Equity Method of Accounting

Exposure Draft

IAS 28 Investments in Associates and Joint Ventures (revised 202x)

FR TEG-CFSS 10 March 2025

EFRAG
Financial reporting

DISCLAIMER

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BACKGROUND

IASB ED *IAS 28 Investments in Associates and Joint Ventures (revised 202x)* (published 19 September 2024 open for comments until 20 January 2025)

EFRAG's Final Comment Letter (published on 20 January 2025)

EFRAG's Equity Method project page

PRESENTATION STRUCTURE

- EFRAG's positions in Final Comment Letter (FCL)
- EFRAG Secretariat's suggested areas of prioritisation during redeliberation
- Questions to the EFRAG FR TEG-CFSS members

EFRAG'S FINAL COMMENT LETTER POSITIONS

EFRAG'S GENERAL COMMENTS ON ED PROPOSALS

- **Positive step**: Overall, EFRAG agreed with many of the ED's proposals and considered them to be a positive step towards reducing the existing diversity in practice, but EFRAG also had significant concerns with several of the proposals.
- **Need to be explicit on underlying conceptual assumptions:** EFRAG asked the IASB to be explicit in the Basis for Conclusions about the assumed conceptual feature of the equity method underpinning each proposed amendment.
- **Further simplification needed**: EFRAG suggested extending the simplification principle to all areas of the ED (i.e. the layered approach of accounting for acquired ownership interests while retaining significant influence) to reduce complexity.
- **Crafting the way forward**: EFRAG recommended the IASB carefully considers the totality of the feedback from stakeholders to the ED and to address the areas of concern and further clarifications. In addition, considering lingering questions amongst several stakeholders about the nature and purpose of the equity method, EFRAG recommended that, for its forthcoming agenda consultation, the IASB includes and seeks views on the fundamental review of the equity method as a possible candidate for the future IASB workplan.
- A fundamental review could entail a review of the usefulness, purpose, scope, and nature of equity method including whether it is a one-line consolidation or measurement method.

EFRAG'S POSITION – MEASUREMENT OF THE COST OF AN ASSOCIATE OR JOINT VENTURE (JV)

EFRAG Final comment letter position:

- Overall**, EFRAG supported the ED proposal** as it would:
  - ✓ reduce diversity in practice
  - ✓ align with existing practices
- **Request for additional clarifications on the following:**
  - ✓ ED is silent on accounting for transaction costs, EFRAG suggested capitalisation of transaction costs (i.e. their inclusion in cost of investee)
  - ✓ How to (re)measure previously held ownership interest
  - ✓ EFRAG called for clarifying definition of cost in Appendix A versus definition of cost in other IFRS Accounting Standards

IASB's ED proposal:

- **Cost = fair value (FV) of the consideration transferred**
- Consideration transferred includes:
  - ✓ FV of previously held ownership interest
  - ✓ contingent consideration measured at FV
- Purchase price allocation (PPA) resulting in:
  - ✓ goodwill (part of the carrying amount) or
  - ✓ bargain purchase (statement of profit or loss (P&L))
  - ✓ recognition of related deferred taxes
- **Subsequent measure of contingent consideration:**
  - ✓ FV at each reporting date with changes accounted in P&L, if liability
  - ✓ no revaluation, if equity

EFRAG'S POSITION – CHANGES IN AN INVESTOR'S OWNERSHIP INTEREST WHILE RETAINING SIGNIFICANT INFLUENCE

EFRAG final comment letter position:

- **EFRAG disagreed** with the ED's proposals for accounting for **step acquisitions and other ownership interest changes**. **EFRAG supported** the ED's proposal for **accounting for disposals of ownership interests**.
- **Concerns:** EFRAG had the following concerns
  - ✓ PPA at each acquisition is too complex and costly, excessive compared to its benefits (EFRAG **suggested potential alternative-modified PPA**)
  - ✓ accounting for deemed acquisition and deemed disposal are too complex, not economically equivalent to actual transactions
  - ✓ recognition of goodwill and bargain purchase gain between different layers without offset
  - ✓ inconsistent unit of account used in the ED

IASB's ED proposal:

- **Additional purchase** of ownership interest:
  - ✓ additional share is added to the carrying amount based on the FV of net assets acquired (layered approach)
- PPA resulting in:
  - ✓ goodwill (part of the carrying amount) or
  - ✓ bargain purchase gain (P&L)
- **Disposal** of ownership interest:
  - ✓ derecognise proportion of the carrying amount with gain or loss recognised in P&L
- **Other changes**
  - ✓ treat as deemed purchase or deemed disposal

EFRAG'S POSITION - RECOGNITION OF THE INVESTOR'S SHARE OF LOSSES

EFRAG Final comment letter position:

- EFRAG supported the principle of not **'catching-up'** unrecognised losses, **except in certain situations.**
- EFRAG asked for **clarification of various aspects** of the ED's proposals with regard to the recognition of each component of comprehensive income.
- **Concerns and clarifications**
  - ✓ EFRAG disagreed with recognising goodwill in de facto funding or bail-out scenarios
  - ✓ EFRAG asked for additional clarification on several aspects of the recognition of each component of the comprehensive income
  - ✓ EFRAG called for guidance when resuming the recognition of profit

IASB's ED proposal:

Losses not recognised and purchase of additional interest

- In presence of unrecognised losses, the investor or joint venturer **does not 'catch-up'** those losses by reducing the carrying amount of the additional ownership interest (treat as separate unit of account).

Recognition of each component of comprehensive income

- The investor or joint venturer would:
  - ✓ recognise its share of P&L **and then** its share of OCI
  - ✓ **recognise separately** its share of P&L and its share of OCI
  - ✓ if an investment is reduced to nil, recognise separately its share of P&L and its share of OCI **retaining carrying amount of nil**

EFRAG'S POSITION – TRANSACTIONS WITH ASSOCIATES AND JOINT VENTURES

EFRAG final comment letter position:

- **EFRAG overall supported for ED proposal because it:**
  - ✓ eliminates conflict between IAS 28 and IFRS 10 on the accounting for an investor's sale/contribution of a subsidiary to its associate or joint venture
  - ✓ will result in desirable consistency for all transactions with associates or joint ventures
- **Concerns, clarifications and suggested enhancements:**
  - ✓ EFRAG noted some stakeholders have concerns on earnings management, especially with joint ventures. EFRAG recommended disclosures to alleviate concern.
  - ✓ EFRAG called for IASB to clarify whether side stream transactions are in scope of the ED proposals.
  - ✓ EFRAG suggested additional disclosures for side stream and upstream transactions.

IASB's ED proposal:

- To require the investor recognise in **full gains or losses from all** 'upstream' and 'downstream' transactions with its associates or joint ventures, including transactions involving the loss of control of a subsidiary.

EFRAG'S POSITION – IMPAIRMENT INDICATORS (DECLINE IN FAIR VALUE)

EFRAG final comment letter position:

- Overall, **EFRAG supported** the ED's proposals albeit acknowledging stakeholders had mixed views on the proposal to remove the 'significant or prolonged' decline in fair value criterion for impairment testing. EFRAG's support was due to the ED proposal's alignment with IFRS 9 requirements.
- EFRAG's suggested clarifications and enhancements:
  - ✓ EFRAG called for the clarification of reversal of impairment loss under IAS 28.
  - ✓ EFRAG suggested 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.

IASB's ED proposal:

- Replace 'decline…below cost' with 'decline… to less than its carrying amount';
- Remove the reference to **'a significant or prolonged'** decline in the fair value of an investment.

EFRAG

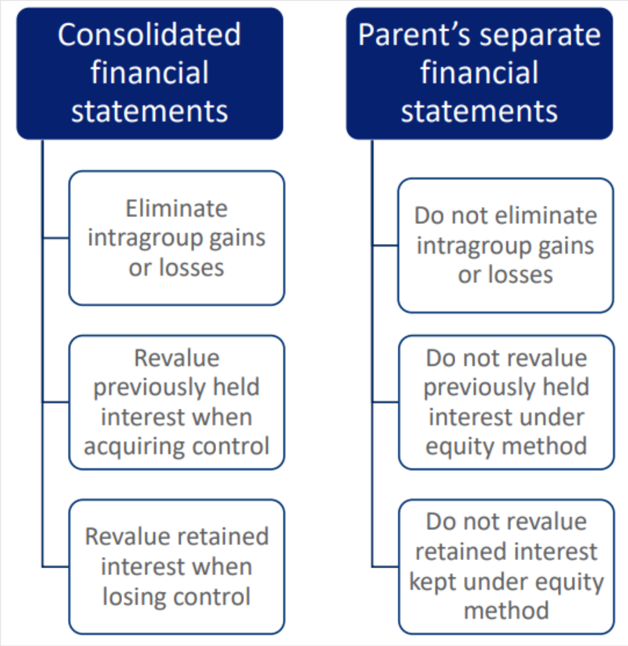
EFRAG'S POSITION – INVESTMENTS IN SUBSIDIARIES IN SEPARATE FINANCIAL STATEMENTS (SFS)

EFRAG final comment letter position:

- **Partial support:**
  - ✓ **EFRAG supported** the ED's proposed application of a single equity method across IFRS Accounting Standards except for the recognition of full gains or losses from all transactions with subsidiaries (including side stream transactions).
  - ✓ **EFRAG recommended the exemption of subsidiaries** from full gain/loss recognition in SFS (i.e. due to concerns about structuring and misrepresentation of economic substance).
- **Other concerns in EFRAG's FCL:**
  - ✓ EFRAG noted stakeholder concerns about not remeasuring previously held interest on step acquisition (loss of control) of a subsidiary.
  - ✓ EFRAG noted stakeholder concerns about the applicability of the ED's proposals for investments measured at cost in SFS.

IASB's ED proposal:

- Apply **the same proposals** for the investees accounted used the equity method in Separate Financial Statements.



EFRAG'S POSITION – DISCLOSURE REQUIREMENTS

EFRAG Final comment letter position:

- EFRAG **supported the ED's disclosures** balancing their need in light of the ED's proposals for transactions with associates or joint ventures against the concerns voiced by some stakeholders about the cost and sensitivity of the proposed disclosures of gains or losses from downstream transactions.
- EFRAG suggested expanding the disclosures to encompass upstream and side stream transactions.
- To alleviate stakeholder concerns, EFRAG suggested aggregating the disclosure of gains or losses of immaterial investments, and introducing a sensitivity carveout.

IASB's ED proposal:

- Amount of the gains or losses from other changes in ownership interest.
- Gains and losses from transactions with associates or JVs on 'downstream transactions'.
- Information on the nature of the arrangement, amounts recognised, their changes and range of possible outcomes for contingent considerations arrangements.
- Reconciliation of the opening to closing balance of the carrying amount showing the changes related to:
  - ✓ share of profit or loss
  - ✓ share of OCI
  - ✓ distributions received
  - ✓ impairment losses
  - ✓ changes in ownership interest

EFRAG'S POSITION – TRANSITION REQUIREMENTS

EFRAG final comment letter position:

- Overall**, EFRAG supported** the ED proposals **except for the retrospective application of the remaining portion of a previously restricted gain or loss** arising from transactions with associates or joint ventures (i.e. due to it being costly). EFRAG recommended the IASB permit prospective application for the latter.
- **EFRAG's suggested clarifications and enhancements:**
  - ✓ EFRAG asked the IASB to clarify the scope of the contingent consideration during the transition (i.e., the requirement only applies to any remaining unrecognised contingent consideration that was either not recognised or was recognised on a basis other than fair value).
  - ✓ EFRAG asked for clarification of application of prospective requirements for investments measured at nil at transition date.
  - ✓ EFRAG suggested 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.

IASB's ED proposal:

- Apply the proposals **prospectively, except**, at transition date, recognise:
  - ✓ previously restricted **portion of gains or losses** from transactions with associates or joint ventures
    - ❖ as an adjustment to the carrying amount of the investment and the retained earnings
  - ✓ **contingent consideration** at fair value
    - ❖ as an adjustment to the carrying amount of the investment

EFRAG'S POSITION – EXPECTED EFFECTS (COST-BENEFIT BALANCE)

EFRAG final comment letter position:

- EFRAG acknowledged benefits of reduced diversity in practice but also noted the costs and complexity of certain proposals (layered approach for step acquisitions, other changes in ownership interest, more frequent impairments, and disclosure requirements).

IASB's ED proposal:

- IASB's identified costs to preparers:
  - ✓ changes in accounting policies
  - ✓ adaptation of the IT systems, processes, controls and procedures (i.e. staff training)
  - ✓ potential additional reconciliations / disclosures for differences between consolidated and SFS
- Magnitude of cost born by preparers would vary based on the significance of its investments affected by the proposals and the frequency of the transactions.
- IASB's identified benefits include:
  - ✓ reduction of diversity in practice
  - ✓ improved comparability for users
  - ✓ reduced cost for preparers (no longer necessary to develop company's own accounting policies in case of application questions)

EFRAG'S POSITION – OTHER COMMENTS

EFRAG final comment letter position:

- EFRAG highlighted additional concerns related to:
  - ✓ interaction with other standards
  - ✓ scope of paragraph 28.18 (option to apply FV measurement):
    - ❖ unclear notion of 'similar entities' as it might create diversity in practice
    - ❖ interaction with IFRS 18 *Presentation and Dicslosure in Financial Statements* transition requirements for financial sector (i.e., insurance contracts and accounting mismatch)
  - ✓ articulation of concepts and scope of the revised IAS 28

SUGGESTED PRIORITISATION AREAS

EFRAG SECRETARIAT'S SUGGESTED AREAS OF PRIORITISATION DURING REDELIBERATIONS

Finalisation of the current project (Most critical areas to address):

- **Simplification** of proposals for changes of ownership interest
  - ✓ step acquisitions (need to develop a simpler and less costly approach than the full-fledged PPA)
  - ✓ other changes in ownership interest (need to develop an alternative, simplified principle-based approach capturing all transactions)
- **Recognition of each component of comprehensive income:** The ED's guidance was unclear and confusing. Need to revisit entire proposals as this affects investors assessment of performance.
- **Separate financial statements-** revisit transactions with subsidiaries.

Finalisation of the current project (Other priority areas to address):

- **Measurement of cost:** Clarify treatment of transaction costs
- **Additional disclosure** requirements to mitigate potential earnings management / structuring opportunities
- **Transition** requirements (allow prospective application for unrecognised gains/losses and address other identified clarification areas)
- **Other clarifications** (applicability of ED proposals for investments at cost in SFS)

Upcoming agenda consultation:

- Include the fundamental review of the equity method as a possible candidate for the future IASB workplan. In so doing, get stakeholders views on what should be in the scope of such a review should be. For instance, whether the following questions should be addressed
  - Is equity method useful and should it be retained?
  - What investments should be in scope of equity method?
  - Is the equity method a one-line consolidation or a measurement method?

QUESTIONS FOR EFRAG TEG-CFSS MEMBERS

QUESTIONS TO THE EFRAG FR TEG-CFSS MEMBERS

Q1. Do you agree with EFRAG Secretariat's suggested priority areas for the IASB's redeliberation based on EFRAG's positions in its final comment letter including those that are categorised as most critical to address? If not, what areas of redeliberations should the IASB prioritise?

Q2: Do you agree with the suggestion that the need for a fundamental review including constituents views on the scope of such a fundamental review should be included in the next IASB agenda consultation? Any views on what the scope of such a fundamental review should entail?