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ED/2024/7 Equity Method of Accounting – IAS 28 Investments in Associates and Joint Ventures (revised 202x)

Grant Thornton International Ltd is pleased to comment on the International Accounting Standards Board's (IASB or the Board) Exposure Draft ED/2024/7 Equity Method of Accounting – IAS 28 'Investments in Associates and Joint Ventures (revised 202x)'. We have considered the exposure draft (ED), as well as the accompanying draft Basis for Conclusions and application examples.

Our detailed responses to the ED's Invitation to Comment are set out in the Appendix, and we have summarised our key comments here.

We believe many of the proposed amendments to this Standard will help reduce diversity in practice because they provide additional direction on the application of equity accounting in situations where there is no current guidance. Another objective of this project was to make IAS 28 more understandable and this, in our opinion, has been broadly achieved.

Building on many of the improvements that have been made to the proposed Standard, we would specifically like to see these important matters being addressed:

- **Transaction costs:** The Basis for Conclusions refers to applying principles of IFRS 3 'Business Combinations'. However, in our view, the drafting of the ED could be clearer as to whether the IASB intends that IFRS 3 principles should be applied to transaction costs. If this is the intention we note it goes against a previously published IFRS Interpretations Committee (IFRIC) agenda decision that indicates transactions costs should be included in the cost of investment.

- **Consideration of circumstances where an ownership change might not result in gaining or losing significant influence**: In addition to what has already been reflected in the ED and the Basis for Conclusions, we would like to see more cross references to IFRS 10 'Consolidated Financial Statements'. We believe it would be helpful to preparers of financial statements if the IASB provided some direction in circumstances where there may be a change in the net assets of an associate without any change in direct ownership interest.

- **Recognition of investors share of losses:** We would encourage the IASB to provide additional guidance on a wider range of scenarios that might arise for recognition of share of profit or loss and other comprehensive income (OCI) in various iterations where an entity has profits or losses in each category. More specifically we would really like to see the inclusion of an example of a situation where losses have previously been recognised, but then they were reversed having generated future profits.

- **Transactions with associates:** We agree with the proposals set out in this area, and we also agree that this should be applied retrospectively to enhance comparability.

- **Separate financial statements and the application of equity accounting**: Our network overwhelmingly supports the alternative view set out in the ED.

If you have any questions on our response, or wish us to amplify our comments, please contact me by email (mark.hucklesby@gti.gt.com).

Yours sincerely,

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Appendix: Responses to the Invitation to Comment questions

Question 1 – Measurement of cost of an associate (Appendix A and paragraphs 13, 22, 26 and 29 of [draft] IAS 28 (revised 202x))
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.

Question 1 – Response

We agree with the IASB's proposals, and support the objective of increasing consistency, however we think that greater clarity could be achieved relating to transaction costs.

We note the definition of cost included in Appendix A does not include transaction costs, and our interpretation is these should be excluded and recognised as an expense, similar to their treatment in a business combination when applying IFRS 3. We note this contradicts previous guidance issued by IFRIC on the matter, and it also contradicts the notion that this is a cost model. Transaction costs are pervasive and will often be a material part of an acquisition for a reporting entity, so the lack of any specific mention in the ED may not reduce diversity in practice. We do not prefer one treatment over the other, however we think it would be beneficial to specifically clarify how these costs should be treated and include information in the Basis for Conclusions on the reasoning and intention of the conclusion of the IASB in this matter. If in the final version the conclusion is to expense transaction costs, this should be flagged as a change to the prior version of IAS 28. We also note the approach of alignment with IFRS 3 raises the question of how to deal with transactions costs when the acquired interest does not meet the definition of a business. For example, if the acquisition was of an interest in a joint venture which was a group of assets, expensing transaction costs would not be consistent with IFRS 3 or the acquisition of a group of assets under IAS 16/IAS 38.

We also support the proposal to include contingent consideration measured at fair value in the cost of the investment when gaining significant influence. Alignment with IFRS 3 on this matter will help to increase consistency and reduce confusion by aligning measurement principles.

In our experience the ED's requirement to separately identify the deferred tax position of associates and joint ventures is an approach that many preparers are already taking, and we therefore welcome this updated guidance aligning with current practice.

We believe it would be helpful in the Basis for Conclusions to explicitly comment on common control transactions because this is a matter that is not specifically dealt with in IFRS 3. For the avoidance of doubt, we would like the IASB to make it clear in the Basis for Conclusions that the scope exception of IFRS 3 for common control transactions is not available for equity accounted investments.

Finally, we would like to suggest that the IASB considers including guidance similar to IFRS 3 with respect to having a 12-month window in which to reassess initial measurement assessments. Determining the fair value of the assets and liabilities of an associate or joint venture takes time and it will often require the help of valuation experts. Therefore allowing sufficient time to perform this assessment, as currently provided for in IFRS 3, and having it explicitly and directly referred to in the proposed Standard would be welcomed.

Question 2 – Changes in an investor's ownership interest while retaining significant influence (Paragraphs 30-34 of [draft] IAS 28 (revised 202x))
IAS 28 does not include requirements on how an investor accounts for changes in its ownership interest in an associate, while retaining significant influence, that arise from: (a) the purchase of an additional ownership interest in the associate; (b) the disposal of an ownership interest (partial disposal) in the associate; or (c) other changes in the investor's ownership interest in the associate. The IASB is proposing to require that an investor: (a) at the date of purchasing an additional ownership interest in an associate: (i) recognise that additional ownership interest and measure it at the fair value of the consideration transferred; (ii) include in the carrying amount the investor's additional share of the fair value of the associate's identifiable assets and liabilities; and (iii) account for any difference between (i) and (ii) either as goodwill included as part of the carrying amount of the investment or as a gain from a bargain purchase in profit or loss. (b) at the date of disposing of an ownership interest: (i) derecognise the disposed portion of its investment in the associate measured as a percentage of the carrying amount of the investment; and (ii) recognise any difference between the consideration received and the amount of the disposed portion as a gain or loss in profit or loss. (c) for other changes in its ownership interest in an associate: (i) recognise an increase in its ownership interest, as if purchasing an additional ownership interest. In (a)(i), 'the fair value of the consideration transferred' shall be read as 'the investor's share of the change in its associate's net assets arising from the associate's redemption of equity instruments'. (ii) recognise a decrease in its ownership interest, as if disposing of an ownership interest. In (b)(ii) 'the consideration received' shall be read as 'the investor's share of the change in its associate's net assets arising from the associate's issue of equity instruments'. Paragraphs BC20-BC44 of the Basis for Conclusions explain the IASB's rationale for these proposals. Do you agree with these proposals? If you disagree, please explain why you disagree and your suggested alternative.

Question 2 – Response

We agree with the IASB's proposal to deal with increasing and decreasing ownership interests in 'layers', and then subsequently treat the entire investment as one unit of account for future transactions/changes in ownership interest.

Although it may not specifically be in the scope of these proposals, we believe that the IASB could consider including cross references to IFRS 10 paragraphs on determining significant influence over an investee. These new proposals assume that significant influence is retained through these increases and decreases in ownership interest, however this may not always be the case. We believe it would be beneficial for the users of IAS 28 to be reminded of the assessment required by IFRS 10 on whether they have significant influence, even if it is not directly included in the amended IAS 28.

We would like to expand further on the matter noted in the previous paragraph. As currently drafted in the ED, what is not clear to us is how to determine the share of net assets "disposed of" where an associate is partially sold without losing significant influence. For instance, if one takes the example of a 40% stake in an associate that was acquired in two successive tranches ie 25% five years prior to the reporting date and another 15% two years later (three years prior to the reporting date). The investor performed a PPA at the date of each acquisition which almost certainly will have resulted in identifying different assets and liabilities between both tranches. The investor then decides to sell 10% of its stake (ie 10/40 of the net assets). For the purpose of subsequently applying the equity method which consists in picking up its share of the associate net income and OCI, it would be helpful if the proposed Standard clearly set out how to determine the portion of net assets disposed that were sold. This is key as it impacts the subsequent adjustments that the investor should apply when recognising its share of net income.

We also noted in our discussions situations in which an associate may be required to redeem its equity instruments at an above market rate, due to some agreements/commitments to shareholders. In such cases goodwill may be recognised and then subject to immediate impairment of the additional value. The IASB may want to consider whether this warrants consideration in the Basis for Conclusions.

We also discussed situations in which the net assets of an investee may change without there being a change in direct ownership interest. For example, when an investor has an ownership interest in an associate which is the parent of a group that includes NCI. If the associate acquires that NCI interest, the net assets attributable to the owners of the associate would decrease, and therefore the investor's share of the net assets will decrease, but there has been no change in the ownership interest held by the investor. For completeness, the IASB may want to consider providing guidance on a situation like this.

Question 3 – Recognition of the investor's share of losses (Paragraphs 49-52 of [draft] IAS 28 (revised 202x))
Paragraph 38 or IAS 28 requires that if an investor's share of losses equals or exceeds its interest in the associate, the investor discontinue 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 do not agree, please explain why you disagree and your suggested alternative.

Question 3 – Response

We agree with the proposals for the recognition of the investor's additional share of losses when acquiring an additional interest in an investment.

An aspect we would like to see more guidance on is when an investor resumes recognising its share of the associate's profits. In situations where current year profits and OCI are sufficient to fully offset unrecognised loses the treatment is clear, however when current year profits are not sufficient, having some additional guidance in the final Standard to address this circumstance would be appreciated.

In addition, it is not clear how this approach applies to OCI where OCI is a net loss and where the share of profit or loss is a profit. In this case, we are unclear how the cap applied to the OCI, as suggested in the illustration provided in paragraph 52, is recognised between the various components of OCI and how it should be applied/allocated between the components. It could be done in order of priority or by a proportionate approach, however this is not clear in the current proposals so we would welcome clarification on this point.

Question 4 – Transactions with associates (Paragraph 53 of [draft] IAS 28 (revised 202x))
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 this proposal? If you disagree, please explain why you disagree and your suggested alternative.

Question 4 – Response

We agree with the proposal to fully recognise gains and losses from both upstream and downstream transactions with associates as this will provide useful information to users of financial statements. However, we note this treatment diverges from what US GAAP currently requires.

We also agree with the proposal to apply this change retrospectively. We note that without retrospective application comparability might be compromised, in some cases significantly. The information required to achieve this should be available to preparers as it is required for some aspects of the current requirements (BC182 – BC186 of the existing standard for example), so we do not believe that there would be significant issues in transition.

Question 5 – Impairment indicators (decline in fair value) (Paragraph 57 of [draft] IAS 28 (revised 202x))
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 or 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 investments 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 reorganize the requirements in IAS 28 relating to impairments 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.

Question 5 – Response

We do not have any concerns with the proposed amendments to the impairment indicators. The changes align with IAS 36 and remove old language from the standard, which we fully support.

Question 6 – Investments in subsidiaries to which the equity method is applied in 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 this proposal? If you disagree, please explain why you disagree and your suggested alternative.

Question 6 – Response

We have some concerns about the implication of this proposal. We much prefer the alternative view and arguments set out by Mr Tadeu Cendon. The full recognition of gains and losses arising from transactions with associates in separate financial statements will result in more differences in the shareholder's equity or net profit attributable to the owners of the parent, when compared to consolidated financial statements. We also agree that in various jurisdictions the separate financial statements are important for legal purposes, and any differences between consolidated and separate financial statements will increase compliance costs.

We also support the proposal made by Mr Cendon to allow an option for parents to apply the equity method with the procedures used to prepare consolidated financial statements, and therefore eliminate gains and losses resulting from other entities within the same group structure.

Question 7 – Disclosure requirements (Paragraphs 20(c), 21(d)-21(e) and 23A-23B of IFRS 12 and paragraph 17A of IAS 27)
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 amounts 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.

Question 7 – Response

We agree with the proposals set out by the IASB for additional disclosures. We also agree with BC145, that disclosing information about the investor´s share of gains or losses recognised in upstream transactions is not necessary, noting also that such information could be costly and difficult for investors to obtain. We think the requirement to provide a reconciliation between the opening and closing carrying amount of its investments will provide a lot of useful information to the users of the financial statements.

We would suggest that additional disclosures in respect of unrecognised losses once the investment value is reduced to nil would also provide useful information. We also believe that information about profits from bargain purchase arrangements would also be useful, in line with the requirements of IFRS 3.

In our discussions we also identified certain types of downstream transactions that could present application difficulties when applying this. For example, lease or interest payments being made by the associate to the investor. It is unclear how gains or losses on such transactions would be calculated, so we would welcome additional application guidance on this matter.

Question 8 – Disclosure requirements for eligible subsidiaries (Paragraphs 88(c), 91A and 240A of IFRS 19)
The IASB 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 eligibility 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).

Question 8 – Response

We agree with the proposed amendments to IFRS 19 'Subsidiaries without Public Accountability'.

Question 9 – Transition (Paragraphs C3-C10 of [draft] IAS 28 (revised 202x))
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.

Question 9 – Response

As we have set out in our response to question 4, we agree with the proposal to retrospectively apply the changes to recognition of full gains and losses.

In relation to contingent consideration, we think it would be helpful to clarify that any unrecognised contingent consideration attributable to investments in associates or joint ventures before the transition date should be measured at fair value as the wording in C6 could be construed as saying that all contingent consideration should be remeasured.

We believe that it would be beneficial to have some additional guidance on how to apply the new requirements on unrecognised losses on transition. For example, how amounts of unrecognised losses determined under the current accounting treatment should be treated at the transition date and subsequently.

We agree with all the other transitional requirements set out in the ED.

Question 10 – Expected effects of the proposals
Paragraphs BC217-BC229 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?

Question 10 – Response

Other than what is noted in our responses to previous questions, we do not have any further observations on the impact of these proposals.

Question 11 – Other comments
Do you have any comments on the other proposals in this Exposure Draft, including Appendix D to the Exposure Draft of the Illustrative Examples accompanying the Exposure Draft? Do you have any comments or suggestions on the way IAS 28 is proposing to re-order the requirements in IAS 28, as set out in [draft] IAS 28 (revised 202x)?

Question 11 – Response

We note that paragraphs 45 and 48 refer to 'total comprehensive income', which differs to the terminology used in paragraphs 50 through to 52 of 'profit or loss' and 'other comprehensive income'. We recommend that the terminology in paragraph 45 and 48 refers to 'profit or loss' and 'other comprehensive income' separately to reinforce the different considerations which should be made for each.

Given the proposed reordering of the requirements within IAS 28, the table of concordance published in the ED would be useful to accompany the revised IAS 28.

Relating to the illustrative examples, a recommendation we would like to make the IASB is to expand on example 2 in IE3 to illustrate paragraph 34(a) on deemed acquisition, particularly to illustrate how to determine the consideration transferred. We would also welcome some elaboration on example 3 to address the concerns raised in question 3 about the subsequent accounting for profit or loss and OCI where the investment value has been reduced to nil. The illustration could consider situations where the profit is made up of: (a) a profit in profit or loss and a profit in OCI; or (b) a profit in profit or loss and a loss in OCI ; and (c) a loss in profit or loss and a profit in OCI as we believe those preparing financial statements involving any one of these circumstances would find this guidance very useful.

We would also suggest the IASB relocate into IAS 28, the footnote (a) of section “Part I: Illustrative presentation of financial statements" in IAS 1, which clarifies how an investor's share of the associate’s net identifiable assets and liabilities should be calculated. Where the associate is a group with its own non-controlling interests, this footnote excludes the portion of net assets attributable to non-controlling interests from the net assets considered to calculate the portion attributable to the investor. We think this guidance is better located in IAS 28 than in IAS 1.

Finally, following the issuance of this proposed Standard we think a second project on equity accounting should be added to the IASB’s work programme to address other conceptual areas which continue to cause practical problems. What has been changed in the ED is helpful, but in our view, it is not complete.