOSED TRANSITION REQUIREMENTS

The Exposure Draft requires the proposals to be applied prospectively, apart from certain exceptions, which include the following, that need retrospective application:

- Requirements related to gains or losses on transactions with associates or joint ventures:

  Any previously restricted portion of gains or losses from transactions with associates or joint ventures would be recognised in the opening balance of retained earnings.

- Investor or joint venturer early applying IFRS 10.B99A[1]:

  An investor or joint venturer that early applied IFRS 10.B99A might have certain remaining portion from a previously restricted gain or loss from remeasurement at fair value of an investment retained in a former subsidiary. Such amount would be required to be recognised in the opening balance of retained earnings.

- Contingent consideration:

  Any contingent consideration for investments in associates or joint ventures purchased before the transition date would be recognised and measured at fair value at the transition date. The contingent consideration would be classified in accordance with proposed paragraph 26. Any corresponding adjustment in contingent consideration would be recognised in the carrying amount of the investments in associates or joint ventures at the transition date.

- Impairment implications of the above requirements:

  If, as a result of the retrospective application of the requirements specified above, the carrying amount of the investment in an associate or joint venture exceeds its recoverable amount at the transition date, the carrying amount would be reduced to the recoverable amount. The impairment loss would be recognised in the opening balance of retained earnings at the transition date.

If an investor or a joint venturer presents more than one period of comparative information, the Exposure Draft proposes to permit the investor or joint venturer to present comparative information for any additional prior periods unadjusted for the effects of the proposed requirements.

[1] The IASB issued *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28)* in 2014. These amendments added paragraph B99A and Example 7 in IFRS 10. The effective date of these amendments was deferred indefinitely. But entities were permitted to early apply the amendments. IFRS 10.B99A applies to situations where a parent loses control of a subsidiary that does not contain a business, as a result of a a transaction involving an associate or a joint venture that is accounted for using the equity method. If the parent retains an investment in the former subsidiary and the former subsidiary is now an associate or a joint venture that is accounted for using the equity method, IFRS 10.B99A requires the parent to recognise the part of the gain or loss resulting from the remeasurement at fair value of the investment retained in that former subsidiary in its profit or loss only to the extent of the unrelated investors' interests in the new associate or joint venture.

FOR MORE INFORMATION:

BDO's IFRS Policy Committee

BDO's IFRS Country Leaders

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