EFRAG Secretariat: Vincent Papa, Aleksandra Sivash, Isabel Batista, Ioana Kiss, Taha Daoudi

Equity Method of Accounting, IAS 28 *Investments in Associates and Joint Ventures* (revised 202x)

Cover Note and Summary of feedback and proposed changes

Objective

1 The objectives of the session are:

(a) to consider the feedback received in response to EFRAG's Draft Comment Letter on the Exposure Draft, *Equity Method of Accounting, IAS 28 Investments in Associates and Joint Ventures (revised 202x)* (the ED) published on 19 September 2024. The ED is still open for comments until 20 January 2025 (i.e., 120+ days comment period).

(b) for EFRAG FRB and FR TEG to discuss a final comment letter on the ED;

(c) for EFRAG FR TEG to recommend to the EFRAG FRB, and for the EFRAG FRB to approve a final comment letter on the ED.

Introduction

2 Over the years, the IFRS Interpretations Committee has received numerous requests to clarify various aspects of accounting under the equity method in IAS 28 *Investments in Associates and Joint Ventures.* The IASB considered these requests and the ED proposes amendments to reduce diversity in practice in the application and to enhance the understandability of IAS 28, improving comparability, and improving information with ED disclosures.

3 When deciding the scope of the project, the IASB considered whether to undertake a fundamental review of the equity method or focus on application questions. The IASB decided not to undertake a fundamental review of the equity method, which:

(a) would have required the IASB to consider whether the equity method should continue to be used and, if so, for which types of investments in other entities. The IASB noted that in developing the Conceptual Framework for Financial Reporting (Conceptual Framework), it did not consider whether and how the economic entity perspective or the reporting entity concept could affect the use of the equity method.

(b) might have resulted in fundamental changes to the equity method. The IASB noted that the equity method is well established and fundamental changes would require significant stakeholder support.

4 The IASB decided instead to focus on developing answers to application questions. This approach would, in a shorter time, provide preparers with solutions to long-standing application difficulties, reduce diversity in practice, and lead to more comparable and understandable information for users.

Structure of the cover note

5 This cover note contains:

(a) Agenda papers; and

(b) Question to EFRAG FRB and FR TEG.

(c) Overview of comment letters received;

(d) Summary of comment letters' feedback;

(e) Summary of outreach feedback;

(f) EFRAG Secretariat's proposed changes to the comment letter; and

(g) Next steps.

Agenda Papers

6 In addition to this 03-01 cover note, agenda papers for this session are:

(a) Agenda paper 03-02 – draft final comment letter (clean version);

(b) Agenda paper 03-03– draft final comment letter (marked-up version compared to the draft comment letter); and

(c) Agenda paper 03-04 – detailed analysis of outreach and comment letters received.

Question for EFRAG FRB and FR TEG

7 Do EFRAG FRB and FR TEG members have questions or comments with regard to the draft final comment letter response (agenda papers 03-02 or 03-03) based on the EFRAG Secretariat's recommendations outlined in paragraphs 69 - 95 below?

8 Does EFRAG FR TEG recommend the final comment letter to the EFRAG FRB?

9 Does EFRAG FRB approve the final comment letter?

Overview of comment letters received

10 At the time of writing, EFRAG has received comment letters from 16 respondents, out of which 9 were final and 7 in a draft form, representing an academic institution, national standard setters, a regulator/enforcer, a user organisation, preparers, a preparer organisation, and a professional accounting organisation. The final letters can be found here.

11 A detailed comment letter analysis can be found in Agenda Paper 03-04.

Terms used in the comment letter analysis	**Number of entities as a %**	**Comment letters received**
Most	>75%	12-15
Majority	>50-75%	8-11
Many	20-50%	4-7
Some, others, a few	<20	2- 3

* The % in this document compares to either the total number of entities or to the entities that provided feedback, unless indicated differently.

Summary of comment letters' feedback

Overall comments on the ED proposals

12 Many respondents (eight) considered that the current project was a unique opportunity and the right time to address the fundamental conceptual issues of the equity method (i.e., whether it is a consolidation approach or measurement method). These respondents called for the IASB to consider adding such a project to its agenda.

Question 1: Measurement of cost of associate or joint venture upon obtaining significant influence

General comments

13 Most respondents welcomed the ED's proposal noting that it aligns with the current practice and principles of IFRS 3. Many constituents questioned how to apply the proposals in situations where the investment is to acquire an ownership interest in an asset rather than business and they gave their views on the impact of these on other areas of the ED proposals (e.g., the recognition of goodwill, contingent consideration, transaction costs). Some constituents corroborated the concerns raised in EFRAG's DCL about the ED's proposed definition of cost being different from the definition in other IFRS Accounting Standards.

Measurement of previously held ownership interest on obtaining significant interest

14 Some respondents asked for additional clarification with relation to the fair value measurement or re-measurement of the previously held ownership interest and accounting consequences in case of the re-measurement at the acquisition date (i.e., treatment of significant influence premium).

Transaction costs

15 Most respondents (14) asked the IASB to clarify the treatment of transaction costs. A majority (10) of the respondents gave a view on the appropriate treatment with half supporting expensing the transaction costs and half supporting their capitalisation and inclusion in the carrying amount of the investment.

Contingent consideration

16 Most of the respondents agreed with the IASB's proposal and EFRAG's DCL calling for additional clarification of certain areas. A few stakeholders stated that the subsequent

changes in the fair value of the contingent consideration should be reflected in the carrying amount of the investment to better align with the definition of the cost of an asset.

Recognition of goodwill and bargain purchase gains

17 Many respondents (four) disagreed with the recognition of goodwill or bargain purchase gain for the acquisition of an asset and asked the IASB to clarify whether this was required. However, some respondents (two) respondents noted that the general practice was to recognise goodwill or bargain purchase gain for asset acquisitions as well.

18 One respondent supported the IASB's proposal to not offset a bargain purchase gain against previously recognised goodwill, whereas three respondents disagreed with the proposal noting that the economics of the investment would be better reflected if there is an offset. A banking sector organisation highlighted that goodwill has a negative effect on prudential ratios making it desirable to offset a bargain purchase gain against previously recognised goodwill.

19 Some respondents reiterated the comment included in EFRAG's DCL regarding the clarification of the measurement period and the need to have additional safeguards in case of a bargain purchase gain.

Deferred tax effects

20 Most respondents supported the ED's proposal, albeit that some concerns about the associated application complexity were raised by some respondents.

Question 2: Changes in an investor's ownership interest while retaining significant influence

Purchase of additional ownership interest while retaining significant influence

21 Most respondents supported the ED's proposal to not remeasure previously held ownership interest during step acquisitions while retaining significant influence. At the same time, most respondents expressed significant concerns with the ED's requirement to perform a purchase price allocation exercise (PPA) for each additional acquisition (layered approach). This is due to the disproportionate cost and complexity of this approach.

22 On the other hand, a few respondents noted that application challenges are inherent to the equity method rather than primarily emanating from the layered approach. They suggested that the IASB further explore whether there are frequent material changes in an investor's ownership interest in an associate, which lead to a high degree of complexity and pose significant difficulties in obtaining the necessary data for accounting purposes. An assessment of the prevalence of these situations can help determine a proportionate level of complexity and relevance of the solution provided.

23 EFRAG's DCL proposed and sought constituents' views on two possible alternative solutions (i.e., a modified-PPA approach, and a cost-accumulation approach). There was both support and reservations towards each of these alternatives. The modified-PPA approach was not considered suitable for acquisitions that occurred many years ago while the cost-accumulation approach's subsequent measurement basis was not clear. Plus, it would need a change in the ED's initial measurement. It may be de facto an alternative rather than a variant of the equity method. One stakeholder suggested a third alternative and another stakeholder noted that one of the EFRAG's suggested alternatives could be further improved and suggested some adjustments. One respondent noted that both alternatives

can be applied as part of the application of materiality considerations only and should therefore not be framed as alternatives.

Disposing of an ownership interest while retaining significant influence

24 Some respondents supported the ED proposals and a few asked for additional clarifications. Some respondents observed, however, that there are situations in which a specific identification method would be more appropriate and simpler to apply. For example, a) when an investment is held by various entities within a group and only one entity disposes of its ownership interest, or b) when the purchase and subsequent disposal occur within narrow time windows. On the other hand, one respondent noted that a specific identification method would potentially reduce comparability, create structuring opportunities and be inconsistent with a consolidated entity view that treats the group as a single economic entity.

Other changes in ownership interest while retaining significant influence

25 Many respondents provided comments on the ED proposal for other changes in ownership interest. Half of them disagreed with the ED's proposals noting that a) the economic substance of other changes was different from the transactions in which an investor actively takes part, b) the requirement to perform a separate PPA for each deemed acquisition is overly burdensome, and b) ensuing financial information is not useful to users. The other half of these respondents either supported or didn't disagree with the proposals but requested additional clarifications, including amongst others:

(a) whether and how to apply the proposals for changes involving non-controlling interest within the investee or share buy-backs;

(b) whether the proposals are only applicable to ordinary shares or also other hybrid instruments, having, for example, impacts on dividends but not on voting rights;

(c) whether the concept of 'changes in ownership interest' refers to direct ownership only or is meant to capture the broader term of 'economic ownership'

Question 3: Recognition of the investor's share of losses

Losses not recognised and purchase of an additional interest

26 The proposal to not recognise a "catch-up" of unrecognised losses when additional ownership interests in an associate are purchased generally received support from many respondents. However, a majority of respondents commenting on the proposal noted that recognising additional goodwill when the carrying value of the investment is zero, particularly when the net assets value of the investee is negative, does not faithfully represent the investment's economic reality, it is inconsistent with the prudence principle, and does not provide useful information to users, many of whom do not deem that the goodwill recognised from the equity method accounting is meaningful. Further, some respondents suggested the IASB should add explicit guidance requiring the investor to assess whether the additional purchase is a funding arrangement/ bail-out, which creates a constructive obligation.

Recognition of each component of comprehensive income

27 There was broad support from respondents for the proposed requirements related to the recognition of the investor's share of losses in the components of total comprehensive

income. However, all the respondents who commented on this topic suggested that further clarification and examples were necessary to ensure the consistent application of these requirements in practice.

Question 4—Transactions with associates

28 The majority of respondents agreed with the ED proposal and EFRAG's preliminary position for similar reasons to those of EFRAG in its DCL (resolves practical issues, reduces practical complexity, associates and joint ventures are not within the boundaries of a group and improves consistency with IFRS Standards).

29 The following observations/ concerns were noted:

(a) Respondents noted the proposal represented a significant change to the current practice under IAS 28 (and in some cases local regulations) that might go beyond the primary objective of answering application questions about how to apply the equity method and suggested a more fundamental review of the equity method.

(b) Like EFRAG, most respondents (including a regulator and a user organisation) highlighted concerns with possible structuring opportunities and earnings management particularly for transactions with joint ventures in which the joint venturers share joint control and transactions within larger groups where entities in the financial statements of sub-groups are associates of the ultimate (same) parent company. Some of these respondents suggested improved and more transparent disclosure requirements to mitigate this concern including disclosure of gains and losses arising on all transactions between a parent and its equity-accounted investees (upstream and side stream intercompany transactions).

(c) One respondent considered upstream and side-stream transactions equally relevant noting that these transactions are not mentioned in the ED and therefore unclear how these kinds of transactions would be impacted by the proposals.

Question 5—Impairment indicators (decline in fair value)

30 Below is a summary of feedback on the ED proposals:

(a) All respondents who commented on the proposal to replace 'cost' with 'carrying amount' agreed with it;

(b) The majority of the respondents supported the proposal to consider indicators to determine the observable fair value of investment;

(c) Many respondents supported the removal of the reference to 'significant or prolonged' decline in fair value. However, some respondents considered that deleting this term would increase the frequency of impairment testing and trigger frequent impairments and impairment reversals which will result in increased volatility and higher costs for preparers;

(d) Some respondents provided further suggestions of how the impairment requirements in IAS 28 could be improved.

Question 6—Investments in subsidiaries to which the equity method is applied in separate financial statements

31 Most respondents who commented on this question agreed with the IASB proposals mainly because entities in their jurisdiction were not impacted by the proposal (or significantly impacted) and considered that having a single equity method (consolidated and separate financial statements) was easier to understand.

32 A few respondents noted concerns (significant concerns) with the proposal to recognise full gains and losses arising from transactions with subsidiaries when these are accounted for under the equity method in the separate financial statements.

33 One respondent strongly opposed the proposal to recognise gains and losses on transactions with subsidiaries in the separate financial statements. This respondent stated that, in their jurisdiction, entities have the option to apply the equity method in the separate financial statements - with mandatory elimination of intra-group results. This respondent recommended the IASB prescribe an alternative treatment when applying the equity method for subsidiaries in the separate financial statements that would require the elimination of gains and losses as currently required by IAS 28. This respondent considered that:

(a) subsidiaries are fundamentally different from transactions with associates and the full recognition of gains and losses could potentially lead to transactions that do not reflect the economic substance and create the risk of structuring opportunities and earnings management as there is no conflict of interest between shareholders.

(b) additional disclosures will not be sufficient to mitigate this risk and recommended to prescribe an alternative treatment when applying the equity method for subsidiaries in the separate financial statements. This alternative treatment should eliminate gains and losses as currently required by paragraph 28 of IAS 28.

34 Another respondent was concerned that the ED did not address investments measured at cost in separate financial statements. This respondent noted that in their jurisdiction entities apply IFRS Standards also to separate financial statements and most entities measure investments in subsidiaries, associates and JVs at cost in their separate financial statements. Hence, it was crucial to clarify how to account for investments measured at cost.

35 Some respondents answered EFRAG's questions to constituents on the use of the equity method in the separate financial statements. These respondents noted that the equity method is not widely used in the EU (cost was more common). They did not support the proposal in EFRAG's DCL for a reconciliation nor did they agree with having an option for recognition of gains and losses on transactions with equity-accounted investees in the separate financial statements.

Question 7—Disclosure requirements

36 Many respondents expressed general support for enhancing the disclosure requirements for investments accounted for using the equity method. However, one of these respondents considered that the disclosure requirements should only be provided individually for material investees and immaterial investees should be aggregated.

37 Some respondents were concerned about the cost and burden of producing the disclosures and these respondents had particular concerns with the disclosures of gains or losses from downstream transactions. They considered that IAS 24 *Related Party Disclosures* suffice for these transactions. A respondent suggested that changes in ownership interest should be disaggregated into those arising from acquisitions, disposals and other changes in ownership interest.

Question 8—Disclosure requirements for eligible subsidiaries

38 The feedback received was brief and mostly supportive of the proposals and EFRAG's DCL position. However, one respondent considered the proposed disclosure to be inconsistent with the objective of IFRS 19 *Subsidiaries without Public Accountability*.

Question 9 —Transition

39 Respondents provided mixed views on the proposed transition requirements. Some supported the IASB proposals, others supported EFRAG's preliminary view and one respondent preferred to have prospectively application for all the proposals.

40 However, more than half of respondents agreed with EFRAG's position in its DCL (EFRAG agreed with the proposed transition requirements except for the proposal to apply retrospectively the proposal for full gains and losses).

41 Some respondents, while not disagreeing with EFRAG's preliminary view, asked for clarification on the following aspects of the proposed transition requirements:

(a) how the proposed prospective transition requirements in paragraph C3 of the ED would apply to investments measured at nil at the transition date and subsequent periods, for which the investor ceased to recognise losses.

(b) how unrecognised gains and losses could be accounted for prospectively.

42 Regarding (a) above, one respondent raised the following questions on the transition of unrecognised losses:

(a) Should the amount of unrecognised losses be reset to nil at the transition date?

(b) Should that amount continue to be monitored under the current accounting policy, which would result in two accounting policies being applied in parallel?

(c) Should the amount of unrecognised losses be recalculated retrospectively, and if so, how should it be allocated between profit or loss and the recyclable and non-recyclable components of other comprehensive income?

43 One respondent noted strong disagreement with the lack of a requirement, or even the possibility, to perform an impairment test at the transition date.

44 Based on feedback received from some respondents, it seems unclear whether paragraph C4 is intended to require a full retrospective or whether it's a modified retrospective approach.

Question 10 —Expected effects of the proposals

45 Some respondents commented on this question. Most of them agreed with EFRAG's assessment of the cost and complexity of several aspects of the ED proposals including the layered approach, other changes in ownership, frequent impairment testing, and

additional disclosures. Some respondents pointed to the significant implementation cost and/or operational complexity associated with the ED proposals.

Question 11—Other comments

46 Some respondents commented on this question. Several respondents addressed the interaction with IFRS 18 *Presentation and Disclosure in Financial Statements* and they raised issues pertinent to the banking and insurance sector.

47 One respondent suggested repositioning paragraph 35 regarding the continued application of the equity method when an investment changes between associate and joint venture, noting its current placement could restrict its scope.

Summary of Outreach Feedback

48 Since the publication of EFRAG's DCL, the Secretariat performed the following outreach activities:

(a) Held session with EFRAG IAWG on 13 November 2024

(b) Held session with EFRAG Academic Panel on 25 November 2024

(c) Held session with EFRAG User Panel on 28 November 2024

(d) Held session with EFRAG TEG-CFSS on 3 December 2024

(e) Calls were held with a preparer representative who reached out to the EFRAG Secretariat, EFFAS and Accountancy Europe to discuss and clarify some aspects of the ED and/or EFRAG's DCL.

General- project scope

49 The call for a fundamental review of the equity method was aired in some of the discussions during outreach (e.g., at the EFRAG FR TEG-CFSS and Academic panel meetings). Moreover, some stakeholders (including some users) questioned the need for the equity method. They considered that fair value measurement or cost measurement basis could be alternatives to the equity method. However, a few other stakeholders (including some users) affirmed the usefulness of the equity method particularly for the acquisition of businesses that are integral to a reporting entity's operations. These stakeholders pointed to several limitations of both the fair value (too volatile) and cost (does not get updated for changes in economic circumstances) as measurement bases, and they considered the equity method to be a superior/best alternative to account for certain 'significant influence' investments.

Question 1 – Measurement of cost of associate or joint venture

50 The feedback obtained through various outreach activities corroborated, to a large extent, the analysis included in EFRAG's DCL, specifically on:

(a) inconsistencies in cost definition with other IFRS Accounting Standards;

(b) cost and complexity associated with some of the proposals;

(c) call for clarification of accounting of the transaction costs

51 Several users questioned the usefulness of recognising goodwill when an investor has significant influence.

52 Further, some constituents suggested that the IASB enhances the definition of significant influence noting that an investor's access to the relevant and reliable data of an investee may be one of the criteria to assess if significant influence is obtained.

53 Some stakeholders disagreed with EFRAG's suggestion to require an offset of the bargain purchase gains against previously recognised goodwill, noting that bargain purchase gains were relatively rare in practice.

Question 2—Changes in an investor's ownership interest while retaining significant influence

54 Stakeholders raised significant complexity and cost related to a full-fledged PPA at each additional acquisition and questioned the reliability of the exercise considering the investor sometimes has limited access to the investee's internal data.

55 Stakeholders also questioned how to apply the proposals related to other changes in ownership interest to the transactions with non-controlling interests within the investee's group.

56 Mixed views were provided with regard to EFRAG's suggested alternative solutions to the layered approach.

Question 3 – Recognition of the investor's share of losses

57 No feedback was obtained through outreach activities

Question 4 – Transactions with associates

58 The results of a multi-stakeholder survey conducted by academics showed strong support for the ED proposal to recognise full gains and losses from all transactions with equity-accounted investments. Those in support considered that the ED proposal supports the view that the equity method is more akin to a valuation approach rather than a one-line consolidation method.

59 EFRAG CFSS members agreed with the ED proposal but noted concerns regarding restructuring opportunities and earnings management, particularly for transactions with joint venturers.

Question 5 – Impairment indicators (decline in fair value)

60 EFRAG CFSS members expressed broad support for the position included in the EFRAG DCL related to impairment indicators as proposed in the ED.

61 Furthermore, members commented that the ED was not sufficiently clear to what extent recognised impairment losses on investments accounted for using the equity method should be reversed and, if so, on what basis.

Question 6 – Investments in subsidiaries to which the equity method is applied in separate financial statements

62 EFRAG User Panel members supported having one definition of the equity method for the consolidated and separate financial statements.

63 A few EFRAG CFSS members highlighted significant concerns with applying the proposal for full recognition of gains and losses to subsidiaries accounted for under the equity method in the separate financial statements.

Question 7 – Disclosure requirements

64 No feedback on the specific disclosure proposals was obtained during the outreach. A meeting with a user organisation focused on the areas where they had concerns. They aired no concerns with and thus implicitly supported the disclosures. Furthermore, during the outreach to the User Panel done before the publication of EFRAG's DCL (see link), users supported the proposed disclosures.

Question 8 – Disclosure requirements for eligible subsidiaries

65 No feedback was obtained on disclosures for eligible subsidiaries through outreach activities.

Question 9 – Transition

66 A preparer representative who reached out to the EFRAG Secretariat had a significant concern about the retrospective application of the unrecognised gains and losses arising from past transactions with associates and joint venturers. This preparer, who has been only partially recognising the gains and losses under IAS 28, noted that it would be difficult to explain to management and investors why they are recognising a significant gain in retained earnings on transition date and noted the possibility for other consequences including tax issues.

Question 10 – Expected effects of the proposals

67 No feedback was obtained during the outreach activities.

Question 11 – Other comments

68 EFRAG IAWG members expressed concerns with relation to IFRS 18 transition requirements stating that current paragraph 18 of IAS 28 is subject to interpretation resulting in diversity in practice and does not cater for indirect insurance contracts accounted under the general model or premium allocation approach.

EFRAG Secretariat's proposed changes to the comment letter

69 Based on the feedback received from respondents to the EFRAG DCL and outreach conducted on the project, the EFRAG Secretariat recommends the below changes to be made in the EFRAG final comment letter on the ED. These changes are reflected in the draft final comment letter (agenda papers 03-02 and 03-03).

Cover letter

70 EFRAG Secretariat recommends the following changes:

(a) adding that EFRAG considers that a fundamental review of the equity method should be added to the IASB agenda;

(b) noting some concerns about structuring opportunities and earnings management with relation to the full gain and loss recognition, asking for enhanced disclosures;

(c) asking for a clarification of the accounting treatment of transaction costs instead of expressing a preference for their capitalisation;

(d) removing concerns related to the deferred tax effects;

(e) expressing EFRAG's support for a single equity method instead of expressing mixed views;

(f) unambiguously expressing EFRAG's disagreement with the transition requirements related to the retrospective application of full gains and losses instead of noting mixed views;

(g) asking for clarification on some aspects of the transition proposals (investment at nil and unrecognised gains or losses).

Overall comments on the ED proposals

71 EFRAG Secretariat recommends that EFRAG's final position should reflect the call by several constituents for a fundamental review of the equity method.

Question 1: Measurement of cost of associate or joint venture

72 EFRAG Secretariat recommends grouping more general comments in the 'General comments' section which would include constituents' questions on the <u>distinction between the acquisition of a business vs asset</u>, and concerns about the complexity and cost of some proposals mainly driven by information access constraints. Moreover, <u>significant influence</u> indicators should include the absence of information access constraints.

73 <u>Previously held ownership interest</u>: The EFRAG Secretariat suggests incorporating the call for clarification related to the measurement (or re-measurement) of the previously held ownership interest.

74 <u>Transaction costs:</u> Based on the mixed views and underpinning considerations expressed, the EFRAG Secretariat suggests calling for the clarification of the treatment of transaction costs depending on whether these relate to the acquisition of a business or asset. This should be done without expressing a preference on whether these should always be capitalised or expensed.

75 <u>Contingent consideration:</u> The EFRAG Secretariat suggests asking for clarification that the fair value of a liability for contingent consideration should be classified in the operating category, similar to the provisions treating IFRS 3-related contingent consideration.

76 <u>Recognition of goodwill and bargain purchase gains:</u> The EFRAG Secretariat notes general support for the DCL's position, therefore the Secretariat recommends keeping the comments included in the DCL with relation to i) the principle of recognising goodwill or bargain purchase gain for equity-accounted investment, ii) the need of additional checks and transparency in case of a bargain purchase gain recognition and iii) the offset of bargain purchase gain with previously recognised goodwill emphasising the stakeholders' preference to require offsetting bargain purchase gains against previously recognised goodwill.

Question 2: Changes in an investor's ownership interest while retaining significant influence

77 <u>Purchase of additional ownership interest while retaining significant influence:</u> The EFRAG Secretariat recommends keeping EFRAG's tentative position (i.e., emphasising significant concerns about the cost and complexity of full-fledged PPA) which can be further enhanced with the areas of complexity identified by the respondents. EFRAG Secretariat suggests including a call for further simplification and highlighting the modified-PPA alternative as a potential starting point while acknowledging other alternatives including the cost

accumulation that was in the DCL and others suggested by constituents. It should be noted that the other alternatives including the cost accumulation approach are conceptually inconsistent with the ED proposals. Hence, they may be better suited to a fundamental review of the equity method.

78 We also took account of the comment letter that considered the alternatives in EFRAG's DCL could be applied as part of the application of materiality considerations only and should therefore not be framed as alternatives. However, during outreach, there was also a view that materiality judgments are necessary but not sufficient to guide the accounting treatment and they do not resolve the complexity associated with the layered approach. Leaving it to materiality could compound the problem of diversity in practice.

79 <u>Disposing of ownership interest while retaining significant influence</u>: The EFRAG Secretariat recommends keeping EFRAG's tentative position, incorporating additional feedback obtained from the respondents.

80 <u>Other changes in ownership interest while retaining significant influence:</u> The EFRAG Secretariat recommends keeping EFRAG's tentative position of scoping these out of the amendments, incorporating additional clarification requests raised by the constituents. Also, adding justification for doing nothing until a suitable solution can be found.

Question 3: Recognition of the investor's share of losses

81 <u>Losses not recognised and purchase of an additional interest:</u> the EFRAG Secretariat recommends keeping EFRAG's tentative position, incorporating additional requests for clarification raised by the constituents.

82 <u>Recognition of each component of comprehensive income:</u> the EFRAG Secretariat recommends keeping EFRAG's tentative position, incorporating additional requests for clarification raised by the constituents and providing further examples to better illustrate the proposals' application.

Question 4—Transactions with associates

83 EFRAG Secretariat recommends maintaining EFRAG's DCL position supporting the proposals.

84 However, given the significance of the concerns by some respondents around restructuring opportunities and earnings management particularly for transactions between associates and joint ventures under common control, we recommend that the IASB further examine how to enhance the disclosure requirements for all transactions between a parent and its equity-accounted investees (including upstream and side-stream transactions) without duplicating any existing related party disclosures under IAS 24. This is in order to provide transparency on the rationale for the pricing of these types of intercompany transactions.

85 We also recommend that the IASB clarify whether side-stream transactions are within the scope of the proposal and if so, we recommend that disclosure of any gains or losses arising from such transactions be required. We understand side-stream transactions to be transactions between associates, joint ventures and/or between subsidiaries of a parent entity.

Question 5—Impairment indicators (decline in fair value)

86 Based on feedback received, the EFRAG Secretariat recommends that EFRAG's response to Question 5 be expanded to include concerns related to the lack of clarity on the interaction between the requirements in IAS 36 on reversal of impairment loss with the requirements in paragraph 58 of the ED.

Question 6—Investments in subsidiaries to which the equity method is applied in separate financial statements

87 The EFRAG Secretariat recommends including in EFRAG FCL that transactions with subsidiaries be exempted from the requirement for the recognition of full gains or losses in the separate financial statements.

88 Based on the feedback received, except for streamlining, we do not recommend further changes to the EFRAG DCL.

Question 7—Disclosure requirements

89 Based on the feedback received, the EFRAG Secretariat recommends retaining the support for the ED disclosures. We note that there are concerns from some comment letter respondents with the disclosures of gains or losses from downstream transactions but there was also support for these disclosures from some respondents including a user organisation and an enforcer. We also take account of the concerns about structuring that would arise from the ED proposals for transactions with associates or joint ventures. In addition, we propose the FCL includes a suggestion made by a respondent that 'that changes in ownership interest should be disaggregated in acquisitions, disposals and other changes in ownership interest';

Question 8—Disclosure requirements for eligible subsidiaries

90 No change to EFRAG's DCL is recommended.

Question 9 —Transition

91 Given that the majority of respondents agreed with EFRAG's position in its DCL, we recommend maintaining this position (supporting the proposals except for the unrecognised gains and losses arising from past transactions (pre-effective date) which EFRAG recommended be applied prospectively.

92 Should the IASB decide to require retrospective application of unrecognised gains and losses arising from past transactions as stated in paragraph C4 of the ED, the EFRAG Secretariat recommends that EFRAG ask the IASB for clarification on how retrospective application is intended to be applied and provide an example to illustrate this requirement. The EFRAG Secretariat notes that it is not clear whether paragraph C4 is intended to require a full retrospective or whether it's a modified retrospective approach.

93 Based on feedback received, the EFRAG Secretariat recommends that EFRAG's final position ask the IASB to clarify the transition requirements for unrecognised losses. Specifically, the IASB should provide guidance to clarify the following questions:

(a) should the amount of unrecognised losses be reset to nil at the transition date?

(b) should that amount continue to be monitored under the current accounting policy, which would result in two accounting policies being applied in parallel?

(c) should the amount of unrecognised losses be recalculated retrospectively, and if so, how should it be allocated between profit or loss and the recyclable and non-recyclable components of other comprehensive income?

Question 10 —Expected effects of the proposals

94 Based on the feedback received, the EFRAG Secretariat does not recommend any changes to EFRAG DCL's response to Question 10.

Question 11—Other comments

95 Taking into consideration the feedback received, the EFRAG Secretariat recommends incorporating additional considerations provided by the EFRAG IAWG members related to the expansion or clarification of the scope of current paragraph 18 of IAS 28 to cater for insurance contracts accounted for under the general model or premium allocation approach.

Next steps

96 Following EFRAG FR TEG recommendation and FRB approval, the EFRAG Secretariat will submit EFRAG's final comment letter to the IASB by 20 January 2025 (deadline) and prepare the feedback statement.