SAS Quadra 05. Bloco J. CFC
Brasilia, Distrito Federal – Brazil
www.cpc.org.br

March 25, 2013

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

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

Dear Board Members,

The "Comitê de Pronunciamentos Contábeis" - CPC[1] welcomes the opportunity to support you with our comments on the Exposure Draft: Equity Method: Share of Other Net Asset Changes.

This response summarizes the views of our members, which may be supported by the opinions of external parties, sent to us for analysis and to enhance the discussion on the subject matter. We have also made efforts to encourage other external parties to send comments directly to the IASB.

Yours sincerely,

Idésio da Silva Coelho Júnior
Deputy chair of international affairs
Comite de Pronunciamentos Contabeis (CPC)

[1] The Brazilian Accounting Pronouncements Committee (CPC) is a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidances for Brazilian companies. Our members are nominated by the following entities: ABRASCA (Brazilian Listed Companies Association), APIMEC (National Association of Capital Market Investment Professionals and Analysts), BMFBOVESPA (Brazilian Stock Exchange and Mercantile & Future Exchange), CFC (Federal Accounting Council), FIPECAFI (Financial and Accounting Research Institute Foundation) and IBRACON (Brazilian Institute of Independent Auditors).

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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?

Preliminarily we should observe the following:

- The proposed amendment clarifies how to recognise the investor's share of changes in investee's equity other than by profits or losses or distributions, which includes cases of dilution of investor's ownership interest (paragraph 10(d) below reproduced). Additionally, the proposed amendment provides that amounts previously recognised by the investor in its own equity should be reclassified to profit or loss when the investor discontinues the use of the equity method (paragraph 22(c)(iii), below reproduced).

  10(d) "The investor's share of the investee's net asset changes, other than profit or loss or other comprehensive income and distributions received, is recognised in the investor's equity".

  22(c) "When an investor discontinues the use of the equity method, the investor shall:

  (i) account for all amounts previously recognised in the investor's other comprehensive income in relation to that investment on the same basis as would have been required if the investee had directly disposed of the related assets or liabilities; and

  (ii) reclassify to profit or loss the cumulative amount of equity that had previously been recognised in accordance with paragraph 10(d)."

- Therefore, the text has made distinction between a dilution of investor's ownership interest and other reductions in ownership interest, such as a partial disposal:

  25: "If an investor's ownership interest in an associate or a joint venture is reduced, but the investor continues to apply the equity method, the investor shall reclassify to profit or loss the proportion of the gain or loss previously recognised in accumulated other comprehensive income relating to that reduction in ownership interest if that gain or loss would be required to be reclassified to profit or loss on the disposal of the related assets or liabilities. The investor shall not reclassify to profit or loss the amount that it had previously recognised in equity in accordance with paragraph 10(d), until the investor discontinues the use of the equity method."

Answer to Question 1:

We understand that any changes (increase and decreases) in the investee's equity should be reflected in the carrying amount of the investor’s investment. So, we agreed that the investor's share of changes in investee’s equity (other than for profit or loss or other comprehensive income) be recognised in the investor’s equity.

However, a reduction caused by a dilution of investor’s ownership interest may result in an increase in the carrying amount of the investment (as in illustrative example included after the paragraph 10d), but can also result in a reduction of the carrying amount of investment, such as when the change is a capital increase, the investor declines to participate in this capital increase and a third party can then purchase a portion or all of the newly issued shares. So, we understand that regardless of how they processed the capital increase, any effect resulting from the reduction of the participation by a dilution of investor’s ownership interest should be treated in accordance with paragraph 10 (d).

If our understanding is correct, the proposed amendment will result in two distinct procedures when there is a reduction in investor’s ownership interests that does not involve the loss of influence or joint control:

(a) By a dilution of investor’s ownership interest: adjusts the carrying amount of the investment resulting from the effect of dilution (due to the adjustment of the investor's share of others components of the investee’s equity, other than OCI) is recognised directly in equity investor (10d). This is because paragraph 25 states that “The investor shall not reclassify to profit or loss the amount that it had previously recognised in equity in accordance with paragraph 10(d), until the investor discontinues the use of the equity method”;

(b) By other reductions (other than by a dilution of investor’s ownership interest), such as a partial disposal: the investor shall reclassify to profit or loss the proportion of the gain or loss previously recognised in accumulated other comprehensive income relating to that reduction in ownership interest if that gain or loss would be required to be reclassified to profit or loss on the disposal of the related assets or liabilities.

The following example illustrates the reduction in investor’s ownership interests caused by a dilution:

From the start, an investee has four shareholders. Earlier this year the investee there was a capital increase and three shareholders declined from their subscription right, so that fourth shareholder paid up all the new shares issued.

Example:

Investee's Equity:

Before the issue of new shares:	After the issue of new shares:
Common stock………………… - $10.000	Common stock………………… - $15.000
1st partner: 300 stocks (30%)	*1st partner: 300 stocks (20%)*
2nd partner: 50 stocks (5%)	*2nd partner: 50 stocks (3,333%)*
3rd partner: 50 stocks (5%)	*3rd partner: 50 stocks (3,3333%)*
4th partner: 600 stocks (60%)	*4th partner: 1.100 stocks(73,3333%)*
Paid in Surplus…………………..- $ 5.000	Paid in Surplus…………………..- $ 5.000
OCI (financial instruments). - $ 5.000	OCI (financial instruments). - $ 5.000
Retained earnings……………. - $30.000	Retained earnings………….. - $30.000
Total shareholders' equity. - $50.000	**Total shareholders' equity. - $55.000**

First Investor (investor's share in the components of the investee's equity)**:**

Before the issue of new shares: 30%	After the issue of new shares: 20%
Common stock………………… - $ 3.000	Common stock………………… - $ 3.000
Paid in Surplus…………………..- $ 1.500	Paid in Surplus…………………..- $ 1.000
OCI (financial instruments). - $ 1.500	OCI (financial instruments). - $ 1.000
Retained earnings……………. - $ 9.000	Retained earnings…………….- $ 6.000
Total Investment……………. - $15.000	**Total Investment……………. - $11.000**

The investor's share decreases from 30 per cent to 20 per cent in each component of the investee's equity. So, in accordance with paragraphs 10(d) and 25, the procedure will be:

(a) The investor shall reclassify to profit or loss the proportion of the OCI previously recognised in accumulated other comprehensive income relating to that reduction in ownership interest. So, the carrying amount of the investor's investment is reduced in $500.

(b) The effect of dilution, other than by the reduction in the investor's share of the investee's OCI, is recognised directly in the investor´s equity. So, the carrying amount of the investor's investment is additionally reduced by $3.500 ($500 in Paid in Surplus and $3.000 in retained earnings). That is because the investor does not discontinued use of the equity method.

There is a conceptual difficulty because there are two different views concerning the application of the equity method: (a) the equity method is a consolidation methodology in one line only (and therefore, interest changes not altering the nature of the relationship and it should be recognized in equity); and (b) the equity method is a valuation method (and thus such changes are recognized in the profit or loss or an incremental purchase of the investment, dependent on if the change implies in a reduction or increase of the investor's ownership interest in the investment).

So, if the equity method is considered a consolidation process in one line only , in the example above, the full effect of the dilution, ie $4.000 ($500 + $3.500) doesn't represent a economic loss and therefore it should be recognised directly in the investor´s equity (this transaction does not involve recognition of income and expenses and, therefore, does not represent a performance of the investee). In this way, the investor shall not reclassify to profit or loss this effect until the investor discontinues the use of the equity method.

On the other hand, if the equity method is a valuation method, in the example above , the investor should reclassify to profit or loss the full effect of the dilution ($4.000). In this way, the paragraph BC2 of the ED makes sense:

> *BC2 […] In responding to the IASB's request, the Interpretations Committee tentatively agreed on the following principles:*
>
> *(a) where an investor's ownership interest in the investment is reduced, whether directly or indirectly, the impact of the change should be accounted for as a partial disposal and recognised in profit or loss of the investor; and*
>
> *(b) where an investor's ownership interest in the investment increases, whether directly or indirectly, the impact of the change should be accounted for as an incremental purchase of the investment and recognised at cost.*

Regardless of this, we believe that it should not have two different accounting procedures. Therefore, we agree with the requirement in paragraph 10 (d), but we suggest that the same accounting treatment be required for any equity reductions in the investor's interest that do not involve the loss of influence or joint control.

Additionally, we would like to suggest that this issue be clarified so that there are no doubts in the application of the procedures required as well as to ensure the comparability.

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?

<u>Answer to Question 2:</u>

COMITÊ DE PRONUNCIAMENTOS CONTÁBEIS

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In summary, we believe that the application of the equity method, which can be called "consolidation of a single line," implies that the investor makes adjustments to the carrying amount of the investment as a result of the recognition of the investor's share in (i) investee's profit or loss for the period (ii) reduction in the investee's equity due to distributions and (iii) any other changes in investee's equity.

Therefore, we agree that when the investor discontinue use of the equity method the investor shall reclassify to profit or loss the investor's share of changes in investee's equity that were previously recognized directly in the investor's equity. This procedure better reflects the end of the relationship between investor and investee, as well as the effect of this transaction on the investor's performance.

Question 3:

Do you have any other comments on the proposals?

Answer to Question 3:

We have no additional comments on the proposal.