European Financial Reporting Advisory Group

**ED/2012/3** ***Equity Method: Share of Other Net Asset Changes (Proposed amendments to IAS 28)***

# Feedback to Constituents – EFRAG Final Comment Letter

**June 2013**

## Objective of this feedback statement

EFRAG published its final comment letter on the ED/2012/3 *Equity Method: Share of Other Net Asset Changes (Proposed amendments to IAS 28)* ('the ED') on 15 April 2013.

This feedback statement summarises the main comments received by EFRAG on its draft comment letter and explains how those comments were considered by the EFRAG Technical Expert Group (EFRAG TEG) during its technical discussions when reaching a final position on the ED.

## Background to the ED

In November 2012, the IASB published the ED with a request for comments by 22 March 2013.

The ED aimed to provide guidance on how investors should recognise their share of the changes in the net assets of an equity-accounted for investee that are not recognised in profit or loss or other comprehensive income of the investee, and that are not distributions received ('other net asset changes'). No guidance currently exists in IAS 28 *Investments in Associates and Joint Ventures.*

The amendments proposed that an investor should recognise directly in equity its ownership interest of other net asset changes. Such changes include those arising from movements in the share capital of the investee (e.g. when the investee issues additional shares to third parties or buys back shares from third parties) and movements in other components of the investee's equity (e.g. when an investee accounts for an equity settled share-based payment transaction).

In addition, the proposed amendments would require reclassification to profit or loss ('recycling') of the cumulative amount of equity that the investor previously recognised when the investor discontinues the use of the equity method.

Further details are available on the project page on EFRAG´s website.

## EFRAG's draft comment letter

On 21 December 2013, EFRAG published its draft comment letter on the proposals. In the draft comment letter EFRAG agreed that diversity in practice existed on how investors recognised their share of other net asset changes, but did not reach a tentative position on the proposals. Instead, the draft comment letter set out three views held by EFRAG TEG members.

## EFRAG's final comment letter

EFRAG's final comment letter agreed that diversity in practice existed on how investors recognise their share of other net asset changes and welcomed the IASB's efforts to address the issue.

However, EFRAG believed that a short-term solution should not create inconsistencies with existing IFRS nor introduce a new category of 'recyclable equity' and therefore did not support the proposed amendments.

# Detailed analysis of issues, comments received and changes made to EFRAG final comment letter

## EFRAG's tentative views expressed in the draft comment letter and constituents' comments

*EFRAG's tentative position*

In the draft comment letter EFRAG agreed that diversity in practice existed on how investors recognised their share of other net asset changes.

However, EFRAG TEG members had three different views on the accounting for these and therefore no tentative position was taken. The three different views were set out in the draft comment letter, and can be summarised as follows:

**View 1:** Agreed that other net asset changes should be recognised in equity and reclassified to profit or loss when the investor discontinues the use of the equity method (the IASB's proposal).
**View 2:** The investor should only recognise changes in the investee's net assets that arise from profit or loss, other comprehensive income and distributions received. Under this view, reclassification would not be necessary.
**View 3:** The investor should account for other net asset changes that result in indirect decreases and increases in the investor's ownership interest in the same way as actual disposals and acquisitions of interest in the investee. Under this view, reclassification would not be necessary.

*Comments received from constituents*

The majority of constituents did not support the proposals and identified what they saw as significant flaws with the proposed amendments.

Those constituents who did support the proposed amendments generally did so on the grounds that they were a pragmatic, short term solution. There was no consensus on the ideal accounting for other net asset changes.

## EFRAG's response to constituent comments

In its final comment letter EFRAG did not support the proposed amendments. The final comment letter identified the inconsistency with the requirements of IAS 1 which requires an entity to present all owner changes in equity within a statement of changes in equity. Non-owner changes in net assets are presented in the statement of comprehensive income, and arguably the investee's other net asset changes should also be presented in the statement of comprehensive income. Overall, the proposals in the ED highlighted that there was a lack of clarity about the purpose of the equity method.

The final comment letter requested that the IASB clarify the principles (for example, whether it is considered a 'one-line consolidation' or a valuation approach), in order to address the various types of transactions that result in other net asset changes, in a way that would provide a basis for resolving practice issues relating to the equity method and ensure consistency with existing IFRS.

This would require the IASB to undertake further work on how to address the issue, which could be done before the IASB starts work on its longer term project on the equity method.

Given the diversity in constituents' views, EFRAG did not propose an alternative situation, but provided examples of transactions that could give rise to other net asset changes that should be considered when the underlying principle is clarified.

EFRAG also disagreed with the proposed reclassification to profit or loss when the investor ceased to use the equity method. This was on the basis that there was no conceptual basis for such a requirement, given that the ED starts from the premise that other net asset changes should be treated in the same way as

## EFRAG's tentative views expressed in the draft comment letter and constituents' comments

Supportive of the proposed amendments

A minority of constituents supported View 1 (and the proposed amendments) Of those constituents, most did not support the proposed reclassification to profit or loss requirements.

Constituents who supported the proposals in the ED generally did so on the grounds they were a pragmatic short-term solution or that the proposals were a return to previous requirements. However, these respondents called for a more comprehensive debate about what equity method accounting is.

Not supportive of the proposed amendments

The majority of constituents did not support the proposed amendments, and of these most expressed a view equivalent to View 3 in EFRAG´s draft comment letter. The reasons given included:

- Other net asset changes are not transactions with owners of the group and therefore their recognition in equity conflicts with the requirements of IAS 1 *Presentation of Financial Statements*;
- As associates are not part of the group if the equity method was a one-line consolidation, this should follow 'parent company model' rather than economic entity model;
- That the accounting treatment for a dilution or implied disposal should not differ from the accounting for a direct disposal given that it was economically the same;
- This was the accounting already used by preparers.

Some constituents also commented that the treatment suggested is inconsistent with established accounting principles in other areas and furthermore that the difficulties in this area are indicative of wider problems with the equity method accounting.

None of these constituents supported the proposed reclassification to profit or loss when the investor ceased to use the equity method.

## EFRAG's response to constituent comments

transactions with owners.

Given that the IASB was currently considering the principles that should govern recycling in its work on the Conceptual Framework, EFRAG did not believe it was the time to introduce a new category of 'recyclable equity'.

## List of respondents to EFRAG's draft comment letter

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| CL01 | Financial Reporting Council |
| CL02 | Estonian Accounting Standards Board |
| CL03 | FSR – Danske Revisorer |
| CL04 | Accounting Standards Committee of Germany |
| CL05 | Institute of Chartered Accountants of England and Wales |
| CL06 | European Securities and Markets Authority |
| CL07 | Federation of European Accountants |
| CL08 | BusinessEurope |
| CL09 | Norwegian Accounting Standards Board |
| CL10 | Instituto de Contabilidad y Auditoria de Cuentas |
| CL11 | Autorité des Normes Comptables |
| CL12 | Organismo Italiano di Contabilità |