20 January 2024

International Accounting Standards Board
Email: commentletters@ifrs.org

Cc: EFRAG

Dear Sir/Madam

Exposure Draft – Equity Method of Accounting

Norsk RegnskapsStiftelse (the Norwegian Accounting Standards Board, NASB) welcomes the opportunity to comment on the proposals in the Exposure Draft (ED) *Equity Method of Accounting*.

We support several of the proposed amendments, including the revised structure of the standard, and welcome the IASB's initiative to improve the application of the equity method.

While we think the time is right also for a project on the scope of the equity method, we recognise that it has not yet been prioritised on the agenda and have therefore only commented on the specific proposals in the ED.

While the proposed amendments address particular application issues, for some of the proposals we believe the ED only partially address the underlying issue, or create new questions that need to be addressed and resolved. This includes issues such as whether transaction costs should be included in the cost of an associate, an investor's accounting for an associate's transactions with its non-controlling interests, the recognition of an investor's share of losses as well as certain impairment requirements, which we believe all warrant further attention from the IASB.

In our view, the impairment requirements should be moved to IAS 36 in their entirety, and if the IASB decides to continue with specific impairment requirements in IAS 28, further clarifications are required. A recent enforcement decision in our jurisdiction, which might have implications for entities within the EU/EEA, has illustrated how the interaction between IAS 36 and IAS 28 is currently unclear, and may lead to counterintuitive solutions.

Lastly, we disagree with several aspects of the proposed transition requirements, and strongly disagree with the absence of a requirement, or even the option, to perform an impairment test at the transition date.

In Appendix 1 below, we have included our responses to the individual questions in the ED and elaborated on our concerns. In Appendix 2, we have included an expansion of the proposed Illustrative Example 3 to IAS 28, to illustrate the lack of clarity we believe remains in this area. Appendix 2 must be read in conjunction with our comments to Question 3 in Appendix 1. Similar to the ED, any reference to an 'associate' in our comment letter applies equally to other equity-accounted investments, to the extent applicable.

Should you wish to discuss our comments further, please do not hesitate to contact Bjørn Einar Strandberg.

Yours faithfully,

Bjørn E Strandberg

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Appendix 1 – our comments to the questions in the exposure draft

Below we provide our responses to the questions in the ED.

Response to Question 1 – Measurement of cost of an associate

Overall, we support the proposed amendments regarding the initial measurement of investments in associates. In our view, the proposed clarifications are largely converged with current practice.

In our view, the main area where current practice might be mixed, is the measurement of contingent consideration. We do, however, agree with the proposed solution of requiring all contingent consideration to be measured at fair value and included in the cost of the associate.

By anchoring the proposed solution in IFRS 3 *Business combinations* and defining the 'cost of the associate or joint venture', rather than just 'cost', we believe the risk of unintentional effects to other standards where assets are initially recognised at cost, is low.

However, the proposed definition does not specify whether transaction costs incurred when acquiring the interest in an associate should be included. While 'cost' is usually understood to include transaction costs, the reference to IFRS 3 suggests that transaction costs should be expensed instead. As the proposed requirements have introduced new uncertainty in this area, we urge the IASB to provide clarification, while not expressing a view on which way to go.

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

We generally agree with the proposed clarifications of how investors account for changes in the ownership interest while retaining significant influence.

We recognise that there are different views among constituents on whether the layered approach is appropriate, but we support the IASB's proposed requirements for increases in ownership interests in associates. There might be practical difficulties when applying the equity method, particularly if the associate is listed and the investor's access to information is legally restricted, but such difficulties are general to the equity method, and not the layered approach specifically.

Nonetheless, we believe the concept of 'changes in ownership interest' lacks a definition and should be explained in more detail. It is not clear whether ownership interest refers to direct ownership interest in the investee measured as a percentage of voting rights or financial interest only, or is meant to capture a more broad term 'economic ownership'. This distinction is important, because it determines how events or transactions, such as a change in the non-controlling interests (NCI) in the investee's subsidiaries potentially impacting the investor's carrying amount of the investment in the investee, should be accounted for.

In general, there is a lack of clarity in paragraph 27 of the current standard, as it is silent on the situation where the investee's consolidated statements include an NCI. In contrast, paragraph 37 of the current standard explains in detail how preference shares held by other investors should be treated. Paragraph 27 only say that "the profit or loss" and "net assets" of the associates [consolidated] financial statements are taken into account. In our opinion a clarification is needed that only the *controlling interest* of the profit and net assets should be taken into account.

Based on the current wording there is diversity in practice, and it is not uncommon that the percentage of ownership in the associate is used to include profit attributable to both controlling and non-controlling interests in the consolidated financial statements of the investee, even if this does not make economic sense.

Further, our understanding of the equity method, both currently and after the proposed changes, is that transactions between the associate and its NCI without loss of control, should also be accounted for using the layered approach as a change in the ownership interest. The current wording is, however, not clear in this respect.

We are of the opinion that changes in NCIs through equity transactions, for instance a dilution of the parent in an associate that is a consolidated group, should be reflected as a change in ownership in the investor's financial statements, even if the ownership percentage in the associate parent is unchanged. However, it is not clear from the ED whether such changes should be included in the investor's share of the investee's profit or loss, or if it should be recognised directly in the investor's equity (and hence mirror the investee's accounting). If our understanding of the IASB's intention is correct, this would mean that the term 'ownership interest' is to be understood in the more general term 'economic ownership' rather than 'direct ownership interest'. As mentioned, we believe this needs to be clarified in the standard.

While this is not a new issue, it is a common one, and the IASB's current project is in our view the right place to address it. In paragraph BC46 of the ED, the IASB explains that developing such requirements "would have been time consuming and would probably delay the project considerably". It is not clear to us what specifically would make such a narrow and targeted amendment time consuming. The IASB explains that such transactions "typically do not have a pervasive or significant effect for investors". While that might be the case, the frequency of such transactions, combined with what we would reasonably expect to be a limited effort required, suggests that adjustment to the standard to complete the amendment for all changes in economic interests is warranted.

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

We support the IASB's proposed clarifications of some aspects of the recognition of the investor's share of losses. However, we believe further clarifications are required.

We do not agree with the IASB's assumption set out in paragraph BC62 of the ED, that situations where an investor resumes recognising its share of profits, and therefore needs to determine the order of recognising profits, are uncommon. In practice, this issue does arise in various situations, and one such common example relates to investments in associates or joint ventures in an early development phase.

When reading the proposed Illustrative Example 3 to IAS 28, we are not convinced that the accounting in the second period is in fact the only reasonable interpretation of the requirements. Furthermore, we believe there are several possible approaches to accounting for future periods, depending on when the associate becomes profitable and the recognition in the investor's financial statements resumes. In Appendix 2 to our comment letter, we have expanded the Example 3 with one additional year to show that there are (at least) four different possible interpretations of the requirements to recognise the investor's share of profit or loss and other comprehensive income separately. We are concerned that this lack of clarity could result in significant diversity in practice, which would in turn require lengthy and unnecessarily complex accounting policy disclosures. We believe the issue is even more explicit if the periods illustrated are interim periods within the same annual period, i.e. the annual reporting may be different depending on the frequency of interim reporting.

We therefore urge the IASB to provide additional clarifications, including expanding Illustrative Example 3 by at least one additional period as illustrated in our example in Appendix 2.

Response to Question 4 – Transactions with associates

We agree with the proposed amendments regarding the accounting for transactions with associates, as described in paragraphs BC76-BC80. Removing the requirement to eliminate gains and losses resulting from upstream and downstream transaction will reduce the ongoing cost and complexity of applying the equity method.

We note that the introduction of paragraph B99A in IFRS 10, which is now proposed to be removed, has affected practice, even in our jurisdiction where the amendments to IFRS 10 have not been endorsed and therefore may not be applied. Specifically, some entities have recognised a full gain only if a business is transferred, while others have not made the same distinction. Therefore, current practice in situations where IFRS 10 and IAS 28 provide inconsistent answers, is mixed. In order to foster consistency, we welcome the IASB's proposal to IAS 28 on this issue.

Response to Question 5 – Impairment indicators (decline in fair value)

The NASB agrees with several of the prosed changes covered by Question 5, but as explained below, we believe that the changes should aim at ensuring that IAS 36, rather than IAS 28, is the standard containing the impairment requirements for equity method investments.

We agree with the proposal to amend the impairment indicators in IAS 28. We also agree with the aim of aligning the wording with IAS 36 to a larger extent, but in our view the indicators in paragraph 57 of IAS 28 could be aligned with paragraph 12 of IAS 36 to an even larger extent. For example, the wording in IAS 28.57(h) should in our view refer to 'a decline in the **value**', rather than 'fair value'. This would be consistent with the wording in IAS 36.12(a) and would remove the suggestion that an entity needs to determine the fair value of the investment in accordance with IFRS 13 to determine whether there is any indication that the investment may be impaired, which we assume has not been the IASB's intention.

Location of impairment requirements for investments in associates
In our view, removing the impairment requirements from IAS 28 entirely and making a few targeted amendments to IAS 36, would be a more logical and effective way to improve the interaction between IAS 36 and IAS 28. Paragraph 4(b) and (c) of IAS 36 currently specify that the standard applies to investments in associates and joint ventures. That in itself clearly states that the general impairment requirements in IAS 36 apply, and thus IAS 36 and not IAS 28, should specify the impairment requirements for such investments.

We acknowledge the specific challenges related to the application of IAS 36 to such investments, but believe that moving the key requirements from IAS 28 to IAS 36 as follows, would reduce confusion and further improve the structure of the requirements (IAS 28 references below are based on the ED, not the current standard):

- The specific impairment indicators in IAS 28.57 in the exposure draft could, if deemed necessary to be retained, be moved to IAS 36.12. There is already a precedent for including impairment indicators specific to certain assets in IAS 36 in paragraph 12(h)
- The fact that the entire investment is the unit of account for impairment testing, and that goodwill is not tested separately, as IAS 28.58 explains, could be clarified in the scope considerations in IAS 36.4.
- IAS 28.58(a) and (b) and the sentence before these bullets, could be included as a new paragraph 32A of IAS 36 as they explain how the value in use is calculated for investments in associates.
- IAS 28.59 could be included as a new paragraph 73A in IAS 36, as it explains how the cash-generating unit is determined for investments in associates.

IAS 28.58 currently causes more confusion than clarity around reversals, as noted below, and relying on IAS 36 will provide more clarity for such situations. The amendments we propose to IAS 36 are narrow in nature and ringfenced to the application of IAS 36 to investments in associates, so the risk of unintended impacts to the general application of IAS 36 is low.

Necessary changes to impairment requirements if current location is retained
If the IASB is opposed to such an approach, in our view several other changes to IAS 28 would be required. The proposed amendments to IAS 28 do not provide the necessary clarity with respect to reversal of impairments recognised in prior periods.

Similar to paragraph 42 of the current standard, paragraph 58 of the revised standard refers to "reversal of (…) impairment loss (…) recognised in accordance with IAS 36". In our understanding, this refers to the amounts determined by comparing the recoverable amount to the carrying amount of the investment. It does, however, not explain *when* a test for reversal needs to be performed. Since the impairment indicators for investments in associates in IAS 28 differ from those in IAS 36.12, we encourage the IASB to clarify which indicators of reversals are applied to these investments.

Further, there is currently a lack of clarity around how the requirements for reversing an impairment loss in IAS 36 and IAS 28 interact. The proposed IAS 28.58 will in our view not provide the necessary clarity. We observe that the proposed IAS 28.58 retains the wording from the current paragraph 42 for reversal of impairment (emphasis added):

> *"Accordingly, any reversal of that impairment loss is recognised in accordance with IAS 36 <u>to the extent</u> that the recoverable amount of the net investment subsequently increases".*

In our view, this wording does not appropriately reflect some situations that are relatively common in practice. For example, the wording does not capture a situation where an investor recognises an impairment of an associate in one period, and the associate itself recognises an impairment loss of its assets, for the same event, in a later period, reducing the carrying amount of the net assets of the associate and with no change in the investor's recoverable amount of the investment. Restricting a reversal to an increase in the recoverable amount will in such situations result in a double impairment charge in the investor's financial statements.

Similar effects may occur if the associate distributes dividend in a later period. A dividend typically decreases the recoverable amount and the carrying value of the investment for the same amount. We believe that there is a basis for reversing an impairment of the investment in the associate in these situations if the carrying amount of the investment in the associate is below its recoverable amount, and below the carrying amount of the investment that would have been determined had no impairment loss been recognised in prior years, similar to the requirement in IAS 36.117. We see no benefit in requiring that the recoverable amount must increase sufficiently to first compensate for the decrease in carrying amount due to the dividend before a reversal of the impairment can be recognised.

In our jurisdiction, a recent enforcement decision by the Norwegian regulator addresses an entity's reversal of a prior period impairment in a listed associate[1]. The entity in question had recognised multiple impairments of its investment in a listed associate and also recognised reductions in the carrying value of its investment due to the recognition of its share of losses, including goodwill impairments, in the associate. In a subsequent period, the recoverable amount increased, and the entity recognised a reversal of prior period impairments. Even though the carrying amount after the reversal did not exceed the recoverable amount, the reversal was larger than the period's increase in the recoverable amount. This was due to the investor's recognition of its share of losses. This can be illustrated by a simplified example:

[1] Review of Schibsted ASA's financial reporting published on 27 November 2024, publicly available on the NFSA's homepage (in Norwegian). See Issue 2 b).

- An entity has an investment in an associate with a carrying amount of 100
- The entity determined that the recoverable amount of the investment is 80 and recognises an impairment of 20
- In the following period, the entity recognises its share of the associate's losses of 10 and reduces the carrying amount to 70 (the loss includes goodwill impairment in the associate)
- At the end of the period, the entity determines that the recoverable amount has increased from 80 to 90. The entity recognises a reversal of the previous impairment of 20, bringing the carrying amount of the investment to 90. In the entity's view, this is the accounting required by IAS 36.114, which states that "(…) the carrying amount of the asset shall (…) be increased to its recoverable amount."
- In the regulator's view, the entity should only have recognised a reversal of 10, equal to the increase in the recoverable amount from 80 to 90. The regulator based its decision on the wording of IAS 28.42, which states that (emphasis added): "(…) any reversal of that impairment loss is recognised in accordance with IAS 36 <u>to the extent that the recoverable amount of the net investment subsequently increases</u>."

The regulator required the entity to restate its reporting and reduce the reversal to the change in recoverable amount for the period, and not a full reversal of prior period impairments. Due to the fundamental nature of this issue, and the likely deliberations between European enforcers of this issue that may have taken place, we expect that this view might become widespread in the European jurisdictions. In our view, the IASB should include this aspect and confirm or change the wording of paragraph 42 in its deliberations of the proposed impairment requirements in IAS 28.

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

We recognise the concerns raised in the alternative view described in paragraphs AV1-AV13, but in our view, the benefits of having one version of the equity method outweigh the potential benefits of creating specific versions of the equity method for specific circumstances. We therefore support the IASB's proposal to continue to permit the full application of the equity method in separate financial statements. For your information, the application of the equity method for investments in subsidiaries in separate financial statements is not widespread in our jurisdiction, and the proposed amendments are therefore expected to have little impact.

Response to Question 7 – Disclosure requirements

We support the IASB's proposed amendments to IFRS 12. The proposed reconciliation between the opening and closing carrying amounts of investments is already commonly provided in practice and provides helpful information to users. The proposal in IFRS 12.21(e) to disclose gains or losses from downstream transaction, as opposed to eliminating such gains or losses, will provide significant relief.

Response to Question 8 – Disclosure requirements for eligible subsidiaries

We have not assessed the proposal for IFRS 19, as this standard is currently not relevant for our jurisdiction.

Response to Question 9 – Transition

We support the proposed requirement in paragraph C3 to apply the revised standard prospectively. However, we disagree with the proposed requirement, as currently drafted, for retrospective initial application of the amendments. In practice, the retrospective application of the requirements could be highly complex, as the IASB has also recognised in paragraph BC181 of the ED. We believe the information is generally available in situations when the investor has eliminated a gain in a downstream transaction and eliminates periodic effects of that gain, such as depreciation, amortization, impairment, gains or losses reported by the associate in following periods. However, for transactions reported at carryover basis in the receiving entity, including many upstream transactions, the information is not readily available in our experience. Hence, we believe that the IASB's observation in paragraph BC184 of the ED that the information should be available, might not be appropriate.

The cost of retroactively applying the amendments could be significant, for example due to a larger number of transactions, which may in part be old and for which there is now limited information available. In our view, this cost for preparers would likely exceed the benefit to users. In order to faithfully apply the amendments retrospectively, additional impairment assessments would also be required, as discussed further below, but this would be challenging and adds additional costs for preparers. We therefore propose that the IASB replaces the requirement for retrospective application with a requirement for prospective application, or at least that the IASB introduces a simplified retrospective approach.

We strongly disagree with the lack of a requirement, or even the possibility, to perform an impairment test at the transition date. The proposals as currently drafted could result in arbitrary impacts on initially recognised amounts and profit or loss in the periods after the transition date, depending on whether the investor had estimated the recoverable amount at the transition date. Some entities could be required to inflate their carrying amounts, only to recognise an impairment in the subsequent period (the comparative period), even though the conditions or events that give rise to the lower recoverable amount and consequential impairment stem from earlier periods. The ED also does not address how the requirements in IAS 28.C6 and C8 would apply in situations where the investor has unrecognised losses. The proposed amendments seem to require an entity to recognise an increase in the investment even in such cases, which we do not believe would result in meaningful information to users of the financial statements.

We note that the IASB considered, but dismissed, allowing an investor to test the investment for impairment at the transition date. One of the reasons for not allowing an impairment test laid out in paragraphs BC196 and BC203 of the ED, is that such a test would often involve the use of hindsight. This argument however seems inconsistent with the requirement in IAS 28.C6 of the ED, which requires the determination of fair value, and which could arguably require the use of hindsight. It is not clear to us why the potential use of hindsight is not an issue for the retrospective determination of fair value, while it is considered problematic for a retrospective impairment test. An impairment test that could be influenced by hindsight is more useful than no impairment test at all. On this basis, we urge the IASB to introduce an option or a requirement to apply IAS 36 at the transition date, and to address how the retrospective application interacts with unrecognised losses, if the IASB chooses to retain a retrospective method of transition.

In summary, we urge the IASB to address these matters before the amendments are finalised, since the current proposals in many cases will result in information that is not relevant to understand, or might even distort, the entity's performance.

Response to Question 10 – Expected effects of the proposals

In our experience, entities often do not perform notional PPAs upon the purchase of additional interests in an associate, which differs from the proposed requirements. Some entities also make distinctions between the accounting for associates that meet the definition of a business in IFRS 3 and those that do not. This accounting practice would also be impacted by the proposed amendments. Please see our responses to the individual questions above for our comments on the expected effect of the other proposals.

Response to Question 11 – Other comments

We have no other comments.

Appendix 2 – Expanded version of Illustrative Example 3

To illustrate the complexity in accounting for gains when unrecognised losses have accumulated in previous periods, we have added period 20x4 to the example. We summarise the following key figures from Entity E's perspective for the periods 20x2 and20x3:

Amounts in CU	P&L	OCI	Total	Carrying amount Entity E
Opening balance 20x2				500
Recognised 20x2	-400	-100	-500	0
Recgnised 20x3	-50	50	0	0
Amounts recognised by entity F in 20x2 and 20x3, Entity E's share	-600	-150	-750	
Amounts unrecognised by Entity E, accumulated	-150	-100	-250	

In 20x4, we assume that Entity F reports a total gain of CU 300, with a net profit of CU 100 and a net gain of CU 200 in other comprehensive income (OCI). Due to the unrecognised losses of CU 250 at the beginning of the period, Entity F recognises a net gain of CU 50 in 20x4. We have identified four reasonably possible alternative interpretations of the proposed guidance, illustrated below. The alternatives result in different amounts recognised as share of profit or loss (P&L) and share of OCI in period 4 and accumulated for the periods, while the recognised carrying amount of Entity F's investment in Entity E remains the same (CU 50).

- Alternative 1 considers the P&L first. As the P&L in the period shows a profit, Entity F recognises a positive result up to the amount of net profit in the period, or equal to the ending carrying value of the investment, whichever is the lower amount. In this example, the net carrying value of CU 50 is the lower of the two, and hence CU 50 is recognised directly in P&L.
- Alternative 2 is based on the view that the P&L is considered first. However, under this alternative, Entity F recognises the gross amount of profit in P&L, CU 100, and reduces the carrying value of the investment to CU 50 through recognising a loss of CU 50 in OCI, as the accumulated losses in OCI in previous periods have not been fully recognised.
- Alternative 3 reflects the recognition of unrecognised losses in P&L and OCI separately. In this alternative, unrecognised losses in P&L as of the end of period 20x3 of CU 150 combined with the profit of CU 100 in 20x4, results in the recognition of a loss of CU 50 in the P&L for 20x4. The unrecognised loss of CU 100 in OCI as of the end of period 20x3 and the gain of CU 200 in 20x4, results in the recognition of a gain of CU 100 in OCI for 20x4. The accumulated amounts recognised over the three periods in both P&L and OCI equal Entity E's share of the amounts reported in Enity F.
- Alternative 4 reflects a pro rata recognition of the positive end balance of CU50 as profit in P&L and in OCI, respectively.

The following summary of amounts recognised by the investor, Enity E, during the three periods illustrates the impact on acculated amounts under the four different alternatives.

Investor E's share of Compnay F's P&L, OCI, TCI, Net assets				
	20x2	20x3	20x4	Total
P&L	-400	-200	100	-500
OCI	-200	50	200	50
Total comprehensive income (TCI)	-600	-150	300	-450
Net assets CB	-100	-250	50	

The four identified potential recognition alternatives in period 20x4 are summarised as follows:

Recognised E's interest in F period 20x4; CU	Alt 1	Alt 2	Alt 3	Alt 4
P&L	50	100	-50	16.7
OCI	0	-50	100	33.3
Total comprehensive income (TCI)	50	50	50	50
Carrying amount of investment in Entity F	50	50	50	50

The identified potential recognition alternatives in period 20x4 results in the following accumulated amounts presented as share of profit or loss and share of OCI respectively, in the periods 20x2 to 20x4, while the carrying amount of the investment in Entity F remains the same for all alternatives:

E's recognised interests in F period 20x2 to 20x4; CU	Alt 1	Alt 2	Alt 3	Alt 4
P&L	-400	-350	-500	-433.3
OCI	-50	-100	50	-16.7
Total comprehensive income (TCI)	-450	-450	-450	-450