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Invitation to comment – Exposure Draft ED/2012/3 Equity Method: Share of Other Net Asset Changes

Dear IASB members,

Porsche Automobil Holding SE is pleased to submit comments on the above Exposure Draft. Overall, we support the Board's proposal to clarify the accounting treatment for other net asset changes of the investee when applying the equity method on the level of the investor. However, we do have a number of comments and concerns on the proposals of the ED.

In summary, our key areas of concern are:

Interrelation between IAS 28.10d) (revised) and IAS 28.22cii) (revised)
We come to the conclusion that an application of the ED, as currently drafted, might lead to accounting treatments that might be in conflict with existing other IFRS and their underlying principles, especially when the equity method is interpreted as a one-line consolidation procedure.

28.10d) requires as a catchall element that all net asset changes that are not profit or loss, OCI, or distributions received to be recognized in the investor's equity. IAS 28.22cii) refers to IAS 28.10d) and requires to reclassify to profit or loss the cumulative amount of equity that had previously been recognized for these net asset changes. There are no exemptions to this accounting treatment included in ED/2012/3 as currently drafted. As a result, changes in the associate's equity arising from the application of IAS 8 or from the purchase or sale of the associate's own equity instruments are subject to the regulations set forth in IAS 28.10d) (revised) and IAS 28.22cii) (revised) and will therefore be included in profit or loss upon discontinuance of the use of the equity method. In our view, this contradicts the underlying principle of retrospective application in IAS 8 and the principle set forth in IAS 32.33, stating that no gain or loss shall be recognized in profit or loss on the purchase, sale, issue or cancellation of an equity's own equity instrument. We recommend to reconsider the scope of these new regulations and to find individual accounting policies for the accounting issues leading to the recognition of an amount within equity according to IAS 28.10d) (revised).

IAS 28.25 (revised)
Sentence 2 of IAS 28.25 states that the investor shall not reclassify to profit or loss the amount that it had previously recognized in equity in accordance with IAS 28.10d) until the investor discontinues the use of the equity method. The question arises whether the timing of reclassification leads to a fair presentation in all cases, especially with regard to the requirements set forth in Sentence 1 of IAS 28.25, which requires earlier reclassification for OCI. We therefore recommend to reconsider this regulations by analyzing the effects on a case-by-case study.

IAS 28.45A
The unlimited retrospective application of the requirement to reclassify all amounts that must be recognized in equity might be impracticable in practice, as it might force users to apply current versions of IFRS on facts and circumstances that occurred in the past for which the respective information is no more accessible. We therefore recommend to limit the retrospective application in a way similar to the transitional provisions implemented in IFRS 10.

Should you wish to discuss the contents of this letter with us, please contact Jochen Holzwarth at +49 711 911 11062.

Yours faithfully,

Porsche Automobil Holding SE

Question 1

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 agree with the Board's intention to 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.

However, we come to the conclusion that the scope of IAS 28.10d) (revised) should be defined more exactly. It is our understanding that IAS 28.10d) (revised) represents a catchall element for all net asset changes other than those mentioned in IAS 28.10a)-c) (revised). Therefore, under IAS 28.10d) (revised) as currently drafted, at least the following changes are within the scope of the regulations according to the current wording:

- Changes already mentioned in IAS 28.10d) (revised):
  - Issuance of share capital to third parties
  - Share buyback of third parties (IAS 32.35)
  - Accounting for an equity-settled share-based payment transaction (IFRS 2.10 et seq.)
- Changes not already mentioned in IAS 28.10d), but stated in other IFRS:
  - Movements in other components of equity arising from compound instruments (IAS 32.28)
  - Sale, issuance or cancellation of treasury shares (IAS 32.35)
  - Transaction costs of an equity transaction (net of any related income tax benefit; IAS 32.35)
  - Considerations paid for a purchased call option or other similar contract (IAS 32.AG14)
  - Changes in the proportion held by non-controlling interests (IAS 27.30, IFRS 10.B96)
  - Movements in other components of equity arising from the application of IAS 8 on the investee's level:
    - Changes required by an IFRS (IAS 8.14a))
    - Voluntary changes in accounting policies (IAS 8.14b))
    - Correction of errors (IAS 8.42)
- Changes not already mentioned in IAS 28.10d) resulting from the application of standards in the past that were replaced or superseded in the meantime:
  - Revaluation reserves that resulted from business combinations achieved in stages (IFRS 3 (Example 6) (2004))

One might argue, for example, that changes resulting from the application of IAS 8 on the associate's level do not fall in scope of IAS 28.10d) (revised), as IAS 1.110 states that retrospective adjustments and retrospective restatements are not changes in equity but they are adjustments to the opening balance. However, the following arguments could be raised against that:

- there is no exemption set forth in ED/2012/3;
- adjustments to the opening balance might also lead to movements in other components of the investee's equity as set forth in IAS 28.10d) (revised); and
- The question arises why the Board uses the term "net asset changes" in IAS 28.10d) (revised), whereas the term "changes in equity" is used in IAS 1.110.

Therefore, we ask the Board for clarification on the scope of IAS 28.10d).

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?

We agree with the Board' intention to define the accounting treatment for the cumulative amount of equity that had previously been recognized in accordance with IAS 28.10d) (revised).

However, we recommend that the accounting treatment upon discontinuance should be based on the respective underlying facts and circumstances of each individual net asset change (we refer to our list included in the answer to Question 1). Questions have arisen whether the reclassification to profit or loss of the entire cumulative amount of equity irrespective of its individual underlying facts and circumstances always leads to a fair presentation and does not contradict other regulations set forth in IFRSs, especially when the equity-method is interpreted as a one-line-consolidation procedure.

For example, if the cumulative amount of equity that had previously been recognized in accordance with IAS 28.10d) (revised) includes amounts resulting from the application of IAS 8 on the investee's level (we refer to our explanations set forth in Question 1), they would, from our perspective, be reclassified to profit or loss under IAS 28.22cii) (revised) as currently drafted. We consider this to be contradictory to the concept of retrospective application implemented in IAS 8.

Furthermore, IAS 32.33 states that no gain or loss shall be recognized in profit or loss on the purchase, sale, issue or cancellation of an entity's own equity instrument. Equally, changes in the proportion held by non-controlling interests on the level of the investee do not affect profit or loss, even upon deconsolidation of the subsidiary in which non-controlling interests hold their share on the level of the investee. However, amounts arising from these facts and circumstances and included in the cumulative amount of equity according to IAS 28.10d) (revised) on the level of the investor would be reclassified to profit or loss under IAS 28.22cii) (revised) as currently drafted. At least from the point of view from someone that interprets the equity method as a one-line-consolidation procedure, these outcomes might raise the question whether the accounting leads to a fair presentation.

As a result, we recommend to change IAS 28.22cii) (revised) and implement the requirement to account for the cumulative amount of equity according to IAS 28.10d) (revised) based on the accounting treatment of each individual net asset change that the investee would have to follow upon sale, disposal, derecognition or discontinuance of the underlying facts and circumstances. Examples for the respective accounting treatments should be included in an implementation guidance or illustrative examples of IAS 28.

Question 3

Do you have any other comments on the proposals?

Thank you for giving the opportunity to provide the following other comments on the proposals:

IAS 28.10b) (revised)
IAS 28.10b) (revised) states that changes in the investee's other comprehensive income include those arising from the remeasurements of the net defined benefit liability (asset), from the revaluation of property, plant and equipment and from foreign exchange translation differences. Compared to the definition of other comprehensive income included in IAS 1, the examples are not complete, as IAS 1.7 also mentions the revaluation surplus of intangible assets as well as gains and losses from the remeasurement of available-for-sale financial assets and the effective portion of gains and losses from hedging instruments. Furthermore, the cross-reference to IAS 1 which is included in brackets at the end of the first sentence in IAS 28.10b) (revised) might be read as the recognition of the investor's share of the investee's components in the investor's other comprehensive is dealt with in IAS 1, which is not the case. To avoid any misinterpretations, we suggest that the cross-reference to IAS 1 in brackets is placed at the end of the second sentence in IAS 28.10b) (revised).

IAS 28.25 (revised)
Sentence 2 of IAS 28.25 states that the investor shall not reclassify to profit or loss the amount that it had previously recognized in equity in accordance with IAS 28.10d) until the investor discontinues the use of the equity method.

Questions have arisen whether this accounting treatment leads to a fair presentation in all circumstances.

For example, when applying the equity method, changes in OCI of the investee affect both the carrying amount of the investment and the OCI of the investor (IAS 28.10). When the investee issues shares to third parties other than the investor, which results in a change of the investor's share of the investee's other net assets, the investor has to recognize the change in its equity. Part of the change to be recognized in the investor's equity might relate to former changes in OCI of the investee. According to IAS 28.25 as currently drafted, if the investor continues to apply the equity method, the part of the gains and losses recognized in OCI relating to the reduction in ownership interest are to be reclassified when the ownership interest is reduced, whereas the change to be recognized in equity according to IAS 28.10d) (revised) that relates to former changes in OCI of the investee remain within the investor's equity until discontinuance of the use of the equity method.

It remains unclear why the Boards requires the two effects that have the same origin on the level of the investee to be reclassified to profit or loss at different point in times, especially when taking into consideration that at the point in time when the investee issues shares to third parties other than the investor, no performance takes place at the level of the investee, which, in the Board's opinion, seems to be a prerequisite for the recognition of profit or loss on the level of the investor (see ED/2012/3.BC4). In our view, a fair representation of the investee's performance would be given when the part of the change to be recognized in the investor's equity that relates to former changes in OCI of the investee is also reclassified to profit or loss at the point in time when the investee issues shares to third parties other than the investor. We therefore ask for clarification by the Board on this topic.

IAS 28.45A (revised)
IAS 28.45A as currently drafted requires retrospective application of all amended paragraphs. Entities will have difficulties in gathering the information required for this approach, especially for the reclassification according to IAS 28.22cii).

For example, Entity A holds a 25%-investment in Entity B since 2X00. In 2X02, B issued shares to third parties other than the investor, which resulted in a 5% decrease of A's share in B. A recognized the effects of the decrease in ownership interest in B in profit or loss in 2X02, but continued to apply the equity method on its remaining interest. In 2X13, A decides to sell its remaining 20%-investment in B to Entity C.

From our point of view, IAS 28.45A as currently drafted would require Entity A

- to gather information about an incidence that occurred more than 10 years ago and
- to reclassify to profit or loss in 2X14 the amount that was originally recognized in profit or loss in 2X02.

The gathering of information for incidents of the past will not be possible in many cases. Furthermore, the question arises how changes in accounting policies that became mandatory in the meantime should be dealt with. For example, in the example above, A should have calculated in 2X02 the effect of the decrease in ownership based on applying the corridor approach for defined benefit obligations according to IAS 19 (2003). In 2X13, however, the application of the corridor approach should no longer allowed under IAS 19 (2011), the IFRS applicable for defined benefit obligations in 20X13. Provided that the effects of the decrease on ownership interest in 2X02 would differ when A would have applied IAS 19 (2011), this would mean that A would have to gather the information required for the application of IAS 19 (2011) in 2X02, in order to be able to make the necessary adjustments. The gathering of information would be even more difficult for A provided the investment in B would already have been sold by A when A applies the new requirements for the first time.

We consider such an accounting treatment to be impracticable and therefore ask the Board to limit the retrospective application of IAS 28.10d) and IAS 28.22cii) in a manner similar to the transitional provisions of IFRS 10.

Disclosure of the amount recognized pursuant to IAS 28.10d)
The Board decided that it will not require disclosure of the amount recognized in equity by an investor resulting from an investee's equity transactions, thereby arguing that these amounts would form part of the disclosures in IAS 1.106.

We cannot follow the argumentation made by the Board on this topic. It remains open whether the Board considers the amounts recognized in equity according to IAS 28.10d) (revised) to represent a separate component of equity or whether such amounts just represent a change within a component of equity according to IAS 1.106(d)(i)-(iii), e.g., retained earnings. In the latter case, the amount recognized would only be presented for two periods, as the statement of changes in equity according to IAS 1.106 normally only covers the reporting period and the comparative period. Given the fact that these amounts might have a significant impact on future results of the reporting entity due to the requirement to reclassify them to profit or loss according to IAS 28.22cii), we recommend that the Board either classifies the respective amounts as a separate component of equity or to require disclose of the amounts in the notes.