EQUITY METHOD IN SEPARATE FINANCIAL STATEMENTS – PROPOSED AMENDMENTS TO IAS 27

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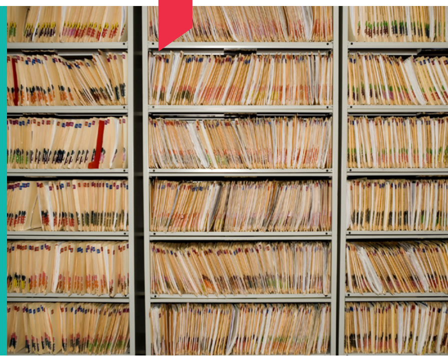

Summary

The International Accounting Standards Board (IASB) has issued Exposure Draft 2013/10 *Equity Method in Separate Financial Statements (Proposed amendments to IAS 27)* (the ED) for public comment. The ED proposes the introduction of an option for an entity to account for its interests in subsidiaries, joint ventures and associates using the equity method in its separate financial statements.

This option would be available by class of investment, and would reintroduce an accounting approach which was prohibited as part of a broad range of amendments made to IFRSs in 2003.

The ED also proposes minor consequential amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*, and IAS 28 *Investments in Associates and Joint Ventures*.

It is proposed that the amendments to IAS 27 *Separate Financial Statements*, if finalised, would be applied retrospectively with early application permitted. No effective date has been proposed.

The ED has been published with a 60 day consultation period, with comments due by 3 February 2014.

STATUS
Exposure Draft

EFFECTIVE DATE
To be confirmed

ACCOUNTING IMPACT
May be significant for entities that are required, or opt to, prepare separate financial statements.

Background

The ED has been proposed as a result of responses to the IASB's 2011 *Agenda Consultation*, in particular from constituents in jurisdictions in which an entity is required by law to prepare separate financial statements in which interests in subsidiaries, joint ventures and associates are accounted for using the equity method.

Currently, entities in these jurisdictions that report wholly in accordance with IFRS are required to prepare two sets of separate financial statements:

(i) In accordance with IFRS: interests in subsidiaries, joint ventures and associates are accounted for accordance with IAS 27 *Separate Financial Statements* (meaning that they are recorded either at cost, or financial assets in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*/ IFRS 9 *Financial Instruments*), and

(ii) In accordance with local law: interests in subsidiaries, joint ventures and associates are accounted for using the equity method.

Often, the only difference between these two sets of separate financial statements is the accounting treatment of the entity's interests in its subsidiaries, joint ventures and associates.

In some cases, local law contains requirements for separate financial statements to be prepared in accordance with IFRS and to include equity accounting, and those requirements can be difficult to reconcile.

The equity method

The equity method is a method of accounting currently required in accounting for interests in joint ventures and associates in an entity's consolidated and/or individual financial statements, subject to the exemptions from applying the equity method in IAS 28 (2011) paragraphs 17-19.

The equity method requires that the investor's investment is initially recognised at cost and then subsequently adjusted for the post-acquisition change in the investor's share of the investee's net assets (IAS 28.3).

Summary of the proposals

The ED proposes an amendment to IAS 27 that would introduce an option for an entity to account for its interests in subsidiaries, joint ventures and associates using the equity method in its separate financial statements, by class of investment.

This would result in amendments to various paragraphs in IAS 27 to incorporate the proposed equity method option:

- Introduction (paragraph IN1)
- Definitions (paragraphs 4 to 7)
- Preparation of separate financial statements (paragraph 10).

In addition the ED proposes to amend IAS 27.12 to clarify the treatment of dividends received from its interests in subsidiaries, joint ventures and associates in its separate financial statements, depending on whether the entity has, or has not, chosen to adopt the equity method option:

(i) Equity method option is not adopted: The dividend is recognised in profit or loss as income

(ii) Equity method option adopted: The dividend is recognised as a reduction in the carrying amount of the investment in the entities statement of financial position.

Currently, IFRS does not require the preparation of separate financial statements. There is no proposal in the ED to change this.

What the proposals mean

Provided it is not prohibited by law in their own jurisdictions, equity accounting in separate financial statements would be available for any entity that reports in accordance with IFRS and prepares separate financial statements (either voluntarily or as required by local law).

If an entity were to adopt the proposed equity accounting option, its separate financial statements would including a share of profit or loss, and other comprehensive income, of subsidiaries, joint ventures and associates with a corresponding adjustment to the carrying amount of the equity accounted investment in the statement of financial position.

Any dividends received would be deducted from the carrying amount of the equity accounted investment, and would not be recorded as income in profit or loss.

What should entities do in response to the ED?

Although the changes have only been proposed at this point, they may be finalised largely as drafted. Consequently, entities should consider whether they might wish in future to take advantage of the equity accounting option in their separate financial statements. It is also worth noting that, although the amendments would seem unlikely to be effective before 2015, an option to early adopt them is proposed.

The amendments are likely to be particularly attractive to those entities in jurisdictions where the law requires separate financial statements which include equity accounting. The proposals might enable them either to eliminate the need for two sets of separate financial statements (one IFRS and one legal), or make the adoption of IFRS possible for both consolidated and separate financial statements.

For those entities in jurisdictions which permit (but do not require) equity accounting in separate financial statements, the proposals might represent an attractive option depending on their overall effect.

Entities that might be affected by the proposals, and other interested parties, may wish to send their views to the IASB.

Effective date and comment period

It is proposed that the amendments to IAS 27, if finalised, would be applied retrospectively with early application permitted. No effective date has been proposed at this point.

The ED has been published with a 60 day consultation period, with comments due by 3 February 2014.

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