AUSTRIAN FINANCIAL REPORTING AND AUDITING COMMITTEE

C/O KAMMER DER WIRTSCHAFTSTREUHÄNDER
SCHOENBRUNNER STRASSE 222–228/1/6
A-1120 VIENNA
AUSTRIA

TEL +43 (1) 81173 228
FAX +43 (1) 81173 100
E-MAIL office@afrac.at
WEB http://www.afrac.at

Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Mr Hoogervorst,

On behalf of the Austrian Financial Reporting and Auditing Committee (AFRAC), the privately organised standard-setting body for financial reporting and auditing standards in Austria, I appreciate the opportunity to comment on the IASB's Exposure Draft *Equity Method: Share of Other Net Asset Changes* (ED/2012/3).

Principal authors of this comment letter were Josef Arminger, Otto Nowotny and Andreas Rauter. The professional background of these authors is heterogeneous (one preparer, one academic, and one auditor) in order to assure a balanced Austrian view on the ED.

GENERAL REMARKS

We agree that diversity in practice exists on how investors should recognise their share of the change in the net assets of an investee that are not recognised in profit or loss or other comprehensive income of the investee and are not distributions received. Therefore, we support the IASB's efforts to address the issue.

The meaning of the equity method is central to the issue under consideration. As noted in paragraph BC6 of the ED, some believe that the equity method is a one-line consolidation, while others believe that it is more akin to a valuation method. Even though the interpretation of the equity method would seem to be central to the topic, IAS 28 is not explicitly pointing towards a clear resolution of this issue. We believe that a short-term solution should not introduce a conceptually new approach before there has been a thorough debate about the conceptual issues related to the equity method of accounting; a short-term solution should avoid creating inconsistencies with existing IFRSs.

AFRAC
Austrian Financial Reporting and Auditing Committee

Specific remarks

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

We do not agree. The investor should account for the investee's other net asset changes that result in indirect decreases and increases in the investor´s ownership interest in the same way as for actual disposals and acquisitions of interests in the investee. We do not agree on the solution proposed in the ED because (a) it is inconsistent with principles in existing IFRSs and (b) it would not provide timely and useful information about the investee's performance.

In our view, an investee's other net asset changes should be accounted for in the same way as actual disposals and acquisitions of interests in an investee, namely as deemed disposals and acquisitions. This view is in line with the tentative decision taken by the IFRS Interpretations Committee in its initial recommendation to the IASB, and largely in line with current practice, as documented in the IFRS manuals published by various audit firms.

Example: Capital increase of the investee, in which investment by a new shareholder dilutes the interests of existing ones

When focusing on the changes of interest in the relevant assets and liabilities of the investee resulting from dilution caused by a capital increase, the principle of profit realisation is relevant. As with disposals and acquisitions, it is also true for dilution effects that the investor's share in the risk position, i.e., the interest in certain assets and liabilities, changes when a certain portion of goodwill is exchanged for cash. In these cases, existing shareholders sell notional positive future cash flows (goodwill) and receive cash. Thereby, they partially realise their hidden reserves and interest in goodwill. This holds true from an economic perspective, and even more so when the "look-through" principle is applied.

For example, shareholder A owns 49.9% of a start-up business which is just enjoying first successes with ground-breaking products. The own funds/net assets of the investee amount to EUR 100 before a capital increase is undertaken. Now, if a capital increase of EUR 10,000,000 for 60% of the investee's shares is carried out, shareholder A's share is diluted from 49.9% to 20%.

Conclusion: shareholder A is now exposed to less risk and indirectly owns EUR 2,000,000 in cash. The nature of his investment and his risk position have been materially altered. A proportional "look-through" consolidation would identify additional net assets in form of cash, which evidences profit realisation and a risk-free settlement for cash.

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 recognized when the investor discontinues the use of the equity method. Do you agree? Why or why not?

For the example discussed in response to question 1, we believe that an investor should account for an investee's other net asset changes as deemed acquisitions and disposals, if such changes result in indirect increases and increases in the investor's ownership interest. Under this view, recycling would not be needed because any gains or losses would be reported in profit or loss in the period in which the net asset change occurs at the investee level. In the case of impairment, any loss would be immediately recognised in profit or loss.

Question 3 – Do you have any other comments on the IASB's proposals?

As indicated in the general remarks, the meaning of the equity method should be clarified before establishing concrete rules. If the equity method is seen as a one-line consolidation, it should in essence mirror the financial position and performance of the investee. As a consequence, the regulations in IAS 28.29 are not consistent with this principle. To discontinue the recognition of the share of further losses of the associate in the investor's books when the interest in the associate would become negative is not in compliance with consolidation principles.

Please do not hesitate to contact me if you wish to discuss any aspects of our comment letter in greater detail.

Kind regards,

Romuald Bertl

Chairman