EFRAG

Financial reporting

Comment Letter

International Accounting Standards Board
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom
20 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 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 of accounting 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. EFRAG understands the rationale for the IASB's approach, which aims to provide preparers with solutions to long-standing application difficulties in a shorter time than would be the case if a fundamental review were to occur.

Overall, EFRAG agrees with many of the ED's proposals and considers these to be a positive step towards reducing the existing diversity in practice, but we also have significant concerns with several of the proposals. Therefore, in deciding the next steps and finalising the proposed amendments, we recommend the IASB carefully consider the totality of stakeholders' feedback to the ED and address the areas where further simplification and clarifications are needed.

The feedback EFRAG has received also conveys that, amongst several stakeholders, there are lingering questions about the nature and purpose of the equity method as well as a desire for a fundamental review of the equity method. Therefore, EFRAG recommends that, for its forthcoming agenda consultation, the IASB includes and seeks views on the fundamental review of the equity method (including the scope of its application and the definition of significant influence) as a possible candidate for the future IASB workplan.

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 transactions with associates or joint ventures. It is also a simplified and less costly solution compared to the other alternatives considered by the IASB. However, EFRAG expresses some concerns about restructuring opportunities and earnings management arising from the proposals and, as noted below, recommends enhanced disclosures to alleviate this concern. EFRAG also asks for clarification on whether side stream transactions are in the scope of the ED.
- Disclosures: EFRAG supports the ED's proposed disclosures. In our support, we balance the need for these disclosures in light of the ED's proposals for transactions with associates or joint ventures against the concerns voiced by some stakeholders about the cost and sensitivity of the proposed disclosures of gains or losses from downstream transactions. EFRAG suggests expanding the disclosures to encompass upstream and side stream transactions. In tandem, we suggest steps to alleviate stakeholder concerns (i.e., aggregating the disclosure of gains or losses of immaterial investments, and introducing a sensitivity carveout).
- Impairment indicators: 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 highlights key concerns and makes the following suggestions.

- Measurement of cost of an associate or joint venture (transaction costs treatment): The ED is silent on whether transaction costs are included in the carrying amount of the investment. EFRAG recommends clarifying the appropriate accounting treatment for transaction costs, i.e., whether to expense or capitalise these costs.
- Acquiring additional ownership interest while retaining significant influence (layered approach): EFRAG considers the ED's proposal to treat each additional acquired ownership interest as a separate unit of account as being preferable to the fair value remeasurement of the entire investment. However, due to the associated significant cost

and complexity, EFRAG disagrees with a full-fledged purchase price allocation (PPA) for each additional acquisition of ownership interest as proposed in the ED. EFRAG recommends further simplification of this proposed approach. In our response to Question 2, we suggest a modified-PPA approach that the IASB can consider as a starting point for the recommended simplification.

- Other changes in ownership interest while retaining significant influence (e.g. an associate's or joint venture's issuance or redemption of shares): Due to the associated cost and complexity, EFRAG disagrees with the ED's proposal to treat other changes in ownership arising from non-exchange transactions by the investee as deemed purchases or disposals of ownership interest. We recommend the IASB develop a holistic, principle-based solution that encompasses all non-exchange transactions and events within an investee that result in changes in ownership and/or the investor's claims on the investee's resources.
- Recognition of the investor's share of losses: EFRAG supports the ED's proposed exclusion of 'catch-up' losses from the cost of acquiring additional ownership interests when the carrying amount of the associate or joint venture is nil due to the investor's share of losses. We however recommend that the IASB prohibit the recognition of goodwill for the acquired additional ownership interest/investment if the latter is a *de facto* funding or bail-out arrangement. We also 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 supports the ED's proposed application of a single equity method across IFRS Accounting Standards except for the recognition of full gains or losses from all transactions with subsidiaries (including side stream transactions). EFRAG 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 in paragraph C4 of the ED to require retrospective application of the remaining portion of a previously restricted gain or loss arising from transactions with associates or joint ventures. EFRAG asks for clarification on the transition requirements for contingent consideration and some other specific aspects of the proposed transition requirements (investments measured at nil and unrecognised gains or losses) (See response to Question 9).

In general, EFRAG notes that the simplification principle is only selectively applied in some of the proposed solutions (e.g. for the recognition of full gains or losses for transactions with associates and joint ventures) and that it could also be applied to other proposals (e.g. the layered approach of accounting for acquired additional 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.

2 EFRAG is cognisant that, as outlined in paragraph BC 8 of the Basis for Conclusions, the ED is not focused on fundamentally reviewing and revising the equity method (e.g., it does not include a review of the scope of application of the equity method, or how to define and assess whether an entity has significant influence) nor is the ED clarifying whether the equity method is either a measurement approach or a one-line consolidation as long called for by constituents including during the 2011 IASB agenda consultation. 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 paragraphs BC 15 and 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.

3 *Equity method as a hybrid approach*: Many respondents to EFRAG's draft comment letter have highlighted that an articulation of the IASB's assumption about the nature of the equity method (i.e., whether it is a one-line consolidation approach or measurement method) would have enhanced stakeholders' understanding of the ED's proposals and also led to the formulation of durable and coherent answers to the practical application challenges. In this regard, EFRAG considers 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, <u>the equity method can be effectively deemed to be a hybrid approach encompassing the features of both a consolidation approach and measurement method</u>. Whether the emphasis is one or the other can depend on the

[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

nature and timing of the transaction or event as well as the accounting step being considered. For instance, the equity method could 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.) and/or it could have the features of a measurement method (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). One of our stakeholders has also opined that the equity method ought to be a measurement method for the statement of financial position and it ought to be a consolidation approach for the statement of comprehensive income.

4 Overall, it would be helpful for stakeholders' understanding of the IAS 28 requirements, if the IASB characterises the equity method as a hybrid approach and thereafter, <u>if the IASB is explicit about the assumed conceptual feature of the equity method underpinning each proposed amendment</u> (i.e., if the logic of the consolidation approach prevails and analogies to IFRS 3 are drawn versus if the view of the equity method as a measurement method was the predominant consideration). EFRAG recommends that this be done in the Basis for Conclusions for the IAS 28 amendments.

5 *Need for further simplification*: In general, EFRAG observes that some of the proposals are significant amendments that will change current practice. For example, this is the case for the recognition of full gains or losses for transactions with associates addressed in Question 4, and the application of a single equity 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 that it could be also applied to 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.

6 *Fundamental review of equity method*: EFRAG notes that, notwithstanding the IASB's understandable justification for excluding a fundamental review of the equity method from the scope of the ED (see paragraph 2 above), during our outreach on the ED, we have heard

a range of views on the usefulness of the equity method. Some stakeholders, including users, have confirmed its usefulness[3] and complementary nature to the fair value and cost measurement bases. These stakeholders deem the equity method to be the best/least worst alternative for accounting for the acquisition of ownership interests with significant influence in a business, particularly for businesses that are integrated into the investor's operations. However, many other stakeholders, including other users, are sceptical about the usefulness of the equity method due to the complexity of IAS 28 (existing requirements and the ED's proposed amendments) along with the numerous still unanswered application questions, notwithstanding the ED. Questions about the nature and purpose of the equity method were also raised by several of the EFRAG's draft comment letter respondents and in the feedback[4] to a survey conducted by academics from three Spain-based universities.

7 *Way forward*: Overall, EFRAG agrees with many of the ED's proposals and considers these to be a positive step towards reducing the existing diversity in practice, but we have significant concerns with some of the proposals (e.g., the proposed version of the layered approach for step acquisitions, and the proposals for other changes of ownership interest while retaining significant influence). Simplified solutions are needed for these areas of concern. We have also pointed to several areas where further clarifications are needed (e.g., recognition of each component of comprehensive income when the carrying amount of the investment is nil). Therefore, in deciding the next steps and finalising the amendments, we recommend the IASB carefully consider the totality of the feedback from stakeholders to the ED and address the areas of concern and further clarifications. As suggested in paragraph 4, on the premise that the equity method has features of both a consolidation approach and measurement method (i.e. is a hybrid approach), the IASB should also be explicit in the Basis for Conclusions about which of the two features is the primary emphasis/assumption underpinning each proposed amendment.

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[3] These stakeholders pointed to several limitations of both the fair value (too volatile) and cost (does not get updated for changes in economic and the entity's actual circumstances, does not reflect investee losses in a timely manner, equity method better indicates potential for dividend distribution than cost does) as measurement bases, and they considered the equity method to be a superior/best alternative to account for 'significant influence' investments. In the outreach to the User Panel done before EFRAG's DCL was published (see link), users also noted that management is responsible for the invested capital and not for the fair value of a non-controlled investee and therefore the equity method is better suited for this purpose. They emphasised it is the analyst's job to determine the fair value of the investee entities while valuing the reporting entity.

[4] The survey garnered feedback from 117 respondents with a diverse professional background (academics, auditors, analysts and preparers). The survey results were presented at the EFRAG Academic Panel meeting in November 2024.

8 Finally, as there are lingering questions amongst several stakeholders about the nature and purpose of the equity method, EFRAG recommends that the IASB includes a fundamental review of the equity method (including reviewing the scope of its application and the definition of significant influence) in the forthcoming agenda consultation. This would present an excellent opportunity to ask stakeholders – after many years – whether the fundamentals of the equity method still work and whether financial reporting will be improved by a fundamental review further to the finalisation of ED's amendments.

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

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 comments

9 Cost definition: The definition of cost[5] in Appendix A of the ED is similar to that under IFRS 3 but it is not exactly the same as the definition of cost[6] in other IFRS Accounting Standards (IAS 16.6, IAS 38.8 and IAS 40.5). Stakeholders have highlighted that the different definitions of cost across various 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[7] to the Discussion Paper[8] *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. that it might not result in the most relevant reported information.

10 Based on the above, we suggest that definition of cost in Appendix A should be enhanced to clarify its interaction with either cost as defined or other notions of cost applied in other IFRS Accounting Standards (see our response to Question 6 on separate financial statements).

11 Acquisition of a business versus an asset: IAS 28 does not distinguish between the acquisition of a business and the acquisition of an asset. However, the appropriate accounting treatment for various application questions (e.g. whether to recognise goodwill on acquisition of ownership interests, how to treat transaction costs, contingent consideration transactions) would depend on whether the investment represents either the acquisition of a business or an asset.

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[5] 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*.'

[6] 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*.

[7] EFRAG, April 2024, Feedback Statement, *Accounting for Variable Consideration –A Purchaser Perspective*, Discussion Paper.

[8] EFRAG, September 2022, *Accounting for Variable Consideration – A Purchaser Perspective*, Discussion Paper.

12 Moreover, based on stakeholders' feedback, EFRAG is aware 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 that the IASB should clarify the accounting for recognition and subsequent changes in ownership interests in assets, including ownership interests in non-financial assets, when an investor has a significant influence.

13 <u>Primary feature of the equity method</u>: As suggested in paragraphs 4 and 7 of the general comments, the IASB should be explicit about the primary feature (consolidation approach or measurement method) of the equity method underpinning each proposed amendment. This will aid stakeholders' understanding of the IAS 28 amendments including those related to the components of measurement of cost of an investment (e.g., transaction costs, deferred tax effects) and the other ED proposals.

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

14 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*. That is, unless the consideration transferred constitutes mainly of a non-monetary asset, in which case it would inherently have higher measurement uncertainty.

15 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. EFRAG assumes that these incremental costs are likely to be insignificant.

16 Further, EFRAG suggests that the IASB should:

(a) clarify, similarly to the requirement in paragraph 42 of IFRS 3, how to account for the difference, if any, between the fair value of the previously held ownership interest and its previous carrying amount. This clarification could be helpful, as the unit of account used to determine the fair value of any previously (i.e. before obtaining significant influence) held ownership interest can have an impact on the determination of the fair value of this ownership interest (i.e. whether a premium for significant influence should be included in the fair value); and

(b) specify what is meant by 'the fair value of any previously held ownership interest', as the current definition could lead to confusion as to whether it refers to the fair value already recognised by the investor of its previously held ownership interest or to a remeasurement of the investor's previously held ownership interest when purchasing an additional ownership interest (obtaining significant influence).

Transaction costs

17 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. Via a question to constituents, EFRAG sought and received mixed views on the appropriate treatment of transaction costs.

18 The view favouring expensing transaction costs stemmed from analogising the treatment of transaction costs under IFRS 9 *Financial Instruments* and IFRS 3[9]. The view favouring capitalisation of transaction costs was premised on deeming the equity method to be an inherent cost-based approach that is adjusted for changes in net assets. Moreover, capitalisation is consistent with the accounting for other assets accounted at cost, it is consistent with the 2009 IFRIC agenda decision, and it would align with the local requirements for certain jurisdictions.

19 The feedback received affirms the need for the IASB to clarify the accounting for transaction costs to reduce diversity in practice. In so doing, the IASB should distinguish between the treatment of transaction costs for the acquisition of a business and the acquisition of an asset.

20 EFRAG observes that the proposed requirements for the measurement of cost of an associate are similar to IFRS 3 requirements reflecting an implicit view or a leaning towards treating the equity method as a consolidation approach when acquiring ownership interests that obtain or retain significant influence. However, consistent with the July 2009 IFRIC agenda decision, which considered that the cost of an equity-accounted investment would include any directly attributable expenditure to obtain it, EFRAG would favour the

[9] 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'.

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

Contingent consideration

21 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 that IFRS 3 only applies to the acquisition of business. Therefore, to avoid ambiguity and exacerbating the inconsistency in the accounting for variable and contingent consideration as highlighted in the 2022 EFRAG Discussion Paper[10], 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 a business.

22 EFRAG also suggests that the IASB clarify whether a 12-month window to revise contingent consideration, as permitted under IFRS 3, will be allowed in the context of IAS 28.

23 Further, EFRAG suggests that the IASB clarify whether paragraph B55 of IFRS 18 *Presentation and Disclosure in Financial Statements*, which states that remeasurements of the fair value of a liability for contingent consideration in a business combination recognised by applying IFRS 3 should be classified in the operating category, is also applicable for the equity method under IAS 28.

Recognition of goodwill and bargain purchase gains

24 Stakeholders have expressed mixed views on the ED proposals for the recognition of goodwill or bargain purchase gains for 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 and/or in case of an asset acquisition.

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[10] 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.

25 Should the ED proposals be retained, EFRAG suggests the amendments include disclosures that help users identify[11] goodwill and bargain purchase gains derived from acquisitions of ownership interests that are accounted for under the equity method.

26 *Faithful representation of bargain purchase gains*: Stakeholders 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 similar safeguards to those included in the related IFRS 3 requirements[12]. In addition, in our response to Question 7, we recommend disclosures that inform users about bargain purchase gains.

Deferred tax effects

27 Despite concerns raised by some stakeholders relating to the cost and complexity of recognising and tracking the reversal of deferred taxes and/or changes in local tax rates and the investee's fiscal status, EFRAG supports the ED's proposed inclusion of deferred tax effects in the carrying amount of the investment. This proposal is consistent with current practice and is aligned with the IFRS 3 principles, where deferred taxes arising from fair value adjustments are included in the purchase price allocation (PPA). EFRAG also agrees with the IASB's reasoning that the inclusion of a deferred tax asset or liability in the carrying amount of the investment allows a faithful representation of the tax effects that could arise after significant influence is obtained

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

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

[11] 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.

[12] 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 …'.

(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

Purchase of additional interest while retaining significant influence

28 EFRAG acknowledges the conceptual reasoning behind the ED's proposal to not require 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. The ED's proposal[13] is referred to as the layered approach in this comment letter.

29 *Cost and complexity of layered approach:* Though the layered approach is conceptually consistent with the initial measurement of cost of the investment, most stakeholders have significant concerns about its associated cost and complexity specifically with regards to:

(a) difficulties in obtaining all the needed information when the investor does not control the investee and/or when the investee is a listed company not being able to provide one investor with more information than any other investor. These difficulties will not be encountered only at initial recognition, but throughout the life of the investment (tracking of the deferred taxes and their reversal, items in other comprehensive income and their recycling, etc.);

(b) 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. including changes in the fair value of net assets). 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;

(c) application difficulties as an investor would be required to reset to nil any investee's item of other comprehensive income recognised in its financial statements, when the equity method is applied for the first time, and for any subsequent additional layer. Such periodic resets would create major practical difficulties and impair the investor's capacity to identify and track those items; and

[13] For each additional layer acquired, the investor or joint venturer is required to measure at fair value the investee's identifiable assets and liabilities at the acquisition date and perform a purchase price allocation (PPA) recognising the goodwill or bargain purchase gain.

(d) complexity in the implementation of the requirements in paragraphs 21(b)(ii) and B12 and B13 of IFRS 12 *Disclosure of Interests in Other Entities* to disclose summarised financial information on current and non-current assets and liabilities of joint ventures and associates with related fair value step-ups. Applying the layered approach would result in presenting amounts of assets and liabilities arising from a compilation of several values and result in limited usefulness for users.

30 In addition to the noted cost and complexity concerns, stakeholders (including users) 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 that 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.

31 Based on the above concerns, EFRAG disagrees with the ED proposal requiring a PPA for each acquisition of additional ownership interest while retaining significant influence and recommends that the IASB explores simplifying the proposed layered approach. In this regard, EFRAG notes that many stakeholders expressed support for a modified-PPA approach that we sought feedback on. Under this approach, the PPA-related information that was applied while obtaining significant influence is the reference point for the measurement of the additional acquired layers of ownership interest while retaining significant influence. Key features of the modified-PPA model are as follows:

(a) *Initial PPA information*: 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 for any subsequent acquisitions while retaining significant influence.

(b) *Subsequent-period adjustments*: These initial fair values of assets and liabilities need to be adjusted for depreciation, amortisation, impairment and other changes, for instance, by applying a premium or discount for changes in the economic prospects of the investee since the investor obtained significant influence.

(c) This subsequent-period 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. To alleviate this estimation uncertainty, subsequent-period adjustments can be restricted (for example, with a requirement for updating the PPA after a certain period).

32 The suggested modified-PPA approach would 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. This reasoning is also consistent with paragraph BC328 of IFRS 3, which explains that the standard was amended to simplify the measurement of goodwill for step acquisitions due to its complexity and cost.

33 There are other approaches besides the modified-PPA approach that would also be simpler and less costly than the ED's layered approach. However, these other approaches would conceptually differ and be a fundamental departure from the ED's approach. For instance, this would be the case for the cost-accumulation, non-PPA approach[14] that EFRAG sought feedback on and other[15] approaches that stakeholders highlighted. Feedback received by EFRAG also highlighted (a) the challenges in subsequent measurement and (b) the need to rethink the ED's proposed initial measurement of cost of an investment, if a cost-accumulation approach was the alternative to the ED's layered approach.

34 Overall, EFRAG recommends that the IASB further explore plausible simplifications to the ED's layered approach, and it could consider the modified-PPA approach as a starting point. The other alternatives, including the cost-accumulation approach, could be considered were the IASB to undertake a fundamental review of the equity method.

35 *Offsetting bargain purchase gains against goodwill*: EFRAG notes that the recognition of goodwill and bargain purchase gains on the acquisition of ownership interests is indicative

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[14] EFRAG Draft Comment Letter included **Alternative 2,** which is a cost-accumulation, non-PPA approach. Under this approach, the fair value of the consideration transferred is assumed to be a proxy for the fair value of each incremental acquisition. This approach is akin the cost accumulation approach with no required PPA. Similar to the modified PPA approach and the ED's version of the layered approach, under the cost-accumulation approach, each acquisition would be a separate unit of account. However, unlike the modified PPA approach and the ED's version of the layered approach, Alternative 2 would deemphasise linking the IAS 28 requirements to IFRS 3's principles.

[15] One stakeholder that responded to EFRAG's draft comment letter suggested an approach where goodwill is determined as the difference between the fair value of consideration transferred and the book value of the net assets at the time of an additional purchase of ownership interest. This would eliminate the challenges and costs of the investor obtaining the fair value of net assets of the associate or joint venture.

of the equity method being viewed as akin to a consolidation approach, even though this inference is not explicitly stated in the ED. 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 recognised 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. Moreover, some banking sector stakeholders were concerned about the adverse effects of an 'overstated goodwill' amount on their prudential regulatory capital ratios. Hence, EFRAG suggests the IASB should reconsider the proposal by giving more weight to the faithful representation of the economics of an investment than to conceptual consistency/alignment with IFRS 3 principles.

Disposing of an ownership interest while retaining significant influence

36 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.

37 However, EFRAG notes that different units of account are used across the ED's proposals for the treatment of additional purchases of ownership interests while retaining significant influence versus those for the disposals of ownership interests while retaining significant influence. EFRAG questions whether this may distort the representation of the economics of the investment and lead to structuring opportunities, for example, when the acquisition of ownership interests and their subsequent disposal occur within narrow time windows.

38 Further, stakeholders have provided examples of where a specific identification method would be more appropriate and simpler to apply. For instance, this would be the case if individual entities A, B and C are part of a consolidated group ABC, if each of these individual entities obtains a proportion of ownership interest in entity X and, in the ABC consolidated financial statements, if 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. Similar considerations may be relevant where ownership interests in the associate or joint venture are related to different classes of ordinary shares.

39 Whereas EFRAG understands and shares the concerns expressed by the stakeholders outlined above asking for allowing or requiring, in certain circumstances, a specific identification method, EFRAG also acknowledges that the specific identification would potentially reduce comparability between entities, create structuring opportunities and it would be inconsistent with a consolidation approach that assumes the group is a single economic entity.

40 Further, EFRAG suggests the IASB clarify how the share of the net assets disposed of is determined, making paragraph 32(b) of the ED more explicit and providing more guidance in BC35(a) in relation to equity instruments with different economic rights (i.e. preference shares).

Other changes in ownership interest while retaining significant influence

41 EFRAG is concerned with the ED's proposals for other changes in ownership that occur in the absence of an exchange transaction with the investor (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). We disagree with these proposals because:

(a) Other changes without an exchange transaction are not economically equivalent to actual acquisitions and disposals of ownership interest. Some stakeholders consider these changes to be 'mechanical' adjustments.

(b) The requirement to perform a separate PPA for each deemed acquisition is overly burdensome and costly with limited benefits (as outlined in response to acquiring additional ownership interest). This concern is particularly acute for entities whose associates or joint ventures have high volumes of share buybacks for example.

42 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.

43 Hence, EFRAG recommends that the IASB develop a simpler and a more balanced approach for layered acquisitions from a cost-benefit perspective along with a holistic principle-based approach, which 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.

44 Were the IASB to retain the proposal, based on the feedback received, EFRAG points to the following areas not addressed in the ED where further clarifications would be required:

(a) 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 and what is encapsulated within the broad term- 'economic ownership';

(b) whether and how to apply the ED proposals in situations where an investee's net asset changes as a result of a transaction with non-controlling interests within the investee or share buy-backs (in situations where the investee is a consolidated group by itself);

(c) 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;

(d) the calculation of the investee's net assets. The absence of this may lead to confusion and diversity in practice; and

(e) with regard to the decrease in relative ownership interest, whether such changes should result in a realisation of any accumulate currency translation adjustment (CTA) and whether IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* should not apply in such cases because the application of IFRS 5 would require an actual sale of interests in the investee.

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

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 the investor's share of losses

Losses not recognised and purchase of an additional interest

45 EFRAG acknowledges 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 albeit having favourable long-term economic prospects). Hence, EFRAG supports the exclusion of an investor's share of unrecognised losses of an associate or joint venture from the cost of purchased additional ownership interest when the carrying amount of the investment is nil (i.e., we support excluding catch-up losses in the cost of additional investment while retaining significant influence).

46 Relatedly, EFRAG suggests that the IASB explicitly state that when an entity purchases an additional ownership interest while having unrecognised losses, the entity needs to assess whether this additional investment represents an implicit funding of the associate or the joint venture and if this is indicative of an existing constructive obligation. If so, the unrecognised losses ought to be recognised in line with the proposed requirement in paragraph 47 of the ED.

47 Although EFRAG agrees with the ED's proposed exclusion of catch-up losses from the cost of additional investment, EFRAG considers that, if the carrying amount of the investee is nil (and the net assets of an investee are negative), in certain cases, the recognition of additional goodwill for the acquired layer may be inappropriate, lead to structuring opportunities, and will distort the faithful representation of the investment's economic reality. In this regard, EFRAG notes that the feedback from users indicates they struggle with interpreting the economic meaning of goodwill recognised under the equity method. The limited usefulness of recognised goodwill will be exacerbated if it occurs in circumstances where the carrying amount of the investment is nil and the investor has a bail-out towards the investee.

48 Hence, EFRAG recommends the prohibition of the recognition of additional goodwill in circumstances where the additional investment is a *de facto* funding or bail-out arrangement. If this were done, goodwill stemming from the additional acquisitions of ownership interest would be expensed under the said circumstances, an approach that is consistent with the treatment of bargain purchase gains. This will also align with EFRAG's suggestion to require the offsetting of bargain purchase gains against previously recognised goodwill (see our response to Question 2).

49 Finally, EFRAG asks the IASB to clarify the composition of the associate's carrying amount in cases where the related net assets are negative. Specifically, whether the carrying amount of the associate consists of goodwill and an offsetting share of the associate's negative asset value?

Recognition of each component of comprehensive income

50 There is a need for the IASB to clarify various aspects of the ED's proposal for the recognition of each component of comprehensive income when the carrying amount of the investment is nil. Specifically, with respect to paragraph 48 of the ED[16], the IASB should clarify whether the investor's share of unrecognised losses are to be considered:

[16] '*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*.'

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

51 Further, the IASB should clarify whether paragraph 52 of the ED[17] 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). Based on feedback received, EFRAG suggests that the example included in paragraph 52 be extended to include situations where:

(a) 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;

(b) the net investment is not reduced to nil;

(c) the investor's share in total comprehensive income is a loss that exceeds the net investment in the associate; and

(d) the investor's share in profit or loss is a loss and its share of the other comprehensive income is a profit (or vice versa).

52 With regard to other comprehensive income, the ED proposal does not address whether and how 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.

53 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 (such as the order of priority between recyclable and non-recyclable components of other comprehensive income or to allocate on a proportionate basis between all

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[17] '*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.*'

components of other comprehensive income and how the history of prior unrecognised losses is considered when determining the accounting for the comprehensive income of the period).

54 Notwithstanding the IASB's argument that the above 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 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

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

55 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.

56 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.

57 Overall, 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, which are summarised in paragraph B67 of the ED's Basis for Conclusions.

58 However, EFRAG notes that some stakeholders expressed concerns about restructuring opportunities and earnings management particularly for transactions between associates and joint ventures under common control. Furthermore, the ED does not refer to or discuss side stream transactions (i.e., transactions between associates, joint ventures and/or between subsidiaries of a parent entity) and whether these are covered by the scope of the proposals when applying the equity method both in the consolidated and separate financial statements. EFRAG therefore recommends that the IASB clarify whether side stream transactions are within the scope of the proposal.

59 As discussed in our response to Question 7, for the benefit of users, EFRAG recommends enhanced disclosures to improve the transparency and information content on gains and losses recognised on transactions with and between equity-accounted investments (including side stream transactions).

Specific comments on the ED proposal

Reasons for supporting proposed recognition of full gains or losses for transactions with associates or joint ventures

60 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.

61 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 the recognition of full gains or losses for transactions with joint ventures

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

63 As detailed in our response to Question 7, enhanced disclosure requirements would help to provide transparency for users on the rationale for and pricing of downstream, upstream and side stream transactions between an investor and its equity-accounted investees.

64 Finally, 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 concerns on earnings management, EFRAG notes that some stakeholders have called for a 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 the paragraphs below), particularly for transactions with subsidiaries which are equity-accounted in the separate financial statements.

Separate financial statements

65 As addressed in EFRAG's response to Question 6, some stakeholders have raised significant concerns with applying the proposals for subsidiaries (controlled by the investor/parent) accounted for under the equity method in the separate financial statements including side stream transactions with subsidiaries.

Other comments

66 *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 the 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. To further clarify the requirements in paragraph 54 of

the ED, EFRAG suggests that 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 equity-accounted subsidiaries in the separate financial statements.

Question 5 – Impairment indicators (decline in fair value)

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)

67 *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).

68 *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.

69 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 reduce diversity in practice.

70 On the other hand, some stakeholders noted that this criterion has been useful in practice, and that its removal would increase the frequency of the impairment tests that an investor or joint venturer would undertake and 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 to ascertain the respective fair value of the associates or joint ventures (e.g. the financial statements of the associates or joint ventures).

71 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.

72 In its support of 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.

73 *Reversal of impairment loss under IAS 28 requirements*. Some stakeholders have indicated that there was a lack of clarity on how the requirements for reversing an impairment loss in IAS 36 interact with the requirements in paragraph 58 of the ED (i.e. in situations where an investor recognises an impairment of an associate in one period, and the associate recognises an impairment loss of its assets in a later period, therefore, reducing the carrying amount of the net assets of the associate with no change in the investor's recoverable amount for the investment). The stakeholder suggested that impairment requirements in IAS 28 should include additional provisions allowing for the reversal of the impairment of the associate in such situations as the carrying amount of the investment would be below its recoverable amount.

74 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

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

75 EFRAG supports the ED's proposed application of a single equity method across IFRS Accounting Standards except for the proposal for recognition of full gains or losses in investments in subsidiaries in which the equity method is applied in the separate financial statements. EFRAG considers that introducing two versions of the equity method would introduce unnecessary complexity.

76 EFRAG acknowledges 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.

77 The feedback received by EFRAG and a review of financial statements[18] done by the EFRAG Secretariat confirms the IASB's observation (paragraph BC121 of the ED's Basis for Conclusions) that the use of the equity method in separate financial statements is prevalent in only a few jurisdictions and the cost option under IAS 27 is typically used. However given that some jurisdictions use the equity method to measure investments in subsidiaries in the separate financial statements, EFRAG recommends that the IASB further engages with stakeholders in these jurisdictions to better understand the potential consequences of the proposed amendments.

Applying the equity method to investments in subsidiaries in the separate financial statements

78 Questions and concerns about the effects of the ED's proposals have been raised by several stakeholders from jurisdictions that apply the equity method to subsidiaries in separate financial statements. These stakeholders have expressed significant concerns with the ED's

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[18] The EFRAG Secretariat found indicative (albeit not statistically representative) evidence of a limited use of the equity method to account for subsidiaries in separate financial statements across a selection of financial statements. This finding was from the EFRAG Secretariat's review of the financial statements of a judgmental (non-representative) sample of 37 companies across eight countries (Belgium, Denmark, Italy, Netherlands, Norway, Portugal, Spain and Switzerland) and a variety of industries. Only five of these companies (**13.5%)** were clearly identified as applying the equity method in the separate financial statements. 14 (38%) applied the cost method and 18 (48.6%) did not disclose or applied fair value. It was difficult to perform such an analysis for a larger and statistically representative sample due to the data not being readily available in the databases at EFRAG's disposal.

proposal for recognising full gains or losses for an investor's transactions with its subsidiaries in the separate financial statements. They consider that transactions with subsidiaries are fundamentally different from transactions with associates. Therefore, the recognition of full gains or losses for transactions with subsidiaries could potentially fail to reflect their economic substance and it creates the risk of structuring opportunities and earnings management.

79 Although some stakeholders consider that enhanced disclosure could mitigate these concerns, it has also been noted that additional disclosures will not be sufficient to mitigate the noted risks**.** EFRAG therefore considers that the ED's proposed disclosures (discussed in Question 7) are necessary but not sufficient to allow users to assess the reasonableness and sustainability of these transactions and their pricing for benchmarking against market terms.

80 EFRAG also notes that in jurisdictions where separate financial statements serve as a basis for compliance with local regulations such as for dividend distribution, there is an increased risk of entities declaring dividends based on ''unrealised gains'' from transactions with subsidiaries.

81 Another concern is the widening of differences[19] between consolidated and separate financial statements from the ED proposals due to:

(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.

82 For the above reasons, <u>EFRAG recommends that transactions with subsidiaries be exempted from the requirement for the recognition of full gains or losses in the separate financial statements</u>. This means eliminating gains and losses resulting from upstream, downstream and side stream transactions with subsidiaries. This exemption could be included by either amending IAS 27 or IAS 28.

[19] Under existing requirements, there are differences between consolidated and separate financial statements due to differences in impairment testing, recognition of losses and differing requirements for capitalisation of borrowing costs.

83 *Step acquisition (or loss of control) of a subsidiary*: In paragraphs BC 129-133 of the Basis for Conclusions of the ED, the IASB provides its rationale for not requiring the remeasurement of previously held ownership interest when a parent either obtains control of an associate or loses control of subsidiary while retaining significant influence. Essentially, the non-change in accounting method holds more weight in the IASB's reasoning on the appropriate required accounting for step acquisition (or loss of control) of a subsidiary than does a change in economic circumstances of the reporting entity. In this regard, some of EFRAG's stakeholders have called for the IASB to rethink its conclusions and give consideration to the occurrence of an economic event (loss of control) as a determinant of the appropriate accounting. Foremost, this will align the accounting of the consolidated financial statements and separate financial statements as done in other aspects of the ED's proposals for separate financial statements. The are other reasons[20]for the concern with this aspect of the proposed amendments.

84 In effect, these stakeholders consider that a parent entity should be required to remeasure previously held interests after either obtaining control of an associate or losing control of a subsidiary while retaining significant influence. EFRAG notes that this suggestion is aligned with Mr Tadeu Cendon's alternative view.

Project on IAS 27

85 EFRAG acknowledges that separate financial statements play an important role when used to declare dividends, for tax reasons and/or to fulfil commercial law requirements. However, we consider that any issues and concerns related to separate financial statements ought to be addressed in a project on IAS 27 rather than under amendments to

[20] The current IASB decision for the step acquisition or (loss of control) of a subsidiary will be a departure from current practice. Moreover, the IASB's reasoning in BC 129-133 may create inconsistencies in accounting for investments under IAS 27. For example, on the loss of control, a parent entity will not remeasure the previously held interest while applying the equity method but if it applied cost, it would have had to remeasure the previously held interest at fair value, since it has changed the accounting method.

IAS 28. EFRAG acknowledges and agrees that the uptake[21] of such a project [22] would depend on stakeholder feedback to future IASB agenda consultations.

Transaction costs and cost definition in Appendix A

Transaction costs

86 Similar to consolidated financial statements addressed in Question 1, EFRAG notes that it is unclear how transaction costs are treated in separate financial 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 equity-accounted subsidiaries in separate financial statements.

Applicability of the equity method proposals for investments measured at cost in separate financial statements

87 EFRAG notes that 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 be part of the cost of an investment in an associate or a joint venture. As explained in paragraphs BC91 and 92, this proposal is consistent with IFRS 3 and consistent with predominant current practice.

88 EFRAG also recommends that the IASB clarify 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 consistency across different notions of cost could be expected.

89 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

[21] 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.

[22] 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 contain some useful related thinking (e.g. they outline the perspectives of users of separate financial statements and have suggestions for narrowing differences between consolidated financial statements).

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 also valid when the investment is measured at cost before and after the transaction.

90 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 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) to investments measured at cost in separate financial statements.

Question 7 – Disclosure requirements

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

91 *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.

92 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.

93 *IFRS 12 Disclosures of Interests in Other Entities:* IFRS 12 requires an investor/reporting entity to disclose[23] 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.

94 *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.

95 *Disclosures of gains or losses from 'downstream' transactions with associates or joint ventures*: EFRAG acknowledges the reason for this disclosure articulated in paragraph BC144 of the Basis for Conclusions (i.e. to assess earning quality, allow users to make

[23] 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 also requires 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.

analytical adjustments of recognised gains or losses and assess the 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.

96 However, some stakeholders have raised concerns about requiring disclosures of gains and losses from 'downstream' transactions, based on:

(a) 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 disclosure;

(b) the need to disclose commercially sensitive information on transfer prices and related margins between the investor and its associate or joint venture.

97 To alleviate these concerns, EFRAG suggests that the IASB consider requiring this disclosure at a more aggregated level for immaterial investments and/or introducing a sensitivity carve-out.

98 *Scope of disclosures*: 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. It is also not clear whether side stream transactions (transactions between subsidiaries) are within the scope of this proposal.

99 In this light, EFRAG recommends that the IASB further examine how to enhance the disclosure requirements for <u>all transactions</u> between a parent and its equity-accounted investees (including upstream and side stream transactions) without duplicating any existing related party disclosures under IAS 24.

100 *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 whether it relates to any other overall changes. Furthermore, EFRAG suggests that changes in ownership interest should be disaggregated into those related to acquisitions, disposals and other changes in ownership interest.

Question 8 – Disclosure requirements for eligible subsidiaries

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

101 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.

102 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.

103 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

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

104 EFRAG agrees with the proposed transition requirements <u>except</u> for the proposal in paragraph C4 of the ED to apply retrospectively the requirement to recognise the remaining portion of a previously unrecognised gain or loss on transactions with associates or joint ventures.

105 As explained below, EFRAG also seeks clarification from the IASB on the proposed transition requirements in paragraph C6 with respect to contingent consideration and some other aspects of the proposed transition requirements.

Paragraph C4 of the ED - retrospective application for gains and losses

106 EFRAG notes that some stakeholders support retrospective application as proposed in paragraph C4 of the ED as they deem this to be less burdensome than continually monitoring the amortisation or future realisation of the previously unrecognised restricted gains or losses. However, the majority of EFRAG's stakeholders did not support the

retrospective application for gains and losses on transactions with associates and joint ventures. These stakeholders are concerned that applying the proposals retrospectively could be costly in some cases as the information might not be readily available (for example when there was a contribution of a business in an associate or joint venture in past years). The proposals will result in the reporting entity 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 expressed this concern.

107 Based on the above concerns, EFRAG recommends that the IASB permit prospective application for the proposal in paragraph C4 relating to recognition of unrecognised 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 could 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 in paragraph 53 of the ED for recognition of full gains or losses would only apply to transactions with investees from the date the proposal becomes applicable unless it is impracticable for an entity to do so.

108 Furthermore, should the IASB either require or permit the retrospective application of paragraph C4, EFRAG recommends that the IASB introduces a requirement for an impairment test of the carrying amount of the related investment at the transition date. This will ensure that any corresponding impairment of the investment will be reflected in retained earnings to match the increase in the carrying amount of the investment also reflected in retained earnings at the transition date due to the transition requirements under paragraph C4.

109 EFRAG notes that BC 183 explains that 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.

110 Furthermore, 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.

111 EFRAG observes that, for many stakeholders, it is unclear whether paragraph C4 of the ED is intended to require a full retrospective application or whether it is a modified retrospective approach. Therefore, should the IASB retain the proposal to require retrospective application of unrecognised gains and losses arising from past transactions as stated in paragraph C4 of the ED, EFRAG recommends the IASB clarify how retrospective application is intended to be applied and provide an example to illustrate this requirement.

Paragraph C6 of the ED – retrospective application for contingent consideration

112 EFRAG agrees with the proposed transition requirements in paragraph C6 of the ED with respect to any remaining unrecognised contingent consideration (classified as a financial liability) for investments in associates or joint ventures acquired before the transition date, to the extent that contingent consideration was not previously measured at fair value at acquisition date.

113 EFRAG notes that as currently drafted paragraph C6 of the ED could be read as a requirement to fair value all contingent consideration arrangements, including paid contingent consideration. Although EFRAG considers that this might not be the intention of the IASB based on what is stated in paragraphs BC190 and BC192 of the Basis for Conclusions, we recommend that the IASB clarify in paragraph C6 that the requirement only applies to any remaining unrecognised contingent consideration that was either not recognised or was recognised on a basis other than fair value.

Clarification point in Appendix C of the ED

114 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.’

115 EFRAG is uncertain on whether 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.

Investments measured at nil and unrecognised gains and losses

116 EFRAG notes that the following aspects of the proposed transition requirements are unclear:

(a) how the proposed prospective transition requirements in paragraph C3 of the ED would apply to investments measured at nil at the transition date and subsequent periods, for which the investor ceased to recognise losses; and

(b) how unrecognised gains and losses could be accounted for prospectively.

117 Regarding (a) above, EFRAG seeks clarification on how to deal with the following questions related to transition requirements for unrecognised losses.

(a) Should the amount of unrecognised losses be reset to nil at the transition date?

(b) Should that amount continue to be monitored under the current accounting policy, which would result in two accounting policies being applied in parallel?

(c) Should the amount of unrecognised losses be recalculated retrospectively, and if so, how should it be allocated between profit or loss and the recyclable and non-recyclable components of other comprehensive income?

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

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:

118 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).

119 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.

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

120 *Interaction with other standards*: Many stakeholders raised concerns in relation to the interaction between IAS 28's current requirements and IFRS 18 *Presentation and Disclosure in Financial Statements* requirements. Specifically, IFRS 18 requires all entities to classify income and expenses from equity-accounted 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.

121 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.

122 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. For instance, for the insurance entities it is a common practice to have equity-accounted investments as part of the specific business models, which may include a direct link between investments in the

equity-accounted associates or joint ventures to insurance liabilities forming part of the underwriting result included within the operating profit. Such contracts are generally accounted for under the variable fee approach (VFA).

123 The same question about the application of IAS 28.18 is raised for other types of contracts, for example, property and casualty contracts (P&C), accounted for under the general model or the premium allocation approach (PAA). Whereas there will be a direct link between the insurance liability and its servicing asset under the VFA model, there will be no direct link for the contracts accounted for under the general model or PAA. However, the investments in associates or joint ventures will still serve the same purpose – i.e. to provide income to the insurance entity so that it can service its insurance liabilities.

124 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. Because of the current diversity in the interpretation of the requirements of IAS 28.18, it was not always possible for the concerned entities to select the fair value option in order to mitigate the classification mismatch. Consequently, the intended objective of the IFRS 18 transition requirements to mitigate the classification mismatch may not be met.

125 Based on the concerns raised by stakeholders, EFRAG suggests that the IASB introduce a general option in IAS 28 allowing an entity to account for the associates and joint ventures at FV through PL available at inception of the contract (and upon transition to amended IAS 28) only if it eliminates or significantly reduces an accounting mismatch.

126 *Integrate articulation of concepts*: EFRAG acknowledges that Table 2 and paragraphs BC 15 and 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 include, among other things, 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.

127 *Scope*: 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.’

128 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.