

International Financial Reporting Standard

Equity Method in Separate Financial Statements

August 2014

BASIS FOR CONCLUSIONS – AMENDMENTS

[IAS 27]

[Related to AASB 2014-9]

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Amendments to the Basis for Conclusions on IAS 27 *Separate Financial Statements*

The heading before paragraph BC9 is amended. Paragraph BC19 is amended. Headings before paragraphs BC9 and BC11, and paragraphs BC10A–BC10H and BC33 and their related headings are added. Deleted text is struck through and new text is underlined.

Measurement of investments in subsidiaries, joint ventures and associates in separate financial statements ~~(2003 revision and 2008 amendments)~~

2003 revision

BC9 ...

Equity method in separate financial statements (amendments issued in 2014)

BC10A In their responses to the Board's 2011 Agenda Consultation, some respondents said that:

- (a) the laws of some countries require listed companies to present separate financial statements prepared in accordance with local regulations, and those local regulations require the use of the equity method to account for investments in subsidiaries, joint ventures and associates; and
- (b) in most cases, the use of the equity method would be the only difference between the separate financial statements prepared in accordance with IFRS and those prepared in accordance with local regulations.

BC10B Those respondents strongly supported the inclusion of the equity method as one of the options for measuring investments in subsidiaries, joint ventures and associates in the separate financial statements of an entity. In May 2012, the Board decided to consider restoring the option to use the equity method in separate financial statements through a narrow-scope project. Consequently, the Board issued an Exposure Draft in December 2013, the proposals in which would facilitate convergence of local GAAP in those jurisdictions with IFRS for separate financial statements, and that would help to reduce compliance costs for some entities without the loss of information.

Definition of separate financial statements

BC10C Some respondents to the Exposure Draft commented that the proposed amendments to paragraphs 4 and 6 of IAS 27 create an inconsistency in the definition of 'separate financial statements', especially for an investor that has investments in associates or joint ventures and no investments in subsidiaries. The financial statements of such an investor in which the investments in joint ventures and associates are accounted for using the equity method would be the investor's primary financial statements as well as its separate financial

statements. Consequently, they assert that there could be confusion about the applicability of the disclosure requirements in IAS 27 and IFRS 12. IFRS 12 does not apply to an entity's separate financial statements.

BC10D The Board noted that the financial statements of an investor that has no investments in subsidiaries, and has investments in associates or joint ventures that are required by IAS 28 to be accounted for using the equity method, are not separate financial statements. Consequently, in those financial statements, such an investor is required to comply with the disclosure requirements in IFRS 12. As a logical consequence, such an investor is less likely to prepare separate financial statements in which investments in associates or joint ventures are accounted for using the equity method. If such an investor presents separate financial statements, the Board expects that the investor is likely to account for its investments in associates or joint ventures either at cost or in accordance with IFRS 9.

BC10E The Board also noted that an investor that is exempted in accordance with paragraph 17 of IAS 28 from applying the equity method to its investments in joint ventures and associates may elect to present separate financial statements in which the investor elects to account for those investments using the equity method. In those separate financial statements, the investor is not required to present the information required by IFRS 12 for its investments in joint ventures and associates (see paragraph 6(b) of IFRS 12).

Application of the equity method

BC10F IAS 28 contains guidance on the application of the equity method. IAS 28 notes 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 (see paragraph 26 of IAS 28).

BC10G In general, the application of the equity method to investments in subsidiaries, joint ventures and associates in the separate financial statements of an entity is expected to result in the same net assets and profit or loss attributable to the owners as in the entity's consolidated financial statements. However, there could be situations in which applying the equity method in separate financial statements to investments in subsidiaries would give a different result compared to the consolidated financial statements. Some of those situations are:

- (a)** impairment testing requirements in IAS 28. For an investment in a subsidiary accounted for in separate financial statements using the equity method, goodwill that forms part of the carrying amount of the investment in the subsidiary is not tested for impairment separately. Instead, the entire carrying amount of the investment in the subsidiary is tested for impairment in accordance with IAS 36 *Impairment of Assets* as a single asset. However, in the consolidated financial statements of the entity, because goodwill is recognised separately, it is tested for impairment by applying the requirements in IAS 36 for testing goodwill for impairment.
- (b)** subsidiary that has a net liability position. IAS 28 requires an investor to discontinue recognising its share of further losses when its cumulative share of losses of the investee equals or exceeds its interest in the

investee, unless the investor has incurred legal or constructive obligations or made payments on behalf of the investee, in which case a liability is recognised, whereas there is no such requirement in relation to the consolidated financial statements.

- (c) capitalisation of borrowing costs incurred by a parent in relation to the assets of a subsidiary. IAS 23 *Borrowing Costs* notes that, in some circumstances, it may be appropriate to include all borrowings of the parent and its subsidiaries when computing a weighted average of the borrowing costs. When a parent borrows funds and its subsidiary uses them for the purpose of obtaining a qualifying asset, in the consolidated financial statements of the parent the borrowing costs incurred by the parent are considered to be directly attributable to the acquisition of the subsidiary's qualifying asset. However, this would not be appropriate in the separate financial statements of the parent if the parent's investment in the subsidiary is a financial asset, which is not a qualifying asset.

Some respondents to the Exposure Draft asked the Board to consider providing additional guidance to align the carrying amount of a subsidiary in the parent's separate financial statements with the net assets of the subsidiary that are attributable to the parent in the parent's consolidated financial statements. The Board concluded that creating any additional guidance within IAS 28 to eliminate such differences was outside the scope of this project. The Board was concerned that the development of such guidance would not be possible without adequate research and analysis, which would delay the amendments. Consequently, the Board decided not to consider these requests.

- BC10H Some respondents to the Exposure Draft commented that IAS 28 should be amended to provide guidance on the application of the equity method to a subsidiary in the separate financial statements of the parent. The Board concluded that amending IAS 28 to provide such guidance was outside the scope of the project, and a parent that has elected to apply the equity method to account for its subsidiaries in its separate financial statements should follow the methodology in IAS 28 as applicable to an associate or a joint venture.

2008 amendments

- BC11 ...

Dividend received from a subsidiary, a joint venture or an associate

...

- BC19 To reduce the risk that removing the definition of the cost method would lead to investments in subsidiaries, joint ventures and associates being overstated in the separate financial statements of the investor, the Board proposed that the related investment should be tested for impairment in accordance with IAS 36 *Impairment of Assets*.

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Transition requirements (2014 amendments)

BC33 Some respondents to the Exposure Draft suggested that the Board should consider providing some form of relief to make the transition to accounting for investments in subsidiaries, joint ventures and associates using the equity method easier. However, the Board noted that an entity should be able to use the information that is used for consolidation of the subsidiary in its consolidated financial statements for applying the equity method to the investment in the subsidiary in its separate financial statements. Investments in associates and joint ventures (after applying the transition provisions of IFRS 11) are accounted for using the equity method in the consolidated financial statements, which means that an entity need not perform any additional procedures and can use the same information in its separate financial statements. The Board also noted that many entities would be able to draw on the information in the financial statements of its ultimate, or any intermediate, parent in order to calculate the carrying amount of its investment in a subsidiary, joint venture and associate on the initial application of these amendments. Furthermore, the application of the equity method in separate financial statements is optional and not mandatory. Consequently, the Board concluded that additional transition relief was not needed and that an entity that elects to use the equity method should be required to apply the amendments retrospectively in accordance with IAS 8.