EFRAG
Financial reporting

[Draft] Comment Letter

You can submit your comments on EFRAG's draft comment letter by using the 'Express your views' page on EFRAG's website, then opening the relevant news item and clicking on 'Comment on publication' at the bottom of the news item.

Comments should be submitted by 6 January 2025.

International Accounting Standards Board
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom
[XX 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, from the feedback received so far, stakeholders consider that the ED's proposals are a positive step that will help to reduce existing diversity in practice and meet the other intended objectives.

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 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.

- Disclosures: EFRAG supports the proposed 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 that they be included, and this is in line with the July 2009 IFRIC update.
- Via a question for constituents, because of mixed views received, EFRAG is also exploring whether there are any issues related to the ED's proposed inclusion of deferred taxes in the carrying amount of the investment.
- Acquiring additional ownership interest while retaining significant influence (layered approach): Though EFRAG considers the ED's proposal to treat each additional acquired layer as a separate unit of account as being the only alternative to the fair value remeasurement of the entire investment, EFRAG questions the need for a full-fledged purchase price allocation of each acquisition and highlights stakeholders' concerns about the cost and complexity of aspects of the version of layered approach proposed in the ED. We seek constituents' views on stakeholders' proposed alternatives.
- Other changes in ownership interest while retaining significant influence (e.g. an associate's or joint venture's issuance or redemption of shares): As opposed to treating these other changes as deemed purchases or disposals of ownership interest, due to the associated cost and complexity, EFRAG recommends that changes in ownership arising from non-exchange transactions (those addressed in the ED, issued hybrid instruments, etc.) be scoped out of the amendments until a holistic, principles-based solution can be developed.
- 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. 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 notes there are mixed views on the ED's proposed application of a single equity method across IFRS Accounting Standards, with a concern expressed by some stakeholders similar to the Alternative View in the ED about the application of the ED's proposals to account for transactions with subsidiaries in separate financial statements. Via a question to constituents, EFRAG is assessing the pervasiveness of the application of the equity method in separate financial statements and whether there are any concerns related to the ED's proposal within EU jurisdictions. 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 has received mixed views from stakeholders on this proposal.

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 be also applied towards other proposals (e.g. the layered approach of accounting for acquired 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 reduce existing diversity in practice and meet the other 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.

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

Notes to constituents – Summary of proposals in the ED

Measurement of the cost of an associate on obtaining significant influence

4 *IAS 28 currently require an investor or joint venturer that obtains significant influence in an associate or joint venture to account for the difference between the cost of the investment and its share of the net fair value of the associate's identifiable assets and liabilities as goodwill or bargain purchase. However, IAS 28 does not specify how to measure the cost of the investment, resulting in diversity in practice. Therefore, the IASB decided to propose requiring that:*

a) *the cost of an associate or joint venture, upon obtaining significant influence, be measured at fair value of the consideration transferred, including the fair value of any previously held interest in the associate or joint venture.*

b) *contingent consideration be recognised as part of the consideration transferred and measured at fair value. After initial recognition:*

(i) *contingent consideration classified as equity should not be measured;*

(ii) *other contingent consideration should be measured at fair value at each reporting date, with changes recognised in profit or loss.*

5 *These amendments aim to ensure consistency with IFRS 3 Business Combinations principles on business combinations. The requirement to measure the cost of an investment at fair value of the consideration transferred, including the fair value of any previously held ownership interest is based on the considerations that:*

a) *obtaining significant influence changes both the relationship between the investor and the investee, and the accounting method used by the investor;*

b) *measuring the cost of the investment at fair value would align with measurement at fair value of the underlying assets and liabilities;*

c) *measuring previously held interest at fair value would not be overly costly for entities because the previously held interest would have been measured at fair value in accordance with IFRS 9 Financial Instruments.*

Contingent considerations:

6 *The IASB proposes that, on obtaining an investment in an associate or joint venture or purchasing an additional interest, the investor or joint venturer should recognise contingent consideration as part of the consideration transferred and measure it at fair value. The IASB further proposes that contingent consideration classified as equity should not be measured after initial recognition, and any settlement of this consideration should be recorded within equity. For contingent consideration classified as a liability, the IASB recommends that it be measured at fair value at each reporting date, with any changes in fair value recognised in profit or loss.*

7 *In reaching this decision, the IASB considered that the proposed requirements would be similar to those in IFRS 3 for contingent consideration on the acquisition of a subsidiary. Further, the IASB understands that this approach is already commonly applied in practice when accounting for contingent consideration on the initial recognition of an investment in an associate or the purchase of an additional interest. Therefore, IASB thinks that in most cases, the new requirements are not expected to impose significant additional costs on preparers.*

Recognition of Deferred Taxes

8 *IAS 28 requires an investor or joint venturer to determine its share of the net fair value of the associate's or joint venture's identifiable assets and liabilities, which includes adjustments to the carrying amounts of the assets and liabilities as reported in the associate's financial statements (referred to as 'fair value adjustments'). An application question arises about whether the investor or joint venturer is required to include the deferred tax effects related to those fair value adjustments in the carrying amount of an investment in an associate on initial recognition of the investment. The IASB understands that various approaches are applied in practice. The most common practice is to include those deferred tax effects in the carrying amount of the investment.*

9 *The IASB decided to propose requiring an investor or joint venturer to include in the carrying amount of its investment the deferred tax effects related to measuring its share of the*

associate's identifiable assets and liabilities at fair value both at obtaining significant influence and when purchasing additional ownership interest. In reaching this decision, the IASB considered that the proposed approach would:

a) *be consistent with concepts underlying the procedures used in accounting for the acquisition of a subsidiary as outlined in IFRS 3;*

b) *provide faithful representation of the financial effects related to future tax consequences;*

c) *provide useful information to users, for example, when the adjustments to the investor's or joint venturer's share of the associate's or joint venture's profit or loss in subsequent reporting periods would include both the reversal of fair value adjustments and the reversal of related deferred tax effects.*

10 The IASB acknowledged that applying the proposed approach would result in some costs and complexity for preparers, but took the view that the benefits to users of the proposed approach would outweigh the costs to preparers.

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 comment- inconsistency in the definition of cost in the ED versus other IFRS Accounting Standards

11 The definition of cost[4] in Appendix A of the ED is similar to that under IFRS 3 but 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). As a cross-cutting concern, some stakeholders have highlighted that the different definitions of cost across some IFRS Accounting Standards and the absence of its 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.

12 Hence, EFRAG acknowledges there is unlikely to be a definition of cost applicable across IFRS Accounting Standards. and we suggest the Appendix A definition of cost should be

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[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*.

[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.

enhanced to clarify its interaction with cost as defined or other notions of cost applied in other IFRS Accounting Standards (see our response to Question 6 on separate financial statements).

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

13 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*.

14 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. There may also be additional costs in cases where an updated valuation of the previously held ownership interest is necessary after the investor obtains significant influence and there is an embedded significant influence premium. EFRAG assumes that these incremental costs are likely to be insignificant.

15 Some stakeholders have highlighted to EFRAG the lack of clarity on the accounting for increases in ownership interests in assets rather than businesses and on whether the equity method principles, including the fair value remeasurement of previously held interest on obtaining significant influence, would be applicable. These stakeholders have indicated 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 clarify or address in a different project the accounting for increases in ownership interests in assets, including ownership interests in non-financial assets.

Transaction costs

16 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 or not the principles of IFRS 3 should be analogised[8] to determine the appropriate accounting treatment for the transaction costs incurred. In this regard, EFRAG observes that the chosen treatment for transaction costs may depend on whether the equity method is deemed to be akin to a consolidation approach as done under IFRS 3 (and then costs would be expensed as incurred) or to be a measurement method (where costs would be included in the carrying amount). Based on the feedback received so far and consistent with the July 2009 IFRIC update, EFRAG recommends that transaction costs be included in the carrying amount of the investment. We have also posed a question seeking constituents' views on the appropriate treatment for transaction costs.

17 Our response to Question 6 also touches on unaddressed questions related to transaction costs under separate financial statements.

Contingent consideration

18 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 whereas IAS 28 does not explicitly distinguish between the acquisition of a business and the acquisition of an asset.

19 Therefore, to avoid ambiguity and exacerbating the inconsistency in the accounting for variable and 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. EFRAG also suggests that the IASB clarify whether a 12-month

[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'.

[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.

window to revise contingent consideration, as permitted under IFRS 3, will be allowed in the context of 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. Moreover, as IAS 28 does not differentiate between the acquisition of an asset or a business, stakeholders have questioned the appropriateness of recognition of goodwill or bargain purchase gains for an asset acquisition. These stakeholders argue that goodwill is more meaningful in the context of the consolidation of businesses and where the reporting entity has control over the subsidiary.

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 expensing of bargain purchase gains on the acquisition of ownership interests is indicative of the equity method being viewed as akin to a consolidation approach. 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 accounted for in profit or loss. These stakeholders have argued that the economic value of the investment is better reflected if bargain purchase gains are first netted against the previously recognised goodwill.

23 *Faithful representation of bargain purchase gains*: During EFRAG's outreach, users 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

[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

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 EFRAG has gotten mixed views from stakeholders on the ED's proposed inclusion of deferred tax effects arising from the fair value adjustments of the associate's identifiable assets and liabilities in the carrying amount of the investment. Some stakeholders support this inclusion, which is consistent with current practice as far as they are aware. These stakeholders agree with the alignment of the inclusion to IFRS 3 principles, where deferred taxes arising from fair value adjustments are included in the purchase price allocation (PPA).

25 EFRAG notes that the inclusion of a deferred tax asset or liability in the carrying amount of the investment also allows a faithful representation of the tax effects that could arise after significant influence is obtained. For instance, as illustrated in an IASB staff paper[12], if an associate disposes[13] an asset after significant influence is obtained, such inclusion will avoid the recognition of the investor's share of the associate's current tax expense/income without the corresponding recognition of the investor's share of the associate's gain/loss on disposal of the asset.

26 However, some stakeholders have raised concerns about including deferred tax effects in the carrying amount of the investment. They question the appropriateness of the chosen

[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 …'.

[12] https://www.ifrs.org/content/dam/ifrs/meetings/2023/march/iasb/ap13d-initial-recognition-of-an-investment-in-an-associate-deferred-taxes.pdf

[13] Consider a scenario where the carrying amount of the investor's share of the associate's asset was increased to its fair value on obtaining significant influence and the tax base of the asset remained at cost to the associate. If the associate subsequently disposes of the asset, it will report a gain and tax expense in its profit or loss. In tandem, if the investor did not recognise a deferred tax liability on obtaining significant influence, it will recognise its share of the tax expense without a corresponding gain on the disposal of the asset. Under the ED's proposal, the investor would derecognise the deferred tax liability instead of recognising the associate's tax expense, and there wouldn't be a P&L mismatch.

unit of account [14] and they point out that the investee's assets and liabilities (upon which the tax base for the investee's deferred tax determination is ascertained) are not part of the reporting boundary of the investor/reporting entity.

27 Stakeholders have also raised practical challenges, including difficulties in obtaining the necessary information to calculate deferred taxes due to limited data availability from associates and joint ventures in different tax jurisdictions upon initial recognition and throughout the life of an investment when the deferred taxes are reversed. Other stakeholders have questioned the appropriateness of applying the proposals when the associate or joint venture does not meet the definition of a business.

28 Due to the mixed views expressed by stakeholders on this matter, via a question to constituents, EFRAG is assessing current practices in the treatment of deferred tax effects.

EFRAG's questions to constituents- Measurement of cost of an associate or joint venture

1.1 Should transaction costs incurred during the acquisition of an associate or joint venture be included in the cost of the investment and capitalised, or expensed as incurred? Please provide reasons for your preference and describe any practical implications.

1.2 As outlined in paragraphs 20 to 23, some stakeholders are concerned about a) the proposed recognition of goodwill upon obtaining significant influence and for each subsequent layer of ownership interest acquired (addressed in Question 2 of the ED); and b) the ED's proposal to not offset bargain purchase gains with previously recognised goodwill. Do you agree with these concerns? Please explain.

1.3 As described in paragraphs 24 to 27, EFRAG has received mixed views on the proposed inclusion of deferred tax effects in the carrying amount of investment. Do you agree or disagree with the proposed inclusion of deferred tax effects in the carrying amount of all equity-method accounted investments? Based on your experience, is the proposed

[14] These stakeholders consider the unit of account for an associate to be the investment as a whole (IAS 28.10) and, therefore, that the deferred tax and IAS 12 ought to only apply on acquisition if the tax base and the cost of investment differ (i.e. as defined by paragraph 5 of IAS 12). As per this view, there should not be any deferred tax recognition arising from the purchase price allocation (PPA) allocation on obtaining significant influence. Moreover, it could be argued that unlike assets and liabilities of a subsidiary, which are recognised in an entity's consolidated financial statements, the individual assets and liabilities of an associate are not recognised in the investor's financial statements. Therefore, an entity does not identify temporary differences arising from the fair value adjustments of the associate's assets and liabilities.

treatment of including deferred tax effects in the carrying amount of the investment common in practice? Please explain.

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

Notes to constituents – Summary of proposals in the ED

29 IAS 28 does not specify how an investor or joint venturer is required to account for the purchase of an additional interest, for the disposal of a portion of its investment or for other changes of its ownership interest in an associate or joint venture while retaining significant influence, leading to diversity in practice.

Purchase of an additional ownership interest

30 The IASB decided to propose requiring the investor or joint venturer, at the date of purchase:

a) to recognise that additional ownership interest and measure it at the fair value of the consideration transferred;

b) to include in the carrying amount of that additional ownership interest the investor's or joint venturer's share of the fair value of the associate's or joint venture's identifiable assets and liabilities; and

c) to account for any difference between (a) and (b) 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.

31 The IASB decided to use an approach that would result in the investor or joint venturer measuring its additional interests in an associate or joint venture after obtaining significant influence as an accumulation of purchases, so the investor or joint venturer would not remeasure the carrying amount of its previously held interest in its associate or joint venture, because:

a) in this circumstance, the purchase of an additional interest would not change the relationship between an investor and an investee, or the accounting method an investor applies;

b) the proposed approach is consistent with the requirements in IFRS 11 where a joint operator purchasing an additional interest in a joint operation does not remeasure its previously held interest;

c) remeasuring the previously held interest when purchasing an additional interest would result in intermittent revaluation of an investment which would not provide useful information to users.

32 In requiring including in the carrying amount of the additional ownership interest the investor's or joint venturer's share of the fair value of the associate's or joint venture's net assets, the IASB considered that:

a) measuring the acquiree's identifiable assets and liabilities at fair value provides relevant information;

b) the proposed approach is consistent with the requirements of IFRS 11 when an entity acquires an interest in a joint operation which is a business (IFRS 11 requires to apply the principles of IFRS 3 that do not conflict with IFRS 11);

c) any additional goodwill included in the investment would be faithfully represented because it would be measured in the same way as the initial goodwill.

33 Since the purchase of an additional ownership interest is treated as an accumulation of purchases measured separately and does not result in a remeasurement of previously held interest, the IASB decided that it would be appropriate to treat each acquired layer as a separate unit of account and thus do not require an investor or joint venturer's to offset a bargain purchase gain against previously identified goodwill, but to recognise it in profit or loss.

Disposal of an ownership interest

34 The IASB decided to propose requiring the investor or joint venturer at the date of the disposal:

a) *to derecognise the disposed portion of its investment in the associate or joint venture;*

b) *to measure the disposed portion of its investment as a percentage of the carrying amount of the investment (that percentage is calculated as the disposed ownership interest divided by the total ownership interest); and*

c) *to recognise any difference between the consideration received and the disposed portion as a gain or loss in profit or loss.*

35 When developing the proposal, the IASB considered whether the derecognition requirements should mirror the principle of accumulation of purchases outlined above. If an investment is considered as comprising multiple components, an investor or joint venturer would need to determine which layers of the investment to derecognise in a partial disposal. Possible approaches considered by the IASB included specific identification method or the use of cost formula, such as FIFO, LIFO or weighted average.

36 However, the IASB noted that viewing the investment as a single unit of account would be more consistent with the principles underlying IAS 28 and would:

a) *provide a more faithful representation of an investment that comprises instruments with the same economic rights, because each instrument is fungible;*

b) *reflect that an investment in an associate or joint venture is usually managed as a single asset;*

c) *be more understandable (for example, the measurement of the amount derecognised in a partial disposal would be easier to understand); and*

d) *be less complex and, therefore, less costly for entities to apply.*

Other changes in the investor's ownership interest

37 The IASB considered the situations in which the associate or joint venture issues or redeems its shares changing the investor's or joint venturer's ownership interest with or without its participation in said issuance or redemption of shares.

38 The IASB decided to propose requiring an investor or joint venturer that retains significant influence to:

a) *recognise an increase in its ownership interest, as if purchasing an additional ownership interest; and*

b) *recognise a decrease in its ownership interest, as if disposing of an ownership interest.*

39 In reaching this decision, the IASB considered paragraph 1.12 of the Conceptual Framework stating that general purpose financial statements provide information about the effects of transactions and other events that change a reporting entity's economic resources and claims. In IASB's view, changes to an investor's or joint venturer's ownership interest is an event that changes the investor's or joint venturer's economic resources. Further, the proposed approach would be consistent with the definition of the equity method, which states that the investment is adjusted for the post-acquisition change in the investor's or joint venturer's share of the investee's net assets.

40 The IASB also considered whether to require an investor or joint venturer to present the gain or loss associated with a dilution in profit or loss or in other comprehensive income, noting that in principle all items of income and expense are to be presented in the statement of profit or loss and that the IASB did not identify any reason to require an investor or joint

venturer to present the dilution gain or loss in other comprehensive income instead of in profit or loss.

41 *As outlined in paragraphs BC45 and BC46 of the Basis for Conclusions, the IASB decided not to address application questions related to equity-settled share-based payments and share warrants because "in practice, there are many types of transactions in which entities issue potentially dilutive instruments". The IASB considered that developing requirements to address such transactions when applying the equity method would have been time-consuming and would probably delay the project considerably. Therefore, in the IASB's view, the costs of developing requirements to address these transactions when applying the equity method were likely to outweigh the benefits, as such transactions typically do not have a pervasive or significant effect for investors or joint venturers*.

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:

(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

General comments

42 Paragraphs BC34 and BC35 of the Basis for Conclusions outline that the IASB considered treating the investment as a single unit of account as this would be more consistent with the principles underlying IAS 28 (summarised in Principles B and E in Table 2 of the Basis for Conclusions). Moreover, it would provide a more faithful representation of the underlying economic substance due to the fungibility of the investment, and it would also be more understandable, and less complex and costly to apply. EFRAG agrees with this reasoning.

43 However, EFRAG notes that different units of account are used across proposals for the treatment of additional purchases versus disposals of ownership interests while retaining significant influence. EFRAG questions whether this may distort the representation of the economics of the investment.

Specific comments on the ED proposals for changes in ownership interest while retaining significant influence

Purchase of additional interest while retaining significant influence

44 EFRAG understands the reason for the ED proposal of treating each additional acquired ownership interest while retaining significant influence as a separate unit of account and not requiring 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. As outlined in paragraph BC23 of the Basis for Conclusions, this proposal is conceptually justified and is often applied in practice. Moreover, during EFRAG's discussions with stakeholders when the ED proposals were being developed, both preparers and users disagreed with an alternative approach explored and discarded by the IASB entailing the remeasurement of the carrying amount of previously held interest at fair value when an additional ownership interest is purchased. Stakeholders deemed that such an approach would lead to inconsistent and incomparable reporting (i.e. fair value remeasurement of previously held ownership interests only being done by those entities that acquire additional ownership interests while retaining significant influence) and that this could lead to opportunistic acquisitions and earnings management.

45 However, EFRAG highlights significant concerns expressed by stakeholders, including preparers, about the ED proposals for the measurement of additional purchased ownership interest. Under the proposed requirements, at acquisition, each additional layer is treated as a separate unit of account, and the investor's or joint venturer's additional share of the associate's or joint venture's identifiable assets and liabilities are measured at their fair value at the acquisition date and a purchase price allocation-PPA performed (this accounting treatment is also referred to as the layered approach in this comment letter). This proposal would result in significant cost and complexity for preparers. For example, getting access to the investee's internal information (i.e. business plans, cash flow projections, customer relationship data, etc.) and obtaining the fair value of net assets of the associate or joint venture at the date of each acquisition of additional ownership interest while retaining significant influence would be challenging for many investor/reporting entities. *Inter alia*, preparers would expend considerable efforts performing the purchase price allocation exercise and they would also incur additional audit costs.

46 Moreover, EFRAG notes that with the cost of each additional layer of ownership interest being measured at a different underlying fair value of the associate's or joint venture's assets and liabilities, there will be 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. if there are changes in the fair value of the net assets of the same underlying associate or joint venture being considered for different acquired layers, it may be cumbersome for preparers to ascertain and reflect the necessary adjustments in the mentioned fair value of the net assets of the associate or joint venture). Of note, 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.

47 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.

48 Based on the above paragraphs, EFRAG recommends that while retaining the concept of treating each acquisition of ownership interest as a separate unit of account and not remeasuring previously held ownership, the IASB should further assess the cost-benefit balance of the version of the layered approach proposed in the ED. In addition, the IASB should explore simplified alternative approaches. For example, some stakeholders have suggested the following two alternatives.

a) *Alternative 1 (Using PPA-related information that was applied while obtaining significant influence)*: Under this approach, instead of continually gathering updated information from the associate or joint venture in order to perform a PPA for each acquired layer, 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 as a basis for estimating the revised fair value of the net assets of the investee at the date of acquisition of additional ownership interest while retaining significant influence. For instance, it can be adjusted to reflect the proportion of the additional ownership interest acquired and with a premium or discount applied for changes in the economic prospects of the investee since the investor obtained significant influence. This suggested subsequent 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 and may be restricted (for example, with a requirement for updating the PPA after a certain period). This alternative PPA-determination approach will reduce the mentioned cost and burden concerns.

This approach would also 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.

b) *Alternative 2 – No PPA approach*. Under this approach, the fair value of the consideration transferred is assumed to be a proxy for the investor's share of the fair value of the assets and liabilities of the associate or joint venture related to the acquired additional interest. In this case, a PPA (with the accompanying recognition of either goodwill in investee carrying amount or bargain purchase gains in profit or loss) is unnecessary. This is because it is assumed that the investor's share of the fair value of net assets related to the acquired additional ownership interest would be equal to the fair value of the consideration transferred by the investor. Similar to Alternative 1 and the ED's version of the layered approach, under Alternative 2, each acquisition would be a separate unit of account. However, unlike Alternative 1 and the ED's version of the layered approach, Alternative 2 would deemphasise the equity method being applied similarly to a consolidation approach.

49 EFRAG has also included a question to constituents in order to gather views on Alternatives 1 and 2 or any other potential alternatives for the measurement of additional ownership interests acquired while retaining significant influence.

Disposing of an ownership interest while retaining significant influence

50 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.

51 However, stakeholders have provided examples of where a specific identification method would be appropriate. 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.

52 A specific identification method may also be appropriate in the following cases: a) where ownership interests in the associate or joint venture are related to different classes of ordinary shares; or b) when the acquisition and disposal happen within a short time period. Overall, EFRAG considers there are situations where the specific identification method would better reflect the economics of the disposal.

Other changes in ownership interest while retaining significant influence

53 EFRAG is aware that some 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).

54 Stakeholders are concerned about applying the ED proposals in the absence of an exchange transaction between the investor and the associate or joint venture. They consider the change of ownership interest (via dilution or anti-dilution of the proportion of the investor's holdings) to be a 'mechanical' adjustment that will be costly for entities whose associates or joint ventures have high volumes of share buybacks.

55 In addition, some stakeholders noted that it was not clear from the ED 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. Similarly, stakeholders questioned 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. Moreover, as noted earlier, applying the version of the layered approach proposed in the ED for acquired additional ownership interests while retaining significant influence is complex, costly and of questionable usefulness. Extending the ED's layered approach to deemed purchases increases the overall complexity and lessens the usefulness of the ED proposals for other changes in ownership.

56 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.

57 Hence, EFRAG recommends that unless the IASB can develop 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, all such transactions and events should be scoped out of the amendments to IAS 28.

58 If the ED proposals are retained, some stakeholders have suggested that the IASB clarify that the requirements of IFRS 5 *Non-Current Assets Held for Sale and Discontinued Operations* would not be applicable for deemed disposals. These stakeholders construe that an investor's sale/disposal of its ownership interests would be in the scope of IFRS 5 but a non-exchange change in ownership interest/ deemed disposal would not.

EFRAG question to constituents- change in ownership while retaining significant influence

2.1. Paragraph 48 lays out alternatives to the ED's proposal for accounting for purchases of additional ownership interest. Considering the complexity and cost, do you agree with the suggested alternative measurement methods when accounting for purchases of an additional ownership interest while retaining significant influence?

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

Notes to constituents – Summary of proposals in the ED

Losses not recognised and purchase of an additional interest

59 IAS 28 does not specify if an investor or joint venturer that has reduced its investment in an associate or joint venture to nil is required to 'catch up' unrecognised losses if it purchases an additional interest in an associate or joint venture. The IASB decided to propose that an investor or joint venturer would not deduct its share of any losses not recognised from the cost of the additional ownership interest. In reaching its decision, the IASB considered that this approach would be consistent with its proposed approach to the purchase of an additional ownership interest measured as an accumulation of purchases, each independent of another. An investor or joint venturer would, therefore, not remeasure the previously held interest in an associate or joint venture when recognising the additional interest. In the IASB's view, requiring an investor or joint venturer to deduct any losses not

recognised relating to the previously held interest from the cost of an additional interest would be inconsistent with its proposed approach to the purchase of the additional interest.

60 *Further, in IASB's view, this approach would faithfully represent the purchase of the additional interest, because deducting the investor's or joint venturer's share of losses not recognised from the cost of the additional investment could imply that the investment is impaired. However, the IASB noted that the presence of unrecognised losses does not necessarily mean the investment is impaired. If an impairment exists, an investor or joint venturer would be required to apply the requirements in IAS 28 and IAS 36 Impairment of Assets. Recognition of an impairment loss immediately following the recognition of a purchase of an additional interest in the associate or joint ventures would provide relevant information to users of the investor's or joint venturer's financial statements. That information might include, for example, an explanation of the investor's or joint venturer's rationale for investing additional funds in the associate or joint venture.*

Recognition of each component of comprehensive income

61 *IFRS 18 (and its predecessor, IAS 1 Presentation of Financial Statements) requires an investor or joint venturer to present:*

a) *its share of the profit or loss from associates or joint ventures accounted for using the equity method in the statement of profit or loss; and*

b) *its share of other comprehensive income of associates or joint ventures accounted for using the equity method in other comprehensive income.*

62 *An associate or joint venture might report a loss in its statement of profit or loss and a loss in its other comprehensive income. If the investor's or joint venturer's share of those losses, in total, exceeds the carrying amount of its investment, an application question arises about the amount of losses it should recognise in profit or loss and in other comprehensive income. Various approaches are applied in practice. For example, an investor or joint venturer might recognise its share of the associate's or joint venture's total losses in profit or loss and other comprehensive income proportionately—or it might first recognise the full amount of its share of the associate's or joint venture's loss in profit or loss and then recognise the remaining balance of its share of the associate's or joint venture's total losses in other comprehensive income.*

63 *Another application question arises once the investor or joint venturer has reduced the carrying amount of its investment to nil and an associate or joint venture subsequently reports a loss in its statement of profit or loss and income in its other comprehensive income*

(or vice versa). In this situation, the question arises as to whether the investor or joint venturer should recognise any amounts for its share of the associate's or joint venture's loss (or profit) and other comprehensive income.

64 *The IASB decided to propose requiring an investor or joint venturer to recognise its share of an associate's or joint venture's total comprehensive income (which, therefore, would include a loss reported in an associate's or joint venture's other comprehensive income) until the investor's or joint venturer's investment in the associate or joint venture is reduced to nil.*

65 *The IASB also decided to propose requiring the investor or joint venturer to 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. Furthermore:*

a) *if the investor's or joint venturer's share of profit or loss and its share of other comprehensive income are both losses that in aggregate equal or exceed its net investment in the associate or joint venture, an investor or joint venturer would first recognise its share of profit or loss and then its share of other comprehensive income.*

b) *after an investor or joint venturer has reduced its investment to nil, it would continue to recognise separately its share of profit or loss and its share of other comprehensive income. For example, if an investor's share of profit or loss is a loss of CU250 and its share of other comprehensive income is a profit of CU100, the investor would recognise a loss of CU100 in profit or loss and a profit of CU100 in other comprehensive income. The carrying amount of the investor's investment would remain at nil.*

66 *The IASB decided not to develop proposed answers for other related application questions, such as 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 joint venture's profits. Those questions do not commonly arise in practice and, therefore, were not on the list of application questions selected for the project.*

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

67 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 rosy long-term prospects).

68 However, in line with our concerns raised in Questions 1 and 2, EFRAG considers that the recognition of additional goodwill in situations where the net assets of an investee are already negative would be inappropriate. Giving primacy to the application of a consistent unit of account in this instance even when it may distort the faithful representation of economic reality seems to be unjustified. Moreover, the relevance and faithful representation of reported information should be the topmost consideration for reporting requirements. Hence, 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.

69 Moreover, not recognising the investor's share of losses when the carrying amount of the investment is reduced to nil as proposed by the ED is aligned with the view of the equity method as a measurement basis (i.e. the entire investment is viewed as a single unit of account) rather than as a consolidation approach. The emphasis on the acquired ownership interest as a separate unit of account from previously held interest is more aligned with the view of the equity method as a consolidation approach. There is conceptual inconsistency in this regard.

70 Finally, 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.

Recognition of each component of comprehensive income

71 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.

72 Specifically, paragraph 48 of the ED states: "*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"*. Therefore, stakeholders have called for clarification on whether the investor's share of unrecognised losses are

a) to be considered 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) to be considered in their entirety at the level of total comprehensive income without differentiating the amounts respectively arising from profit or loss and other comprehensive income.

73 Further, paragraph 52 of the ED states: "*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*". It is not clear if this requirement 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). Stakeholders suggested that the example included in paragraph 52 be extended to the situations where 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 and to clarify how the application of the ED proposals considering the primacy of the statement of profit or loss.

74 With regard to other comprehensive income, stakeholders raised concerns that 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.

75 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. The IASB argues that these 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 by the IASB 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

Notes to constituents – Summary of proposals in the ED

76 *The IASB is proposing to change the requirements in IAS 28 and require that an investor or joint venturer recognise in full gains and losses resulting from all transactions with associates or joint ventures. This includes 'upstream' transactions (such as a sale of assets from an associate or joint venture to an investor or joint venturer) and 'downstream' transactions (such as a sale or contribution of assets from an investor or joint venturer to an associate or joint venture) including the sale of a subsidiary to its associate or joint venture resulting in the loss of control of a subsidiary.*

77 *Currently, paragraph 28 of IAS 28 requires an investor to recognise gains and losses resulting from transactions with an associate or a joint venture only to the extent of unrelated investors' interests in the associate or joint venture. For example, if an investor owns 25% of an associate and sells an asset to that associate, the investor recognises 75% of the gain at the date of the sale (the third parties share), and the remaining 25% over the asset's life or when the asset is sold to third parties. This requirement in IAS 28 for partial recognition of gains and losses on a sale of a subsidiary to an associate or joint venture is different to the requirement in IFRS 10 to recognise in full the gain or loss on losing control of a subsidiary. IAS 28 does not provide specific guidance on transactions between equity-accounted investees and whether unrealised profit or losses on such transactions should be eliminated.*

78 *The proposed amendment addresses the application questions on the accounting for transactions with associates or joint ventures that are listed in Table 1 of paragraph BC13 of the Basis for Conclusions of the ED. Some of the application questions arose because of the inconsistency with IFRS 10.*

79 *The IASB is proposing that an investor or joint venturer disclose the amount of gains or losses from 'downstream' transactions (sales from an investor to its associates or joint ventures). See question 7 on disclosure requirements.*

80 *As explained in paragraph B67 of the Basis for Conclusions, in reaching its decision on transactions with associates or joint venturers the IASB considered the following alternatives:*

c) *Alternative 1 – Apply the approach in IFRS 10 and recognise in full the gains and losses on all transactions with an associate and a joint venturer.*

d) *Alternative 2 – Apply the approach in IFRS 10 first, and then an overlay using the approach in current IAS 28 and recognise only partial gains and losses on all transactions with an associate and a joint venture.*

e) *Alternative 3 – Apply the approach in current IAS 28 (partial gain or loss) or IFRS 10 (full gain or loss), depending on whether the transaction involved the transfer of an output of the entity's ordinary activities (i.e. whether this transaction is within the scope of IFRS 15 Revenue from Contracts with Customers or not). This approach would require partial gains or losses on transactions in the scope of IFRS 15 and full gains or losses if outside the scope of IFRS 15.*

f) *Alternative 4 – Under this approach the investor would recognise the full gains or losses when a transaction constitutes a business and partial gains or losses when a transaction constitutes an asset.*

81 The IASB noted that unlike a subsidiary, an associate or a joint venture is not part of the group and is not controlled by the parent. A group's investment in an associate or joint venture is considered more like an asset of the group. It is therefore questionable why IAS 28 restricts gains or losses and requires the elimination of the ''unrealised'' gain or loss. When an entity sells an item of property, plant and equipment, IAS 16 Property Plant and Equipment requires the entity to recognise the full gain or loss on disposal of the asset. This is in line with Alternative 1. Alternative 2 would continue to require the recognition of partial gains and losses.

82 The IASB considered that Alternatives 3 and 4 would be complex to apply as they would require judgement to determine which requirements to apply and also raised conceptual questions. For instance, the IASB notes that Alternative 4 could be perceived as inconsistent with the IASB's views in developing IFRS 10 that the loss of control of a subsidiary is, from the group's perspective, the loss of control over some of the group's individual assets and liabilities. Therefore, drawing a line for different requirements between the sale of an asset and the sale of a business would be difficult to justify.

83 After considering user information needs, practical application to preparers and conceptual reasoning as to why it is not conceptually justified why an investor or joint venturer should eliminate its portion of the gain or loss in a transaction with an associate or joint venture (as these investments are not part of the group entity), the IASB considered Alternative 1 as the best alternative.

Contribution of non-monetary assets in exchange for equity interest

84 *The IASB decided to combine paragraphs 30 and 31 of current IAS 28 into a single paragraph as proposed in paragraph 54 of the ED. The IASB did not change the existing requirements except for the effects of paragraph 53 of the ED on full recognition of gains and losses on ''downstream" and ''upstream transactions''. Specifically, paragraph 54 of the ED says:*

a) *If an investor or joint venturer contributes non-monetary assets to an associate or joint venture in exchange for an equity interest in that associate or joint venture, and that contribution lacks 'commercial substance' as described in IAS 16 Property, Plant and Equipment, the investor or joint venturer shall regard the gain or loss on that contribution as unrealised and eliminate it against the carrying amount of the investment.*

b) *If, in addition to receiving an equity interest in the associate or joint venture, an investor or joint venturer receives monetary or non-monetary assets, the investor or joint venturer shall recognise in full in profit or loss the portion of the gain or loss on the non-monetary contribution relating to the monetary and non-monetary assets received.*

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

85 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.

86 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.

87 Overall, though there are concerns about possible structuring opportunities, especially for joint ventures and downstream transactions that have been raised by stakeholders (as further described in the paragraphs below), 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. Moreover, as described below and in Question 7, the proposed disclosures for downstream transactions can alleviate concerns about structuring opportunities.

Specific comments on the ED proposal

Reasons for supporting proposed recognition of full gains or losses

88 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.

89 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

90 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 acknowledged by the IASB and explained in paragraph BC111 of the Basis for Conclusions.

91 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.

92 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

93 As addressed in EFRAG's response to Question 6, some stakeholders have 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

94 *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)

Notes to constituents – Summary of proposals in the ED

95 *IAS 28 requires an investor or joint venturer to determine whether there is any objective evidence indicating that its net investment in an associate or joint venture might be impaired. If there is indication of impairment, an investor or joint venturer tests its net investment in an associate or joint venture for impairment in accordance with IAS 36. IAS 28 describe various events that are indications of impairment and 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. An application question arises about whether an investor or joint venturer 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 or joint venture at the reporting date or to the cost of the investment on initial recognition. Approaches applied in practice vary, but it is common for entities to compare the fair value of the investment with its carrying amount at the reporting date.*

Cost or carrying amount

96 *The IASB decided to propose replacing 'cost' in paragraph 41C of IAS 28 with 'carrying amount'—to require the investor or joint venturer to compare the fair value of the investment to its carrying amount, not its cost on initial recognition, when determining whether a decline in fair value indicates that an investment in an associate or joint venture might be impaired. In the IASB's view, this approach is aligned with IAS 36. When applying IAS 36, the investor or joint venturer measures the impairment of an investment in an associate or joint venture by comparing the investment's recoverable amount with its carrying amount, not its original cost.*

A significant or prolonged decline in fair value

97 *When deciding to propose replacing 'cost' with 'carrying amount', the IASB also decided to propose removing 'significant or prolonged' to further align the requirements with IAS 36. If an investor or joint venturer recognises an impairment of an investment in an associate or joint venture, it subsequently recognises a reversal of that impairment loss if the impairment no longer exists or decreases. The IASB therefore considered that the rationale for referring to a 'significant or prolonged' decline in fair value did not apply in the context of an investment in an associate or joint venture accounted for using the equity method.*

The IASB also noted that application difficulties had arisen in the past about how entities assessed whether a decline in the fair value of an available-for-sale equity instrument was significant or prolonged.

Additional impairment guidance

98 *The IASB decided to propose adding further guidance on the impairment requirements in IAS 28 to explain that information about the fair value of an investment might be observed from the price paid to purchase an additional ownership interest in an associate or joint venture or the price received to sell an ownership interest. As such, the IASB noted that a bargain purchase gain might be an indication of impairment.*

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)

99 *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).

100 *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.

101 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.

102 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).

103 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.

104 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.

105 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

Use of the equity method in separate financial statements

106 Paragraph 10 of IAS 27 Separate Financial Statements requires an entity that prepares separate financial statements to account for investments in subsidiaries, joint ventures and associates:

a) at cost;

b) *In accordance with IFRS 9; or*

c) *using the equity method as described in IAS 28*

107 The use of the equity method was reintroduced by the IASB in 2014, as a measurement option for investments in subsidiaries, joint ventures and associates in separate financial statements because the law in some jurisdictions requires listed companies to present separate financial statements using the equity method for investments in subsidiaries, joint ventures and associates.

Retaining the equity method when applying it in the separate financial statements

108 When developing the proposals in the ED, the IASB decided not to develop a different equity method for use in the separate financial statements. This means that paragraph 10 of IAS 27 will remain unchanged and would apply to investments in subsidiaries to which the equity method is applied in the investor's separate financial statements.

109 The IASB noted that for separate financial statements, the focus is on the performance of the assets as investments, including investments in subsidiaries. Paragraph BC117 of the Basis for Conclusions explains that paragraph BC7 of the Basis for Conclusions on IAS 27 notes that the IASB drew a distinction between accounting for investments in subsidiaries as equity instruments and accounting for the economic entity that a parent controls. Therefore:

a) *in separate financial statements, an investment in a subsidiary is accounted for as an asset under the parent's control (similar to an investment in an associate or joint venture), using one of the measurement options in IAS 27; whereas*

b) *in consolidated financial statements, a subsidiary is accounted for as an entity under the parent's control, so that the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity*

110 Paragraph BC121 of the Basis for Conclusions of the ED explains that feedback from outreach with stakeholders suggests that the use of the equity method to account for investments in subsidiaries in separate financial statements is prevalent in only a few jurisdictions. In other jurisdictions in which separate financial statements are prepared, the cost option in IAS 27 is typically used.

Differences between the results of the equity method in the consolidated accounts and separate financial statements

111 Paragraph BC10G of the Basis for Conclusions on IAS 27 notes that there could be situations in which applying the equity method to investments in subsidiaries in separate financial statements would give a different result compared to consolidated financial statements.

112 As explained in paragraph BC122, the IASB was informed that there is diversity in practice when the equity method is applied to investments in subsidiaries in separate financial statements. For example, when a parent entity applies the equity method to an investment in a subsidiary:

a) *some parent entities aim to align the amounts reported in separate financial statements with those reported in consolidated financial statements, by analogising to IFRS 3 and IFRS 10; whereas*

b) *other parent entities do not aim to achieve that alignment.*

113 Hence the IASB notes that the effects, in practice, of applying the IASB's proposed solutions to the application questions to investments in subsidiaries in separate financial statements will vary depending on a parent entity's existing accounting policies.

*114 Paragraph BC10G of IAS 27 explains the situations in which applying the equity method in separate financial statements to investments in subsidiaries would give a **different result compared to the consolidated financial statements**. These include:*

a) *impairment testing requirements in IAS 28. For an investment in a subsidiary accounted for in separate financial statements using the equity method, goodwill is tested for impairment as a single asset, which is different to what is done in the consolidated financial statements of the entity.*

b) *subsidiary that has a net liability position. IAS 28 requires an investor to discontinue recognising its share of further losses when its cumulative share of losses of the investee equals or exceeds its interest in the investee, unless a liability exists whereas there is no such requirement in relation to the consolidated financial statements.*

c) *capitalisation of borrowing costs incurred by a parent in relation to the assets of a subsidiary. In some circumstances, it may be appropriate to include all borrowings of the parent and its subsidiaries when computing a weighted average of the borrowing costs. However, this might not be the case in the separate financial statements of the parent if the parent's investment in the subsidiary is a financial asset, which is not a qualifying asset.*

115 As explained above, there are already differences between consolidated and separate financial statements regarding the equity method. The IASB acknowledged that in some cases, new or increased differences between separate and consolidated financial statements could arise from the ED proposals. For example, applying the proposed requirements, the parent would recognise, in full, gains or losses on transactions with subsidiaries in its separate financial statements. However, in its consolidated financial statements, it would eliminate, in full, such gains or losses.

Aligning the amounts reported in separate financial statements with those reported in consolidated financial statements for subsidiaries

116 *In practice entities that opt to apply the equity method in the separate financial statements for subsidiaries generally want to achieve the same result for net assets and profit or loss attributable to the owners in the entity's separate financial statements as in the consolidated financial statements. This could be because the separate financial statements are used to determine dividend payouts or tax reasons.*

Alternative View of IASB member Mr Tadeu Cendon

117 *As explained in paragraph AV1 of the Basis for Conclusions of the ED, Mr Cendon supports the proposals in the ED including recognition, in full, the gains and losses resulting from all its upstream and downstream transactions with its associates or joint ventures. However, he considers that IAS 27 should have been amended to include an option to apply the equity method of accounting differently when the parent has control of the investee (the investee is a subsidiary) and the entity elects to apply the equity method.*

118 *In Mr Cendon's provides the following arguments in support of his alternative view:*

a) *associates or joint ventures not part of the reporting entity in consolidated financial statements. However, this characteristic is not present when the investee is a subsidiary. Subsidiaries are part of the reporting entity as the parent controls the individual assets and liabilities of the subsidiary.*

b) *The proposed amendments, in practice, assume that the equity method is a measurement basis because they disregard the existence of control and require the same treatment in both consolidated and separate accounts prepared under IFRS. However, he notes that because of the notion of control, a subsidiary is fundamentally different from an associate or joint venture.*

c) *IAS 27 does not provide much insight into the purpose of separate financial statements or the principles behind the accounting options for investments in subsidiaries, joint ventures or associates.*

d) *The proposed amendment to recognise full gains and losses on transactions on transactions with a subsidiary when applying the equity method in the separate financial statements will result in* ***an additional difference*** *to the outcome in the consolidated financial statement (such gains and losses are eliminated under IFRS 10). This will pose a concern in jurisdictions where separate financial statements play an important role (for example for taxation and capital maintenance, including paying dividends and assessing insolvency and bankruptcy) and an entity opts to*

apply the equity method for subsidiaries in its separate financial statements. Such differences between the two sets of accounts could increase the cost of compliance and add complexity for users as they would need to understand why such differences exist.

119 *In conclusion, Mr Cendon believes that, until the IASB addresses the conceptual questions about the nature and purpose of the equity method and the purpose of separate financial statements:*

a) *An option should be added to IAS 27 to allow a parent to apply the equity method for investments in subsidiaries consistently with the procedures used when preparing consolidated financial statements.*

b) *A parent choosing this option would eliminate gains or losses resulting from upstream and downstream transactions with its subsidiaries and remeasure the previously held interest when it obtains control of an associate or joint venture, or remeasure its retained investment when an entity loses control of a subsidiary and retains an investment in that former subsidiary as an investment in an associate or joint venture.*

120 *Paragraphs AV2-AV13 of the Basis for Conclusions of the ED explain Mr Cendou's alternative view.*

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

121 The ED proposes the application of a single equity method across consolidated and separate financial statements prepared under IFRS Accounting Standards. EFRAG notes there are mixed stakeholder views on the ED's proposals. Most stakeholders we've heard

from so far support the ED proposal as they consider that introducing two versions of the equity method would introduce unnecessary complexity. At the same time, some stakeholders have reservations with the ED's proposal, and EFRAG also acknowledges the Alternative View expressed in the ED (by Mr Cendon),

122 Based on the feedback, on balance, EFRAG cautiously supports the ED's proposal and seeks further feedback from constituents on the pervasiveness of the application of the equity method in the separate financial statements of EU entities, any concerns with the ED proposal, and the suggested possible steps to alleviate these concerns.

123 EFRAG's initial position of cautious support is based on the understanding 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.

124 EFRAG also notes that based on outreach conducted by the IASB (see paragraph BC121 of the Basis for Conclusions of the ED), the use of equity in separate financial statements is prevalent in only a few jurisdictions. Instead, the cost option under IAS 27 is typically used. However, EFRAG considers that this could change in the future if local requirements change.

Concerns with the ED's proposals

Alternative View in the ED

125 EFRAG acknowledges that, as highlighted in Mr Cendon's Alternative View, there could be a question about the conceptual merits of juxtaposing the principles of the equity method applied in the consolidated financial statements to the equity method applied for subsidiaries in the separate financial statements.

126 Another concern is the widening of differences[15] between consolidated and separate financial statements from the ED proposals due to:

[15] 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.

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.

127 That said, even though EFRAG acknowledges that separate financial statements play an important role when used to declare dividends, tax reasons and/or fulfil commercial law requirements, we consider that, if at all, 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[16] [17] would depend on stakeholder feedback to future IASB agenda consultations.

Recognition of full gains or losses for transactions with subsidiaries

128 Similar to Mr Cendon's Alternative View referred to in paragraphs 126 and 127-a above, some stakeholders are concerned with applying the ED's proposal for full recognition of gains or losses from transactions with subsidiaries (where the parent has control) in the separate financial statements.

129 For these stakeholders, concerns about possible earnings management and structuring are elevated when the ED's proposals are applied for transactions with controlled subsidiaries. That said, EFRAG notes that, as addressed in Question 7, the ED requires disclosures that will allow users to assess the reasonableness and sustainability of these transactions and their pricing for benchmarking against market terms.

Transaction costs and cost definition in Appendix A

Transaction costs

130 Similar to consolidated financial statements addressed in Question 1, stakeholders have highlighted that it is unclear how transaction costs are treated in separate financial

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[16] 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.

[17] 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).

statements when an entity 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

131 Stakeholders have indicated 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.

132 Stakeholders have also questioned and are seeking clarification on 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 some stakeholders may expect consistency across different notions of cost.

133 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.

134 As per paragraph 128, 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.

Other suggested next steps

135 EFRAG seeks constituents' views on whether to recommend that the IASB explore the proposal by Mr Cendon (see paragraph AV13 of the Basis for Conclusions) **to add an option to IAS 27** to allow a parent to apply the equity method for investments in subsidiaries consistently with the procedures used when preparing consolidated financial statements. This means that a parent entity choosing this option would:

a) eliminate gains or losses resulting from upstream and downstream transactions with its subsidiaries; and

b) remeasure the previously held interest when it obtains control of an associate or joint venture or remeasure its retained investment when an entity loses control of a subsidiary and retains an investment in that former subsidiary as an investment in an associate or joint venture.

136 EFRAG is also seeking constituents' views on whether to recommend that the IASB consider requiring an entity that applies the equity method for subsidiaries in its separate financial statements to **provide a reconciliation**[18] that explains the differences between the amounts in the consolidated financial statements and the separate financial statements. The reconciliation could explain the following:

a) amounts reported in the shareholder's equity in the parent's separate financial statements, with the equity attributable to the owners of the parent in consolidated financial statements; and

b) the carrying amount of its investment in a subsidiary in the parent's separate financial statements, with the net assets of the subsidiary attributable to the parent as in the parent's consolidated financial statements.

137 The reconciliation could be an aggregate for all subsidiaries or require disaggregated information for each material subsidiary (that is material to the reporting entity). EFRAG understands that gauging the suitability of such a reconciliation will depend on balancing the practicability versus the benefits of transparency on the differences between consolidated and separate financial statements for users of financial statements. Hence, via a question to constituents and outreach, EFRAG is seeking views on this reconciliation.

EFRAG questions to constituents- separate financial statements

[18] The reconciliation would be in the separate financial statements

6.1. In your jurisdiction, is the equity method for transactions with subsidiaries applied by companies? If so, is it analogised to IFRS 3 and IFRS 10 requirements (e.g., for transaction costs, and the elimination of gains or losses for transactions with subsidiaries)? Are there significant differences between any of the line items in the separate financial statements versus consolidated financial statements? 6.2. Do you agree with the suggested clarification of the applicability of the equity method principles towards investments that are measured at cost in separate financial statements? 6.3 Do you agree with the suggestion for an option to be allowed and a reconciliation required as stated in paragraphs 132 to 134? If not, please explain why.

Question 7 – Disclosure requirements

Notes to the constituents – Summary of proposals in the ED

Proposed amendments to IFRS 12

138 The IASB is proposing to amend IFRS 12, in relation to:

a) *Changes in an investor's ownership interest while retaining significant influence.*

b) *Transactions with associates;*

c) *Contingent consideration; and*

d) *Other matters raised by users.*

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

139 The IASB decided not to propose new disclosure requirements for the purchase or the disposal of an ownership interest in an associate or joint venture, while retaining significant influence, to be consistent with existing disclosure requirements in IFRS Accounting Standards applied to investments in associates.

140 The IASB decided to require investors to disclose gains and losses resulting from changes in ownership interest in profit or loss, as it is not expected to be costly for preparers of financial statements and would provide useful information.

Transactions with associates

141 The IASB decided to propose requiring an investor to disclose any gains or losses from downstream transactions with its associates. This would help users to assess earning quality. It would also allow users to adjust the recognised gain or loss in their analysis and to assess the reasonableness and sustainability of these transactions and their pricing for benchmarking against market terms.

Contingent consideration

142 *The IASB decided to propose requiring an investor that enters into a contingent consideration arrangement to disclose:*

a) *For the period in which it obtains significant influence over an associate or joint venture or purchases an additional ownership interest:*

(i) *the amount recognised as at the date the entity obtains significant influence or purchases an additional ownership interest.*

(ii) *a description of the arrangement and the basis for determining the amount of the payment.*

(iii) *an estimate of the range of outcomes (undiscounted) or, if a range cannot be estimated, the fact, and the reasons why a range cannot be estimated. If the maximum amount of the payment is unlimited, the investor would be required to disclose that fact.*

b) *For each subsequent reporting period until the investor collects or settles the contingent consideration or it is cancelled or expires:*

(i) *any changes in the amounts recognised, including any differences arising upon settlement.*

(ii) *any changes in the range of outcomes (undiscounted) and the reasons for those changes.*

(iii) *the valuation techniques and key model inputs used to measure the contingent consideration.*

Other matters raised by users

143 *The IASB acknowledged users' request for additional disclosure on interests in other entities. However, it also noted that it would need to assess the costs of implementing the new requirements and the benefits of the additional information. Because the IASB concluded that entities can meet the disclosure objective in IFRS 12, it assessed the matter to be of low priority.*

144 *The IASB decided to propose:*

a) *a disclosure objective requiring an investor to disclose information that enables users of its financial statements to evaluate the changes in the carrying amount of investments in associates or joint ventures; and*

b) *a reconciliation between the opening and closing carrying amount of its investments in associates or joint ventures, to meet the new disclosure objective. In the IASB's view, it would help users distinguish between changes arising from cash transactions and changes arising from non-cash transactions.*

145 The IASB observed that a reconciliation between the opening and closing amount of particular types of assets and liabilities is often required in other IFRS Accounting Standards. The IASB does not expect the proposed requirement to disclose such a reconciliation to be overly costly for preparers.

Applying the proposed disclosure requirements to investments in joint ventures

146 The IASB decided to propose the same improved disclosure requirements for investments in joint ventures, as it would be consistent with IFRS 12, which generally requires the same information to be disclosed for the two categories of investments.

147 The IASB decided not to develop a specific requirement with two separate reconciliations – one for the investor's investments in its associates and another for its investments in joint ventures.

148 The IASB also considered whether to extend the proposed disclosure requirement relating to downstream transactions to gains or losses from upstream transactions with joint ventures but decided not to do so. It would be costly to apply, and entities sometimes experience difficulties with accessing information about gains or losses recognised by an associate in upstream transactions.

Proposed amendments to IAS 27 Separate Financial Statements

149 The IASB decided that its proposed solutions to the application questions in the scope of the project would also apply to a parent that chose to use the equity method to account for its investments in subsidiaries in its separate financial statements.

150 The IASB decided, with one exception, not to require the same information to be disclosed, for two reasons: the disclosure requirements in IFRS 12 generally do not apply to separate financial statements; and the disclosure requirements in IAS 27 or other IFRS Accounting Standards do not require the disclosure of quantitative information in separate financial statements about investments in subsidiaries to which the equity method is applied.

151 However, the IASB decided to propose requiring a parent that chose to use the equity method to account for investments in subsidiaries in its separate financial statements to disclose gains or losses from downstream transactions with its subsidiaries. The information

would help users understand how much of the parent's profit or loss was generated from such transactions.

152 *The IASB decided to not propose similar disclosure requirements for gains or losses recognised by the parent's subsidiaries in upstream transactions.*

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

153 *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.

154 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.

155 *IFRS 12 Disclosures of Interests in Other Entities:* IFRS 12 requires an investor/reporting entity to disclose[19] 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.

156 *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.

157 *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.

158 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

[19] 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.

disclosure. EFRAG also suggests that the IASB further clarify the level of disaggregation required for this information.

159 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 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.

160 *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.

Question 8 – Disclosure requirements for eligible subsidiaries

Notes to constituents – Summary of proposals in the ED

161 The IASB decided to propose amendments to IFRS 19 to require an eligible subsidiary:

a) *To disclose gains or losses resulting from downstream transactions with its associates or joint ventures;*

b) *To disclose, in the period in which the entity obtains significant influence or joint control or purchases an additional ownership interest, for contingent consideration arrangements:*

(i) *The amount recognised at the date it obtains significant influence or joint control, or at the date it purchases that additional ownership interest;*

(ii) *A description of the arrangement; and*

(iii) *The basis for determining the amount of the payment;*

c) *To disclose, for each subsequent reporting period until the entity collects or settles that contingent consideration or it is cancelled or expires:*

(i) *Any changes in the recognised amounts, including any differences arising upon settlement; and*

(ii) *The valuation techniques and key model inputs used to measure contingent consideration; and*

d) *To disclose gains or losses resulting from downstream transactions with its subsidiaries if the entity is a parent that uses the equity method to account for its investments in subsidiaries in its separate financial statements.*

162 Based on the principles that inspired the IASB to develop IFRS 19, in the IASB's view:

a) *The information about contingent consideration would provide users with useful information about cash flows and commitments. Also, the proposed disclosure requirements are consistent with the disclosure requirements in IFRS 19 for contingent consideration in business combinations.*

b) *The information about gains or losses from downstream transactions would help users disaggregate those gains or losses from gains or losses from transactions with third parties, and is, therefore, consistent with the disaggregation principle.*

163 The IASB also decided not to propose amendments to IFRS 19 for the other proposed amendments to IFRS 12.

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

164 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.

165 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.

166 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

Notes to the constituents – Summary of the proposals in the ED

167 The proposed requirements would require some entities to change their accounting policies when using the equity method to account for an investment in an associate or joint venture.

168 The ED proposes that, on transition, an investor or joint venturer shall apply the proposed amendments prospectively, except in the following cases:

a) *Gains or losses from transactions with associates or joint ventures (Paragraph C4 of the ED and BC183 of the Basis for Conclusions) - apply retrospectively the requirement to recognise the full gain or loss on all transactions with associates or joint ventures (paragraph 53 of the ED). This means that, at **transition date**, an investor shall recognise it shall recognise the previously restricted portion of gains or losses:*

   (i) *In the opening balance of retained earnings for transactions that occurred before the transition date; and*

   (ii) *In the profit or loss in the comparative period for transactions that occurred in the comparative period.*

b) *Paragraph B99A of IFRS 10 – Paragraph B99A of IFRS 10 has been deleted. Under Paragraph C5 of the ED an investor that applied paragraph B99A of IFRS 10 early*

shall apply paragraph C4 of the ED to any gain or loss from the remeasurement at fair value of an investment retained in a former subsidiary.

169 Contingent consideration *(Paragraph C6 of the ED and BC192 of the Basis for Conclusions) –An investor shall recognise and measure contingent consideration (for investments or joint venturers purchased before the transition date) as follows: at* ***fair value at the transition date.*** *The investor or joint venturer shall classify contingent consideration in accordance with paragraph 26 of the ED and recognise any corresponding adjustment to the carrying amount of its investments in associates or joint ventures at that date. The IASB's reasoning for retrospective application for gains and losses on transactions with equity-accounted investees are explained in paragraphs BC182 – BC186 of the Basis for Conclusions. Essentially, the IASB considers that the information should be available to preparers. For contingent consideration, the IASB argues in paragraphs BC187-BC192 of the Basis for Conclusions that applying the proposals prospectively would result in a lack of comparability.*

170 *The IASB proposes that in relation to transition:*

a) *the date of initial application is the beginning of the annual reporting period in which an investor or joint venturer first applies the proposed requirements; and*

b) ***the transition date is the beginning of the annual period immediately preceding the date of initial application****, except for entities that present more than one period of comparative information.*

171 *In deciding on the transition requirements, the IASB acknowledged that retrospective application would result in the most useful information for users. However, the IASB concluded that for the other proposed amendments the costs to preparers to apply the proposals retrospectively would outweigh the benefits to users.*

172 *The IASB is also proposing relief from restating any additional prior periods presented. As explained in C9 of the ED, the IASB is granting an option not to adjust prior periods if an entity presents more than one period of comparative information.*

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

173 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 has received mixed views from stakeholders on this proposal as we elaborate below.

174 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.

175 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.

176 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.

177 However, other stakeholders have concerns about applying this proposal retrospectively. They are concerned it 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 [20] expressed this concern.

178 Based on the concerns, EFRAG tentatively recommends that the IASB consider requiring **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. EFRAG seeks constituents' views on its tentative recommendation for a prospective approach for the restricted gains or losses from transactions with investees.

Clarification point in Appendix C of the ED

179 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.'

180 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.

EFRAG Question to constituents

9.1 Do you agree with EFRAG's recommendation for prospective application for restricted (unrecognised) gains or losses from transactions with investees prior to application date? Please explain

[20] During EFRAG's outreach, fact patterns were presented highlighting this difficulty. For instance, it was highlighted in cases where an entity applied a net investment hedge for an associate or joint venture located in a foreign jurisdiction.

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

Notes to constituents – Summary of proposals in the ED

181 *The ED proposals would affect entities that:*

a) *Are required to apply the equity method under IAS 28 to investments in associates and joint venturers in their consolidated financial statements or in individual financial statements; and*

b) *Choose to use the equity method for investments in subsidiaries, associates and joint ventures in the separate financial statements as permitted under IAS 27.*

182 *The impact of the proposals on affected entities will depend on the level of transactions entities undertake with equity-accounted investees and on how different the entity's existing accounting policies are from the proposed requirements for those transactions.*

Expected effects on information reported in the financial statements

183 Paragraph BC221 provides a table that summarises the IASB's view on the expected effects on information reported in the consolidated financial statements and where applicable in the separate financial statements.

184 The IASB explains that:

a) *The main effects will arise because the proposals in the ED might require an entity to change their accounting policies (for example changes in ownership interest, recognition of losses and transactions with equity-accounted investees. The other effect will arise from the additional proposed disclosure requirements.*

b) *With regards to the proposals on the accounting for deferred taxes and contingent consideration, the IASB notes that, although approaches in practice vary, it is common for entities to apply a similar approach to that required by IFRS 3 for business combinations.*

c) *Concerning the impairment proposals, the IASB notes that the proposals do not change the way an entity tests equity-accounted investees for impairment.*

Expected benefits of the quality of information reported (paragraphs BC222 and BC223 of the Basis for Conclusions)

185 *The IASB explains that:*

a) *Users will benefit from more comparable information given that the proposals in the ED address aspects of the equity method for which there is currently no guidance or where current guidance is inconsistent with other IFRS Accounting Standards.*

b) *Users will also benefit from the proposed disclosure requirements which ought to provide a better understanding of transactions with equity-accounted investees.*

Expected costs of implementing and applying the proposals (paragraphs BC224 – BC229 of the Basis for Conclusions)

186 *The IASB considers that the proposals will reduce costs to preparers, auditors and regulators by providing answers to application questions arising in practice for entities applying the equity method.*

187 *The IASB acknowledges that entities will need to change their current accounting policies to apply many of the proposals and will also need to provide additional disclosure. This will attract additional costs to preparers. For example, the IASB notes that the proposal to measure the investor's additional share of the associate's identifiable assets and liabilities at their net fair value, and include the related deferred tax effects, when purchasing an additional interest in an associate, may be more costly than what entities currently do.*

188 *However, the IASB notes that some other proposals (for instance the proposals on full recognition of gains and losses for transactions with associates and joint venturers) will be less costly to apply than the current requirements/ current accounting policies in place (as tracking of the unrealised gain or loss will no longer be required).*

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

189 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); and

190 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.

191 EFRAG will further evaluate the cost-benefit balance based on the constituents' response to Question 10 of the ED and their feedback during EFRAG's ongoing outreach.

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

192 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.

193 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.

194 Similarly, 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.’

195 With regard to 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.

196 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.

197 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. Indeed, 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. 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. EFRAG’s stakeholders consider that the fair value option should be possible for these situations regardless of the structure of the entity which holds the investment (venture organisation, mutual fund or similar entities) as it would better reflect their operating activity considering IFRS 18 requirements.