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International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
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Vienna, March 8th, 2013

Comment Letter to ED/2012/03

Ladies and Gentlemen,

Please find enclosed my comments on the above mentioned Exposure Draft.

Regards,

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Comments on specific questions:

Question 1

I do not agree.
From the point of view of the investor, transactions with an investee or changes in the net assets of the investee are not transactions with the owners (of the investor). Therefore, it is inconsistent and not in line with the Framework to recognize the effects of such transactions in the financial statements of the investor directly in equity as it should only be done for transactions between the investor and it´s owners.

In the Basis for Conclusion to the Exposure Draft, the Board gives three reasons for the proposed treatment:

1) One-line consolidation (BC 6)
2) Misleading representation of the investee´s performance (BC 4)
3) Anomalous results, eg for share-based payments (BC 5)

Ad 1) One-line consolidation
Even if the equity method is seen as one-line consolidation – a view that I would agree - , the accounting treatment for changes recognized directly in equity in the financial statements of the investee should not be a recognition directly in equity in the financial statements of the investor. Similar, changes recognized directly in equity in the separate statements of a subsidiary are not recognized directly in equity in the consolidated financial statements of the parent.

The most simple example is transaction cost for an increase in share capital:
Assume a parent owns 100% of a subsidiary and the share capital of the subsidiary is increased by 100, triggering a transaction tax of 1% ie 1. In the separate financial statements of the subsidiary, this transaction tax is recognized directly in equity (IAS 32.35). From the parent´s point of view, this transaction is not a transaction with its owners. Instead, this is a intragroup transaction, which is eliminated in the consolidated financial statements. However, as the intragroup transaction triggers an outflow of resources (transaction tax), this outflow must be shown in the consolidated financial statements in the income statement.

Now assume an investor owning 30% of an investee accounted for using the equity-method. The equity of the investee is increased by 100, with all owners participating in the increase proportionally, ie the investor pays 30. If the transaction triggers transaction cost of 1%, ie 1, the investor´s share in net assets of the investee will be increased by 29.7. To be consistent

with consolidation in IFRS 10, the difference of 0.3, ie the investor's share of the transaction cost, should be recognized in the income statement.

In this example it does not matter if the investee is part or not part of the consolidated group like described in BC8 to the exposure draft – in both cases the transaction between the reporting entity and the investee is not a transaction with owners and should not be accounted for as such.

In other examples the concept of the equity-method as a one-line consolidation might justify the recognition directly in equity – ie transactions with a decrease or increase in the investor's interest in the investee. However, there is a fundamental difference: for a subsidiary, the other owners, ie non-controlling interest, are seen as equity-holder, therefore IFRS 10 requires transactions between the controlling and non-controlling interest holders to be accounted for as transactions between owners in the consolidated financial statements of the parent. In case of an associate, the interests of the other owners are NOT recognized in the consolidated financial statements of the investor at all, therefore these interest cannot be seen as interest of owners from the groups point of view. The can be illustrated by the following examples:

a) *The parent owns 80% of a subsidiary, 100% of the subsidiary are shown in the consolidated financial statements, both the 80% holder and the 20% holders are seen as owners. Therefore, if the parent sells 5% to the holders of non-controlling interest, this is clearly a transaction between owners.*
b) *If the parent owns 30% of an investee, only 30% are shown in the consolidated financial statements, the owners of the remaining 70% are not owners of net assets shown by the group and cannot be seen as owners of the group. Therefore, if the parent sells 5% of the investee, this is NOT a transaction between owners and is NOT recognized directly in equity, but in profit and loss. (This treatment out of question, there is no diversity in practice and this is not touched by the exposure draft – attached to this comment letter you find excerpts of the IFRS-guidelines of the large audit firms which all require recognition in profit and loss).*
c) *If the parent owns 80% of a subsidiary and the parent's share is diluted in a capital increase, this transaction is the same as in a) and therefore accounted for in the same way.*
d) *If the parents owns 30% of an investee and the parent's share is diluted in a capital increase, this transaction is the same as in b) and should be accounted for in the same way.*

I cannot see any reason why any similarity of equity-accounting in IAS 28 to consolidation in IFRS 10 should cause example d) be accounted for like example c). If this were be the case,

example b) would have to be accounted for like example a) as well, which is clearly not the case.
However, if the Board believes that the change in net assets in example b) should be recognized directly in equity, there are more changes necessary to IAS 28 than those proposed in the Exposure Draft.

Ad 2)
In the first example above (transaction cost of an increase in share capital), the investor (together with the other owners of the investee) restructures the capital of the investee without any additional economic substance. If such a transactions triggers the outflow of resources, this is not part of the performance of the investee, but it is part of the performance of the investor´s share in the investee: in order to sustain the investment in the investee, the investor has accepted this outflow, therefore this is a part of the performance from the investor´s view and should be shown in the profit & loss in the consolidated financial statements of the investor.

Ad3)
The anomalous results for share-based payments transactions are not generated by the recognition of transactions between investor and investee in profit & loss, but by other inconsistencies of the equity-method, ie the fact that potential dilutive effects of the investor are not considered when applying the equity method according to IAS 28.

Assume an investor owning 30% of an investee A with total equity of 100, ie the investor´s share is 30. There is no goodwill from the acquisition, ie the investor measures the share in the investee at 30 using the equity method.
Now assume the same investment in investee B, but in addition, investee B has issued option to new investors, whereby the new investors will get newly issued shares for a price of 20, granting them an interest of 50%. The option can be exercised one day after balance sheet date. In case of the options being exercised, the investor´s share in investee B will be diluted to 20%, ie it´s share in net assets will be reduced from 30 to 24 (20% of 120).
Applying the equity-method according to IAS 28, there is no way to reflect this dilution that will happen one day after the balance sheet date, ie in the consolidated financial statements of the investor, the accounting for investments A and B will be exactly the same, although the economic situation of both investments is completely different.

In a share-based payment transaction, there is a potential dilutive effect for the owners, which is shown by a debit in the income statement and a credit directly in equity. Picking up the debit entry in the income statement of the investor is consistent with the equity-method and gives the correct performance measure. Picking up the credit entry in the income statement is

also consistent with the equity-method: the potential dilutive effect is ignored as it done by the equity-method in all other cases. I understand that this inconsistency of the equity-method cannot be solved easily, but that should not be an argument for an inconsistent treatment of transactions which are transactions with owners from point of view of the investee but are not transactions with owners from the point of view from the investor. This would mean fixing one inconsistency by introducing another inconsistency.

For the reasons given in 1 – 3 above, I believe the only accounting treatment consistent with the other standards and the framework is the recognition in profit and loss.

Question 2:

Given the answer to question 1 – recognition in profit and loss - the question of recycling is not relevant.

However, the proposal of the board – recycling of changes in net assets recognised directly in equity – is inconsistent with the accounting for subsidiaries where IFRS 10 does not allow such a recycling.

Question 3:

No further comments.

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Decreasing a stake in an existing associate and retaining significant influence

27.180.1 An investor may sell part of its interest in an associate, but maintain significant influence so that the investee continues to be an associate.

27.180.2 If an investor's ownership interest in an associate is reduced, but the investment continues to be an associate, the following steps should be performed:

- Derecognise the carrying value of the associate proportionate to the percentage reduced.
- Recognise the fair value of the consideration received.
- Resulting gain or loss recognised in profit or loss.
- Remaining investment measured in accordance with IAS 28.

27.180.3 Under paragraph 19A of IAS 28, if an investor's ownership interest in an associate is reduced, but the investment continues to be an associate, the investor reclassifies to profit or loss a proportionate amount of the gain or loss previously recognised in other comprehensive income. In July 2009, the IFRIC concluded that the reclassification of amounts from other comprehensive income to profit or loss is generally required as part of determining the gain or loss on disposal. Hence, paragraph 19A of IAS 28 should be applied to all reductions in the investor's ownership interest, no matter what the cause. [IAS 28 para 19A]. Similarly, if a revaluation surplus previously recognised in other comprehensive income would be transferred directly to retained earnings on the disposal of the asset, the investor transfers the revaluation surplus directly to retained earnings for the proportion of that associate that is loses. [IAS 27 para 35].

Example – Partial disposal of an associate retaining significant influence

Entity A has a 40% stake in entity B. Entity B is an associate of entity A. During the period entity A sells a quarter (10%) of its stake in entity B for consideration of C80m. From the date of the partial disposal entity A will continue to recognise its remaining 30% interest in entity B as an associate. Entity B's net asset carrying value at the date of the partial disposal is C300m. Goodwill was calculated at C30m at the date of acquiring the associate and there has been no impairment recognised.

At the date of the partial disposal, the associate's carrying values in entity A's consolidated financial statements are as follows:

	Cm
Investment in associate (including goodwill) (40% × C300m + C30m)	150
Cumulative share of associate's other comprehensive income (for example an AFS reserve)	20

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	Cm Dr	Cm Cr
Dr Cash	80.0	
Cr Investment in associate (25% × C150m)		37.5
Cr Gain on partial disposal		42.5
Dr Equity (reclassification adjustment)	5.0	
Cr Profit or loss (presented as part of the gain on partial disposal)		5.0

The remaining investment in the associate will continue to be accounted for using the equity method for the remaining 30% interest.

Associate to an investment

27.181 An investor ceases to use the equity method from the date an investment ceases to be an associate that is the date on which an investor ceases to have significant influence over the associate or on the date it is classified as held for sale. [IAS 28 paras 13(a),14,18]. The words 'from the date of' indicate clearly that neither the results for the period before the change in status nor the comparatives should be restated to reflect the changed status.

[The next paragraph is 27.182.1.]

27.182.1 The Board observed that the loss of control of an entity and the loss of significant influence over an entity are economically similar events, and hence, they should be accounted for in the same way. The Board concluded that the accounting guidance on the loss of control of a subsidiary should be extended to events, transactions or other changes in circumstances in which an investor loses significant influence over an investee. [IAS 28 BC21].

27.182.2 Thus, when an investor loses significant influence over an associate, the investor measures any retained investment at fair value. The investor has to recognise in profit or loss any difference between:

> *"(a) the fair value of any retained investment and any proceeds from disposing of the part interest in the associate; and*
>
> *(b) the carrying amount of the investment at the date when significant influence is lost."*

[IAS 28 para 18; BC21].

27.182.3 When an entity ceases to be an associate and is accounted for in accordance with IAS 39, the fair value of the investment at the date when it ceases to be an associate will be its fair value on initial recognition as a financial asset in accordance with IAS 39. [IAS 28 para 19].

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able-for-sale revaluation reserve, foreign currency translation reserve) or in their transfer to retained earnings (e.g. revaluation reserve). In our view, the portion of reserves reclassified or transferred is calculated in proportion to the interest disposed of, so that it is calculated on a consistent basis with the gain or loss calculated on the partial disposal. If the cost of investment sold is determined under a first-in, first-out method (see 3.5.570.10), then the determination of the amounts to be reclassified or transferred would require detailed analysis. [*IAS 21.48C, 28.19A, IU 07-09*]

Example 15 – Decrease in interest – Average-cost method

3.5.570.40 Company P owns 30% of Associate D. The contribution of D to P's consolidated statement of financial position immediately before the decrease in ownership interest is as follows.

Investment in associate (D)	120
Net assets	120
Foreign currency translation reserve	24
Available-for-sale revaluation reserve	18
Revaluation reserve	15
Equity	63
Total shareholder's equity	120

3.5.570.50 On 1 January 2012, P sells 10% of D for cash of 50 while maintaining significant influence. D records the following entry.

	Debit	Credit
Cash	50	
Foreign currency translation reserve (24 x 10% / 30%)	8	
Available-for-sale revaluation reserve (18 x 10% / 30%)	6	
Revaluation reserve (15 x 10% / 30%)	5	
Retained earnings		5
Gain (50 - 40 + 8 + 6)		24
Investment in associate (D) (10% / 30% x 120)		40
To recognise decrease in interest in D while maintaining significant influence		

3.5.575 Forthcoming requirements

3.5.575.10 If an entity's ownership interest in an equity-accounted investee is reduced, but the equity method continues to be applied, then an entity reclassifies to profit or loss any equity-

accounted gain or loss previously
the reduction in the ownership i
applies only if that gain or loss w
of the related asset or liability. C
example of such a gain or loss th

3.5.580 Loss of significant

3.5.580.10 The equity method co
or until the investment is classified
- the investment or a portion of t
- there is a dilution in shareholdi
- there is a change in facts and c
- the investor obtains control of
  an associate. [*IAS 28.10, 18, 31.4*

3.5.580.20 In our view, once an i
entity, the investor will be regarde
a specific, identifiable event or tr
changes in the relationship betwe
cessation of joint control or signifi

3.5.590 *Accounting for th*

3.5.590.10 A loss of significant
nature of the investment. Such an
and is accounted for similarly. [*IA*

3.5.590.20 When an investor lo
controlled entity, it recognises a g
- the sum of:
  - the fair value of any proce
  - the fair value of any retai
  - the amount reclassified fr
- the carrying amount of the in
  is lost. [*IAS 28.18, 19A, 31.45, 45*

3.5.590.30 Amounts recognise
controlled entity are accounted f
controlled entity had disposed di
share of the following amounts i
- exchange differences that were
- changes in the fair value of
  comprehensive income in ac

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should reclassify to profit or loss the proportion of the gain or loss that had previously been recognised in 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. [IAS 28(2011):25]

Thus, gains or losses are reclassified or not on the same basis as discussed at **4.4.9**.

An entity's ownership interest in an associate or a joint venture may reduce (but with the equity method continuing to apply) as a result of a disposal or deemed disposal (see **14.3.4** in **chapter A24**). Any gain or loss arising as a result of a disposal or deemed disposal of an associate or a joint venture should be recognised in profit or loss.

4.4.10.2 Entities that have not yet adopted IAS 28(2011)

IAS 28(2003) only deals with circumstances in which an investor's ownership interest in an associate is reduced, but the investment continues to be an associate; in such circumstances, the investor is required to reclassify to profit or loss only a proportionate amount of the gain or loss previously recognised in other comprehensive income. [IAS 28(2003):19A] This is consistent with the equivalent guidance under IAS 28(2011):25 (see **4.4.10.1**).

4.4.11 Impairment and reversals of impairment losses

After application of the equity method, including recognising the associate's or joint venture's losses in accordance with the rules set out above, the investor should apply the requirements of IAS 39 *Financial Instruments: Recognition and Measurement* to determine whether it is necessary to recognise any additional impairment loss with respect to the investor's net investment in the associate or joint venture. [IAS 28(2011):40, previously IAS 28(2003):31]

The investor also applies the requirements of IAS 39 to determine whether any additional impairment loss should be recognised with respect to the investor's interest in the associate or joint venture that does not constitute part of the net investment (e.g. secured loans for which adequate collateral exists – see **3.6**) and the amount of that impairment loss. [IAS 28(2011):41, previously IAS 28(2003):30]

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It should be noted that if significant influence is lost but an interest is retained this reclassification adjustment from equity to profit or loss is for the full amount that is in other comprehensive income and not just a proportionate amount based upon the interest disposed of. The Basis of Conclusions to the IAS 21 explains that the loss of significant influence is a significant economic event that warrants accounting for the transaction as a disposal under IAS 21, *[IAS 21.BC33-34]*, and hence the transfer of the full exchange difference rather than just the proportionate share that would be required if this was accounted for as a partial disposal under IAS 21.

The accounting for loss of significant influence not only applies when an investor disposes of an interest in the associate, but also where it ceases to have significant influence due to a change in circumstances. For example, as a result of the associate issuing shares to third parties it may be that changes to the board of directors or equivalent governing body of the associate result in the investor no longer having significant influence over the associate.

An investor may also 'lose' significant influence over the associate as a result of increasing its ownership interest and thereby gaining control, or joint control, over the investee. The accounting for an increase in an associate that becomes a subsidiary is discussed in Chapter 10 at 9, and where it becomes a jointly controlled entity as a result is discussed in Chapter 13 at 5.7.2. The impact of the accounting that is applied in these situations results in the same effect that is described above for loss of significant influence through a disposal transaction.

As indicated above, as a result of the revised versions of IFRS 3 and IAS 27 issued in January 2008, the IASB made the decision to characterise loss of significant influence as a significant economic event (i.e. in the same way that loss of control is characterised as a significant economic event) and introduced the requirements discussed above. Thus, upon loss of significant influence, this results in the remeasurement to fair value of any retained interest that is taken to profit or loss, not only where the investment becomes a subsidiary or a financial asset under IAS 39, but also where an associate becomes a jointly controlled entity. However, during the joint venture project, the IASB reconsidered this issue, and consequently, although the newly amended IAS 28 effectively includes the same requirements as IAS 28 (2012) where the investment becomes a subsidiary or a financial asset (see 7.12.2 and 7.12.3 above), it now requires that if an investment in an associate becomes an investment in a joint venture (or vice versa), the entity continues to apply the equity method and does not remeasure the retained interest (see 7.12.4 above).

11.5.12.C Partial disposals of interests in associates without loss of significant influence

IAS 28 (2012) does not explicitly state that an investor should recognise a gain or loss when it disposes of a part of its interest in an associate that does not result in a loss of significant influence. However, the standard does require that when an investor's interest in an associate is reduced (but the investee remains an associate), then the investor should 'reclassify to profit or loss only a proportionate amount of the gain or loss previously recognised in other comprehensive income' in relation to that associate. *[IAS 28.19A (2012)]*.

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This requirement of IAS 28 (2012) relating to the accounting for partial disposals of interests in associates without loss of significant influence is effectively unchanged in the newly amended IAS 28. Consequently, the discussion at 7.12.5 above is relevant to applying these requirements of IAS 28 (2012). As explained in that discussion, it is evident that a gain or loss should be recognised on the partial disposal.

11.5.12.D Deemed disposals

An investor's interest in an associate may be reduced other than by an actual disposal. Such a reduction in interest, which is commonly referred to as a 'deemed disposal', gives rise to a 'dilution' gain or loss. Deemed disposals may arise for a number of reasons, including:

- the investor does not take up its full allocation in a rights issue by the associate;
- the associate declares scrip dividends which are not taken up by the investor so that its proportional interest is diminished;
- another party exercises its options or warrants issued by the associate; or
- the associate issues shares to third parties.

In some situations, the circumstances giving rise to the dilution in the investor's interest may be such that the investor no longer has significant influence over the associate. In that case, the investor will account for the transaction in the manner described at 11.5.12.B above. However, in other situations, the deemed disposal will only give rise to a partial disposal as the investor will not lose significant influence over the associate.

As indicated at 11.5.12.C above, IAS 28 (2012) does not explicitly state that an investor should recognise a gain or loss on partial disposal of an interest in an associate, however, it is evident that a gain or loss should be recognised on partial disposals. As the requirement of IAS 28 (2012) relating to the accounting for partial disposals of interests in associates without loss of significant influence is effectively unchanged in the newly amended IAS 28, the discussion at 7.12.6 above is relevant in accounting for deemed disposals under IAS 28 (2012).

11.6 Impairment losses

The requirements in paragraphs 31 to 34 of IAS 28 (2012) relating to the accounting for impairment losses in respect of an associate are effectively unchanged in the newly amended IAS 28. Consequently, the discussion at 8 above is relevant to applying these requirements of IAS 28 (2012).

11.7 Presentation and disclosure

11.7.1 Presentation

In the balance sheet, the aggregate of investments in associates and joint ventures accounted for using the equity method are presented as a discrete line item, *[IAS 1.54(e)]*, and under IAS 28 (2012) classified as non-current assets. *[IAS 28.38 (2012)]*. This is effectively the same as under the newly amended IAS 28. Consequently, the discussion at 10.1.1 above is relevant to applying IAS 28 (2012). Similarly, the discussion at 10.1.2 and 10.1.3 relating to presentation of profit or loss and other items of comprehensive income are also relevant when applying IAS 28 (2012).