STAFF PAPER

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IASB Meeting

Project	**IAS 27 *Separate Financial Statements*: the equity method**
Paper topic	Allow the equity method

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Introduction

1. In May 2012, the IASB decided to develop proposals to amend IAS 27 *Separate Financial Statements* to restore the option to use the equity method of accounting in separate financial statements (SFS).

2. This paper proposes to amend IAS 27 to allow an entity to account for investments in subsidiaries, associates and joint ventures using the equity method in their SFS.

Structure of the paper

3. The structure of this paper is the following:

    (a) background information;

    (b) criticisms of IAS 27 requirements

    (c) staff analysis

    (d) staff recommendation and question for the IASB.

Background information

4. Paragraph 4 of IAS 27 provides the following definition of SFS:

> *Separate financial statements* are those presented by a parent (ie an investor with control of a subsidiary) or an investor with joint control of, or significant influence over, an investee, in which the investments are accounted for at cost or in accordance with IFRS 9 *Financial Instruments*

5. Paragraph 10 of IAS 27 states that:

> When an entity prepares separate financial statements, it shall account for investments in subsidiaries, joint ventures and associates either:
>
> (a) at cost, or
>
> (b) in accordance with IFRS 9.
>
> The entity shall apply the same accounting for each category of investments…

6. IAS 27 (as revised in 2000) permitted entities to measure investments in subsidiaries at cost, using the equity method, or in accordance with IAS 39. IAS 28 *Investments in Associates* permitted the same choices for investments in associates in SFS, and IAS 31 *Interests in Joint Ventures* did not indicate a preference for any particular treatment for accounting for interests in joint ventures in a joint venturer's SFS.

7. In 2003 the IASB decided to require the use of cost or IAS 39 for all investments included in SFS and to remove the equity method as one of the measurement options, because the equity method provide users with information that is reflected in the investor's consolidated or individual financial statements and does not need to be provided to the users of its SFS (paragraph BC10 of IAS 27).

Criticism of IAS 27 requirements

8. On the basis of the replies to the IASB Agenda Consultation, we understand that:

   (a) the corporate laws of some countries require listed companies to present SFS prepared in accordance with local regulations;

   (b) local regulations require that investments in subsidiaries, joint ventures and associates must be accounted for under the equity method; and

   (c) in most cases, the use of the equity method would be the only difference between SFS prepared in accordance with IFRSs and SFS prepared in accordance local regulations. Thus, entities in those countries must currently prepare two sets of financial statements.

9. Consequently, we understand that there is strong support from many interested parties for the IASB to allow the use of the equity method to account for investments in subsidiaries, joint ventures and associates in SFS.

Staff analysis

10. We note that:

    (a) IAS 27 does not mandate which entities produce SFS (paragraph 2 of IAS 27);

    (b) IFRS 10 requires an entity that is a parent to present consolidated financial statements; and

    (c) an entity may elect, or may be required by local regulations, to present SFS that comply with IFRSs (paragraph 3 of IAS 27).

11. Consequently, in our view:

    (a) SFS that comply with IFRSs are optional; they are mandatory only if required by local regulations.

    (b) SFS are strictly linked with local regulations, and for this reason few[1] jurisdictions require entities to present SFS that comply with IFRSs. In many jurisdictions income taxes and dividends are calculated on the basis of the amounts reported in SFS.

12. We are aware that adding the equity method as one of the measurement options in SFS for investments in subsidiaries, joint ventures and associate would impair comparability. However, we think that comparability of SFS is already (and especially) impaired by the fact that SFS that comply with IFRSs are optional. Consequently, we think that, in this specific case, the introduction of an additional accounting option would not imply a significant loss of comparability.

13. In our view, the equity method provides users with useful information, because it provides more timely information than the cost method. Indeed, under the equity

[1] Compared with the number of jurisdictions that require entities to present consolidated financial statements that comply with IFRSs.

method an investment is initially recognised at cost and then its carrying amount is increased, or reduced, to recognise the investor's share of profit or loss of the investee after the date of acquisition.

14. We also note that according to paragraph QC6 of the *Conceptual Framework* information may be relevant even if some users are already aware of it from other sources. Consequently, the fact that the equity method provides information that is already reflected in consolidated financial statements does not necessarily imply that it does not provide relevant information.

15. In our view, the equity method faithfully represents the financial performance of the investments in subsidiaries, joint ventures and associates, because using this method the investor would recognise its share of profit or loss of the investee in its SFS.

16. Consequently, we think that the IASB should amend IAS 27 to allow an entity to account for investments in subsidiaries, associates and joint ventures using the equity method in their SFS, because adding this option

    (a) would not result in a loss of information; and

    (b) would reduce compliance costs in some jurisdictions, because currently many entities prepare two sets of financial statements only because they cannot use the equity method in their SFS prepared in accordance with IFRSs.

Staff recommendation

17. We recommend that the IASB should amend IAS 27 to allow an entity to account for investments in subsidiaries, associates and joint ventures using the equity method in their SFS.

Question for the IASB

Does the IASB agree with the staff's recommendation that the IASB should amend IAS 27 to allow an entity to account in its SFS for investments in subsidiaries, associates and joint ventures using the equity method?