EFRAG
Financial reporting

EFRAG FR TEG meeting
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Paper 05-03
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Summary of recent outreaches, recent EFRAG FRB and FR TEG meetings

	EFRAG Secretariat views as of 8 October 2024, (FR TEG-FRB, EFRAG FIWG, preparer organisations, accounting organisations, National Standard Setters, Italian preparer and Spanish preparer) meetings in October 2024
General comments	<u>EFRAG Secretariat views as of 8 October</u> • Among other things, we observe that the unit of account differs depending on the type of transaction undertaken by the reporting entity. For purchases of ownership interest that result in an investor obtaining significant influence, similar to IFRS 3, the prior ownership interest held is measured at fair value. When the investor obtains an additional ownership interest in an associate while retaining significant influence, similar to IFRS 11, the additional ownership interest is treated as a separate unit of account and a layered /accumulation of purchases approach without a need to remeasure the prior ownership interests. And when the investor disposes of an ownership interest in an associate while retaining significant influence, the entire holding in the associate is the unit of account applied when determining the amount to be derecognised and the gain or loss to be recognised. We also recognise that minimising complexity underpins the IASB's decisions to require the application of different units of account for acquiring while retaining significant influence versus obtaining significant influence or partial disposal of ownership interest while retaining significant influence. • The amendment eliminating the restricted recognition of gains or losses for transactions with associates underscores the need for a clarification of whether the equity method is a one-line consolidation or a measurement method. <u>FR TEG-FRB</u> • As outlined below in the discussions on specific questions, some members agreed with several of the proposed amendments addressing the specific application challenges that arise in practice, and one member noted the initial positive reception of the proposals by stakeholders in his jurisdiction. At the same time, several members disagreed with some of the proposals (e.g., amendments for transactions with associates).

	Moreover, several members noted the missed opportunity to address the challenges associated with the equity method of accounting and they suggested that the fundamental question of whether the equity method is a one-line consolidation or measurement method ought to have underpinned the proposed amendments. They also observed the lack of internal consistency across the ED's proposals in the weight accorded to conceptual reasoning versus simplification and cost-benefit considerations. For instance, there is inconsistency in the IASB primarily viewing the equity method as either a one-line consolidation or measurement method. • A member suggested that the drafting of the EFRAG DCL should be more critical of the proposed amendments (including those related to transactions with associates) than was done in the EFRAG Secretariat's issues paper. <u>EFRAG FIWG</u> • Members agreed that, as noted in the agenda paper, the ED does not address the fundamental issue of whether the equity method is either a measurement method or one-line consolidation, which would impact the answers to the raised questions. <u>Accounting organisation</u> • Several concerns were raised, the PPA in the layered approach, confusing definition of cost, several unaddressed topics including treatment of transaction cost. • Notwithstanding the reservations expressed, AE CRPG members initial impressions were that the ED proposals would help address several challenges faced in current practice. <u>National Standard Setter</u> • General impression of the NSS working group members was that the ED is beneficial as it will address multiple application questions and reduce diversity in practice. <u>National Standard Setter</u> • In general, the ED is useful because it clarifies some aspects of the equity method in which diversity in practice exists.

Questions	EFRAG Secretariat views as of 8 October 2024 informed by past outreach and discussions (FR TEG-FRB, EFRAG FIWG, preparer organisations, accounting organisations, National Standard Setters, Italian preparer and Spanish preparer) meetings in October 2024
Q1 Cost of obtaining significant influence: The IASB is proposing an investor: (a) measure the cost of an associate, on obtaining significant influence, at the fair value, including the fair value of any previously held ownership interest; (b) recognise contingent consideration as part of the consideration transferred and measure it at fair value. Thereafter: (i) not remeasure contingent consideration classified as an equity instrument; and (ii) measure other contingent considerations at fair value at each reporting date and recognise changes in fair value in profit or loss. (c) Include in the carrying amount of the investment the deferred tax effects.	EFRAG Secretariat views as of 8 October informed by past outreach and discussions • Based on the feedback received during the discussions with the EFRAG FR TEG and the EFRAG working groups, the EFRAG Secretariat did not identify any issues with and therefore supports the proposal of measuring the cost of the ownership interests to obtain significant influence at fair value. This proposal is not perceived as controversial as it is widely applied in practice and is conceptually consistent with accounting for business combinations by an acquirer when obtaining control of acquirees under IFRS 3 *Business Combinations*. • Further, measuring the previously held interest at fair value would not be overly costly for entities to apply because before obtaining significant influence, the previously held ownership interest would have been measured at fair value under IFRS 9 *Financial Instruments*. We also support the proposed initial and subsequent measurement of contingent consideration at fair value as this is similar to the approach applied under IFRS 3. It however remains unclear whether, similar to IFRS 3, a 12-month window to revise the contingent consideration will be or ought to be allowed. *Deferred tax effects* • Though not explicitly stated as a requirement in Question 1 of the ED, as noted in the BC 85-88, the IASB has decided to propose requiring an investor to include in the carrying amount of its investment the deferred tax effects related to measuring its share of the associate's identifiable assets and liabilities at fair value. As noted in BC 87, the IASB considered that the proposed approach would be consistent with paragraph 26 of IAS 28, which states that the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for the acquisition of an investment in an associate. IFRS 3 requires an acquirer to recognise and measure a deferred tax asset or liability arising from the assets acquired and liabilities assumed in a business combination under IAS 12 *Income Taxes*. Moreover, the deferred tax effects relate to measuring the associate's identifiable assets and liabilities at fair value at the date of obtaining

	significant influence (Principle D) and the subsequent reversal of the deferred tax effects relates to recognising the investor's share of changes in the associate's net assets (Principle E). • However, although no concerns have been aired by EFRAG's stakeholders, the EFRAG Secretariat is aware of some international stakeholders[1]holding an alternative view and disagreeing with the IASB's proposal for the deferred tax effects treatment. These stakeholders consider the unit of account for an associate to be the investment as a whole (IAS 28.10) and therefore that the deferred tax and IAS 12 ought to only apply on acquisition if the tax base and the cost of investment differ (i.e. as defined by paragraph 5 of IAS 12). As per this view, there should not be any deferred tax recognition arising from the purchase price allocation (PPA) allocation on obtaining significant influence. Moreover, it could be argued that, unlike the assets and liabilities of a subsidiary, which are recognised in an entity's consolidated financial statements, the individual assets and liabilities of an associate are not recognised in the investor's financial statements. Therefore, an entity does not identify temporary differences arising from the fair value adjustments of the associate's assets and liabilities. Of note, the April 2023 IASB staff paper (Paragraphs 12& 28-35 of the IASB staff paper) outlined two alternative views whereby there would be no recognition of deferred tax effects from the fair value adjustments of the associate's assets and liabilities. One of the alternative views is similar to the alternative view just explained. The second alternative view is that an investor should not recognise the deferred tax exemption because it applies the initial recognition exemption in IAS 12. • Hence, this is an area that will need further scrutiny, particularly for consistency with IAS 12. It should also be noted that according to paragraph 4.49 of the Conceptual Framework for Financial Reporting, in some circumstances, it may be appropriate to select one unit of account for recognition and a different unit of account for measurement. FR TEG-FRB • *Proposed definition of cost*: Several members supported the definition of the cost of the equity-accounted investment when obtaining the significant influence, specifically, with the proposed inclusion of the fair value of previously held ownership interest and contingent consideration measured at fair value. It was however suggested that the definition of contingent consideration under IFRS 3 should be broadened (i.e., to include the situations when no control is obtained but there is significant influence) or IAS 28 should include further guidance aligning the requirements with IFRS 3.

[1] Discussions at the 2024 World Standard Setter Forum

	• *Goodwill recognition*: While providing a user perspective, one member considered recognising goodwill to be only relevant in a consolidation context (i.e., when investees are controlled by the investor). This member considered goodwill to be meaningless if the equity method is being applied as a measurement method for significant-influence ownership interests (i.e., when, during the acquisition of ownership interests, an investor either obtains or retains its significant influence). • *Directly attributable transaction costs*: Members called for the directly attributable transaction costs to be explicitly included in the carrying amount of the investment. • *Deferred taxes*: Mixed views were expressed on the proposed inclusion of deferred taxes in the carrying amount of the investment. Some members supported the proposal noting its alignment with IFRS 3 principles whereby deferred taxes arising from fair value adjustments are included in the purchase price allocation (PPA). However, another member questioned the relevance and the rationale behind the inclusion of deferred taxes as part of the PPA. A member suggested that the IASB should further clarify if the intention is to include the deferred taxes arising from the PPA exercise or the deferred taxes specific to the equity method accounting, for example, when the purchase price is deductible at the investor's level. Another member pointed to the significant challenges expected including the challenges in obtaining the necessary information due to limited data availability. It was suggested that the EFRAG DCL should include a question to constituents on whether the proposed treatment of deferred tax is common in current practice. EFRAG FIWG • One member noted that it is a common practice for financial institutions to consider their equity holdings differently depending on whether they are held for investment purposes or as part of their market-making/ trading activity. The former (holding as investment) is accounted for using the equity method and the latter (holding for market making) is accounted for at FVTPL. As such, it will be useful to allow financial institutions to distinguish between these two types of portfolios and have specific requirements outlined similar to current paragraphs 18 and 19 of IAS 28 (included in the ED as paragraphs 5 and 6). • With regards to the subsequent measurement of contingent consideration, a member noted that the current proposal to fair value the contingent consideration at each reporting date (unless accounted for as equity) is inconsistent with the equity method which can be seen as a cost measurement basis (cost is updated for adjustments in net assets attributable to the investor), and this also raises question on consistency of what is meant by cost across IFRS Accounting literature. The complexity of performing the fair value calculation at each reporting date was also highlighted.

	<u>National Standard Setter</u> • The NSS's working group raised a question about the accounting treatment of the transaction costs. In accordance with IFRS 3 Business Combinations, the acquisition related costs are not part of the exchange transaction between the acquirer and the acquiree (or its former owners), they are not considered part of the business combination. Therefore, except for costs to issue debt or equity securities that are recognised in accordance with IAS 32 and IAS 39, IFRS 3 requires an entity to account for acquisition related costs as expenses in the periods in which the costs are incurred and the services are received. ED does not explicitly state how to treat the transaction costs incurred upon acquiring significant influence or when purchasing additional ownership interest which may result in diversity in practice. • Further, a question was raised on the investment which is considered as investment in asset and is accounted in light of IAS 16. Therefore, upon gaining significant influence, the previously held shares are not accounted for at fair value according to IFRS 9 as stated in the ED. How to consider previously held shares if those are accounted for under IAS 16? • The IASB's conclusion that measuring at fair value previously held shares which were measured at FVPL (IFRS 9) would not generate any extra cost for the investor is not correct because a) for smaller entities such FV measurement is not available at any point in time and would only be computed at year-end, and b) form the valuation point of view it is questionable if the fair value is the same, form the point of view on an investor, to hold a financial asset or to have a significant influence (control prime related to a chair at the board for example). • Deferred tax assets were considered a normal element when performing purchase price allocation, however difficulties of getting the tax basis information. <u>Italian preparer</u> <u>National Standard Setter</u> • Some doubts have been expressed about the recognition of DTA and DTL even when an entity acquires an associate or a JV which does not represent a business in accordance with IFRS 3. • The preparer would prefer additional clarification on asset deal vs business and more alignment with US GAAP to avoid that EU companies are in disadvantage.

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<u>Preparer Organisation</u>
• Welcoming the clarification of how to measure / consider the cost of previously held shares.
• Question about the transaction costs and how to treat them (if in line with IFRS 3, then expense, however in practice those costs are generally considered part of the consideration following the logic of IAS 28).
• Not clear how to follow the deferred tax assets after the initial recognition within the PPA exercise.
• When the consideration transferred is not cash but contribution in kind, certain jurisdictions may have additional tax consequences, how to account for the deferred taxes in this case?

<u>Accounting Organisation</u>
• Cost definition is similar to IFRS 3 and in this case an investor cannot include the transaction costs in the carrying amount and will need to expense them. Inconsistent or misleading with the attributable cost paragraph in IAS 28.
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Q2 Change of ownership while retaining significant influence: The IASB is proposing to require that an investor:
(d) at the date of <u>purchasing an additional ownership interest</u> in an associate:
(i) recognise that additional ownership interest and measure it at the fair value of the consideration transferred.
(ii) include in the carrying amount the investor’s additional share of the fair value of the associate’s identifiable assets and liabilities; and
(iii) account for any difference between (i) and (ii) either as goodwill included as
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<u>EFRAG Secretariat views as of 8 October informed by past outreach and discussions</u>
Purchase of additional interest while retaining significant influence
• From a usefulness of information perspective, a majority of EFRAG’s stakeholders have not disagreed with the proposal to only fair value the additional ownership interest acquired while retaining significant influence (i.e., a layered approach). However, some stakeholders have raised concerns about the complexity of the layered approach in cases where multiple purchases of ownership interests in an associate or joint venture by an investor occurs while retaining significant influence. These stakeholders have noted that the proposed requirements would result in a purchase-price allocation exercise being performed for each additional purchase, making this exercise costly and burdensome for preparers. Other stakeholders have also pointed to the inconsistency in the unit of account applied depending on whether an entity is acquiring or disposing of ownership interests while retaining significant influence.
• On the other hand, the majority of the stakeholders, both preparers and users, also expressed their disagreement with the alternative approach explored by the IASB which would entail the remeasurement of the carrying amount of previously held interest at fair value when an additional interest is purchased. These stakeholders deemed that such a remeasurement could result in earnings management opportunities (i.e.,
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part of the carrying amount of the investment or as a gain from a bargain purchase in profit or loss. (e) at the date of disposing of an ownership interest: (i) derecognise the disposed portion of its investment in the associate measured as a percentage of the carrying amount of the investment; and (ii) recognise any difference between the consideration received and the amount of the disposed portion as a gain or loss in profit or loss. (f) for other changes in its ownership interest in an associate: (i) recognise an increase in its ownership interest, as if purchasing an additional ownership interest. In (a)(i), ‘the fair value of the consideration transferred’ shall be read as ‘the investor’s share of the change in its associate’s net assets arising from the associate’s redemption of equity instruments’. (ii) recognise a decrease in its ownership interest, as if disposing of an ownership interest. In (b)(ii) ‘the consideration received’ shall be read as ‘the investor’s share of the change in its associate’s net assets arising from the associate’s issue of equity instruments’.	opportunistic acquisition of additional ownership interest to influence reporting outcomes) and it would also lead to inconsistent and incomparable reporting (i.e., fair value remeasurement of previously held ownership interests only being done by those entities that acquire additional ownership interests). We also note that those who disagree with the layered approach tend to be in favour of eliminating the equity method of accounting entirely and only accounting for equity ownership under either IFRS 9 or *IFRS 10 Consolidated Financial Statements* when having control of the investee. Hence on balance, considering that the IASB is not fundamentally reviewing the equity method, the EFRAG Secretariat supports the IASB proposal. • As it relates to the proposed recognition of the bargain purchase’s gains in the statement of profit or loss, the EFRAG Secretariat notes that the proposals are based on the assumption that each layer is a separate unit of account and there is no ‘netting’ between goodwill identified at previous acquisition and a bargain purchase gain identified during the next layer of acquisition. We note that, for the same reason (i.e. each layer is a separate unit of account), as described below, the IASB has proposed that the recognition of the share of an associate’s losses will not be offset against the carrying amount of an acquired additional ownership interest. • However, this approach (i.e. each layer is a separate unit of account) is not consistently applied across the proposals of the ED and this may possibly result in a distorted representation of the economics of the investment. For example, as noted below, the ED specifies that when performing an impairment test, an entity is to consider the carrying amount as a whole and any impairment loss recognised is not allocated to any asset, including goodwill that forms part of the carrying amount of the net investment (paragraph 58 of the ED). • Moreover, some stakeholders have argued that the economics of the transaction would be better reflected if bargain purchase gains are first netted against the previously recognised goodwill, as that previously recognised goodwill ultimately represents the entity’s expectations of future gains. *Disposing of an ownership interest while retaining significant influence* • EFRAG’s stakeholders expressed overall support for the proposals for the accounting for disposals of ownership interest while retaining significant influence. However, as noted above, there is a difference in the unit of account applied for the acquisition of an additional ownership interest accounted for through the layered approach versus the unit of account applied for the disposal of ownership interests while retaining

	significant influence. For the latter, the entire investment is treated as a single unit of account. This inconsistency in the unit of account may distort the reporting outcomes. • The EFRAG Secretariat acknowledges that when taking the decision, the IASB viewed the proposed approach for accounting for disposals of ownership interest to be more understandable and less complex. However, the EFRAG Secretariat also notes that there might be situations where an entity would be able to specifically identify which layer of its investment it disposes of, for example, if different layers were acquired by different legal entities within the group. The EFRAG Secretariat suggests that in cases, where such specific identification is possible, an entity could be allowed to apply specific carrying value as this could more faithfully represent the economic consequences of the disposal. In other words, the differing units of account at acquisition and disposal could distort results. The EFRAG Secretariat suggests exploring, via a question to constituents, the practicability and cost implications of a layered disposal approach that mirrors the layered acquisition approach, and whether such a layered approach should be allowed as an alternative method. *Other changes in ownership interest while retaining significant influence (e.g. associate issuance or redemption of shares)* • The EFRAG Secretariat has not identified any specific concerns with the proposals based on the limited feedback received. That said, the proposals for changes in ownership via an associate's redemption or issuance of shares are consistent with the proposals for acquiring an additional interest or disposal of an interest while retaining significant influence. Therefore, any concerns related to the additions or disposals expressed above would be applicable to these proposals. FR TEG-FRB • *Acquiring additional ownership interest while retaining significant influence*: Some members expressed their support for the ED's proposed layered approach in accounting for additions of ownership interest while retaining significant influence. They considered the layered approach to be consistent with the cost accumulation principle and that it better reflects the equity method of accounting compared to the fair value measurement. • However, some members also had conceptual questions and reservations about the layered approach. There is a question of whether additions of ownership interests ought to be deemed separate assets. Some members expressed concern about the inconsistent treatment of goodwill and bargain purchases. On the differing units of account respectively applied for additions versus disposals, a member noted that the conceptual framework may allow different units of accounts for recognition and measurement, however, this

	is not the case for recognition and derecognition. Other members noted the risk of earnings management that would arise from differing units of account for additions and disposals. Another member noted the complexity that preparers would face in applying the layered approach (e.g., in tracking fair value adjustments and incorporating deferred tax effects in the PPA). • *Disposal of ownership interest while retaining significant influence:* A member disagreed with the EFRAG Secretariat's suggested treatment of disposals (i.e., allowing specific identification where possible). Another member however noted that the specific identification method could be considered to avoid earnings management. • *Associate's issuance or redemption of shares:* A member expressed concern about the proposed treatment of the resulting change in ownership as being equivalent to the purchase or disposal of shares in the associate. It was noted that the investor entity does not undertake a transaction during either the issuance or redemption of shares by an associate. Moreover, the proposed treatment will be costly for entities whose associates have high volumes of share buybacks. EFRAG FIWG • Several members highlighted the cost and complexity of performing a purchase price allocation exercise for each additional layer of ownership interests purchased while applying the ED's proposed 'layered' approach and they called for further analysis of the cost/benefit considerations. A member questioned whether additional disclosures or considerations similar to IFRS 3 are to be followed in case of a bargain purchase. • Members agreed with the proposed measurement of disposal of ownership interest as a proportion of the carrying amount of the investment and they considered it to be a useful simplification. One member disagreed with the EFRAG Secretariat's concern over the different units of account respectively applied upon recognition and derecognition of ownership interest. The member also disagreed with the EFRAG Secretariat's suggestion that the specific identification method for disposals be allowed. National Standard Setter • The layered approach on purchases of additional ownership interest is viewed as the least bad of all alternatives the IASB considered. • Application complexity and cost both when performing the PPA for each layer but also when calculating investor's share of profit or loss because each layer will generate its own adjustments to fair value of

	underlying assets and liabilities. It is not clear how to apply it in practice – an investor will have multiple ledgers to follow-up though the life of an investment. • The ED's proposals in relation to disposals were deemed simplification, however, inconsistency with the unit of account was noted as well. Further, questions were raised how to apply the proposals if the ownership shares are different (i.e. ordinary share vs preferential shares or shares without voting rights or with extra voting rights etc.) • The ED's proposals related to other changes raised multiple concerns about the cost and complexity of the proposals due to investor's potential lack of information. Stakeholders also inquired about the extent of the proposals assuming that an investee is a group constituted of various companies who might be also equity - accounted and have their own changes of ownership interest – applying the logic of the IASB, any changes would need to be considered at the level of an investor, however, in practice it would be very difficult. Preparer organisation • Concerns about cost and complexity of performing a PPA at each additional acquisition. Does not seem to be conceptually justified by comparing to the consolidation logic, where additional purchase of minority interest would not result in an additional PPA. Unit of account and its consistent application are of concern – if the investment is considered to be a single unit of account, the fair value measurement should only take place at the moment of gaining significant influence and any subsequent acquisitions be accounted at cost. • Suggestion for the IASB to cater for simplicity in application, which can be obtained by stipulating clear principles (consolidation or measurement, unit of account issues). • Not agreeing with the proposals for other changes (deemed acquisition, deemed purchase) – complexity, lack of information (Michael Fechner's point). Shall deemed disposal trigger IFRS 5 requirements? Italian preparer National Standard Setter • The ED does not clarify if the proposal about the other changes in the investor's ownership interest in the associate while retaining significant influence is applicable only for a capital increase (ordinary shares) or

	also for issues of hybrid instruments which, for example, have an impact on dividends but not on voting rights.
Q3 Recognition of losses: The IASB is proposing an investor: (g) on purchasing an additional ownership interest, not recognise its share of an associate's losses that it has not recognised by reducing the carrying amount of the additional ownership interest. (h) recognise and present separately its share of the associate's profit or loss and its share of the associate's other comprehensive income.	EFRAG Secretariat views as of 8 October informed by past outreach and discussions • *Recognition of losses- purchase of additional interest*: EFRAG Secretariat agrees with the reasoning provided by the IASB in its decision that when an entity purchases an additional ownership interest while having unrecognised losses associated with the previously held interest, those losses are not deducted from the carrying amount of the additional investment. It would be an inconsistent application of unit of account (i.e., under a layered approach the unit of account is the additional purchased ownership interest and it would be inappropriate to apportion losses from previously held ownership interest to the additional interest). Moreover, the losses of an associate are not necessarily an indicator of the impairment[2] of the associate. • That said, the EFRAG Secretariat suggests that IASB should explicitly state that when an entity purchases an additional ownership interest while having unrecognised losses already incurred, an entity needs to assess if this additional investment represents an implicit funding of the associate or an investment. Funding, in this situation, would be an indication that a constructive obligation has been created and the unrecognised losses need to be recognised in line with the requirement of paragraph 47 of the ED. • *Recognition of losses- recognition of each component of comprehensive income*: There has been limited feedback received by the EFRAG Secretariat on the proposals related to separate recognition of a parent's share of each component of the associate's comprehensive income and this will be an area of further outreach to users. That said, the EFRAG Secretariat considers the proposal to be aligned with primacy being accorded to the profit or loss statement as the primary source of information about the entity's performance. • However, the EFRAG Secretariat is unconvinced by the IASB's arguments expressed in BC 62 for deciding not to develop proposed answers for other related application questions, such as the order of recognising profits in profit or loss and in other comprehensive income when an investor resumes recognising its share of the associate's profits. The IASB argues that these situations are rare in practice and were not in the application questions. The EFRAG Secretariat considers that the treatment of profit or loss versus OCI is a conceptual question that ought to be addressed via reference to Conceptual Framework-based reasoning and without

[2] The impairment is determined by applying the related impairment requirements in IAS 28 and IAS 36

	making this dependent on the pervasiveness of arising situations. Moreover, accounting standard setting should cater for both losses and gains in the recovery of losses and not only provide asymmetrical answers. FR TEG-FRB • One member raised concerns about the accounting treatment of unrecognised losses when purchasing additional ownership interests. Specifically, he questioned the appropriateness of recognising additional goodwill in situations where the net assets are already negative. National Standard Setter • Stakeholders asked for clarifications on how to interpret paragraphs 48, 50 and 52 as some of the stakeholders viewed them as inconsistent or subject to different interpretation. • Stakeholders called for the IASB to address the question on how an investor would need to account for profits when the investee returns to the profit position (in which order to account for profits if PL and OCI do not return to profit situation at the same time considering that the PL is deemed the primary source of information and have priority over OCI?). • Complexity to separate the losses resulting from PL or from OCI and then further break them down into the components of OCI (is it required to break out by component of OCI? How to do this breakout – ED is silent). • For the accumulated losses from the past, when an investor was not tracing the origin of the loss separately between PL and OCI, how to apply the requirements prospectively? Also knowing that the losses would be impacted by the retrospective application of the ED's proposals on full gain / loss elimination and retrospective application of the FV changes of contingent consideration.
Q4 Transactions with associates: The IASB is proposing to require that an investor recognise in full gains and losses resulting from all 'upstream' and 'downstream' transactions with its associates, including transactions involving the loss of control of a subsidiary.	EFRAG Secretariat views as of 8 October informed by past outreach and discussions • Overall, in alignment with several EFRAG stakeholders that have expressed their support for the full gain or loss approach, the EFRAG Secretariat acknowledges and supports the reasons that the IASB opted for Alternative 1 including that the associate is not within the investor/reporting entity's boundary of reporting, it eliminates the perceived conflict between IFRS 10 and IAS 28, and it lessens the complexity and reduces the diversity in practice that was in place due to consideration of different types of transactions before

	determining the elimination of gains or losses (e.g., whether business or asset or whether housed in or outside subsidiary). EFRAG Secretariat also understands that as articulated in paragraphs BC 72 to 75, the ED's proposal is based on the considerations of users' information needs, preparers' cost constraints and similar requirements in other IFRS Accounting Standards. • However, in the EFRAG Secretariat's view, this amendment also underscores the need for the IASB to further clarify whether the equity method is either a one-line consolidation or measurement method. Such a clarification will help provide a proper conceptual basis for the proposals. <u>FR TEG-FRB</u> • A range of views were expressed on the proposed recognition of full gains or losses for an investor's transactions with associates and joint ventures. Some members supported the IASB's resolution of the current inconsistency between the IFRS 10 (i.e., on the sale of a subsidiary) and IAS 28. • However, other members expressed scepticism about the ED's proposed amendment, particularly in respect of downstream transactions and joint ventures. They noted that the proposed amendment was based on weak conceptual arguments and simplification considerations above anything else. These members were concerned that the proposed amendment would lead to structuring and earnings management. • Via written comments, a member noted that paragraph 54 of the ED (effectively combining paragraphs 30 and 31 of IAS 28) is unclear and difficult to interpret. One interpretation of this paragraph could be that if a contribution that lacks commercial substance is made to a subsidiary in exchange for an equity interest no gain is recognised while a full gain is recognised if monetary or non-monetary assets are received in exchange for the contribution. In effect, if a reporting entity's transaction with its subsidiary is deemed to lack commercial substance, the recognition of gains would seem to depend on whether the reporting entity either obtains an equity interest or receives monetary/non-monetary assets in exchange for its contribution. It is unclear whether this is the intended interpretation of paragraph 54 of the ED. • Several members commented on the implications of the proposed amendment (i.e. recognising full gains or losses for all transactions with associates) for separate financial statements as discussed further below in the summary of discussions on Question 6 of the ED. <u>EFRAG FIWG</u> • Members considered the proposals of the ED requiring companies to recognise full gain or loss on all transactions with its associates to be a useful simplification. However, they also raised concerns about the

	usefulness of the information to users of financial statements on a full gain or loss arising from sales/transfers of assets between an investor and its associates and joint ventures. This amendment meant recognising the 'unrealised' gain or loss on that sale/transfer between the investor and its investee. Similar to what is done for consolidation, users might find eliminating this ''unrecognised'' gain or loss more useful. Overall, members considered that the proposals represent a significant change from the current requirements for partial gain and loss recognition and highlighted that they will impact all transactions between the investor and its associates and joint ventures. National Standard Setter • Viewed as simplification. Concerns about the application cost, for example, making sure that the systems are allowing to trace all transactions and have relevant information for disclosure purposes. Italian preparer National Standard Setter • The proposals will create additional differences between consolidated and SFS, however, it is a simplification. Preparer organisation • The proposals are seen as a simplification measure, conceptually they are not justified because the ED does not address the fundamental question of whether the equity method is a measurement method or one-line consolidation. May lead to further unintended consequences raising questions in regard to IFRS 12 partial consolidation. The proposals will create additional differences between consolidated and SFS which may have tax implications for Pillar II considerations (minimum tax rate calculation).
Q5 Impairment: The IASB is proposing: (i) to replace 'decline...below cost' of an investment in paragraph 41C of IAS 28 with 'decline...to less than its carrying amount';	EFRAG Secretariat views as of 8 October • EFRAG Secretariat is supportive of the proposed requirements albeit having only received limited feedback on this proposal. We in particular welcome the removal of the terminology of significant or prolonged decline in fair value. FR TEG-FRB

(j) to remove 'significant or prolonged' decline in fair value; and (k) to add requirements to IAS 28 explaining that information about the fair value of the investment might be observed from the price paid to purchase an additional interest in the associate or received to sell part of the interest, or from a quoted market price for the investment. The IASB is also proposing to reorganise the requirements in IAS 28 relating to impairment to make them easier to apply and to align their wording with the requirements in IAS 36 *Impairment of Assets*.	• Some members supported the proposed amendments specifying that the decline to below the carrying value is to be considered rather than the decline below cost. • However, another member did not support the proposal removing the terms 'significant or prolonged' in relation to the decline in fair value. The member noted that this wording had proven useful in practice (e.g., for assessing the impairment of quoted investments with volatile fair values). • A member noted that the ED's proposal does not take into consideration that, for an investor, the value in use of an equity-accounted-for investee is the most relevant measurement. Correspondingly, the failure to consider the significant or prolonged decrease in fair value as an indicator of impairment would increase the frequency of impairment testing performed by preparers. • Another member suggested that IAS 36 should be the guide for the impairment indicators instead of these being incorporated into IAS 28. EFRAG FIWG • Members were supportive of the ED proposals related to the impairment considerations including the removal of the significant or prolonged decline in fair value indicator as well as the clarifications provided in relation to the loss recognition. Specifically, members agreed that an investor does not need to catch up on the unrecognised losses when purchasing additional ownership interest to be consistent with the ED's proposed 'layered' approach. National Standard Setter • Question was raised in regard to paragraph 58 and what would be the difference between FV and value in use, as both of them would be based on the expected cash flows from the investment. A member noted that in case of consolidation where an investee and investor are considered as one economic/ reporting entity, one may consider the synergies within that group which would create differences between the FV and Value in use. In his point of view, when an investee is equity-accounted, we cannot talk about synergies and both FV and value in use are calculated in the same way.

Q6 Separate financial statements: The IASB is proposing to retain paragraph 10 of IAS 27 unchanged, meaning that the proposals in this Exposure Draft would apply to investments in subsidiaries to which the equity method is applied in the investor's separate financial statements.	EFRAG Secretariat views as of 8 October • Other than a call for consistency in equity-method accounting requirements, limited specific feedback has been received by stakeholders on separate financial statements and there is a need for further feedback on aspects of the proposals in relation to the step acquisition (or loss of control) of a subsidiary. • Although the EFRAG Secretariat acknowledges that there are considerations specific to the separate financial statements, we note the benefits of having the same accounting requirements applied in those financial statements in order to reduce the diversity in practice and improve the comparability between various financial statements. FR TEG-FRB • A member underscored the importance of closely examining and considering the issues and legal frameworks for separate financial statements that were in place across different EU jurisdictions. • Another member questioned if there would be any earning management opportunities in separate financial statements. Furthermore, a member observed that the proposed amendment contradicts the prudence principle as an entity would be able to recognise gains on transactions with its own subsidiary. However, for the users of financial statements, such a gain does not have any impact on the cash flows of a reporting entity as a whole (investor and its share of the investee). A similar situation would be observed in separate financial statements where gains would be generated on the transactions with group entities that are fully controlled. • Another member noted the concerns raised in the ED's alternative view (dissenting opinion) were particular to a certain jurisdiction. The member suggested the inclusion of a question to the constituents in EFRAG's DCL assessing the pervasiveness of situations addressed in the dissenting opinion. Italian preparers National Standard Setter • Concerns over the definition of the cost (FV + contingent consideration) and how this definition will be impacting separate financial statements. Some stakeholders noted that for associates in SFS when applying IAS 28, the changes in fair value of the contingent consideration would be more relevant when accounted against the carrying amount of the investee and not in PL. ED is not clear on this point. Some stakeholders asked whether there should be an accounting policy choice. Some stakeholders said the ED should specify

	that the definition of cost in IAS 28 should not impact the SFS in IAS 27 and this is important in jurisdictions where the SFS are used for the tax purposes.
Q7 Disclosures: The IASB is proposing amendments to *IFRS 12 Disclosure of Interests in Other Entities* in this Exposure Draft. For investments accounted for using the equity method, the IASB is proposing to require an investor or a joint venturer to disclose: (l) gains or losses from other changes in its ownership interest; (m) gains or losses resulting from 'downstream' transactions with its associates or joint ventures; (n) information about contingent consideration arrangements; and (o) a reconciliation between the opening and closing carrying amount of its investments. The IASB is also proposing an amendment to IAS 27 to require a parent—if it uses the equity method to account for its investments in subsidiaries in separate financial statements—to disclose the gains or losses resulting from its 'downstream' transactions with its subsidiaries.	EFRAG Secretariat views as of 8 October • Based on the feedback received from EFRAG's user panel, members are supportive of the proposed disclosure requirement. It was specifically noted that the reconciliation between the opening and closing carrying amount of the equity-accounted-for investments would be very useful to the users of financial statements. However, the level of granularity is to be further considered as this information would be essential for making accurate estimates of the investee's share of profit and loss, dividends distributions and other inflow/outflow, essential for users to estimate accurately the fair value of the associate. • Thus, the EFRAG Secretariat suggests the IASB considers the need for further clarification on whether the reconciliation should be disaggregated for each investment, in total for all investments, or only for the most significant investments. • The feedback EFRAG received is that some users have called for the fair value disclosure as it provides the most useful information. At the same time, other users raised concerns that the equity method is a cost measurement method and that moving towards more fair value-based measurements could shift the essence of the equity method. National Standard Setter • Overall supportive of the proposals, noting that in practice many entities already provide the reconciliations between the opening and closing carrying amounts, however those reconciliation may not be structured in the same way. The ED's proposals would make this presentation homogeneous amongst the entities. • IFRS 12 requires an entity to provide the balance sheet of its most significant equity investments. If the approach of Question 2 of the ED is applied, it would mean that the balance sheet of the investee would be fair valued at different points in time (first when reaching significant influence and then for each additional layer purchased while keeping significant influence). A member asked which of the fair value adjustments should be presented in light of the IFRS 12 requirements (the one that refers to the significant influence acquisition or the latest one). • Considering that the ED bases many of its considerations by aligning with and referring to IFRS 3, a member asked whether, in regard to the bargain purchase, the ED requirements should be aligned with IFRS 3.

	• The ED states that an entity must disclose gains or losses from transactions with associates. Members wondered at what level of aggregation those gains or losses are to be presented. Since the proposals on gains or losses cover all transactions, including business transactions, there may be a risk of disclosing the margin or other sensitive information. They also recognised complexity to track the information (system-wise) and to present the information in an understandable way. Further, the utility of this information was challenged and the justification provided in the BC – members considered that the IASB should clarify if the equity method is a measurement or a one-line consolidation method and not to try to satisfy both views as this may be misleading (IASB is considering that users may want to adjust the investor's results for the transactions with associate and JV and have the results with unrelated parties only. Preparers viewed that the IASB is ' trying to sit on both chairs' rather than stating clearly how to consider them). • Members wondered whether paragraph 21, lett. d) of the ED refers to the "other changes" as stated in Question 2 meaning the one specified in paragraph 34 of IAS 28 as revised (i.e. when an associate or a joint venture redeems or issues equity instruments), or to any other gains or losses related to the normal acquisition and disposals. <u>National Standard Setter</u> • The reconciliation between the opening and closing carrying amounts of investments measured at equity method could be costly.
Q8 SWPA Disclosures: The IASB is proposing amendments to IFRS 19 to require an eligible subsidiary: (p) to disclose information about contingent consideration arrangements; and (q) to disclose gains or losses resulting from 'downstream' transactions with its associates or joint ventures. The IASB is also proposing an amendment to IFRS 19 to require a subsidiary that chooses to apply the equity method to account for its investments in subsidiaries in separate financial statements to disclose gains or losses	<u>EFRAG Secretariat views as of 8 October</u> • EFRAG Secretariat notes that the reconciliation table between the opening and the closing carrying amount of the investments would also be relevant for the users of subsidiaries without public accountability. • EFRAG Secretariat acknowledges that this information is expected to be available at the subsidiary level especially for subsidiaries applying the equity method, thus alleviating the cost of obtaining this information from the parent entity. • EFRAG Secretariat received the feedback that contingent consideration can be beneficial for users who rely on subsidiary-level reports for their decision making. <u>FR TEG-FRB</u>

resulting from 'downstream' transactions with those subsidiaries.	• One member observed that the reconciliation table should be a required disclosure for subsidiaries without public accountability based on the principles underlying IFRS 19.
Q9 Transition: The IASB is proposing to require an entity: (r) to apply retrospectively the requirement to recognise the full gain or loss on all transactions with associates or joint ventures; (s) to apply the requirements on contingent consideration by recognising and measuring contingent consideration at fair value at the transition date—generally the beginning of the annual reporting period immediately preceding the date of initial application—and adjusting the carrying amount of its investments in associates or joint ventures; accordingly, and (t) to apply prospectively all the other requirements from the transition date.	EFRAG Secretariat views as of 8 October • EFRAG Secretariat notes that the inconsistency between the IFRS 10 and IAS 28 led to diversity in practice as entities were allowed to make an accounting policy choice based on their specific facts and circumstances (see Table of alternatives outlined under the "Transactions with associates" section). • From a limited outreach to some preparers, the EFRAG Secretariat is aware that the requirement to apply the transitional provisions to recognise the full gain or loss retrospectively could create a significant burden on the entities which previously applied partial gain or loss recognition. Further, the EFRAG Secretariat notes that such retrospective application would not always be possible to be applied without hindsight – for example, in cases where an entity applied a net investment hedge for a subsidiary located in a foreign jurisdiction. Moreover, the EFRAG Secretariat notes that IAS 8 allows an entity to apply the accounting requirements prospectively if the retrospective application is impracticable. However, doing so may result in companies being perceived by investors as not complying with the IFRS Accounting requirements. • Therefore, the EFRAG Secretariat suggests that based on the above considerations, the IASB should consider allowing the prospective application of recognition of full gain or loss for transactions with associates. FR TEG-FRB • Some members noted that the retrospective application requirements related to the elimination of partial recognition of gain or loss for transactions with associates and joint ventures would be costly and burdensome to apply. Moreover, reflecting previously unrecognised gains or losses in the retained earnings will impact the net assets of an associate or joint venture, and this may potentially create impairment issues for certain entities. Spanish preparer • In the preparer's view a 'partial gain' accounting policy is preferable because provides a better correlation between the profit or loss and the cash flows of each period. In the event that the IASB decides to propose in an upcoming Exposure Draft to amend IAS 28 so that a 'full gain' criterion would be applied in any transaction between an investor and its associate or joint venture, the preparer believes that the Board should consider proposing a prospective initial application for all adjustments of the Equity Method Project.

	• Alternatively, the Board may consider including an exemption to retrospective initial application of the 'full gain" accounting policy for transactions between an investor and its associate or joint venture that implies an excessive complexity (i.e. retrospective accounting of a net investment in a foreign operation or past transactions executed beyond more than one year before the initial application). *Interaction with IAS 8:* • IASB's current position is that IAS 8 provides for the situations where it is impracticable to apply the retrospective application (para 50-53 of IAS 8). The preparer is of the view that applying IAS 8 provisions puts companies at the disadvantage as it is perceived as deviation from the rule (they need AC approval, it will be disclosed in the FS and investors may perceive it as company's inability to provide information). In the preparer's view this penalty is unjustified because in the past there was an accounting policy choice and companies that selected partial gain application should not be penalised. National Standard Setter • Stakeholders raised question on how to treat the accumulated losses when the carrying amount is reduced to nil when an entity was not differentiating losses originated from PL from those originated from OCI. Further, overall losses would be impacted by the retrospective application of full gain / losses provision of the ED and adjustments to the contingent consideration based on the ED requirements. Complex and costly to put in practice. Italian preparer • Retrospective application may be justified conceptually, however, would be complex and costly to apply for certain entities. IASB should provide some cost relief, for example, in case of undue cost and effort, allow prospective application.