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cutting through complexity

Equity method in separate financial statements

An option proposed

December 2013, Issue 2013/21

IN THE HEADLINES

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> “Companies in some countries will welcome the proposal to allow the equity method in separate financial statements.”
>
> – Peter Carlson, KPMG’s global IFRS business combinations and consolidation deputy leader

An option proposed – accommodating the needs of some countries

In some countries, local laws or regulations require separate financial statements that apply equity accounting for investments in associates, joint ventures and subsidiaries. However, IFRS does not currently permit this. In some cases, the use of the equity method is the only difference between separate financial statements prepared under IFRS and those under local regulations.

Constituents have therefore asked the IASB to restore[1] the option to report investments in associates, joint ventures and subsidiaries using the equity method in their separate financial statements. In response to these requests, and in a departure from past practice – the IASB does not usually flex IFRS to accommodate accounting practices at a national level – the Board issued its exposure draft (ED) *Equity Method in Separate Financial Statements (Proposed amendments to IAS 27)* on 2 December 2013.

1 It was previously eliminated in 2003.

Increasing the use of separate financial statements but also increasing diversity

Currently, companies preparing separate financial statements under IFRS have to elect to measure investments in subsidiaries, associates and joint ventures either at cost or in accordance with the financial instruments standards.

The proposal would implement a third option, allowing companies to account for investments under the equity method, in accordance with IAS 28 *Investments in Associates and Joint Ventures*. This may lead to more companies applying IFRS in their separate financial statements; however, the introduction of a third option may increase diversity in reporting practice.

The option may also be of interest to financial institutions that are regulated on the basis of their separate financial statements.

Equity method – one-line consolidation or financial instruments valuation?

There has been a long line of ‘running amendments’ in relation to equity accounting, raising questions about its nature and purpose – e.g. whether it is a one-line consolidation, or just a type of financial instruments valuation accounting. This proposal appears to put more distance between equity accounting and consolidated financial statements, raising that question again.

At the same time, it has long been recognised that equity accounting would benefit from a complete review – and this is now one of the IASB’s research priorities.

> “The proposal puts more stress on questions about the nature of equity accounting.”
>
> – Mike Metcalf, KPMG’s global IFRS business combinations and consolidation leader

Adoption

The proposal would be applied retrospectively. As usual with EDs, an effective date has not yet been proposed. However, early adoption would be permitted.

A shorter comment period

Comments are due to the IASB by 3 February 2014. The comment period is shorter than usual, because the ED is considered urgent for jurisdictions that would benefit from the amendments.

Next steps

For more information on the proposal, please go to the IASB press release or speak to your usual KPMG contact.

Publication name: *In the Headlines – Equity method in separate financial statements*

Publication number: Issue 2013/21

Publication date: December 2013

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