Equity Method: Share of Other Net Asset Changes - Proposed Amendments to IAS 28

Exposure Draft ED/2012/3, issued by the International Accounting Standards Board (IASB)

Comments from ACCA
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ACCA welcomes the opportunity to comment on the Exposure Draft (ED) of Equity Method: Share of Other net Asset Changes - Proposed amendments to IAS 28 ('Investments in Associates and Joint Ventures'). ACCA's Global Forum for Corporate Reporting has considered the ED, and its views are reflected in the following general comments, and in the answers to the specific questions raised by the IASB.

GENERAL COMMENTS

Following the revision in 2007 of IAS 1 'Presentation of Financial Statements', and the clarification request more recently received by the IFRS Interpretations Committee, ACCA supports the issue of proposals by the IASB which will now set out a standard accounting treatment for 'Other Net Asset Changes'.

As explained in our response to Question 1. below, ACCA principally supports the Alternative View set out in the ED. As the Alternative View favours the immediate recognition of Other Net Asset Changes in profit / loss, the issue of subsequent recycling to profit / loss (Question 2.) does not arise.

At the same time, we note that a lack of consensus is currently apparent, both in information from EFRAG and within the IASB, as to what the solution should be. The extent of this divergence in views is described in our response to Question 1. below, and may be seen as an indication of disagreement, or at least uncertainty, as to the basis on which the equity method of accounting should operate in practice. This issue is discussed further in our response to Question 3 below.

Finally, ACCA believes that it will be practical for a short implementation period to apply to the proposals, with retrospective application required, and early adoption permitted.

SPECIFIC COMMENTS

We now give our comments on the specific questions raised in the ED, as follows:

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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?

ACCA response

The IASB's proposed solution has the advantage of being a clear approach. The Board also points out that this treatment mirrors the practice adopted before IAS 1 was revised in 2007 (para. BC8 of the ED), and is consistent with the treatment of profit / loss and OCI (para. BC7). ACCA also acknowledges that the Board is aiming to arrive at an expeditious short-term solution (as confirmed in para. AV1 of the ED).

However, there may be concerns that the recognition of Other Net Asset Changes in an investors' own equity results in a figure for the investor's equity which is unrealistic or appears lacking in logic. In that respect, the investor's equity might be seen as just a residual section for changes which would it otherwise be difficult to provide recognition for. ACCA has doubts that a return to past accounting practice in itself provides a justification for the proposed change.

We note that the IASB did not achieve unanimity on its proposals, and the alternative view of a member of the Board ('AV') is set out at the end of the ED. This AV supports the recognition of Other Net Asset Changes in the investor's profit / loss (para AV2). The recognition in equity proposed by the other Board members is viewed as conflicting with other IFRS (especially IFRS 10 'Consolidated Financial Statements', and IAS 1 'Presentation of Financial Statements').

The AV also expresses concerns about the distortion of an investor's equity, both on recognising the Other Net Asset Changes, and on the recycling to profit / loss on the cessation of the use of equity accounting (paras. AV7 – AV8). This aspect of the concern about recognition in equity is given some acknowledgement by the IASB in its Basis for Conclusions (para. BC8).

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Members of the European Financial Reporting Advisory Group (EFRAG) have also not reached a consensus on the answer to Question 1., which adds to the diversity of views in practice. Three alternative views have been expressed by EFRAG members, as follows:

1. To support the IASB's proposals.

2. Not to recognise any Other Net Asset Changes. In this scenario, Other Net Asset Changes would still have some effect under equity accounting, principally to the extent that they change the investor's percentage holding, and hence its share of the investee's future profits and distributions.

3. To account for Other Net Asset Changes insofar as they change the investor's ownership interest, in which case the changes would be recognised as if they were actual acquisitions or disposals of interests in the investee. This is the method recommended by the IFRS Interpretations Committee, but rejected by the IASB on the grounds of its limited scope of application, and potential complexity (para. BC3 of the ED).

Within ACCA, there is majority support for the Alternative View (AV) set out by the IASB in its ED, as explained below. Consequently, our preferred solution is that Other Net Asset Changes are recognised in the investor's profit / loss.

We believe that all Other Net Asset Changes in an associate need to be reflected by the investor. This accords with the AV, and contrasts with the treatment set out in View 2 (and View 3) above.

Furthermore, the AV's support for reflection in profit / loss enables the recognition of Other Net Asset Changes to be achieved readily, and is also considered particularly appropriate where a change in the investor's ownership interest is involved (for example, a dilution, which is effectively a part-disposal of the investor's interest). By the same reasoning, it would be less appropriate to recognise all Other Net Asset Changes in equity, as proposed in the ED's majority view.

In our response to Question 3. below, we mention the need for a wider debate on equity accounting. We believe that the above divergence in views is one of the

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indicators of the need for this debate. Without a clearer foundation for equity accounting principles than is currently the case, and insofar as a short-term measure is presently being sought by the ED, we can also see some merit in both the IASB's proposed (majority) solution and View 2. expressed by EFRAG members above.

<u>Question 2</u> **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?**

<u>ACCA response</u>

The answer to this question depends on whether there is support for a method of recognising Other Net Asset Changes which necessitates recycling at a later stage. As the Alternative View is the one principally supported by ACCA, the question does not then arise of a subsequent recycling from equity to profit / loss on the cessation of equity accounting.

Alternatively, should a treatment for other net asset changes be adopted which involves subsequent 'recycling', it would be logical for that method to accord with the accounting for the cessation of equity accounting as an effective disposal (para 22 of IAS 28). However, we believe that this issue should be explored further as a conceptual matter. Consensus on an answer could be arrived at as a result of a wider debate on the purpose of recycling and equity accounting, which is mentioned in our response to Question 3. below.

<u>Question 3</u> **Do you have any other comments on the proposals?**

<u>ACCA response</u>

The need for a wider debate on equity accounting and recycling

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Notwithstanding the relative rarity of Other Net Asset Changes (compared to those which already impact directly on profit / loss or OCI), the diverging views on the proposals in the ED may be seen as an indication of disagreement, or at least uncertainty, as to the basis on which the equity method of accounting should operate in practice.

Equity accounting has elements of two methodologies. Firstly, as a consolidation in 'one-line' form (para BC6 of the ED refers to equity accounting as a 'one line consolidation'). Then in more basic situations, equity accounting is akin to a rough valuation method, in the sense that the initial accounting is at cost, subsequently adjusted for changes in an investee's 'worth' as simply reflected by changes to its net assets.

This situation indicates a need for a clearer conceptual foundation for the equity method of accounting, around which there is greater consensus on what it should be achieving in practice. In our view, this clearer conceptual foundation will assist, amongst other issues, in solving the questions of how Other Net Asset Changes should be recognised.

The above leads to the further matter of a need to discuss the purposes of 'recycling', as set out in our response to Question 2. above (which we understand the IASB will examine as part of its review of the Conceptual Framework). The IASB justifies the recycling of Other Net Asset Changes from equity to profit / loss on the grounds of how OCI is treated on the cessation of the equity method (para. BC10). However, some interested parties may argue that other net assets are of a different nature to OCI, and so might require a different treatment.

Transition and effective date
ACCA notes that the IASB has yet to set a date from which the proposed changes will be effective, although it does envisage retrospective application, and will permit early application.

We believe that a long implementation period will not be necessary, as Other Net Asset Changes should be straightforward to identify and adjust where necessary. Furthermore, the recognition of Other Net Asset Changes is likely to occur more rarely than accounting for changes in the investor's share of profit / loss and OCI,

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so changes in the recognition method adopted should not mean widespread alterations across the financial statements of entities.

ACCA also supports the retrospective application of the changes, with an option for early application. We see no practical impediments to these provisions.

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