Australian Government
Australian Accounting Standards Board

Memorandum

To:	**AASB members**	**Date:**	24 March 2014
From:	**Christina Ng**	**Agenda Item:**	11.1 (M137)
Subject:	**Equity Method: Share of Other Net Asset Changes - Project Update**	**File:**	

Action

Receive an update on recent tentative decisions made by the IASB in its Equity Method: Share of Other Net Asset Changes project and consider whether there are any issues that need to be raised with the IASB on those tentative decisions at this stage.

Attachments

Agenda paper 11.2 – EFRAG paper *Concerns in relation to IASB Tentative Decisions on ED/2012/3 Equity Method: Share of Other Net Asset Changes*

Overview of the project

1 IASB ED/2012/3 *Equity Method: Share of Other Net Asset Changes* (incorporated into AASB ED 228 of the same name) was issued in November 2012. The comment period for AASB ED 228 and ED/2012/3 ended on 8 February 2013 and 22 March 2013 respectively. The AASB provided comments on ED/2012/3 to the IASB on 21 March 2013.

2 ED/2012/3 proposes to clarify the application of the equity method in IAS 28. In particular, the IASB proposes to amend IAS 28 so that:

(a) an investor shall recognise, in its equity, its share of 'other net asset changes' of an investee. That is, the changes in net assets of an investee that are not recognised in profit or loss or Other Comprehensive Income (OCI) of the investee, and that are not distributions received. Examples of 'other net asset changes' are changes to the investee's share capital, such as when an investee issues additional shares to, or buys back shares from, third parties, and movements in other components of the investee's equity, such as, when an investee accounts for an equity-settled share-based payment transaction. ED/2012/3 also proposes to add an example to illustrate the accounting by an investor of its share of other net asset changes in an investee (page 7 of ED 228); and

(b) when an investor discontinues the use of the equity method, the investor shall reclassify to profit or loss the cumulative amount of equity that the investor had previously recognised.

3 At its December 2013 meeting, the AASB was provided an update on this project, in particular, in relation to the limited support for the proposals in ED/2012/3 and the tentative

decisions made at the October 2013 IASB meeting. The IASB tentatively decided not to proceed with the proposals and requested for staff to conduct more analysis on the issue of how an investor should recognise its 'share of other net asset changes' (refer Agenda paper 4.6).

4 The AASB tentatively decided there were no further issues to be raised with the IASB at that stage.

IASB tentative decisions since the December 2013 AASB meeting

5 At its December 2013 meeting, the IASB considered four alternatives[1] to the proposals in ED/2012/3:

(a) Alternative 1: To recognise the investor's share of 'other net asset changes' directly in profit or loss as a deemed disposal (this was the AASB's preferred method);

(b) Alternative 2: To recognise the investor's share of 'other net asset changes' directly in other comprehensive income initially, rather than equity, and subsequently reclassify to profit or loss on discontinuation of the equity method of accounting (this was the AASB's alternative preferred method);

(c) Alternative 3: To recognise the investor's share of 'other net asset changes' as a partial disposal in profit or loss if the ownership interest in the investment is reduced, or as an incremental purchase of the investment and thus recognise the investment at cost if the ownership interest in the investment increases. This alternative excludes call option transactions entered into by an investee over its own equity (such as share-based payments);

(d) Alternative 4: Consistent with Alternative 3, Alternative 4 recognises the investor's share of 'other net asset changes' as a partial disposal in profit or loss if the ownership interest in the investment is reduced, or as an incremental purchase of the investment and thus recognise the investment at cost if the ownership interest in the investment increases. However, in contrast to Alternative 3, Alternative 4 includes call option transactions entered into by an investee over its own equity (such as share-based payments), whereby the investor's share of 'other net asset changes'. Consequently, these transactions would be recognised in the investor's OCI.

6 The IASB observed that each alternative presented has challenges for the accounting for the investor's 'share of other net asset changes'.

7 The IASB then reconsidered its proposed amendments in ED/2012/3 and, in the context of addressing the issue in the short-term, concluded that the proposed amendments are appropriate until the IASB revisits the principles of the equity method of accounting[2]. Accordingly, the IASB tentatively decided to finalise the ED/2012/3 amendments, subject to further analysis of the application of those requirements to some specific fact patterns.[3]

1 More details regarding the four alternatives are outlined in IASB Paper 12A of the December 2013 meeting.
2 The IASB aims to undertake a research project on Equity Method of Accounting. The timing of the project has not been decided.
3 IASB Update December 2013

8 At its February 2014 meeting, the IASB considered the staff's analysis of the application of the proposed amendments in ED/2012/3 to the requested fact patterns[4]. In addition, the IASB staff recommended that the investor should apply the proposed amendments only when the changes in its investee's equity or net assets are attributable to the investor. In other words, changes in the investee's equity that are not attributable to the investor or the class of equity held by the investor should not be recognised by the investor, for example, the issuance of a new class of shares to third party investors or the issuance of equity-settled share based payments to the investee's employees. The IASB staff consider the concept of equity method in this manner as a one-line consolidation method in the investor's financial statements. Accordingly, the investor would not be required to account for all changes in its investee's net assets, as originally proposed in ED/2012/3.

9 The IASB was satisfied that the staff's analysis of the proposed amendments would not result in any unintended consequences and agreed with the staff proposal (outlined in paragraph 8 directly above). The IASB tentatively decided to proceed with the finalisation of the proposed amendments.[5]

10 The IASB aims to discuss the due process steps at a future IASB meeting. The IASB Work Plan dated 25 February 2014 indicates a target standard by Q2 2014.

Other developments

11 At the March 2014 IASB Accounting Standards Advisory Forum (ASAF), the European Financial Reporting Advisory Group (EFRAG) and other ASAF members, including the AASB Chairman, expressed concerns with the IASB's February 2014 tentative decision to proceed with the proposed amendments in ED/2012/3 even as a short-term solution to the diversity in practice (Agenda paper 11.2). In particular, a number of ASAF members were concerned that the IASB's tentative decision would result in cross-cutting issues with existing IFRS principles as it relates to the owner/investor's own equity. For example, paragraphs IN6[6] and 106[7] of IAS 1 *Presentation of Financial Statements*.

12 An IASB member (Ian Macintosh) and staff present at the meeting acknowledged the concerns raised by ASAF members. However, because there is an urgent need for the IASB to address the diversity in practice, the IASB considers that the best approach in this circumstance is to proceed with the proposed amendments until the IASB revisits the principles of the equity method of accounting.

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4 These fact patterns include circumstances where: (i) the investor's ownership interest in the associate decreases as a result of an issue of ordinary shares by the associate to third parties; (ii) the investor's ownership interest in the investee increases as a result of a buy-back of ordinary shares by the investee from other investors; (iii) changes in the investor's share of the investee's net assets are a consequence of transactions between the investee and non-controlling interests in the investee's subsidiary; and ordinary shares or another class of equity are potentially issued to third parties or employees. The IASB staff analysis of the application of the proposed amendments in ED/2012/3 to these circumstances are outlined in IASB Paper 12I of the February 2014 meeting.

5 IASB Update dated February 2014

6 Paragraph IN6 of IAS 1 states, "IAS 1 requires an entity to present, in a statement of changes in equity, all owner changes in equity. All non-owner changes in equity (i.e. comprehensive income) are required to be presented in one statement of comprehensive income or in two statements (a separate income statement and a statement of comprehensive income). Components of comprehensive income are not permitted to be presented in the statement of changes in equity."

7 Paragraph 106(d) of IAS 1 states, "for each component of equity, a reconciliation… separately disclosing changes resulting from: (i) profit or loss; (ii) other comprehensive income; and (iii) transactions with owners in their capacity as owners, showing separately contributions by and distributions to owners and changes in ownership interests in subsidiaries that do not result in a loss of control."

AASB staff recommendation

13 AASB staff consider the IASB's tentative decision in paragraph 9 above, that the investor should apply the proposed amendments only when the changes in its investee's equity or net assets are attributable to the investor, would limit the circumstances when an investor would recognise those changes in its own equity. However, the AASB's concern with reflecting transactions relating to an investee's 'other net asset changes' (or transactions that are not with owners in their capacity as owners) in the investor's own equity remains unaddressed.

14 AASB staff note that, despite the limited support for the proposed amendments in ED/2012/3, the IASB has reconsidered the issues/concerns relating to its proposed amendments on a number of occasions, including the March 2014 ASAF meeting, and ultimately tentatively decided that proceeding with the proposals would be the best approach for the purpose of providing a short-term solution. The IASB member and staff present at the March 2014 ASAF meeting acknowledged that it is not ideal to arrive at this tentative decision; however, due to the urgent need to address the diversity in practice, the IASB need to proceed with its proposed amendments. This IASB member also clarified that the rationale and requirement of this tentative decision would be prohibited from being applied by analogy.

15 Accordingly, although AASB staff continue to have significant concerns in relation to the IASB's tentative decision to proceed with finalising the amendments, AASB staff do not recommend writing to the IASB at this stage on the basis that the IASB is unlikely to revisit its tentative decision outlined in paragraph 9 above.

Question for the Board

Do members agree with AASB staff recommendation in paragraph 15 above?