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Comment Letter

International Accounting Standards Board
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom
20 January 2025

Dear Mr Barckow,

Re: Exposure Draft Equity Method of Accounting IAS 28 *Investments in Associates and Joint Ventures* (revised 202x)

On behalf of the EFRAG, I am writing to comment on the Exposure Draft Equity Method of Accounting IAS 28 *Investments in Associates and Joint Ventures* (revised 202x), issued by the IASB on 19 September 2024 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on the endorsement of definitive IFRS Accounting Standards in the European Union and European Economic Area.

EFRAG acknowledges that the primary focus of the ED is not to fundamentally revise the equity method but to address existing application challenges, reduce the existing diversity in practice in the application of IAS 28 requirements, enhance the understandability of these requirements, and increase the comparability of reported information. Overall, EFRAG considers that the ED's proposals are a positive step that will help to meet the intended objectives. EFRAG recommends the IASB finalise the amendments based on the feedback to the ED as soon as possible. At the same time, based on the feedback received, EFRAG recommends that a fundamental review of the equity method should thereafter be added to the IASB workplan (as the second phase of the project) after finalising the amendments proposed in the ED.

Areas where EFRAG supports the ED's specific proposals: EFRAG supports the following proposals in the ED.

- Measurement of cost of an associate or joint venture: EFRAG generally supports the ED's proposal on the measurement of the cost of associates or joint ventures.
- Transactions of an investor/reporting entity with associates and joint ventures requiring full recognition of related gains or losses: EFRAG considers that the proposal will result in desirable consistency in the application of the equity method for transactions with associates or joint ventures. It is also a simplified and less costly solution compared to the other alternatives considered by the IASB. However, EFRAG expresses some concerns with the proposals (restructuring opportunities and earnings management) and recommends enhanced disclosures as well as clarification about whether side stream transactions are covered by the proposed amendments.
- Disclosures: While acknowledging that there are concerns with some of the proposed disclosures, EFRAG supports the proposed disclosures taking into account the ED proposals for transactions with associates or joint ventures. We have made suggestions to further enhance the disclosures.
- Impairment indicators: While acknowledging there are mixed views, EFRAG supports the ED's proposals related to indicators of impairment of associates or joint ventures.

EFRAG's specific concerns with the ED's proposals: EFRAG has also highlighted key concerns and made suggestions for the following proposals.

- Measurement of cost of an associate or joint venture: The ED is silent on whether transaction costs are included in the carrying amount of the investment. EFRAG recommends clarifying the appropriate accounting treatment for transaction costs, i.e., whether to expense or capitalise these costs and how this can depend on whether the investment relates to either the acquisition of a business or an asset.
- Acquiring additional ownership interest while retaining significant influence (layered approach): EFRAG considers the ED's proposal to treat each additional acquired layer as a separate unit of account as being preferable to the fair value remeasurement of the entire investment. However, EFRAG questions the need for a full-fledged purchase price allocation of each acquisition and highlights stakeholders' significant concerns about the cost and complexity of aspects of the layered approach proposed in the ED. EFRAG recommends further simplification of this proposed approach. In our response to Question 2, we suggest a modified-PPA approach that the IASB can consider as a starting point.

- Other changes in ownership interest while retaining significant influence (e.g. an associate's or joint venture's issuance or redemption of shares): EFRAG disagrees with the ED's proposal to treat other changes in ownership arising from non-exchange transactions as deemed purchases or disposals of ownership interest. This is due to the associated cost, complexity of the proposed accounting treatment and lack of economic equivalence between these transactions and acquisitions or disposals of ownership interests that are based on the exchange of consideration. Thus, we recommend that, unless a holistic, principles-based solution that is not unduly costly can be developed, these changes should be scoped out of the IAS 28 amendments. A transitional scoping out of these other changes in ownership interests may fail to remedy existing diversity in practice but it will certainly not worsen it. Plus, the IASB has in any case considered that existing diversity is acceptable for the other changes in ownership transactions that were not in the scope of the ED.
- Recognition of the investor's share of losses: EFRAG recommends that, in addition to the ED's proposals, the IASB prohibit the recognition of additional goodwill for acquired additional interest when the carrying amount of the investment is reduced to nil due to investor's share of losses. Moreover, we note several areas where the proposals for the recognition of share of profit or loss and other comprehensive income need further clarification and enhancement.
- Separate financial statements: EFRAG supports the ED's proposed application of a single equity method across IFRS Accounting Standards except for the recognition of full gains or losses from transactions with subsidiaries. EFRAG also suggests that the IASB clarify whether the ED's proposals for the equity method are applicable when an investment is measured at cost in separate financial statements.
- Transition requirements: EFRAG agrees with the proposed transition requirements except for the proposal to apply retrospectively the requirement to recognise the full gain or loss on all transactions with associates or joint ventures. EFRAG asks for clarification on other specific aspects of the proposed transition requirements (investments measured at nil and unrecognised gains or losses) (See response to Question 9).

In general, EFRAG notes that the simplification principle is only selectively applied in some of the proposed solutions (e.g. for the full recognition of gains or losses for transactions with associates and joint ventures) and it could also be applied to other proposals (e.g. the layered approach of accounting for acquired additional ownership interests while retaining significant influence).

EFRAG's detailed comments and responses to the questions in the ED are set out in the Appendix.

If you would like to discuss our comments further, please do not hesitate to contact Aleksandra Sivash, Vincent Papa or me.

Yours sincerely,

Wolf Klinz

EFRAG FRB Chair

Appendix – EFRAG's responses to the questions raised in the ED

Overall comments on the ED proposals

1 EFRAG acknowledges that the primary focus of the ED is to address existing application challenges, reduce existing diversity in practice in the application of IAS 28 requirements, enhance the understandability of these requirements, and increase the comparability of reported information. Overall, the feedback received so far indicates that stakeholders consider the ED's proposals to be a positive step that will help to meet the intended objectives.

2 EFRAG is cognisant that the ED is not focused on fundamentally revising the equity method or clarifying whether the equity method is either a measurement approach or a one-line consolidation. EFRAG understands that a more fundamental review would likely lengthen the project duration and defer the resolution of current application challenges. We also acknowledge that Table 2 and BC 15 to 16 in the Basis for Conclusions delineate the principles (i.e. principles A to H) underlying the classification, the boundary of the reporting entity, initial recognition, subsequent measurement and derecognition requirements of IAS 28. These principles taken in conjunction with other IFRS Accounting Standards (e.g. IFRS 3) and the Conceptual Framework for Financial Reporting (Conceptual Framework) have informed the proposals in the ED. EFRAG acknowledges that, as evaluated in the 2014 EFRAG Short Discussion Series paper[1] (SDS) and other National Standard Setters[2] publications, instead of having mutually exclusive underpinnings, depending on the nature of the transaction or event, the equity method can be a hybrid approach encompassing[3] the features of both a consolidation approach and measurement method.

3 In general, EFRAG observes that some of the proposals are significant amendments that will change current practice. For example, the recognition of full gains or losses for transactions with associates addressed in Question 4, and the application of a single equity

[1] 2014 EFRAG Short Discussion Series – The Equity Method: A measurement basis or one-line consolidation?

[2] Korean Accounting Standards Board – Research Report No 35 The Equity Method

[3] The equity method can encompass the features of a consolidation approach (e.g. goodwill recognition occurs on acquisition of ownership interests; bargain purchase gains are recognised in profit and loss; the elimination of the investor's or joint venturer's share of profits and losses from upstream and downstream transactions; etc.) as well as have the features of a measurement basis (including the transaction cost in carrying amount, the non-recognition of losses in excess of the carrying value in most circumstances, and not restricting gains or losses on upstream and downstream transactions with investees).

method across the consolidated and separate financial statements addressed in Question 6. There are unaddressed areas (e.g. the treatment of transaction costs) and insufficiently addressed areas (other changes in ownership while retaining significant influence). EFRAG also notes that the simplification principle is only selectively applied in some of the proposed solutions (e.g. for the full recognition of gains or losses for transactions with associates and joint ventures) and it could be also applied for other proposals (e.g. the layered approach of accounting for acquired ownership interests while retaining significant influence) as indicated in our response to Question 2.

4 Finally, EFRAG notes that during the outreach on the ED, notwithstanding the justification mentioned in paragraph 2 above for the exclusion of a fundamental review of equity method from the scope of the ED, in addition to feedback on the specific proposals to address practical challenges, EFRAG has heard a range of views on the usefulness of the equity method relative to other recognition and measurement approaches. Some stakeholders including users have confirmed its usefulness and complementary nature to fair value or cost measurement basis in the accounting for the acquisition of ownership interests in a business. However, many other stakeholders including other users are more sceptical about its usefulness. Furthermore, many respondents to EFRAG's draft comment letter have pointed out that the IASB's definition of the nature and purpose of the equity method could have enhanced the formulation of suitable answers to the practical application challenges. A similar message emerged from a survey by academics from Spanish Universities with responses from 117 diverse professionals (academics, auditors, analysts and preparers). These survey results were presented at the EFRAG Academic Panel.

5 As noted above, EFRAG considers the ED proposals to be a positive step, and we encourage the IASB to finalise the IAS 28 amendments proposed in the ED as soon as possible. Thereafter, after the issuance of the amendments, EFRAG recommends that a fundamental review of the equity method should be added to the IASB work plan as the second phase of the project.

Question 1 – Measurement of cost of an associate or joint venture

ED Question 1- Measurement of cost of associate or joint venture Paragraph 32 of IAS 28 requires an investor that obtains significant influence to account for the difference between the cost of the investment and the investor's share of the net fair value of the associate's identifiable assets and liabilities either as goodwill (included in the carrying

amount of the investment) or as a gain from a bargain purchase (recognised in profit or loss). However, IAS 28 does not include requirements for how an investor measures the cost of the investment on obtaining significant influence—for example:

(a) whether to measure any previously held ownership interest in the associate at fair value; or

(b) whether and if so how to recognise and measure contingent consideration.

The IASB is proposing an investor:

(a) measure the cost of an associate, on obtaining significant influence, at the fair value of the consideration transferred, including the fair value of any previously held interest in the associate.

(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 consideration at fair value at each reporting date and recognise changes in fair value in profit or loss.

Paragraphs BC17–BC18 and BC89–BC93 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals?

If you disagree, please explain why you disagree and your suggested alternative.

EFRAG's response to Question 1 – Measurement of cost of associate or joint venture

General comments

6 Cost definition: The definition of cost[4] in Appendix A of the ED is similar to that under IFRS 3 but it is not exactly the same as the definition of cost[5] in other IFRS Accounting Standards (IAS 16.6, IAS 38.8 and IAS 40.5). Stakeholders have highlighted that the different definitions of cost across various IFRS Accounting Standards and the absence of its

[4] Appendix A defines cost of associate or joint venture as 'Fair value of the consideration transferred, including the fair value of any previously held ownership interest (or any investment retained) in the *associate* or *joint venture,* measured at the date an investor obtains *significant influence* or a *joint venturer* obtains *joint control*.'

[5] Under IAS 16, IAS 38 and IAS 40, cost is defined as the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction, or, when applicable, the amount attributed to that asset when initially recognised under the specific requirements of other IFRS Accounting Standards, e.g. IFRS 2 *Share-based Payment*.

definition in other Standards may lead to confusion on what ought to be included in (a) what is explicitly labelled as the cost amount and (b) measurements deemed to be part of the notion of cost-based measurement, including the equity method (see our response to Question 6 on separate financial statements). In this regard, EFRAG notes that in the feedback[6] to the Discussion Paper[7] *Accounting for Variable Consideration – A Purchaser's Perspective* some stakeholders similarly supported a single definition of cost across IFRS Accounting Standards to enable consistent interpretation. However, there was also an argument put forward by other stakeholders against the same definition, i.e. it might not result in the most relevant reported information.

7 Based on the above, we suggest that Appendix A's definition of cost should be enhanced to clarify its interaction with either cost as defined or other notions of cost applied in other IFRS Accounting Standards (see our response to Question 6 on separate financial statements).

8 Acquisition of a business versus an asset: IAS 28 does not distinguish between the acquisition of a business and the acquisition of an asset. However, the appropriate accounting treatment for various application questions (e.g., whether to recognise goodwill on acquisition of ownership interests, how to treat transaction costs, contingent consideration transactions) would depend on whether the investment represents either the acquisition of a business or an asset.

9 Moreover, based on stakeholders' feedback, EFRAG is aware that the revision of the definition of a business under IFRS 3 led to more transactions (e.g. exploration or an operating license held through an investee) being classified as asset acquisitions rather than business acquisitions and such transactions are widespread in certain industries. Therefore, EFRAG recommends the IASB should clarify the accounting for recognition and subsequent changes in ownership interests in assets, including ownership interests in non-financial assets, when an investor has a significant influence.

10 Significant influence: Based on the feedback received, EFRAG suggests that the requirements to assess whether an entity has significant influence, as outlined in IAS 28.6 and paragraph 9 of the ED, and is correspondingly within the scope of IAS 28 requirements,

[6] EFRAG, April 2024, Feedback Statement, *Accounting for Variable Consideration –A Purchaser Perspective*, Discussion Paper.

[7] EFRAG, September 2022, *Accounting for Variable Consideration – A Purchaser Perspective*, Discussion Paper.

should also take into account an investor's restrictions to accessing investee information. Such restrictions could arise due to practical or regulatory barriers (e.g., if the investee is listed, the equal access to information rules for listed companies will prohibit allowing privileged access for some investors). This imposes challenges for reporting entities to apply the ED's proposed requirements (e.g., towards applying the requirements for the acquisition of additional ownership interest mentioned in Question 2).

Specific comments on the ED proposals for measurement of cost of associate or joint venture

Measurement of previously held ownership interest on obtaining significant influence

11 EFRAG supports the proposed measurement of the previously held ownership interest at fair value. This proposal is unlikely to be too costly for entities to apply because, before obtaining significant influence, the previously held ownership interest would have already been measured at fair value under IFRS 9 *Financial Instruments*, unless the consideration transferred constitutes mainly non-monetary asset and would inherently contain higher measurement uncertainty.

12 That said, EFRAG notes that for a previously held ownership interest in an unquoted company, the fair value measurement would only have taken place at certain points in time (e.g. at a reporting date). Therefore, additional costs to determine the fair value of previously held interest may be incurred at the time that significant influence is obtained. EFRAG assumes that these incremental costs are likely to be insignificant.

13 Further, EFRAG suggests that the IASB should:

(a) clarify, similarly to the requirement in paragraph 42 of IFRS 3, how to account for the difference, if any, between the fair value of the previously held ownership interest and its previous carrying amount. This clarification could be helpful, as the unit of account used to determine the fair value of any previously (i.e. before obtaining significant influence) held ownership interest can have an impact on the determination of the fair value of this ownership interest (i.e. whether a premium for significant influence should be included in the fair value); and

(b) specify what is meant by 'the fair value of any previously held ownership interest', as the current definition could lead to confusion as to whether it refers to the fair value already recognised by the investor of its previously held ownership interest or it refers to a remeasurement of the investor's previously held ownership interest when purchasing an additional ownership interest (obtaining significant influence).

Transaction costs

14 The ED is silent on and does not specify how an investor or joint venturer should account for the transaction costs incurred in acquiring ownership interests. Accordingly, it is unclear whether the principles of IFRS 3 should be analogised[8] to determine the appropriate accounting treatment for the transaction costs incurred or July 2009 IFRIC update should be applied.

15 EFRAG's constituents expressed mixed views indicating the need for clarification otherwise the diversity in practice will persist. The view favouring expensing transaction costs was premised on analogising the IFRS 9 Financial Instruments and IFRS 3 treatment of transaction costs. The view favouring capitalisation of transaction costs was premised on considering the equity method is inherently a cost-based approach adjusted for changes in net assets and such treatment would be consistent with the accounting for other assets accounted at cost, consistency with the 2009 IFRIC agenda decision; and capitalising the transaction costs aligns with the local requirements for certain jurisdictions.

16 Hence, EFRAG suggests the IASB clarify the appropriate accounting treatment for transaction costs, and in so doing distinguish between the treatment of transaction costs for the acquisition of a business versus the acquisition of an asset. Our response to Question 6 also touches on unaddressed questions related to transaction costs under separate financial statements.

Contingent consideration

17 EFRAG supports the proposed initial and subsequent measurement of contingent consideration at fair value as this is similar to the approach applied under IFRS 3. However, EFRAG notes that the IFRS 3 definition of contingent consideration is applied in the context of obtaining control and IFRS 3 only applies to an acquisition of business. Therefore, to avoid ambiguity and exacerbating the inconsistency in the accounting for variable and

[8] In accordance with IFRS 3, 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, as clarified in the May 2009 IFRIC update: 'except for certain specific costs, 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'. However, in accordance with the July 2009 IFRIC update, paragraph 23 of IASB's agenda paper 13a from October 2023 notes: 'in contrast, the cost of an equity-accounted investment comprises its purchase price and any directly attributable expenditure necessary to obtain it'.

contingent consideration as highlighted in the 2022 EFRAG Discussion Paper[9], EFRAG suggests that the IASB provide additional guidance in IAS 28 defining contingent consideration in the context of an investor/reporting entity obtaining significant influence in either an asset or business.

18 EFRAG also suggests that the IASB clarify whether a 12-month window to revise contingent consideration, as permitted under IFRS 3, will be allowed in the context of IAS 28.

19 Further, EFRAG suggests that the IASB clarify that paragraph B55 of IFRS 18 *Presentation and Disclosure in Financial Statements*, which states that remeasurements of the fair value of a liability for contingent consideration in a business combination recognised applying IFRS 3 should be classified in the operating category, is also applicable for the equity method under IAS 28.

Recognition of goodwill and bargain purchase gains

20 Stakeholders have expressed mixed views on the ED proposals for the recognition of goodwill or bargain purchase gains for the equity-method-accounted investments. Several stakeholders support this aspect of the ED proposals, which is consistent with current practice as far as they are aware. At the same time, other stakeholders, including some users, question the relevance of recognising goodwill in the context of equity-accounted investments where only significant influence but no control is obtained and/or in case of an asset acquisition.

21 Should the ED proposals be retained, EFRAG suggests the amendments include disclosures that help users identify[10] goodwill and bargain purchase gains derived from acquisitions of ownership interests that are accounted for under the equity method.

22 *Offsetting bargain purchase gains against goodwill*: EFRAG notes that the recognition of goodwill and bargain purchase gains on the acquisition of ownership interests is indicative of the equity method being viewed as akin to a consolidation approach, even though this inference is not explicitly stated in the ED. That said, some stakeholders have expressed concern about inconsistency in the treatment of goodwill that is recognised as an asset versus bargain purchase gains that are recognised in profit or loss. These stakeholders have

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[9] EFRAG's Discussion Paper Accounting for Variable Consideration outlines complexities related to both recognition and measurement of the contingent liability as well as the measurement of the related asset.

[10] Unlike goodwill arising from a business combination, equity-method-derived goodwill is included in the carrying amount of the investment and is not separately presented as an identifiable asset.

argued that the economic value of the investment is better reflected if bargain purchase gains are first netted against the previously recognised goodwill. Moreover, some banking sector stakeholders were concerned about the adverse effects of an "overstated goodwill" amount on their prudential regulatory capital ratios. Hence, EFRAG suggests the IASB should reconsider the proposal by giving more weight to the faithful representation of the economics of an investment than to conceptual consistency/alignment with IFRS 3 principles.

23 *Faithful representation of bargain purchase gains*: EFRAG's constituents have also emphasised the need for checks and transparency on the recognition of bargain purchase gains as such gains may be a reflection of an entity's structuring activities. Hence, EFRAG suggests that the ED proposals for the recognition of bargain purchase gains have similar safeguards to those included in the related IFRS 3 requirements[11]. In addition, in our response to Question 7, we recommend disclosures that inform users about bargain purchase gains.

Deferred tax effects

24 Despite concerns raised by some stakeholders relating to the cost and complexity of recognising and tracking the reversal of deferred taxes and/or changes in local tax rates and the investee's fiscal status, EFRAG supports the ED's proposed inclusion of deferred tax effects in the carrying amount of the investment. This proposal is consistent with current practice and is aligned with the IFRS 3 principles, where deferred taxes arising from fair value adjustments are included in the purchase price allocation (PPA). EFRAG also agrees with the IASB's reasoning that the inclusion of a deferred tax asset or liability in the carrying amount of the investment allows a faithful representation of the tax effects that could arise after significant influence is obtained

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

ED Question 2- Change in ownership

IAS 28 does not include requirements on how an investor accounts for changes in its ownership interest in an associate while retaining significant influence, that arise from:

[11] Paragraph 36 of IFRS 3 requires that, 'before recognising a gain on a bargain purchase, the acquirer shall reassess whether it has correctly identified all of the assets acquired and all of the liabilities assumed and shall recognise any additional assets or liabilities that are identified in that review. The acquirer shall then review the procedures used to measure the amounts …'.

(a) the purchase of an additional ownership interest in the associate;

(b) the disposal of an ownership interest (partial disposal) in the associate; or

(c) other changes in the investor's ownership interest in the associate.

The IASB is proposing to require that an investor:

(a) at the date of purchasing an additional ownership interest 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 part of the carrying amount of the investment or as a gain from a bargain purchase in profit or loss.

(b) 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.

(c) 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'.

Paragraphs BC20–BC44 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals?

If you disagree, please explain why you disagree and your suggested alternative.

EFRAG's response to Question 2 – Change in ownership

Purchase of additional interest while retaining significant influence

25 EFRAG acknowledges the conceptual reasoning behind the ED's proposal to not require the remeasurement of the carrying amount of its previously held interest in an associate or joint venture when purchasing an additional interest while retaining significant influence; and, for each additional layer acquired, the investor or joint venturer is required to measure at fair value the investee's identifiable assets and liabilities at the acquisition date and perform a purchase price allocation (PPA) recognising ensuing goodwill or bargain purchase gain (referred to as the layered approach in this comment letter).

26 Though conceptually consistent with the initial measurement of the investment, most stakeholders have significant concerns about the cost and complexity of the layered approach. Specifically, with regards to:

(a) difficulties in obtaining all needed information when the investor does not control the investee and /or when the investee is a listed company not being able to provide one investor with more information than any other investor. These difficulties will not be encountered only at initial recognition, but throughout the life of the investment (tracking of the deferred taxes and their reversal, items in other comprehensive income and their recycling etc.);

(b) significant complexity in applying the equity method on an ongoing basis. For example, IAS 28 requires that the profit or loss, other comprehensive income and net assets taken into account for the equity method should be determined after adjustments are made for uniform accounting policies (i.e. including changes in the fair value of the net assets). Many preparers have indicated that such adjustments would need to be considered for each individual layer of ownership interest, and this would necessitate multiple ledgers to account for the different layers of ownership interest held through a reporting entity's holding period of an investment;

(c) application difficulties as an investor would be required to reset to nil any investee's item of other comprehensive income recognised in its financial statements, when the equity method is applied for the first time, and for any subsequent additional layer. Such periodic resets would create major practical difficulties and impair the investor's capacity to identify and track those items;

(d) complexity to the implementation of the requirements in paragraphs 21(b)(ii) and B12-B13 of IFRS 12 *Disclosure of Interests in Other Entities* to disclose summarised financial information on current and non-current assets and liabilities of joint ventures and

associates with related fair value step-ups. Applying the layered approach would result in presenting amounts of assets and liabilities arising from a compilation of several values and result in limited usefulness for users;

27 Further to the noted cost and complexity concerns, stakeholders question the overall usefulness of a full-fledged PPA for each additional acquired ownership interest while retaining significant influence. They note that the identified goodwill is part of the carrying amount of the investments and it is not recognised as a separate line item on the face of financial statements, and it is therefore ignored by users. Moreover, as highlighted in our response to Question 1, stakeholders consider conducting a PPA to be inappropriate for the acquisition of an asset.

28 Based on the cost-benefit and complexity concerns, EFRAG recommends that the IASB explores simplifying the proposed layered approach. In this regard, EFRAG notes that many stakeholders expressed support for a modified-PPA approach that we sought feedback on. Under this approach, the PPA-related information that was applied while obtaining significant influence is the reference point for the measurement of the additional acquired layers of ownership interest while retaining significant influence. Key features of the modified-PPA model are as follows:

(a) *Initial PPA information*: The fair value of assets and liabilities of the investee (associate or joint venture) that was identified when the investor obtained significant influence can be used for any subsequent acquisitions while retaining significant influence.

(b) *Subsequent-period adjustments*: These initial fair values of assets and liabilities need to be adjusted for depreciation, amortisation, impairment and other changes. For instance, by applying a premium or discount for changes in the economic prospects of the investee since the investor obtained significant influence.

(c) This subsequent-period adjustment of the fair value of the net assets of the investee at the time significant influence was obtained requires judgment and a reasonable estimation basis. To alleviate this estimation uncertainty, subsequent-period adjustments can be restricted (for example, with a requirement for updating the PPA after a certain period).

29 The suggested modified-PPA approach would be consistent with the principle of IFRS 10.23 that specifies that the transactions with non-controlling interest (NCI) that do not change the accounting method are to be accounted for as equity transactions (i.e., no PPA occurs for the changes in NCI's ownership interests). Similarly, a parent does not record any

additional goodwill to reflect its subsequent purchases of additional shares in a subsidiary if there is no change in control.

30 There are other approaches besides the modified-PPA approach that would also be simpler and less costly than the ED's layered approach. However, these other approaches would conceptually differ and be a fundamental departure from the ED's approach. For instance, this would be the case for the cost-accumulation, non-PPA approach[12] that EFRAG sought feedback on and other[13] approaches that stakeholders highlighted. Feedback received by EFRAG also highlighted a) the challenges in subsequent measurement; and b) the need for a rethink of the ED's proposed initial measurement of cost, if a cost-accumulation approach was the alternative to the ED's layered approach.

31 Overall, based on constituents' feedback, EFRAG recommends that the IASB further explores plausible simplifications to the ED's layered approach and it could consider the modified-PPA approach as a starting point. The other alternatives including the cost-accumulation could be considered were the IASB to undertake a fundamental review of the equity method.

Disposing of an ownership interest while retaining significant influence

32 EFRAG supports the ED proposal for an entity to measure the disposed portion of its investment as a percentage of the carrying amount of the investment. EFRAG acknowledges that when taking the decision, the IASB viewed the proposed approach for accounting for disposals of ownership interests as more understandable and less complex, and EFRAG agrees with this statement.

33 However, EFRAG notes that different units of account are used across the ED's proposals for the treatment of additional purchases of ownership interests while retaining significant

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[12] EFRAG Draft Comment Letter included **Alternative 2** which is a cost-accumulation, non-PPA approach. Under this approach, the fair value of the consideration transferred is assumed to be a proxy for the fair value of each incremental acquisition. This approach is akin the cost accumulation approach with no required PPA. Similar to modified PPA approach and the ED's version of the layered approach, under the cost-accumulation approach, each acquisition would be a separate unit of account. However, unlike modified PPA and the ED's version of the layered approach, Alternative 2 would deemphasise the IAS 28 requirements being applied similarly to IFRS 3 principle.

[13] One constituentsuggested that the IASB consider the approach where goodwill is determined as the difference between the consideration transferred and the current book value of the net assets at the time of the additional purchase.

influence versus those for the disposals of ownership interests while retaining significant influence. EFRAG questions whether this may distort the representation of the economics of the investment and lead to structuring opportunities, for example, when the acquisition of ownership interests and their subsequent disposal occur within narrow time windows.

34 Further, stakeholders have provided examples of where a specific identification method would be more appropriate and simpler to apply. For instance, this would be the case if individual entities A, B and C are part of a consolidated group ABC and each of these individual entities obtains a proportion of ownership interest in entity X and, in the ABC consolidated financial statements, investee X is accounted for using the equity method. In case one of the entities disposes of its ownership interest, a specific identification method could more faithfully represent the economic consequences of the disposal and be less complex than the derecognition of a portion of the investments of the other entities within the group. Similar considerations may be relevant where ownership interests in the associate or joint venture are related to different classes of ordinary shares.

35 Whereas EFRAG understands and shares the concerns expressed by the stakeholders outlined above asking for allowing or requiring, in certain circumstances, a specific identification method, EFRAG also acknowledges that the specific identification would potentially reduce comparability between entities, create structuring opportunities and it would contradict a consolidation view that assumes the group is a single economic entity.

36 Further, EFRAG suggests the IASB clarify how the share of the net assets disposed of is determined, making paragraph 32(b) of the ED more explicit and providing more guidance in BC35(a) with relation to the equity instruments with different economic rights (i.e. preference shares).

Other changes in ownership interest while retaining significant influence

37 EFRAG is aware that many stakeholders are concerned with the ED proposal on other changes in ownership that occur in the absence of an exchange transaction (e.g. an associate's or joint venture's issuance or redemption of its shares). Under the ED proposals, these other changes in ownership are deemed to be equivalent to a) the purchase of additional ownership interests while retaining significant influence (deemed purchases), and b) the disposal of ownership interests while retaining significant influence (deemed disposals). Reasons provided for disagreeing with the ED proposals include:

(a) other changes without an exchange transaction are not economically equivalent to actual acquisitions and disposals of ownership interest. Some stakeholders consider these changes to be 'mechanical' adjustments.

(b) requirement to perform a separate PPA for each deemed acquisition is overly burdensome and costly with limited benefits (as outlined in response to acquiring additional ownership interest). This concern is particularly acute for entities whose associates or joint ventures have high volumes of share buybacks for example.

38 EFRAG notes that, as stated in BC 46 in the Basis for Conclusions, due to the associated complexity the IASB did not develop proposals for a change of ownership arising from equity-settled share-based payments and share warrants. Similar reasoning ought to have been applied towards the ED's proposals for deemed purchases and disposals.

39 Hence, EFRAG recommends that the IASB develop a simpler and a more balanced approach for layered acquisitions from a cost/benefit perspective along with a holistic principle-based approach that encompasses all non-exchange transactions and events within an investee (associate or joint venture) that result in changes in ownership and/or the investor's claims on the investee's resources. Unless the IASB can do so, then all such transactions and events should be scoped out of the amendments to IAS 28.

40 A transitional scoping out of these other changes in ownership interests may fail to remedy existing diversity in practice but it will certainly not worsen it. Plus, the IASB has in any case considered that existing diversity is acceptable for the other changes in ownership transactions that were not in the scope of the ED.

41 Were the IASB to retain the proposal, based on the feedback received, EFRAG points to the following areas not addressed in the ED where further clarifications would be required:

(a) whether an investor or joint venturer needs to consider only the changes at the level of its direct associate or joint venture or also the changes that its associate or joint venture may have within their group and is meant to capture the broader term of 'economic ownership';

(b) whether and how to apply the ED proposals in situations where an investee's net asset changes as a result of a transaction with non-controlling interests within the investee or share buy-backs (in situations where the investee is a consolidated group by itself);

(c) if the ED proposals are also to be applied towards other types of events like the issuance of hybrid instruments that may impact the expected dividends but not the investor's ownership interests, including voting rights;

(d) the calculation of the investee's net assets. The absence of this may lead to confusion and diversity in practice; and

(e) with regard to the decrease in relative ownership interest, whether such changes should result in a realisation of any accumulate currency translation adjustment (CTA) and that IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* should not apply in such cases, because the application of IFRS 5 would require an actual sale of interests in the investee.

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

Question 3- Recognition of investor's share of losses

Paragraph 38 of IAS 28 requires that if an investor's share of losses equals or exceeds its interest in the associate, the investor discontinues recognising its share of further losses. However, IAS 28 does not include requirements on whether an investor that has reduced the carrying amount of its investment in an associate to nil:

(a) on purchasing an additional ownership interest, recognises any losses not recognised as a 'catch up' adjustment by deducting those losses from the cost of the additional ownership interest; or

(b) recognises separately its share of each component of the associate's comprehensive income.

The IASB is proposing an investor:

(a) 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.

(b) recognise and present separately its share of the associate's profit or loss and its share of the associate's other comprehensive income.

Paragraphs BC47–BC62 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals?

If you disagree, please explain why you disagree and your suggested alternative.

EFRAG's response to Question 3: Recognition of investor's share of losses

Losses not recognised and purchase of an additional interest

42 EFRAG acknowledges and does not disagree with the reasons underpinning the ED proposal not to offset losses of previously held ownership interest against the carrying amount of an additional ownership interest acquired (while retaining significant influence). That is, the

latter is a separate and different unit of account from the former. Moreover, as noted in paragraph BC 53 of the Basis for Conclusions, the losses of an associate or joint venture are not necessarily an indicator of the impairment of the investment (e.g. it could be a tech start-up facing early-stage startup losses but albeit having favourable long-term economic prospects).

43 However, in line with our concerns raised in Question 1 and based on most of the feedback received, EFRAG considers that the recognition of additional goodwill in situations where the net assets of an investee are already negative would be inappropriate. Emphasising the separate unit of account in this instance may distort the faithful representation of economic reality and lead to structuring opportunities. Furthermore, EFRAG notes that the feedback from users of financial statements indicates they already struggle with interpreting the economic meaning of goodwill recognised under the equity method. This limited usefulness will be exacerbated if goodwill is recognised in circumstances where the carrying amount of the investment is nil. Hence, <u>in addition to the ED proposals, EFRAG recommends that the IASB also prohibit the recognition of additional goodwill when the carrying amount of the investment is nil due to the share of investee's losses.</u>

44 If the IASB proceeds with the current proposal, EFRAG suggests that the IASB explicitly state that when an entity purchases an additional ownership interest while having unrecognised losses, an entity needs to assess if this additional investment represents an implicit funding of the associate or the joint venture and whether this is indicative that a constructive obligation has been created. If that were to be the case, the unrecognised losses need to be recognised in line with the requirement of paragraph 47 of the ED.

45 Finally, EFRAG asks the IASB to clarify:

(a) whether the original and new interests should be tracked separately, and how they should be accounted for going forward;

(b) how the composition of the associate's carrying amount should be seen in the case net assets are negative. Would the carrying amount of the associate be seen in total as goodwill, or will the goodwill be higher and offset by the negative asset value?

Recognition of each component of comprehensive income

46 EFRAG supports the ED proposal that when an investor has reduced the carrying amount of its investment in an associate to nil, the investor shall recognise and present separately its share of the associate's profit or loss and its share of the associate's other

comprehensive income. However, based on the feedback received so far, there is a need for further clarification of aspects of this proposal.

47 Specifically, with respect to paragraph 48 of the ED[14], the IASB should clarify whether the investor's share of unrecognised losses are to be considered:

(a) separately for the respective profit or loss and other comprehensive income portions and whether the corresponding resumed recognition of share of profit in total comprehensive income (i.e. in excess of the unrecognised losses) is to then be similarly recognised separately for profit or loss and other comprehensive income; or

(b) in their entirety at the level of total comprehensive income without differentiating the amounts respectively arising from profit or loss and other comprehensive income.

48 Further, whether paragraph 52 of the ED[15] shall also be applied when an investor or joint venturer has an accumulation of unrecognised losses across the total comprehensive income (i.e. profit or loss amount and other comprehensive amount taken collectively). Based on feedback received, EFRAG suggests that the example included in paragraph 52 be extended to include situations where:

(a) an investor's or joint venturer's share of profit or loss is a profit and its share of other comprehensive income is a loss;

(b) the net investment is not reduced to nil;

(c) the investor's share in total comprehensive income is a loss that exceeds the net investment in the associate; and

(d) the investor's share in profit or loss is a loss and its share of the other comprehensive income is a profit (or vice versa).

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[14] "*subsequently, if an investor's or joint venturer's share of an associate's or joint venture's total comprehensive income is a profit, the investor or joint venturer shall resume recognising its share of that profit only when that share exceeds its share of losses not recognised*." At the same time, paragraph 50 of the ED states: "*the investor or joint venturer shall recognise separately its share of the associate's or joint venture's profit or loss and its share of the associate's or joint venture's other comprehensive income.*"

[15] "*an investor or joint venturer that has reduced its net investment to nil shall continue to recognise separately its share of an associate's or joint venture's profit or loss and its share of an associate's or joint venture's other comprehensive income, retaining a carrying amount in the net investment of nil.*"

49 With regard to other comprehensive income, the ED proposal does not address how and whether to allocate an investor's or joint venturer's share of its associate's or joint venture's other comprehensive income through various components of the other comprehensive income.

50 Moreover, EFRAG is unconvinced by the IASB's arguments expressed in paragraph BC62 of the Basis for Conclusions for being silent and not developing answers for the order of recognising profits in profit or loss and in other comprehensive income when an investor or joint venturer resumes recognising its share of the associate's or of the joint venture's profits (such as what is the order of priority between recyclable and non-recyclable components of other comprehensive income or to allocate on a proportionate basis between all components of other comprehensive income and how the history of prior unrecognised losses be considered when determining the accounting for the comprehensive income of the period).

51 Notwithstanding, the IASB's argument that the above situations are rare in practice and were not in the application questions, EFRAG considers that the treatment of profit or loss versus OCI is a conceptual question that ought to be addressed via reference to the Conceptual Framework principles and it should not be dependent on the pervasiveness of arising situations. In this sense, accounting standard-setting should cater for both losses and gains in the recovery of losses and not only provide asymmetrical answers. In addition, feedback obtained by EFRAG indicates that the matter is considered significant and pervasive by many stakeholders.

Question 4 – Transactions with associates and joint ventures

Question 4- Transactions with associates and joint ventures

Paragraph 28 of IAS 28 requires an investor to recognise gains and losses resulting from transactions between itself and an associate only to the extent of unrelated investors' interests in the associate. This requirement applies to both 'downstream' transactions (such as a sale or contribution of assets from an investor to an associate) and 'upstream' transactions (such as a sale of assets from an associate to an investor).

If an investor loses control of a subsidiary in a transaction with an associate, the requirement in IAS 28 to recognise only a portion of the gains or losses is inconsistent with the requirement in IFRS 10 to recognise in full the gain or loss on losing control of a subsidiary.

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.

Paragraphs BC63–BC84 of the Basis for Conclusions explain the IASB's rationale for this proposal.

Do you agree with these proposals?

If you disagree, please explain why you disagree and your suggested alternative.

EFRAG's response to Question 4: Transactions with associates and joint ventures

General comments

52 EFRAG supports the ED's proposal to require that an investor recognises the full gains or losses from its 'upstream' and 'downstream' transactions with its associates and joint ventures. The proposal is a significant change to the existing requirement in IAS 28 to recognise gains or losses to the extent of unrelated investors' interests in the associate (for instance, an investor with a 25% ownership interest recognises 75% of gains or losses) and it eliminates the conflict between IFRS 10 and IAS 28 on the accounting for the sale/contribution of a subsidiary to its associate or joint venture.

53 The ED's proposal is consistent with the IFRS 10, which requires the full gain or loss to be recognised on the sale or contribution of a subsidiary (loss of control of a subsidiary). Similarly, when an entity sells an item of property, plant or equipment, IAS 16 requires the full gain or loss on disposal of the asset.

54 Overall, EFRAG considers that the proposal will result in a desirable consistency in the application of the equity method for all transactions with associates or joint ventures. It is also a simplified and less costly solution compared to the other alternatives considered by the IASB that are summarised in paragraph B67 of the ED's Basis for Conclusions.

55 However, EFRAG notes that some stakeholders expressed concerns about restructuring opportunities and earnings management particularly for transactions between associates and joint ventures under common control. As discussed in more detail below (also see our response to Question 7), EFRAG recommends enhanced disclosures to improve the transparency and information content to users on gains and losses recognised on transactions with equity-accounted investments.

56 Furthermore, EFRAG notes that the ED does not refer to or discuss side stream transactions and whether they are covered by the scope of the proposals. We understand side stream

transactions to be transactions between associates, joint ventures and/or between subsidiaries of a parent entity. EFRAG therefore recommends 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. (See our response to Question 7).

Specific comments on the ED proposal

Reasons for supporting proposed recognition of full gains or losses

57 EFRAG notes that an associate or joint venture is not controlled by the parent entity and is therefore not part of the reporting boundary for consolidated financial statements under IFRS 10. EFRAG therefore agrees with the IASB's reasoning set out in paragraphs BC76 – BC80 of the Basis for Conclusions of the ED that elimination of gains or losses on transactions with associates or joint ventures should not be required.

58 EFRAG also agrees with the arguments in BC75(b) of the Basis for Conclusions that the proposal will reduce costs for preparers as an entity will no longer need to gather the required information to perform the elimination entries and track the unrecognised gains and losses over future periods.

Concerns about full recognition of gains and losses for transactions with joint ventures

59 Some stakeholders have raised concerns about requiring an entity to recognise the full gain or loss for transactions with a joint venture because such a requirement could potentially allow a joint venturer to manage its earnings and structure transactions that are not arm's length transactions and these include roundtrip transactions. This concern was also acknowledged by the IASB and explained in paragraph BC111 of the Basis for Conclusions.

60 As noted in our response to Question 7, EFRAG considers that disclosing the amount of any gains and losses on 'downstream transactions' will be helpful to users of financial statements as it will help users understand the pricing of such transactions and benchmark it against market terms, whether these are undertaken at arm's length and if there are structuring activities including roundtrip transactions occurring. In this light, EFRAG recommends that the IASB further examine how to enhance the disclosure requirements for <u>all transactions</u> between a parent and its equity-accounted investees (including upstream and side stream transactions) without duplicating any existing related party disclosures under IAS 24 *Related Party Disclosures*. This would help to provide transparency on the rationale on the rationale and pricing for these types of related party transactions and provide useful information to users.

61 Finally, given that this proposal of the ED is a significant amendment that will result in a change in current practice and that it may elevate earnings management concerns, EFRAG notes that some stakeholders have called for stronger articulation of the principles underlying this particular ED proposal and also raised questions about the clarity and robustness of requirements for transactions that lack commercial substance (see paragraphs below), particularly for transactions with subsidiaries which are equity-accounted in the separate financial statements.

Separate financial statements

62 As addressed in EFRAG's response to Question 6, some stakeholders have raised significant concerns with applying the proposals for subsidiaries (controlled by the investor/parent) accounted for under the equity method in the separate financial statements.

Other comments

63 *Transactions that lack commercial substance*. Some stakeholders have expressed that there are difficulties in interpreting paragraph 54, which combines paragraphs 30 and 31 of existing IAS 28 into a single paragraph without changing existing requirements. EFRAG understands that paragraph 54 is consistent with the requirements in IAS 16 on exchanges of non-monetary assets and acts as a safeguard for transactions that lack commercial substance, as described in paragraph 25 of IAS 16. If a transaction lacks commercial substance, then no gain or loss is recognised on the transferred non-monetary asset. However, EFRAG notes that the accounting for gains or losses seems to depend on whether the exchange results in the entity receiving an equity interest or receiving monetary or non-monetary assets. For the sake of clarity of the requirements in paragraph 54 of the ED, EFRAG suggests the IASB provide a related illustrative example. EFRAG notes that, given the proposal for full recognition of gains or losses from transactions with investees, the point on commercial substance is of particular relevance for transactions with subsidiaries that are equity-accounted in the separate financial statements.

Question 5 – Impairment indicators (decline in fair value)

Question 5- Impairment indicators (decline in fair value)

Paragraphs 41A–41C of IAS 28 describe various events that indicate the net investment in an associate could be impaired. Paragraph 41C of IAS 28 states that a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is objective evidence of impairment. One of the application questions asked whether an investor should assess a decline in the fair value of an investment by comparing that fair value to the carrying

amount of the net investment in the associate at the reporting date or to the cost of the investment on initial recognition.

The IASB is proposing:

(a) to replace 'decline…below cost' of an investment in paragraph 41C of IAS 28 with 'decline…to less than its carrying amount';

(b) to remove 'significant or prolonged' decline in fair value; and

(c) 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.

Paragraphs BC94–BC106 of the Basis for Conclusions explain the IASB's rationale for these proposals. Do you agree with these proposals?

If you disagree, please explain why you disagree and your suggested alternative.

EFRAG's response to Question 5: Impairment indicators (decline in fair value)

64 *General comment on the unit of account.* 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, which forms part of the carrying amount of the net investment. EFRAG notes that the unit of account of impairment (i.e. entire investment) differs from the unit of account applied for the recognition of goodwill (i.e. each purchased layer while retaining significant influence).

65 *Specific comment on the ED proposals*. EFRAG supports the ED proposals related to the impairment of investments in associates or joint ventures. Specifically, EFRAG welcomes the IASB's decision to replace 'cost' with 'carrying amount' in paragraph 41C of the current IAS 28 guidance. Further, EFRAG supports specifying that information about the fair value of an investment might be observed from the price paid to purchase additional ownership interest and adding this clarification as part of the objective evidence within the IAS 28 requirements.

66 From the feedback received, EFRAG is supportive albeit aware of mixed views amongst stakeholders on the ED proposal to remove the '"significant or prolonged" decline in fair

value' criterion. Supporters of this proposal note that it would alleviate application difficulties related to the judgemental assessment of this criterion and thus would reduce diversity in practice.

67 On the other hand, some stakeholders noted that this criterion has been useful in practice and its removal would increase the frequency of the impairment tests that an investor or joint venturer would undertake and that this will impose an incremental burden on preparers. These stakeholders have also expressed concerns that more frequent impairment testing due to no longer considering whether there is a significant and prolonged decline in fair value might result in more frequent impairment write-downs and their subsequent reversals. They are concerned that such volatility could lessen the predictive value of reported earnings (earnings quality) for users of financial statements. Relatedly, some users have indicated that rather than relying on the signal of the impairment of equity-accounted investments to gauge the prospects of an associate or joint venture, they rely on their own valuation and other sources of the fair value of the associates or joint ventures (e.g. the financial statements of the associates or joint ventures).

68 That said, with regard to the above paragraph, EFRAG observes that under the ED proposal, the impairment would only occur if the recoverable amount (i.e. the higher of value in use and fair value) is less than the carrying amount and the impairment testing would only occur as frequently as done for other assets. As for users' relying on other complementary information while assessing the prospects of associates or joint ventures, EFRAG observes that the equity method is currently deemed to be the relevant accounting method for associates and joint ventures (i.e. where the investor has significant influence), and impairment only helps to ensure the depiction of a relevant and faithfully representative carrying amount of the associate or joint venture. EFRAG notes that users' reliance on other complementary information (i.e. besides the consolidated financial statements information) should not lessen the need to provide relevant and faithfully representative information in the consolidated financial statements.

69 In supporting the removal of the '"significant or prolonged" decline in fair value' criterion, EFRAG takes into account that it was removed while developing IFRS 9 requirements for the impairment of financial assets and that consistency in the accounting requirements for similar transactions is desirable.

70 *Reversal of impairment loss under IAS 28 requirements*. Some stakeholders have indicated that there was a lack of clarity on how the requirements for reversing an impairment loss

in IAS 36 interact with the requirements in paragraph 58 of the ED (i.e. in situations where an investor recognises an impairment of an associate in one period, and the associate recognises an impairment loss of its assets in a later period, therefore, reducing the carrying amount of the net assets of the associate with no change in the investor's recoverable amount for the investment). The stakeholder suggested that impairment requirements in IAS 28 should include additional provisions allowing for reversal of impairment of the associate in such situations as the carrying amount of the investment would be below its recoverable amount.

71 Finally, based on stakeholders' feedback, EFRAG recommends that IAS 28 simply reference IAS 36 requirements as the applicable guidance for the impairment of an associate or joint venture without repeating the IAS 36 impairment indicators in the IAS 28 text.

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

Notes to constituents – Summary of proposals in the ED

Question 6 - Separate financial statements

Paragraph 10 of IAS 27 permits a parent entity to use the equity method in IAS 28 to account for investments in subsidiaries, joint ventures and associates in 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.

Paragraphs BC112–BC127 of the Basis for Conclusions explain the IASB's rationale for this proposal. Do you agree with these proposals?

If you disagree, please explain why you disagree and your suggested alternative.

EFRAG's response to Question 6 – Separate Financial Statements

General comments

72 EFRAG supports having a single equity method across consolidated and separate financial statements prepared under IFRS Accounting Standards. EFRAG considers that introducing two versions of the equity method would introduce unnecessary complexity.

73 EFRAG acknowledges that applying the same equity method for subsidiaries, associates or joint ventures in separate financial statements is consistent with the IASB's view that, in separate financial statements, an investment in a subsidiary is accounted for as an asset controlled by the investor (the parent entity) rather than as a business and that the focus

is on the performance of the asset. Therefore, regardless of whether an investor has control or significant influence over the investee, the same equity method is used to measure the investments reported in the separate financial statements.

74 Consistent with the IASB observation, the use of equity in separate financial statements is prevalent in only a few jurisdictions and the cost option under IAS 27 is typically[16] used (paragraph BC121 of the ED's Basis for Conclusions), feedback received by EFRAG confirmed the limited use of the equity method in the separate financial statements.

Recognition of full gains or losses for transactions with subsidiaries

75 Stakeholders in jurisdictions with limited use are not concerned with the impacts of the ED's proposals. In contrast, several stakeholders that operate in jurisdictions that apply the equity method to subsidiaries in separate financial statements have expressed significant concerns with the ED's proposals for recognising full gains or losses for an investor's transactions with subsidiaries in the separate financial statements.

76 These stakeholders consider that subsidiaries are fundamentally different from transactions with associates and that 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. Furthermore, although some consider that enhanced disclosure could mitigate these concerns, it has also been noted that additional disclosures will not be sufficient to mitigate the noted risks**.** EFRAG therefore considers that the proposed disclosures (Question 7) are necessary but not sufficient to allow users to assess the

[16]A study by academics from the University of Zaragoza and University of Autonoma Madrid found that **47%** of assessed companies used the equity method in their consolidation financial statements.

In contrast, the EFRAG Secretariat has found indicative (not statistically representative) evidence of a limited use of the equity method to account for subsidiaries in separate financial statements through the review of a selection of financial statements. Due to limited databases, EFRAG Secretariat reviewed the financial statements of a limited judgmental (non-representative) sample of 37 companies across eight countries (Belgium, Denmark, Italy, Netherlands, Norway, Portugal, Spain, Switzerland) and a variety of industries. Only 5 of these companies (**13.5%)** were clearly identified as applying the equity method in the separate financial statements. 14 (38%) applied the cost method and 18 (48.6%) did not disclose or applied fair value.

reasonableness and sustainability of these transactions and their pricing for benchmarking against market terms.

77 Another concern is the widening of differences[17] between consolidated and separate financial statements from the ED proposals due to:

(a) the required full recognition of gains or losses for transactions with controlled subsidiaries instead of restricting the reporting entity's/investor's share, as required under IFRS 10; and

(b) applying the layered approach instead of IFRS 3 principles when acquiring additional interest in controlled subsidiaries.

78 For the above reasons, EFRAG recommends that transactions with subsidiaries be exempted from the requirement for the recognition of full gains or losses in the separate financial statements.

Project on IAS 27

79 EFRAG acknowledges that separate financial statements play an important role when used to declare dividends, tax reasons and/or fulfil commercial law requirements. However, we consider that any issues and concerns related to separate financial statements ought to be addressed in a project on IAS 27 rather than under amendments to IAS 28. EFRAG acknowledges and agrees that the uptake of such a project[18] [19] would depend on stakeholder feedback to future IASB agenda consultations.

Transaction costs and cost definition in Appendix A

Transaction costs

80 Similar to consolidated financial statements addressed in Question 1, EFRAG notes that it is unclear how transaction costs are treated in separate financial statements when an entity

[17] There are existing differences between consolidated and separate financial statements due to differences in impairment testing, recognition of losses and differing requirements for capitalisation of borrowing costs.

[18] The application of the equity method in the separate financial statements was eliminated by the IASB in 2003 and reintroduced in 2014 as it was mandated by some jurisdictions.

[19] If a project were undertaken by the IASB, the 2014 EFRAG Discussion Paper, Separate Financial Statements, and the related 2015 EFRAG Feedback Statement, Responses to the Discussion Paper, Separate Financial Statements would be a useful reference point as they contains some useful related thinking (e.g. outlines the perspectives of users of separate financial statements and has suggestions for narrowing differences between consolidated financial statements).

opts for applying the equity method to account for its subsidiaries. Moreover, EFRAG is concerned that the definition of the cost of an associate or joint venture as defined in Appendix A of the ED could have implications on the accounting for transaction costs relating to subsidiaries that are equity-accounted-for in separate financial statements.

Applicability of the equity method proposals for investments measured at cost in separate financial statements

81 EFRAG notes that it is not clear whether the clarification regarding the definition of the cost of an associate or a joint venture in Appendix A is also applicable to the cost of a subsidiary. Hence, to avoid divergence in practice EFRAG suggests the IASB clarify whether the definition of cost is the same for all types of investments (i.e. associates, joint venturers and subsidiaries) especially given that, as per the ED proposals, the fair value of a contingent consideration is deemed to part of the cost of an investment in an associate or a joint venture. As explained in paragraphs BC91-92, this proposal is consistent with IFRS 3 and consistent with predominant current practice.

82 EFRAG also recommends that the IASB clarifies whether the fair value of contingent consideration is also part of the cost of an investment measured at cost. This clarification is needed because the equity method is also understood as a variant of the notion of cost measurement and thus consistency across different notions of cost could be expected.

83 Similarly, stakeholders are seeking clarification on whether the equity method proposals for a step acquisition or the loss of control of a subsidiary extend to investments that are measured at cost in the separate financial statements. As explained in paragraph BC132, the absence of a change in the accounting method suggests that the parent should not remeasure the previously held interest or the retained interest. Some stakeholders consider that this argument is valid also when the investment is measured at cost before and after the transaction.

84 EFRAG is cognisant that separate financial statement issues may need to be addressed in a future project based on feedback to future IASB agenda consultations. However, at a minimum, based on the expressed stakeholder concerns, EFRAG suggests and considers this to be a key opportunity for the IASB to clarify the applicability of the ED’s equity methods proposals (i.e. in respect of contingent consideration, step acquisitions and loss of control of subsidiaries) towards investments measured at cost in separate financial statements.

Question 7 – Disclosure requirements

Question 7- Disclosures

The IASB is proposing amendments to IFRS 12 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:

(a) gains or losses from other changes in its ownership interest;

(b) gains or losses resulting from 'downstream' transactions with its associates or joint ventures;

(c) information about contingent consideration arrangements; and

(d) 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.

Paragraphs BC137–BC171 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals?

If you disagree, please explain why you disagree and your suggested alternative.

EFRAG's response to Question 7 – Disclosures

85 *Reconciliation of open and closing carrying amount*: Based on feedback from users, EFRAG welcomes the proposed requirements and especially the reconciliation between the opening and closing carrying amount of the equity-accounted investments. We recommend a requirement to further disaggregate this information as that would be useful for users' assessment of the prospects of the reporting entity's associates and joint ventures (dividend distribution and share of net income/losses). To minimise the reporting burden, EFRAG also recommends that a more disaggregated roll forward should only be required for material investments.

86 Despite users supporting the reconciliation of opening and closing balances, some preparers have highlighted that such a reconciliation would be costly and complex to prepare while others have observed that many entities already include a reconciliation between the opening and closing carrying amount of their investments, albeit with different level of details.

87 *IFRS 12 Disclosures of Interests in Other Entities:* IFRS 12 requires an investor/reporting entity to disclose[20] selected financial information for material joint venturers and associates. Relatedly, stakeholders have indicated to EFRAG that it is not clear which adjustments to fair value are to be considered as there could be multiple fair value adjustments if step acquisitions of ownership interests occur while retaining significant influence. It is also not clear how that information is to be reconciled to the carrying amount of the investment. EFRAG therefore suggests that the IASB provide further clarification on these aspects.

88 *Disclosures related to bargain purchase gains*: In the response to Question 1, EFRAG noted that users have called for transparency on bargain purchase gains as these may reflect an entity's structuring activities. Hence, though not included in the ED proposals, EFRAG recommends that the IASB include disclosure requirements for bargain purchase gains similar to the related requirements under IFRS 3. Requiring the suggested disclosures would provide transparency on the reasons for the bargain purchase gains, and this would be beneficial for users of financial statements.

89 *Disclosures of gains or losses from 'downstream' transactions with associates or joint ventures*: EFRAG acknowledges the reason for this disclosure articulated in paragraph BC 144 of the Basis for Conclusions (i.e. to assess earning quality, allow users to make analytical adjustments of recognised gains or losses, and assess reasonableness and sustainability of these transactions). This proposed disclosure will complement the existing IAS 24 *Related Party Transactions* requirements for the disclosure of related party information on transactions with associates or joint ventures.

90 However, some stakeholders have raised concerns about the cost and complexity of detailed tracking of transactions with associates and joint ventures. Hence, these stakeholders have called for the IASB to further consider the cost-benefit balance of this disclosure. EFRAG also suggests that the IASB further clarify the level of disaggregation required for this information.

91 In addition, some stakeholders have called for the IASB to clarify which gains or losses from transactions with an investee (associate or joint venture) are in the scope of the ED's

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[20] Paragraph B14 of IFRS 12 specifies that the joint venturer's or associate's financial information shall be adjusted to reflect adjustments made by the entity when using the equity method, such as fair value adjustments made at the time of acquisition and adjustments for differences in accounting policies. Paragraph B14 requires also that an entity provide a reconciliation of the summarised financial information presented to the carrying amount of its interest in the joint venture or associate.

proposed disclosure requirements. For example, stakeholders noted that it was not clear whether, in the case of an investor/reporting entity having a lease arrangement with its investee, the interest received/receivable from this lease arrangement should be accounted for as a gain. It is also not clear whether side stream transactions (transactions between subsidiaries) are within the scope of this proposal.

92 *Disclosure requirements related to other changes*: EFRAG suggests clarifying whether the required disclosure on gains or losses from 'other changes', as stated in paragraph 21(d) of the amended IFRS 12 presented in the ED, refers only to changes that occur when an associate or joint venture redeems or issues equity instruments or if it means any other overall changes. Furthermore, EFRAG suggests that changes in ownership interest should be disaggregated into those related to acquisitions, disposals and other changes in ownership interest.

Question 8 – Disclosure requirements for eligible subsidiaries

Question 8 – Disclosure requirements for eligible subsidiaries

IFRS 19 permits eligible subsidiaries to apply IFRS Accounting Standards with reduced disclosure requirements. It specifies the disclosure requirements an eligible subsidiary applies instead of the disclosure requirements in other IFRS Accounting Standards.

As part of developing proposed amendments to the disclosure requirements in other IFRS Accounting Standards, the IASB regularly considers which of those proposed amendments should be included in IFRS 19, based on the IASB's principles for reducing disclosure requirements for eligible subsidiaries.

The IASB is proposing amendments to IFRS 19 to require an eligible subsidiary:

(a) to disclose information about contingent consideration arrangements; and

(b) 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 resulting from 'downstream' transactions with those subsidiaries.

Paragraphs BC172–BC177 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals?

If you disagree, please explain why you disagree and your suggested alternative, taking into consideration the principles for reducing disclosure requirements for eligible subsidiaries applying IFRS 19 (see paragraph BC175 of the Basis for Conclusions).

EFRAG's response to Question 8 – Disclosure requirements for eligible subsidiaries

93 EFRAG notes that the reconciliation table between the opening and the closing carrying amount of the investments would also be relevant for users of financial statements of subsidiaries without public accountability.

94 EFRAG 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.

95 EFRAG has received feedback conveying that contingent consideration can be beneficial for users who rely on subsidiary-level reports for decision-making.

Question 9 – Transition

Question 9- Transition

The IASB is proposing to require an entity:

(a) to apply retrospectively the requirement to recognise the full gain or loss on all transactions with associates or joint ventures;

(b) 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

(c) to apply prospectively all the other requirements from the transition date.

The IASB is also proposing relief from restating any additional prior periods presented. Paragraphs BC178–BC216 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals?

If you disagree, please explain why you disagree and your suggested alternative.

EFRAG's response to Question 9 - Transition

96 EFRAG agrees with the proposed transition requirements except for the proposal to apply retrospectively the requirement to recognise the full gain or loss on transactions with associates or joint ventures. As explained below, EFRAG also seeks clarification from the IASB on some aspects of the proposed transition requirements.

97 EFRAG notes that some stakeholders support the proposal as they deem this to be less burdensome than continually monitoring the amortisation or future realisation of the previously unrecognised restricted gains or losses. However, the majority of our stakeholders did not support the retrospective application for gains and losses on transactions with associates and joint ventures. These stakeholders are concerned that applying the proposals retrospectively will result in them not reflecting the gains or losses at the time of realisation in profit or loss (e.g., on the disposal of assets). For example, entities that have a net investment hedge on the associate or joint venture expressed this concern.

98 Based on the concerns noted by our stakeholders, EFRAG recommends that the IASB require prospective application for recognition of gains or losses from transactions with investees that occurred prior to application date. This would mean that previously unrecognised gains or losses from transactions with investees that occurred before the application date should be recognised under the existing IAS 28 requirements (i.e., they would be amortised or realised and reflected in profit or loss over time). In other words, the proposal for full gains or losses would only apply to transactions with investees from the date the proposal becomes applicable.

Application of retrospective application for gains and losses

99 BC 183 notes the retrospective application proposed in the ED requires an investor to recognise any remaining portion of the previously restricted gain or loss:

(a) in the opening balance of retained earnings for transactions that occurred before the transition date; and

(b) in profit or loss in the comparative period for transactions that occurred in the comparative period.

100 Further, BC 185 notes that IAS 8 includes requirements to limit retrospective application if it is impracticable for an entity to determine the effects of a change in accounting policy.

101 In EFRAG's view, it is not clear whether paragraph C4 is intended to require a full retrospective or whether it's a modified retrospective approach.

102 Therefore, 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, EFRAG recommends the IASB clarify how retrospective application is intended to be applied and provide an example to illustrate this requirement.

Clarification point in Appendix C of the ED

103 Paragraph C8 of Appendix C of the ED states: 'If an investor or joint venturer applying paragraphs C4–C7 increases the carrying amount of its investment in an associate or joint venture and estimated the recoverable amount of that investment at the transition date, in accordance with IAS 36, the investor or joint venturer shall reduce that carrying amount to that recoverable amount, if applicable. The investor or joint venturer shall recognise any impairment loss in the opening balance of retained earnings at the transition date.'

104 EFRAG is uncertain if the intention of paragraph C8 is to require an entity to determine the recoverable amount of its investment in an associate or joint venture when it increases the carrying amount of the investment when applying the transition requirements in C4-C7 or whether it is an option. EFRAG considers that if an entity increases the carrying amount of the investment at the transition date, it should be required to carry out an impairment test at the date of transition. This would avoid an entity having to recognise future impairments that result from past adjustments in profit and loss.

Investments measured at nil and unrecognised gains and losses

105 EFRAG notes that the following aspects of the proposed transition requirements are unclear:

(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.

106 Regarding (a) above, EFRAG seeks clarification on how to deal with the following questions related to transition requirements for 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?

Question 10 – Expected effects (cost-benefit balance) of the proposals

> **Question 10 – Expected effects of the proposals**
>
> Paragraphs BC217-229 of the Basis for Conclusions explain the IASB's analysis of the expected effects of implementing its proposals. Do you agree with this analysis? If not, which aspects of the analysis do you disagree with and why?
>
> If you disagree, please explain why you disagree and your suggested alternative.

EFRAG's response to Question 10 – Expected effects of the proposals:

107 As highlighted in our responses to the earlier questions, the feedback from preparers and other stakeholders highlights their concerns about the cost and/or complexity of the ED proposals in respect of:

(a) acquiring additional ownership interest while retaining significant influence (i.e. layered approach) and the need to conduct a purchase price allocation for each acquisition;

(b) changes in ownership interests that occur without exchange transactions by the reporting entity (e.g. share buybacks by associates and joint ventures);

(c) removing the '"significant or prolonged" decline in fair value' criterion increasing the frequency of impairment testing;

(d) disclosure requirements (e.g., reconciliation of opening and closing carrying amounts of investments).

108 At the same time, EFRAG acknowledges that there is an anticipated benefit of more complete and understandable IAS 28 requirements that will reduce diversity in practice and increase comparability. Users are expected to benefit from such comparability as well as from the increased transparency that will result from the proposed disclosures.

Question 11 – Other comments

> **Question 11- Other comments**
>
> Do you have any comments on the other proposals in this Exposure Draft, including Appendix D to the Exposure Draft or the Illustrative Examples accompanying the Exposure Draft?
>
> Do you have any comments or suggestions on the way the IASB is proposing to re-order the requirements in IAS 28, as set out in [draft] IAS 28 (revised 202x)?

EFRAG's response to Question 11- Other comments

109 *Interaction with other standards*: Many stakeholders raised concerns in relation to the interaction of current IAS 28 and IFRS 18 *Presentation and Disclosure in Financial Statements* requirements. Specifically, IFRS 18 requires all entities to classify income and expenses from equity-accounted-for investments within the investing category of the statement of profit or loss. However, upon transition entities are allowed to reconsider the possibility provided by IAS 28.18 to measure the investment at fair value through profit or loss under IFRS 9.

110 Stakeholders raised concerns that the current provisions of IAS 28.18 are subject to interpretation – for example, the notion of 'similar entities' is not clear and results in diversity in practice. Further, it was noted that the fair value option is provided based on the structure of the parent entity (venture organisation, mutual fund, unit trust, etc.) and not based on the characteristics of the associate entity. As such, the same investment held by a different entity would be accounted for differently.

111 In light of the implementation of IFRS 18, many stakeholders, especially entities in the banking and insurance sectors, raised this issue as a significant matter. For instance, for the insurance entities it is a common practice to have equity-accounted-for investments being part of the specific business models, which may include a direct link between investments in the equity-accounted-for associates or joint ventures to insurance liabilities forming part of the underwriting result included within the operating profit. Such contracts are generally accounted for under the variable fee approach (VFA).

112 The same question about the application of IAS 28.18 is raised for other types of contracts, for example, Property and Casualty contracts (P&C), accounted for under the general model or the premium allocation approach (PAA). Whereas there will be a direct link between the insurance liability and its servicing asset under the VFA model, there will be no direct link for the contracts accounted for under the general model or PAA. However, the investments in associates or joint ventures will still serve the same purpose – i.e., provide income to the insurance entity so that it can service its insurance liabilities.

113 Similarly, the banking industry has a practice of establishing joint ventures with entities which provide technical support or other shared services for a pool of banks. Because of the current diversity in the interpretation of the requirements of IAS 28.18, it was not always possible for the concerned entities to select the fair value option in order to mitigate the classification mismatch. Consequently, the intended outcome of the IFRS 18 transition requirements of mitigating the classification mismatch may not be met.

114 Based on the concerns raised by stakeholders, EFRAG suggests the IASB should either introduce a general option in IAS 28 allowing an entity to account for the associates and joint ventures at FV through PL or to broaden the scope of IAS 28.18 to accommodate all types of investments (VFA and non-VFA contracts for example) which are backing up insurance liabilities.

115 *Integrate articulation of concepts*: EFRAG acknowledges that Table 2 and paragraphs BC 15 to 16 in the Basis for Conclusions delineate the principles (i.e. principles A to H) underlying the classification, boundary of the reporting entity, initial recognition, subsequent measurement and derecognition requirements of IAS 28. EFRAG recommends that these principles be updated to, among other things, include the unit of account applied and presentation as well as any other principle analogised from other IFRS Accounting Standards (IFRS 3, IFRS 10) or derived from the Conceptual Framework. These principles should also be integrated into the description of the revised IAS 28 requirements.

116 *Scope*: The description of the proposed scope of the revised IAS 28 in paragraph 2 of the ED is circular, i.e. if the definitions of associate and joint venture from Appendix A were to be synonymously inserted into Paragraph 2. Hence, EFRAG suggests that the IASB consider rewording paragraph 2 of the ED as follows: ‘This Standard shall be applied when an entity is: (a) an investor in an associate; or (b) a joint controlling entity in a joint venture.’

117 Further, EFRAG notes that the definition of the equity method in Appendix A is more of a description of its mechanics and that the link made to the cost of associate or joint venture within the definition results in a circular statement.