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Exposure Draft *Equity Method of Accounting - IAS 28 Investments in Associates and Joint Ventures*

Dear Sir/Madam,

Thank you for the opportunity to comment on your Exposure Draft *Equity Method of Accounting - IAS 28 Investments in Associates and Joint Ventures* published in September 2024. The Volkswagen Group is one of the world's leading automobile manufacturers and the biggest carmaker in Europe. The Group operates globally, with 114 production facilities in 19 European countries and 10 countries in the Americas, Asia and Africa where 684,025 employees produce vehicles, and work in vehicle-related services or other fields of business. On behalf of Volkswagen AG, Wolfsburg, we are pleased to provide you with the requested remarks to the proposed Exposure Draft in response to your invitation to comment.

Best Regards,

Dr. Stephan Jacob

(Head of Group Accounting and External Reporting)

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<u>Question 1 - Measurement of cost of an associate</u>

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.

The propositions, which are strongly based on the statements of IFRS 3, are in clear contradiction to the cost-based approach that the IASB otherwise pursues (see also our criticism of this below). Against this background, we call for transaction costs to be explicitly included as part of acquisition costs. We would propose a clarification in line with IFRS 9.5.1.1.

<u>Question 2—Changes in an investor's ownership interest while retaining significant influence</u>

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:

(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.

While the cost-based approach presented is consistent in itself and accordingly provides a stable basis for deriving questions of doubt,. it also corresponds to the previous prevailing opinion on the application of the equity method, which was originally derived

from an analogous application of the parent company concept for fully consolidated subsidiaries and which considers each tranche separately. In view of the fact that the IASB has conceptually abandoned the parent company concept for the accounting of subsidiaries for more than a decade, we are disappointed that the IASB has not sought a broader discussion on the consistent classification of the equity method here. If, in the IASB's view, the entity view provides an investor with better insights in a company, why does this not also apply if this company itself acts as an investor in an associate or a joint venture? The tranche-by-tranche consideration of individual acquisition progress leads to consistent, but often also highly complex accounting. In particular, the need to carry out a purchase price allocation for each individual acquisition tranche – an outside-in approach that can usually only be carried out reliably by external consultants – leads to considerable additional costs without any real information gain being apparent to users or the management of preparers. The resulting undue complexity and costs could be avoided altogether by treating the associate or joint venture as what it is: a single entity.

<u>Question 3—Recognition of the investor's share of losses</u>

Paragraph 38 of IAS 28 requires that if an investor's share of losses equals or exceeds its interest in the associate, the investor discontinue 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.

As stated above, we disagree with the general approach of the IASB, which treats each tranche separately. However, we acknowledge that – based on this approach – these proposals are consistent.

<u>Question 4—Transactions with associates</u>

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 this proposal?

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

We disagree with the proposal because of the extensive new disclosures accompanying it. In principle, we would welcome the IASB's proposal to abolish the proportional elimination of intercompany profits for transactions with associates or joint ventures in accordance with IAS 28, if the disclosures introduced at the same time not only clearly thwarted the objective of reducing expenses and costs for companies in accordance with BC 75, but also created an excessive level of transparency towards our partners and competitors. Joint ventures may not be third parties, but the partnering JV-shareholders are. Together with the tax authorities, they will normally ensure that joint ventures do not generate any unusual profits. And this is precisely why too much transparency is harmful. And the fact that profits must now also be calculated for services means that the advantage of no longer having to perform and later dissolve proportionate consolidation measures in accounting is practically eliminated.

In particular, determining gains and losses from all transactions, including services, would be significantly more complex than the previous elimination of intermediate results from stocks and, in our case, would require a completely different procedure in the data model, which is why the entire data model would have to be redesigned. This represents a considerable additional expense for preparers.

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.

We disagree with proposition (b). According to IAS 28.41C a **significant or prolonged** decline in the fair value of an equity investment – e.g. a decline in the stock exchange price of an individual share –below its cost is – beside the other Investment-specific indicators stated in IAS 28.41C – objective evidence of an impairment. This means that an impairment test must be performed in accordance with IAS 36 for the investment. A limitation of triggering events to significant or prolonged fair value declines is necessary because the fact that the stock market price has fallen below the book value of an investment does not necessarily mean that the estimated value in use is also below the book value. In our view, it is not unusual for the value in use of strategic investments to be significantly higher than the general stock market value – warranting the payment of acquisition premiums. While we agree that a significant or prolonged decline in stock price in itself is an indicator for an impairment, we do not agree that this also applies to an **immaterial** decline that is **neither significant nor prolonged**. The proposed amendment will result in a considerable burden for companies without any added value for the investor.

Let us assume that a listed investment whose stock price in the current year was predominantly above the carrying amount falls insignificantly below its book value on 1 November of a year without any of the other impairment indicators of IAS 28.41C

being triggered. According to the proposal, a company would then be forced to carry out an impairment test for the investment. Since only publicly available information may generally be used for the valuation of listed investments, every additional valuation is time-consuming and therefore cost-intensive. In case of doubt, an external consultant would need to be commissioned for a significant shareholding, leading to even greater cost burdens. Under these circumstances, impairment testing will in many cases plausibly demonstrate that the recoverable amount of the equity investment has not fallen beneath the carrying amount, regardless of temporary, insignificant stock price fluctuations. Nevertheless, a company would be forced to submit a test for documentation purposes, even in cases where it is already obvious during the adjustment period that the stock price has recovered back to above the carrying amount following the reporting date.

Consequently, in our view the proposed amendment will only increase the costs for preparers without any benefit for users.

<u>Question 7—Disclosure requirements</u>

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.

We disagree with the proposed additional disclosure requirements. As stated in our response to question 4, we particularly disagree with the disclosure of gains or losses resulting from 'downstream' transactions with associates or joint ventures. In addition, IFRS 12 already mandates today to disclose material gains or losses from other changes in the ownership interest. Please keep in mind that – to the best of our knowledge – these disclosures already are common practice at most companies – when they are material. However, from our experience, such transactions mainly relate to investments in startups or companies with share-based payment schemes and hardly ever lead to material changes in ownership interest requiring specific disclosure. Consequently, an explicit reporting obligation only leads to additional administrative burdens for preparers and disclosure overload for users.