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Dear Sir or Madam

Exposure Draft ED/2012/3 Equity Method: Share of Other Net Asset Changes

We would like to make the following overall points on the Exposure Draft, which are explained in more detail in the attached responses to the questions raised in that document:

- any proposed changes to IAS 28 should be considered as part of the Research Project on equity accounting;
- equity accounting should considered in total, rather than continue with piecemeal amendments;
- in so far as any changes are deemed necessary to prevent divergence in practice, such changes should be in line with IFRS as a whole rather than introduce any further inconsistency;
- in our view, the proposed changes in the Exposure Draft are unlikely to resolve any problems that exist and may create new problems.

We hope that you find our comments useful and thank you for the opportunity to be able to comment on this matter.

Yours sincerely

C Steyn

Group Chief Accountant
Encs/

Exposure Draft 2012/3: Equity Method: Share of Other Net Asset Changes – Proposed Amendments to IAS 28

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?

Given that the IASB has recently confirmed its Agenda for the next few years, it could be seen as strange to propose an amendment to the accounting for one of the topics identified in that Agenda to be considered for inclusion in the IASB's work plan. This is not to say that all change on such topics should be frozen pending a major project, but rather that any proposals for change do need to be consistent with existing IFRS and clearly remove identified inconsistencies in application (without creating new inconsistencies). Many respondents would disagree that equity accounting is just "one line consolidation", although there are some similarities. Equity accounted entities are not subsidiaries, and an investor adjusts their initial investment only for post-acquisition changes in the share of the investee's net assets. Nor are equity accounted entities mere investments (at fair value). Quite what they are and how they should be accounted for should be determined as part of the brief of the Research project.

Any short term changes need to start from the current position where amendments to IFRS from IAS 1 (2007), and in 2008 to IAS 21, IAS 28 and IAS 27 (IFRS 10) have changed the accounting for associates and other equity-accounted entities, whether intentionally or unintentionally. Some preparers of accounts might want to put the clock back to how things used to be before these changes, because of the difficulty of explaining deemed disposals of associates arising out of dilution of ownership. However, IFRS (rightly or wrongly) has moved on and to return to how things were in the past as is suggested in paragraph BC 8 of the Exposure Draft would introduce (or reintroduce) an inconsistency to IFRS which would be difficult to justify except as an arbitrary measure or exception to the principles of IFRS on pragmatic grounds, pending a more permanent solution.

If other possible approaches to the perceived problem which are more consistent with the principals of IFRS would help to clarify the required accounting and ensure a consistent approach by preparers of accounts, then these should also be considered. The alternative views expressed in the Exposure Draft by Mr Takatsugu Ochi are in this context logical, pragmatic and consistent with the principles of IFRS.

These principles are stated in a number of standards.

- IAS 1 [paragraph 106] requires that movements in components of equity should show amounts arising from (i) profit or loss, (ii) other comprehensive income, and (iii) transactions with owners in their capacity as owners. Transactions outside profit and loss or other comprehensive income of the equity accounted entity are not transactions with owners in their capacity with owners, nor should these be the default option.

- IAS 1 [paragraph 82A] also requires that components of other comprehensive income should be classified between amounts which will not be subsequently reclassified to profit and loss and those that will be reclassified when specific conditions are met.

- IAS 21 [paragraphs 48-48D] requires the reclassification of foreign exchange to profit and loss as part of the gain or loss on the disposal of a foreign operation and introduces the concept of a partial disposal of an entity's interest in a foreign operation and the reclassification of the proportionate share of the cumulative amounts of exchange differences recognised in other comprehensive income.

- IFRS 10 [paragraph B10] notes that if a parent loses control of a subsidiary, the parent shall account for all amounts previously recognised in other comprehensive income in relation to that subsidiary on the same basis as if the parent had directly disposed of the related assets or liabilities.

The change in the carrying value of an equity accounted entity due to a change in the investor's share of the investee is more like a disposal than anything else; this was the view expressed by IFRIC and is referred to in paragraph BC 2 of the Exposure Draft.

In the *underlying accounts* of the equity accounted entity, assuming all necessary adjustments to the equity accounted entity's own books have been made to comply with IFRS:

1. profit and loss will be recognised in the income statement;
2. items such as foreign exchange on overseas operations, actuarial gains and losses relating to post employment benefits, revaluation surpluses and taxation relating to the above would be shown in other comprehensive income, analysed between items which will not be reclassified to profit and loss, and items which may be so reclassified;
3. transactions with its owners, such as dividends declared, share buyback programmes, share scheme costs and issues of capital, would be shown in other movements in equity.

In the parent Group's consolidated accounts, it would show its share of the items noted above under the same headings, but on consolidation it is accepted that adjustments are needed notably although not exclusively for accounting policies. Moreover, it would be expected that dividends and share buy backs (except to the extent that the parent and other shareholders do not participate equally) would be eliminated. Prior to the changes in IFRS noted above, additionally, any movements in the carrying value of the equity accounted entity due to changes in ownership, e.g. dilution, would generally be shown in other movements in reserves. After the changes in IFRS noted above, the effect of a change in ownership due to dilution is taken to profit and loss as a deemed disposal.

The ED proposes to reinstate the effect of changes in ownership as an equity movement. However the reasons for this are not clear. As the alternative view expressed in the ED points out, a dilution in ownership is essentially a disposal; it is not a change in the equity in so far as IAS 1 defines such items (i.e. as a transaction with owners in their capacity with owners).

The ED also states that recognising all other net asset changes in the P&L would create anomalous results and bases that conclusion on the resultant treatment for share based payments. However, offsetting the debit entry for share scheme costs with a reposting of the credit entry from the investee's own other equity movements is again not necessarily misleading as these entries do not represent share costs of the investor and its Group. There is no effect on the net assets of the equity accounted entity for what is a book entry between profit and loss and equity in the underlying accounts. Even if this was not accepted, the approach in the ED presupposes that all items in the equity movements of the investee should be treated the same in the consolidated accounts regardless of type. It is difficult to see any logic or justification for such an arbitrary approach.

Therefore such items should not appear in equity but should rather appear in profit and loss or in other comprehensive income as appropriate, with gains or losses on deemed disposals in profit and loss and other non owner changes in equity shown as part of other comprehensive income.

The ED suggests that such transactions do not reflect performance and so should be in equity. However, including the investor's share of the investee's own equity transactions within profit or loss does not necessarily misrepresent the presentation of the results of equity accounted entities, as it is the effect on the investor and their presentation of their share of the investee's results that is important, rather than how the investee as a standalone entity shows its results. They are therefore more performance related than they are equity transactions under IAS 1. The definition of profit or loss for an equity accounted entity which includes the share of the investees' own other equity movements might be inconsistent with how subsidiaries are reported, but then equity accounted entities are not subsidiaries.

It is clear that further thought in this area is required, and therefore it would seem better to wait for the Research Project to report back in a discussion paper before proceeding with another change to IFRS which might have to be reversed at some point in the near future.

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 disagree with the proposal as it extends the concept of reclassifying (recycling) amounts (which is applied to certain items appearing in Other Comprehensive Income) to other movements in equity. For the reasons set out above, it would be more appropriate to classify other movements in equity for equity accounted entities to profit and loss or other comprehensive income and then to reclassify as appropriate.

Question 3

Do you have any other comments on the proposals?

We have no further comments.