Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

At a glance

Equity Method of Accounting

IASB Exposure Draft

Have your say

October 2024

Submissions close 20 November 2024

Equity Method of Accounting

The equity method is a method of accounting whereby an investment is initially recognised at cost, and subsequently adjusted for changes in the investor's share of the associate or joint venture's profit/losses and net assets.

The IFRS® Accounting Standards require for-profit entities to use the equity method in their consolidated financial statements for investments in associates and joint ventures (unless exempt).

The requirements for applying the equity method in New Zealand are set out in NZ IAS 28 *Investments in Associates and Joint Ventures.*

New Zealand Environment

There are practical challenges in New Zealand around applying the equity method, and these could result in diversity in practice when applying NZ IAS 28. These include:

- Accessing sufficient and timely data from equity accounted investments to allow for investments to be measured appropriately;
- Elimination of unrealised profits and losses from upstream and downstream transactions; or
- Judgements around the acquisition and disposals of ownership interests.

The International Accounting Standards Board (IASB) proposed amendments to IAS 28 address some, but not all, of those challenges. We are looking to explore cost and benefits of the IASB's proposals in New Zealand and are interested in hearing your views on other practical challenges of equity method and possible solutions to address these challenges.

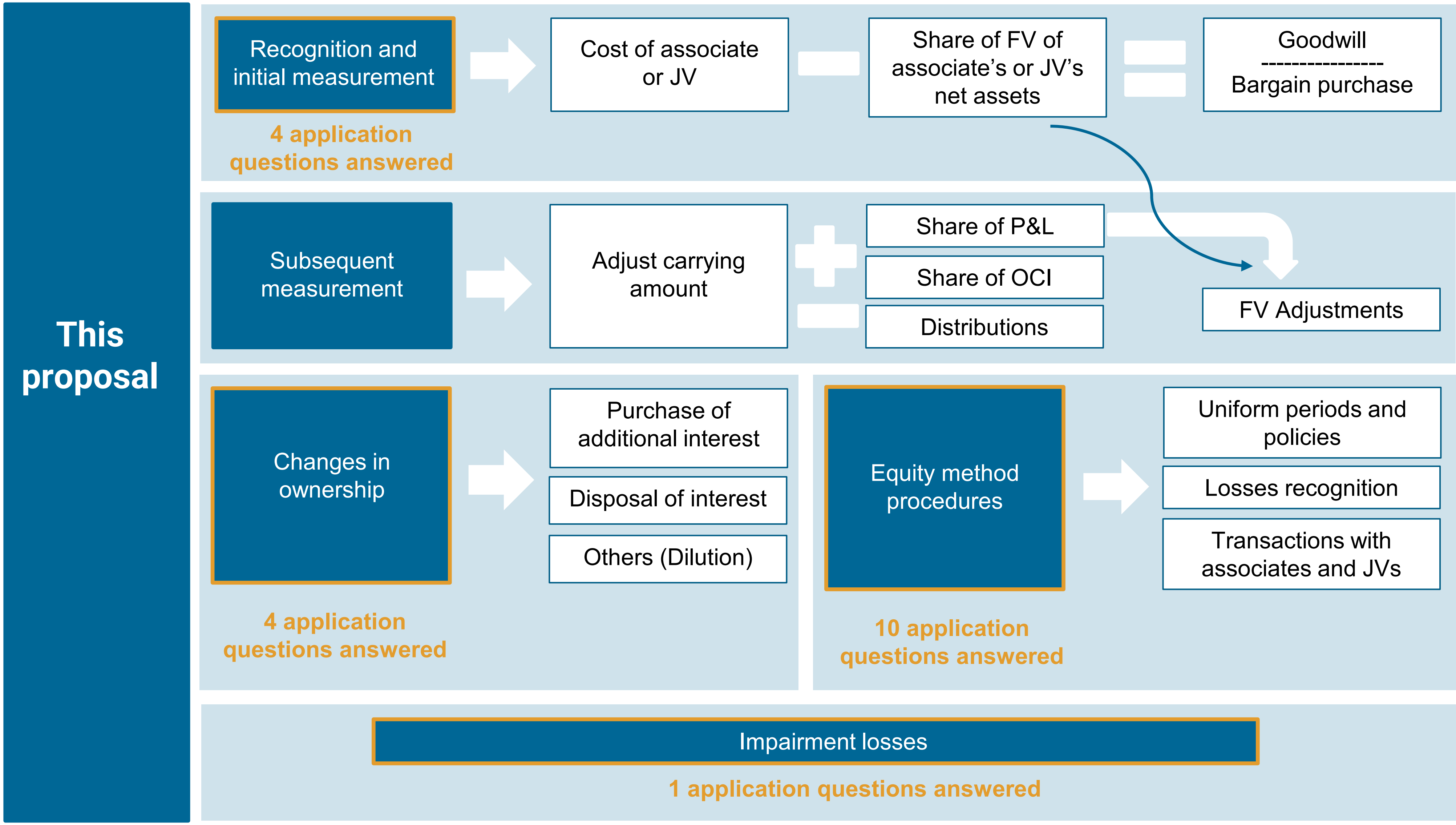
IASB activities

The IASB has received a number of queries on equity accounting and its interaction with the accounting for other ways of holding interests in other entities.

In response, the IASB have undertaken a "clarification project" with the objective to explore the diversity in practice in accounting for investments in associates and joint ventures and have developed answers to application questions about the equity method, using the existing principles in IAS 28.

The IASB have released an Exposure Draft proposing amendments to IAS 28 and reordering the requirements to improve the understandability of IAS 28. We would appreciate your feedback on these proposals.

Equity Method of Accounting



Proposed Amendments to IAS 28

Proposed fundamental change to recognising gains and losses

Currently IAS 28 requires entities to restrict gains and losses from the transactions with the equity accounted investments to the extent of unrelated investors' interests in the investment only (that is, to make elimination entries for the investor's portion).

The IASB's outreach discussions noted that users are focused on recurring cash flows where elimination represent non-cash entries that can create 'disturbing patterns'.

As a result, the IASB Exposure Draft proposes a fundamental change that an entity will be no longer required to restrict the gains or losses and instead recognise in full all transaction with equity accounted investments (that is transactions with investees will be accounted as any other third party).

To provide users with better quality information, the IASB also proposes entities disclose the gains or losses on transactions to its equity accounted investments for "downstream" transactions only. *No disclosures on "upstream" transactions from investees are proposed.*

For overview of the IASB's proposals

- Read IASB Equity Method Snapshot or
- Watch IASB Equity Method Webcasts

Other proposed amendments

Other amendments proposed by the IASB covers aspects where the existing IAS 28 requirements are vague, unclear or missing. These provide further application guidance around how an investor applies the equity method to:

- Changes in its ownership interest on obtaining significant influence, including measuring cost, deferred tax effects and contingent consideration (*Paragraphs 13-29, Appendix A and Example 1*);
- Changes in its ownership interest while retaining significant influence, including purchasing and disposing of ownership interests, and considering other changes in associates net assets (*Paragraphs 30-35 and Example 2*);
- Recognition of its share of losses, including whether an investor that has reduced its investment in an associate to nil has to "catch-up" unrecognised losses if it purchases additional interest and recognises its share of the associate's profit or loss separately in Other Comprehensive Income (*Paragraphs 45-52 and Example 3*); and
- The assessment of whether a decline in the fair value of an investment in an associate is objective evidence that the net investment might be impaired (*Paragraph 57*).

Read

- IASB Equity Method Exposure Draft and Basis for Conclusions

Over to you...

We are keen to hear your feedback and this can be provided formally and informally.

We are seeking comments on the questions raised in the IASB's Exposure Draft, including the potential benefits, and potential costs, of the proposed changes for entities – such as data capturing, system changes, process alignment and staff education.

Read the consultation question 1 to 11 in the IASB Equity Method Exposure Draft

To provide feedback you can:

Email us
Accounting@xrb.govt.nz

Fill in form on
XRB website

Directly to
IASB

The consultation closes 20 November 2024