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International Accounting Standards Board
30 Cannon Street
London
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URL: www.ifrs.org

Dear Sirs

Invitation to comment on ED/2012/3: Equity Method: Share of Other Net Asset Changes[1]

The School of Accountancy of the University of the Witwatersrand, South Africa, has carefully considered ED/2012/3: Equity Method: Share of Other Net Asset Changes (the ED) and has attached a response to the respective question posed by the International Accounting Standards Board (IASB).

We thank you for the opportunity to provide input on this document. Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours sincerely

School of Accountancy

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Response to Question 1
The IASB proposes to amend IAS 28 so that an investor should recognise in the investor's equity its share of the changes in the net assets of the investee that are not recognised in profit or loss or OCI of the investee, and that are not distributions received. Do you agree? Why or why not?

We agree with the proposed amendment. The 'equity method' is specifically defined as a 'method of accounting whereby the investment is initially recognised **at cost** and adjusted thereafter for the post-acquisition change in the investor's share of the investee's **net assets'** (IAS 28, para 3, emphasis added).

We are aware of two current areas where divergence in practice may possibly result:

1. Where a transaction, which does not result in a change in ownership interest, is accounted for directly in equity by the investee, how should the investor's proportionate interest be accounted for? (An example would be an equity settled share-based payment transaction granted by an associate to its employees or a change in ownership interest between the associate and its subsidiary which did not result in a loss of control by the associate of its subsidiary.)

2. Where a change in ownership interest occurs but the investor continues applying the equity method, how should the reduction in the net asset value of the investor's interest in associate be accounted for via profit or loss or equity?

In the first instance there is divergence in practice because IAS 28 para 10 does not deal directly with changes in net assets other than those recognised via profit or loss or other comprehensive income. The perceived tension between IAS 28 para 10 and IAS 28 para 3 has been interpreted by some preparers and auditors as implying that there may be an accounting policy choice regarding how, if at all, these movements are accounted for. We, therefore, believe that, the proposed amendment would clarify the principle of equity accounting and address inconsistent accounting for interests in associates.

Related to this, IAS 28 para 10 requires changes in net asset value of the investee that have been recognised in profit or loss or via other comprehensive income to be accounted for in a comparable fashion by the investor when applying the equity method. By analogy, the same ought to apply to those changes that in net asset value accounted for directly in equity by the investee. Accordingly, recognising these changes, to the extent of the investor's share in the investee, in equity would be consistent with the general principles followed in IAS 28, avoiding the need for a more comprehensive revision of the equity method.

With respect to the second issue, we would recommend that the proposed amendment include guidance on how this additional change in net assets be accounted for. Presently, IAS 28 does not provide guidance on how a change in ownership interest that does not result in the discontinuation of the equity method should be accounted for other than dealing with recycling of amounts previously recorded in other comprehensive income (IAS 28, para 25). For example, where an associate issues additional share capital, how should this be accounted for by the investor assuming that the investor does not participate in the share issue?

IFRS 10 requires that a change in ownership interest that does not result in a loss of control be accounted for via equity with no change in goodwill (IFRS 10 para 23). This is consistent with the fact that the assets and liabilities of the respective subsidiary company, before the change in ownership, are not altered by the transaction which is ultimately regarded as one involving equity participants. In other words, both before and after the change in ownership interest, the consolidated assets and liabilities of the subsidiary (barring any additional consideration raised for the issue of capital) are not altered.

The equity method, however, requires the investor to account for only its proportionate share of the net assets of the investee. Unlike an equivalent transaction involving a subsidiary, the net assets accounted for by the investor are altered by the change in ownership interest (in addition to the increase of assets as a result of the issue of share capital by the investee). This change in net asset value meets the definition of a 'gain' in the Conceptual Framework. It is also not a direct transaction between the investor and the investee in the investor's capacity as an equity participant, but rather the consequence of such a transaction, being the issue of additional share capital by the investee. Consequently, the amount ought to be accounted for in profit or loss by the investor when applying the equity method[2].

[2] On the other hand, where the investor acquires an additional interest in the investee, this would be accounted for at cost, consistent with the guidance provided currently by IAS 28.

Response to Question 2
The IASB also proposes that an investor shall reclassify to profit or loss the cumulative amount of equity that the investor had previously recognised when the investor discontinues the use of the equity method. Do you agree? Why or why not?

We do not agree with this proposal. IAS 28 (para 22) requires that amounts recognised via other comprehensive income (OCI) should be accounted for on the same basis, on discontinuation of the equity method, 'as would have been required if the investee had directly disposed of the related asset or liability'. IFRS 10 contains a comparable principle (IFRS 10 para B99). In both instances, the aim is to simulate the effect of the disposal of the underlying that resulted in amounts raised via other comprehensive income. In each instance the difference between the carrying value of net assets or equity accounted amount, respectively, and the proceeds on disposal, yields an amount included in profit or loss. In keeping with the existing principles of IFRS 10 and IAS 28, unless the amount recognised in equity would also have been released to profit and loss had the underlying been disposed of, we see no reason for the amount to be released to profit or loss simply due to discontinuation of the equity method[3]. Related to this, we do not agree with the argument presented in BC para 10 (of this ED) that because OCI is released to profit or loss on discontinuation of the equity method that, by analogy, the same should apply to amounts raised directly in equity. On a strict reading of the Conceptual Framework, the elements of OCI should have been raised in profit or loss from the outset and not OCI. Further, the OCI lacks a conceptual grounding and, for this reason, should not be used as a relevant analogy. The discontinuance of the use of the equity method is not itself a 'realisation' of the amounts previously recognised in equity. The proposal inappropriately conflates equity and profit.

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[3] Conceptually, items of other comprehensive income represent gains or losses that could reasonably have been recorded as such barring the requirements of IAS 1 and certain of the other IFRS. Releasing amounts of other comprehensive income to profit and loss on disposal of the underlying is consistent with this. With amounts raised directly to equity, this may not necessarily be the case.