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

Dear Mr. Klinz,

The EFFAS Commission on Financial Reporting ("The Commission", "We") would like to express its view on EFRAG's Draft Comment Letter ("DCL") - issued on 12 November 2024 - on the IASB's Exposure Draft Equity Method of Accounting IAS 28 *Investments in Associates and Joint Ventures* (revised 202x).

The Commission acknowledges EFRAG's comments supporting by and large the ED and the positive feedback that EFRAG received from various stakeholders. The Commission also subscribes some of the concerns raised in the DCL.

As EFRAG notes, the Commission also acknowledges that the project has a limited scope ("the focus of the ED is not to fundamentally revise the equity method"). The IASB is seeking to resolve application questions based on the current equity method approach. The aim is to reduce diversity in practice and to guarantee more comparable and understandable information for users of financial statements.

Also, it should be noted that several stakeholders have questioned the conceptual meaning and application of the equity method. Moreover, in spite of the limited scope, some of the proposals can still be seen as significant amendments that will change current practice.

The Commission continues to support EFRAG's comprehensive and high-quality documents. Albeit we would like to stress and reiterate the need for conciseness and simplicity in the documents. A 60-page Draft Comment Letter hinders a fluent reading as the document leans towards density and repetitiveness.

Regarding the points addressed in EFRAG's DCL, we would like to comment as follows:

1.- Measurement of cost of an associate

Given that the project aims at improving the clarity and disclosures to the equity method, the Commission in general agrees with EFRAG's comments.

A few additional remarks:

- The Commission agrees with the comment made in paragraph 20 of the DCL about how goodwill and bargain purchases are approached in IAS 28. Indeed, goodwill and bargain purchases are undoubtedly more meaningful in the context of full consolidation of a business controlled by the parent entity.
- The unit of account in case of “significant influence” is normally the entire investment of which the fair value or the acquisition price as this is based on the expectations regarding free cash flows. In general, full consistency with IFRS 3 is in our view is not always achievable since the context of IAS 28 and IFRS 3 might be different.
- Acquiring a significant influence is different than acquiring full control. Due to this we consider limited the relevance of referring to the fair value of the net assets acquired in the case of acquiring significant influence. The acquirer in our view might not be able to obtain a complete review of the net assets acquired during the due diligence process, as negotiations often are developed on a different basis.
- Definition of cost (paragraph 11). Although it is a good idea to strive for as much consistency as possible between standards, we think that given the nature of some transactions these should be approached differently.
- Regarding the transaction costs, there is in our view a difference between acquiring a piece of PPE and acquiring a significant influence in an associate or joint venture.
- In terms of relevance of information, the transaction costs should be part of the investment in the case of a percentage in a PPE. These costs are part of the investment and the information (which amount is to be recognised on the balance sheet?) is relevant whether the costs are capitalised.
- In the case of IAS 28 it might be different as the carrying amount at initial recognition should refer to the value of the amount at the date of the transaction. Thus, the book value at transaction date would not reflect adequately the book value if the transaction costs were to be capitalised as part of the financial investment. The nature of the transaction costs is different when an entity acquires a fixed asset or a significant stake in an associate or joint venture.

2.- Changes in an investor’s ownership interest while retaining significant influence

The Commission acknowledges the IASB’s attempt to solve this issue as IAS 28 provides limited guidance and this has led to diversity in practice.

We agree with EFRAG and understand the reason to propose (based on a “layered approach”) treating each additional acquired ownership interest as a separate unit of account while retaining a significant influence. Thus, the remeasurement of the carrying amount of the interest held in this associate or joint venture is not considered necessary when purchasing an additional interest in the associate or joint venture. It is different when a “fair value” IFRS 9 investment (financial instrument) becomes an "equity method" investment (associate/joint venture) as this is a different type of investment.

We also support EFRAG's suggestion to further assess the cost-benefit balance as noted in paragraph 48. The Commission understands, as noted in paragraph 45 of the DC, that preparers have raised cost and complexity concerns related to the separate units of account and the PPA that needs to be performed each time.

We opt for Alternative 2 as we consider inadequate to use at this point the notion of "goodwill". The fair value of a significant stake in an investee is dependent upon the investor's expectations regarding free cash flows. To link this with the fair value of the net assets -as if equity were a criterion for value- is in our view not correct.

3.- Recognition of the investor's share of losses

The Commission agrees with the IASB proposal regarding not compensating losses booked previously against the carrying amount of an additional ownership acquired while retaining significant influence. We consider that the proposals are in line with the conceptual thinking behind the IAS 28 equity method.

Regarding paragraphs 68-70 related to uncertainties surrounding the equity method, we agree with EFRAG's statement that the relevance and faithful representation of the information should be the main consideration for reporting requirements. However, we would like to mention that additional clarification on EFRAG's reasoning will be helpful.

The Commission is unclear how to gauge what it adds if an entity is not allowed to recognise goodwill. This notion as already explained should not be part of the conceptual discussions of the equity method. Complexities often arise because the fair value of the net assets is frequently seen as a measurement basis, an approach with which we do not necessarily agree. The fair value of a significant interest in an associate or joint venture depends on the investor's assessment of future cash flows.

4.- Transactions with associates

The Commission welcomes the IASB specific guidance on transactions with equity-accounted investees. Moreover, we think, it should be specified whether or not unrealised profit or losses on these types of transactions have to be eliminated. In our view and as explained in paragraph 81 of the DCL the associate or the joint venture is not part of the consolidated group as the investee is not controlled by the parent company.

We also share the concerns raised by stakeholders related to possible structuring opportunities and earnings management. After all, it is difficult to determine the reason of a company selling or buying an asset for a particular price whether or not a capital gain materialized.

Additionally, it should be deemed that when the parent company initiates a particular transaction, it must consider the interests of the other partners and/or shareholders in the associate or joint venture.

We would like to note that the Commission supports the IASB proposal requiring an investor to disclose any gains or losses from downstream transactions with its associates and joint ventures. This will help the users of the financial statements to assess the impact of these type of transaction and the quality of the earnings and the financial position of the group.

5.- Impairment indicators (decline in fair value)

The Commission in general agrees with the proposal. We believe however that the use of the word “cost” in paragraph 47A is not adequate. Testing for an impairment implies that you compare the recoverable amount with the current carrying amount and not with the initial cost.

With regard to the removal of “significant or prolonged” decline in fair value, we understand that the IASB attempts to align IAS 28 and IAS 36 requirements as different ways to approach the same notion, in this case *impairment,* might lead to inconsistencies in practice. Moreover, it should be noted that when an entity weights whether or not an associate or joint venture is impaired, the notion of *fair value* comes into play. We would like to refer to the significant or prolonged decline in fair value criterion in paragraph 41C.

in addition, we would like to point out that even as EFRAG observes in the DCL “the equity method is currently deemed to be the relevant accounting method for associates and joint ventures”, it can be said that the carrying amount when applying the equity method does not refer in any way to the possible fair value of the investment. Two different approaches come together here. Investigating this further would require a more fundamental review of IAS 28 which is not the aim of this project.

6.- Investments in subsidiaries to which the equity method is applied in separate financial statements

The Commission agrees with EFRAG’s cautious support for the proposal and acknowledges that applying the same equity method to consolidated and/or to separate financial statements leads to certain differences and that these differences could be widening due to the proposals. Also, introducing some “kind” of a second equity method approach could lead to unnecessary complexity and there is a risk that users would not be able to reconcile the amounts as these would depend on the approach used for the equity method.

Moreover, a subsidiary accounted for in the separate financial statements is an asset managed separately while a subsidiary that is incorporated in the consolidated financial statements is part of the group; this is a different type of situation. This raises the question of how important this is since the equity method for separate financial statements is only applied in a few jurisdictions.

7.- Disclosure requirements

We agree with the proposal that the required disclosures should provide a better understanding of the role of the associates and joint ventures in the performance of the group.

In this regard, it is important for users providing relevant information related to the contingent consideration arrangements to be able to understand the amounts recognised, the arrangements and how the amounts recognised evolved over time.

It is also useful to provide the proposed reconciliation between the opening and closing carrying amount of the investments in associates or joint ventures as recognition and measurement sometimes fall short of the proposed reconciliation objective.

8.- Disclosure requirements for eligible subsidiaries

We consider that the information about the contingent consideration arrangements is crucial when assessing the carrying amount of the investee. As noted previously, from an accounting standpoint, the “contingent consideration” amount must be understood by users.

This therefore should include gains and losses from “downstream” transactions which are important to understand and the impact of these transactions on the performance of the group. These “downstream” transactions can also provide information of how a consolidated group is functioning.

Based on this, we would like to underline the answer to question 7. As we noted, to understand the reconciliation between the opening and the closing carrying amounts of an investment is very relevant. This kind of reconciliation helps users understand the evolution of the investment over a period of time.

9.- Transition

By and large the Commission agrees with the transition requirements. As EFRAG notes, there are some concerns about the requirement to recognise retrospectively the full gain or loss on transactions with associates or joint ventures. We are not sure that disclosing past information will provide additional useful information for users.

10.- Expected effects of the proposals

The Commission shares the concerns raised by preparers and other stakeholders regarding the cost and other complexities of the ED. We, however, cannot gauge the implied costs for preparers, auditors and regulators. It will depend on how the application questions are approached and, on the number, and nature of the transactions undertaken with equity-accounted investees.

We think that in practice many entities have *equity method* investments on the balance sheet and therefore the application of new proposals will be quite general. Additionally, the table in BC221 should be more self-explanatory as it depicts some of the complexities.

We agree with EFRAG to evaluate the cost-benefit balance based on the responses and feedback received during the outreach.

11.- Other comments

We agree with EFRAG on the interpretation of IAS 28.18 and the reference therein made to "similar entities". The option of fair value investments in associates and joint ventures should be based on clearer principles linked to the idea of useful financial information.

If you would like to discuss the views expressed in this letter further, please contact us.

Javier de Frutos, Chair
EFFAS Commission on Financial Reporting

EFFAS was established in 1962 as an association for nationally based investment professionals in Europe. Headquartered in Frankfurt am Main, EFFAS comprises 14-member organizations representing more than 16,000 investment professionals. The Commission on Financial Reporting is a standing commission of EFFAS aiming at proposing and commenting on financial issues from an analyst standpoint. CFR members are Javier de Frutos (Chairman, IEAF-Spain), Jacques de Greling (Vice-Chairman- SFAF, France), Friedrich Spandl (ÖVFA, Austria), Henning Strom (NFF, Norway), Serge Pattyn (BVFA/ABAF, Belgium), Luca D'Onofrio (AIAF, Italy), Dr. Carsten Zielke (DVFA, Germany), and Andreas Schenone (SFAA, Switzerland) and Mihail Stan (Romania).