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20 January 2025

Dear Sir

Exposure Draft ED/2024/7: Equity Method of Accounting - IAS 28 *Investments in Associates and Joint Ventures* (Revised 202x)

We are pleased to comment on the above Exposure Draft (the ED). Following consultation with the BDO network[1], this letter summarises views of member firms that provided comments on the ED.

We support the objective of the IASB to provide clarifications on application questions related to the equity method, which aims to reduce diversity in practice and lead to more comparable information for users of financial statements.

However, we have some concerns about the proposals. Our key concerns are as set out below:

- Accounting for partial disposals, while retaining significant influence:

  We believe greater clarity is required for the accounting for partial disposals, while retaining significant influence. Under the proposed requirements, additional investments while retaining significant influence are recognised as an accumulation of purchases. Therefore, when partially disposing an investment while retaining significant influence, the disposed portion might include fair value adjustments and goodwill adjustments from multiple purchases. How these adjustments would be allocated to the disposed portion is not entirely clear. We suggest that the IASB consider including an example to illustrate the requirement.

- Proposed paragraph 34(a):

  We believe that the proposed paragraph 34(a) requires further clarification. It appears that, in case of an increase in the entity's ownership interest on the redemption or issue of equity instruments by the associate or joint venture, there will be no change in the amount of investment, unless a bargain purchase occurs. The effect may be a reclassification between the entity's share in the investee's equity and goodwill, with no

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change in the total amount of investment. We suggest that the IASB consider including an example to provide greater clarity on the requirement.

- Accounting when an entity purchases or disposes of an interest with other changes occurring at the same time:

  The proposed requirements currently do not address scenarios where purchases or disposals of investments occur while significant influence is retained occurring simultaneously with other changes in ownership interest. We believe that further explanatory guidance or illustrative examples would help provide greater clarity.

- Proposed requirement to recognise in full gains and losses resulting from 'upstream' and 'downstream' transactions with associates and joint ventures:

  We disagree with the proposed requirement to recognise in full gains and losses resulting from 'upstream' and 'downstream' transactions with associates and joint ventures. We believe this proposal makes fundamental changes to the equity method, without first undertaking a fundamental review of the equity method. We agree with the concerns raised by Mr. Tadeu Cendon in his alternative view regarding the implications of this proposed amendment on separate financial statements of an entity that applies the equity method to measure its investment in subsidiaries. Therefore, we suggest the IASB does not proceed with this aspect of the proposals.

We also have concerns about the proposed requirement to not set off the previously unrecognised losses against the carrying amount of an additional ownership interest acquired and the proposed disclosure requirements.

Our detailed responses to the questions in the ED, along with the reasons for our concerns, are set out in the attached Appendix.

We hope that you will find our comments and observations helpful. If you would like to discuss any of them, please contact me at +44 (0)7875 311782 or by email at abuchanan@bdoifra.com.

Yours faithfully

Andrew Buchanan

Global Head of IFRS and Corporate Reporting

Appendix

Question 1 – Measurement of cost of an associate

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.

We generally agree with the IASB's proposals related to measurement of cost of an associate. However, we suggest that greater clarity should be provided on the treatment of transaction costs. The proposed definition of the cost of an associate or joint venture does not specify whether transaction costs are to be included in the cost. We believe that an analogy should be drawn to the cost of financial assets subsequently accounted for at amortised cost and transaction costs should be included in the cost of an associate or joint venture. This would also help to reduce diversity in practice in the treatment of transaction costs.

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

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.

We have some concerns about the proposed requirements related to changes in an investor's ownership interest while retaining significant influence as below:

- Accounting for partial disposals:

  The Exposure Draft proposes that when an investor or joint venturer disposes of an ownership interest, while retaining significant influence or joint control, the disposed portion of the investment shall be measured as a percentage of the carrying amount of the investment. That percentage is proposed to be calculated as the disposed ownership interest divided by the total ownership interest.

  Under the proposed requirements, additional investments while retaining significant influence are recognised as an accumulation of purchases. Therefore, when partially disposing of an investment while retaining significant influence, the disposed portion might include fair value adjustments from multiple purchases. The depreciation adjustments on the assets would differ for multiple fair value adjustments. Similarly, the carrying value of the investment would include goodwill related to multiple tranches of purchases. It is not entirely clear how these fair value and goodwill adjustments are to be treated in case of a partial disposal. Since the disposed portion is proposed to be calculated as a percentage of the carrying amount of the investment, it appears that the depreciation adjustment and goodwill on the disposed portion would be arrived at proportionately based on the multiple purchases included in the investment. However, we suggest that the IASB consider clarifying the requirement further and including an example to illustrate the requirement.

- Greater clarity required on proposed paragraph 34(a):

  We believe that the proposed paragraph 34(a) is not entirely clear. It appears that, in case of an increase in the entity's ownership interest on the redemption or issue of equity instruments by the associate or joint venture, there will be no change in the amount of investment, unless a bargain purchase occurs. The effect may be a reclassification between the entity's share in the investee's equity and goodwill, with no change in the total amount of investment. We suggest that the IASB consider including an illustrative example to provide greater clarity on the requirement.

- Accounting when an entity purchases or disposes of an interest with other changes occurring at the same time:

  In practice, purchases or disposal of investments, while retaining significant influence, are commonly seen to occur along with other changes in ownership interest. For example, the investor purchases an additional interest in the associate and at the same time, the associate issues new equity instruments or redeems some instruments that changes the relative shareholdings of the investor.

The proposed requirements currently do not address such scenarios. We understand that the entity would be required to apply the principles in the proposed requirements to determine the appropriate accounting. However, we believe that further explanatory guidance or illustrative examples would help provide greater clarity.

Overall, we suggest that the IASB consider including multiple illustrative examples applying the proposed requirements to commonly encountered scenarios to provide greater clarity and reduce potential diversity in practice.

Question 3 — Recognition of the 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 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 disagree, please explain why you disagree and your suggested alternative.

We agree with the proposal to require the investor or joint venturer to recognise separately its share of the associate's or joint venture's profit or loss and its share of the associate's or joint venture's other comprehensive income.

However, we have some concerns about the proposed requirement to not set off the previously unrecognised losses against the carrying amount of an additional ownership interest acquired as below:

- When an investor purchases an additional ownership interest while retaining significant influence, the investor would recognise the goodwill or bargain purchase gain on the

transaction, but not any previously unrecognised losses. We believe that this may not faithfully represent the economic effects of the transaction. For example, if an entity recognises goodwill on purchase of additional ownership interest without recognising previously unrecognised losses, in true economic sense the goodwill does not exist as there are previously unrecognised losses. In such situations, it may be misleading to the users of financial statements to recognise goodwill.

- The proposals require the investor to consider the investment as a single unit of account when applying the equity method. Proposed paragraph 49 requires an investor or joint venturer, who has not recognised its share of losses, to not recognise the losses by reducing the carrying amount of the investment at the date of that purchase. It is not clear whether at the end of the reporting period, the investor would be required to recognise the previously unrecognised losses against the entire carrying amount of the investment, which includes the additional purchase. If this is the case, the proposed requirement only delays the recognition of previously unrecognised losses against the carrying value of the additional purchase till the end of the reporting period.

Question 4— Transactions with associates

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

While we acknowledge the IASB's objective to propose these amendments, we disagree with the approach of making fundamental changes to the requirements of applying the equity method without first establishing what the equity method is meant to accomplish more broadly. The other amendments proposed in the Exposure Draft address application questions arising from practice, whereas this proposal makes fundamental changes to the measurement requirements.

We acknowledge the inconsistency between the requirements of IAS 28 and IFRS 10 *Consolidated Financial Statements* related to recognition of gains and losses arising from the sale of a subsidiary to an associate (Basis for Conclusions – BC64-BC65). We also acknowledge the necessity to address application questions related to accounting for these transactions. However, we believe that the proposed amendments may not be the most appropriate approach to address this inconsistency as it has much wider implications and may have unintended consequences.

We also have significant concerns about the effect of this proposal on separate financial statements of an entity that applies equity method to measure its investment in subsidiaries. Please see our comments on question 6 below.

Given these concerns, we suggest the IASB does not proceed with this proposed amendment.

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.

We agree with the proposed requirements.

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.

We disagree with the proposal to apply the proposed amendments to the equity method to investments in subsidiaries in the investor's separate financial statements. We agree with the concerns raised by Mr. Tadeu Cendon in his alternative view regarding the implications of this proposal.

We believe that the rationale considered by the IASB for recognising in full the gains and losses from upstream and downstream transactions with associates and joint ventures does not apply in case of a subsidiary, as a subsidiary, being controlled by the parent, is fundamentally different from an associate or joint venture. We believe that not eliminating the gains and losses from upstream and downstream transactions with a subsidiary when applying the equity method in separate financial statements would be misleading to the users of financial statements.

We note that the objective of the Equity Method project is to address application questions, whereas this proposal makes fundamental changes to the measurement requirements in the application of equity method (please see our comments to question 4 above). Therefore, we suggest the IASB does not proceed with the proposed amendment to IAS 28 to remove the requirement to eliminate gains and losses from upstream and downstream transactions with associates and joint ventures. Consequently, there will be no effect on the accounting for investments in subsidiaries which are measured using the equity method in investor's separate financial statements.

Question 7 - Disclosure requirements

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.

We generally agree with the proposals.

If the IASB proceeds with the proposed amendment to recognise in full the gains and losses from 'upstream' and 'downstream' transactions with associates and joint ventures, we have the following suggestions related to disclosure requirements:

- Proposed paragraph 21(e) of IFRS 12 *Disclosure of Interests in Other Entities* requires an entity to disclose the gains or losses from 'downstream' transactions with its joint ventures and associates accounted for using the equity method. We suggest that this disclosure requirement should be amended to require a disclosure of unrealised gains and losses from these transactions (i.e. gains and losses where the underlying asset transferred between the associate/joint venture and the parent has not been sold to an unrelated entity). We believe that the disclosure of the entire gain or loss may not provide useful information to the users of financial statements.
- The proposed paragraph 17A of IAS 27 *Separate Financial Statements* requires an entity that uses the proposed equity method to account for its investments in subsidiaries in its separate financial statements to disclose gains or losses from 'downstream' transactions with its subsidiaries. We suggest that the entity should also be required to disclose the gains or losses from 'upstream' transactions with the subsidiaries. This information for 'upstream' transactions with the subsidiaries is expected to be easily accessible to an entity, which may not be the case in case of transactions with associates.

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).

Our comments for question 8 are similar to those for question 7.

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.

We generally agree with the proposals related to transition requirements.

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?

We do not have any additional comments relating to the expected effects of implementing 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 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)?

We do not have any comments apart from those discussed in our responses to questions 1 to 9.