Deutsches Rechnungslegungs Standards Committee e.V.

Accounting Standards Committee of Germany

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Dear Andreas,

IASB ED/2024/7 *Equity Method of Accounting - IAS 28 Investments in Associates and Joint Ventures (revised 202x)*

On behalf of the Accounting Standards Committee of Germany, I am writing to comment on ED/2024/7 *Equity Method of Accounting - IAS 28 Investments in Associates and Joint Ventures (revised 202x)*, issued by the IASB on 19 September 2024 (herein referred to as 'ED'). We appreciate the opportunity to comment on the proposals.

We understand that the primary focus of the ED is to address existing application challenges, reduce the existing diversity in practice in the application of IAS 28 requirements, enhance the understandability of these requirements, and increase the comparability of reported information.

However, our overall assessment of the proposed amendments is that the IASB has unfortunately missed an opportunity to thoroughly examine the appropriateness and usefulness of the equity method. We think that offering separate and partially inconsistent answers to individual questions (which are certainly relevant in practice) does not justify the changes (and related costs of implementing the changes).

We strongly believe that consistent decisions on the prevalent application issues require a preceding fundamental decision on the underlying interpretation of the equity method as a consolidation method or as a measurement method. Only a clear principle would allow to develop consistent answers to application questions on the equity method.

Further, if the equity method were to be interpreted as a measurement method, it should be examined whether the equity method as a special form of accounting is still necessary. In this context, it should also be deliberated whether the existence of 'significant influence' justifies or requires a distinct status and differentiated accounting for more relevant information on these investments. In particular, the measurement of and accounting for financial assets in accordance with IFRS 9 offers a more stringent alternative and better informative value for

users, as well as, on balance, being easier for preparers to apply. Thus, if the equity method were to be understood as a measurement method, we would favour using IFRS 9 instead so that IAS 28 would no longer be necessary. In this scenario and if investments with a 'significant influence' should be distinguished from regular financial assets, for example, the income and expenses from investments in associates and joint ventures accounted for in accordance with IFRS 9 could be presented separately to take their special nature into account. Using IFRS 9 would also be aligned with the IASB's deliberations on IFRS 18, according to which investments accounted for using the equity method are classified in the investing category to better align with the way users of financial statements use information to analyse investments in associates and joint ventures. Accordingly, accounting for investments in associates and joint ventures as a financial instrument would be consistent.

In contrast, only if the equity method were to be understood as a consolidation method, we think that it would be necessary to clarify a wide range of individual issues. However, this could be facilitated by analogising the principles of IFRS 3.

In summary, we think that the IASB should explicitly ask constituents in its next agenda consultation whether the equity method should be retained and its conceptual guiding principle be clarified. In line with this, we think that it would be advisable to subject the further development of the current project to the feedback received.

Putting aside these more general comments and observations, we have thoroughly considered the ED's proposals which – under the existing IFRS accounting regime for investments in Associates and Joint Ventures – we broadly agree with.

For more details on our findings on the specific proposals in the ED, we refer to our responses to the questions which are laid out in the appendix to this letter. If you would like to discuss our comments further, please do not hesitate to contact Peter Zimniok (zimniok@drsc.de) or me.

Yours sincerely,

Sven Morich

Vice President

Appendix – Answers to the questions in the ED

Question 1 – Measurement of cost of an associate (Appendix A and paragraphs 13, 22, 26 and 29 of [draft] IAS 28 (revised 202x))

[…]

Do you agree with these proposals?

If you disagree, please explain why you disagree and your suggested alternative.

We **agree** with the proposal to require that the cost of an associate or joint venture, upon obtaining significant influence, be measured at fair value of the consideration transferred, including the fair value of any previously held interest in the associate or joint venture.

We also **agree** with the proposal that contingent consideration be recognised as part of the consideration transferred and measured at fair value and that, after initial recognition, contingent consideration classified as equity should not be measured, whereas other contingent consideration should be measured at fair value at each reporting date, with changes recognised in profit or loss.

Beyond that, we think that some **further clarifications** are desirable. We observed diversity in practice in the accounting for transaction costs incurred in acquiring ownership interests; for common control transactions, which are not excluded from the scope of IAS 28; as well as for fair value adjustments due to applying the equity method, in the event of an impairment. Clarifications by the IASB on the intended accounting for these issues would be helpful to improve the consistent application of the standard.

Additionally, we have the impression that many of the IASB's decisions can be understood in terms of an interpretation of the equity method as a measurement method. However, the determination of the investor's share of the fair value of the net assets (akin to a ‘shadow’ purchase price allocation) to be carried out in the event of an acquisition does correspond to the interpretation of the equity method as a consolidation method. As this involves considerable effort for preparers and the added informational value and use of the equity method by analysts and other users is questionable, we think the IASB should deliberate whether a simplification can be found.

Further to our general remark in the cover letter, we think that the aforementioned accounting for transaction costs is only one of many possible examples that show that consistent decisions on the prevalent application issues require an earlier fundamental decision on the underlying interpretation of the equity method as a consolidation method or as a measurement method. The standard and the ED do not specify whether or not the principles of IFRS 3 should be analogised to determine the appropriate accounting treatment for the transaction costs incurred. Determining the proper accounting for transaction costs may depend on whether the equity method is deemed to be a consolidation method (then costs would be expensed as

incurred) or to be a measurement method (where costs would be included in the carrying amount). Only the commitment to a guiding principle would enable consistent answers to the remaining application questions on the equity method.

Question 2 – Changes in an investor's ownership interest while retaining significant influence (Paragraphs 30–34 of [draft] IAS 28 (revised 202x))

[…]

Do you agree with these proposals?

If you disagree, please explain why you disagree and your suggested alternative.

We **support** the IASB proposed requirements for changes in an investor's ownership interest while retaining significant influence, this entails purchases of an additional ownership interest, disposals of an ownership interest as well as other changes in the investor's ownership interest.

We **support** the IASB`s approach that would result in the investor or joint venturer measuring its additional interests in an associate or joint venture after obtaining significant influence as an accumulation of purchases, so the investor or joint venturer would not remeasure the carrying amount of its previously held interest in its associate or joint venture. However, this proposal would result in significant cost and complexity for preparers, as at acquisition, each additional interest is treated as a separate unit of account, and the investor's or joint venturer's additional share of the associate's or joint venture's identifiable assets and liabilities are measured at their fair value at the acquisition date, which necessitates a purchase price allocation (PPA). Therefore, we encourage the IASB to deliberate whether simplifications to this approach may be feasible.

Additionally, we encourage the IASB to follow the requirements of IFRS 3.36 and explicitly require that, before recognising a gain on a bargain purchase, the acquirer shall reassess whether it has correctly identified all of the assets acquired and all of the liabilities assumed and shall recognise any additional assets or liabilities that are identified in that review. The acquirer shall then review the procedures used to measure the amounts that the standard requires to be recognised at the acquisition date. Furthermore, a bargain purchase should constitute a trigger for an impairment test of the previously acquired tranches.

As regards the disposal of an ownership interest while retaining significant influence, we think that the transaction price represents an impairment indicator, which is why an impairment would have to be recognised in the logical second before the sale, if the transaction price is less than the carrying amount of the investment. Accordingly, there would be no effect on profit or loss from the sale.

Also, regarding the disposal of an ownership interest while retaining significant influence, we support the proposal for an entity to measure the disposed portion of its investment as a percentage of the carrying amount of the investment. We think that this is a pragmatic and less complex approach and prefer it to the alternative of needing to determine which layers of the investment to derecognise in a partial disposal, whether it be via a specific identification method or the use of cost formula, such as FIFO, LIFO or weighted average.

Question 3 – Recognition of the investor's share of losses (Paragraphs 49–52 of [draft] IAS 28 (revised 202x))

[…]

Do you agree with these proposals?

If you disagree, please explain why you disagree and your suggested alternative.

We **agree** with the proposals that on purchasing an additional ownership interest, an investor does not recognise its share of an associate's losses that it has not recognised by reducing the carrying amount of the additional ownership interest; and that an investor recognises and presents separately its share of the associate's profit or loss and its share of the associate's other comprehensive income.

We consider the requirement that an investor or joint venturer would not deduct its share of any losses not recognised from the cost of the additional ownership interest to be consistent with the IASB´s proposed approach to the purchase of an additional ownership interest measured as an accumulation of purchases, each independent of another.

Further, we think this approach faithfully represents the purchase of the additional interest, because deducting the investor's or joint venturer's share of losses not recognised from the cost of the additional investment would mean double recognition of these effects, as all future and historical effects are included in the fair value of the additional investment.

Moreover, we would find additional guidance helpful on the order of recognising profits in profit or loss and in other comprehensive income when an investor or joint venturer resumes recognising its share of the associate's or joint venture's profits. We are not convinced by the IASB´s argument that these questions do not commonly arise in practice and, therefore, were not on the list of application questions selected for the project. We think that this issue is considered significant and pervasive by many stakeholders and that the standard should provide symmetrical answers for the treatment of profit or loss versus OCI.

Question 4 – Transactions with associates (Paragraph 53 of [draft] IAS 28 (revised 202x))

[…]

Do you agree with this proposal?

If you disagree, please explain why you disagree and your suggested alternative.

We **agree** with the IASB´s proposal to require that an investor recognise in full gains and losses resulting from all 'upstream' and 'downstream' transactions with its associates and joint ventures, including transactions involving the loss of control of a subsidiary.

We welcome that the proposal eliminates the conflict between IFRS 10 and IAS 28 on the accounting for the sale/contribution of a subsidiary to its associate or joint venture.

While we think that is also a simplified and less costly solution compared to the other alternatives considered by the IASB, we cannot fully agree with the IASB´s argumentation in para. BC75(b) that the proposal will reduce costs for preparers as an entity will no longer need to gather the required information to perform the elimination entries and track the unrecognised gains and losses over future periods. The IASB should revisit the proposed disclosures related to 'downstream' transactions as they necessitate to still gather information in order to disclose gains or losses from 'downstream' transactions with its joint ventures and associates accounted for using the equity method (proposed para. 21(e) of IFRS 12).

Further, we think that the IASB should redeliberate the effects on cross-holdings (i.e. interests in the investor held by the associate or joint venture), as in these cases internal gains or losses would also be recognised in full. We think that a clarification from the IASB on the appropriate accounting for cross-holdings would be helpful.

Question 5 – Impairment indicators (decline in fair value) (Paragraph 57 of [draft] IAS 28 (revised 202x))

[…]

Do you agree with these proposals?

If you disagree, please explain why you disagree and your suggested alternative.

We **partly agree** with the IASB´s proposals.

We **support** to replace 'decline…below cost' of an investment in paragraph 41C of IAS 28 with 'decline…to less than its carrying amount'; to add requirements to IAS 28 explaining that information about the fair value of the investment might be observed from the price paid to purchase an additional interest in the associate or received to sell part of the interest, or from a quoted market price for the investment; and to reorganise the requirements in IAS 28 relating to impairment to make them easier to apply, and to align their wording with the requirements in IAS 36 *Impairment of Assets*.

As regards the proposed removal of 'significant or prolonged' decline in fair value (para. IAS 28.41C, proposed para. IAS 28.57(h)) when determining whether there is objective evidence that the net investment might be impaired, we are **not convinced** that this proposal represents an improvement. We support the intended departure from the IAS 39 terminology and rationale

to better align with the IFRS 9 requirements for the impairment of financial assets. Also, we think that this could lessen application difficulties related to the judgemental assessment of this criterion and thus could reduce diversity in practice. But we notice that this proposal indicates an interpretation of the equity method as a measurement method. Therefore, and in accordance with our cover letter, we think that the IASB should deliberate generally using IFRS 9 to account for these investments.

Further, we think that this amendment represents a significant change for preparers and will likely lead to significantly more frequent impairment tests and thus a considerable increase in the related costs and effort for companies. The removal of the 'significant or prolonged' criterion thus might result in more frequent impairment write-downs and their subsequent reversals and therefore lead to an increase in volatility, which we think would not faithfully represent the character of these investments as long-term assets. This issue, however, could also be addressed by using IFRS 9 and classifying these investments at fair value through other comprehensive income.

Question 6 – Investments in subsidiaries to which the equity method is applied in separate financial statements […]

[…]

Do you agree with this proposal?

If you disagree, please explain why you disagree and your suggested alternative.

We **agree** with the IASB´s proposal to retain paragraph 10 of IAS 27 unchanged, meaning that the proposals in this Exposure Draft would apply to investments in subsidiaries to which the equity method is applied in the investor's separate financial statements.

We also agree with the IASB´s reasoning that developing different requirements for a parent that applies the equity method to investments in subsidiaries in separate financial statements would create two versions of the equity method and introduce unnecessary complexity, with only limited benefits. In the interests of simplification and consistency, such an approach would not be preferable.

Furthermore, in Germany (due to the negligible application of IAS 27) and in contrast to some other jurisdictions, there is no need for deviating requirements for the equity method in separate financial statements.

Lastly, we think that a thorough analysis of the application of the equity method in separate financial statements should not be part of this project on IAS 28 but should be addressed in a separate project on IAS 27.

Question 7 – Disclosure requirements (Paragraphs 20(c), 21(d)–21(e) and 23A–23B of IFRS 12 and paragraph 17A of IAS 27)

[…]

Do you agree with these proposals?

If you disagree, please explain why you disagree and your suggested alternative.

We **generally support** the proposed disclosure requirements. Yet, we want to highlight some points of criticism.

With regard to the gains or losses resulting from ‘downstream’ transactions with its associates or joint ventures as well as from subsidiaries (if a parent uses the equity method to account for its investments in subsidiaries in separate financial statements), we acknowledge the reason for this disclosure articulated in paragraph BC144 of the Basis for Conclusions (i.e. to assess earning quality, allow users to make analytical adjustments of recognised gains or losses, and assess reasonableness and sustainability of these transactions). Nevertheless, we think that this disclosure requirement appears inconsistent with the IASB´s proposal – which we support - to require that an investor or joint venturer recognise in full gains and losses resulting from all transactions with associates or joint ventures (see Question 4). Considering the IASB´s reasoning for changing the requirement in para. 28 of IAS 28, as laid out in paras. BC72-BC83, we think that these disclosure requirements represent unnecessary burden for preparers.

Additionally, we think that the IASB should clarify which gains or losses from transactions with an investee are in the scope of the ED’s proposed disclosure requirements, as it is not clear whether, in the case of an investor/reporting entity having a lease arrangement with its investee, the interest received/receivable from this lease arrangement should be accounted for as a gain.

Further, as regards the proposed reconciliation between the opening and closing carrying amount of the equity-accounted investments we note that this would be costly and complex to prepare for entities with a multitude of investments accounted for using the equity method. We think that it would be sufficient to require such a reconciliation only for the most significant investments accounted for using the equity method.

Question 8 – Disclosure requirements for eligible subsidiaries (Paragraphs 88(c), 91A and 240A of IFRS 19)

[…]

Do you agree with these proposals?

If you disagree, please explain why you disagree and your suggested alternative, taking into consideration the principles for reducing disclosure requirements for eligible subsidiaries applying IFRS 19 (see paragraph BC175 of the Basis for Conclusions).

We **agree** with the IASB's proposals for amending IFRS 19 *Subsidiaries without Public Accountability: Disclosures*, with a caveat regarding the disclosure of gains or losses resulting from 'downstream' transactions (see our answer to Question 7).

Further, we explicitly welcome the IASB´s decision not to propose requiring an eligible subsidiary to disclose a reconciliation between the opening and closing carrying amount of its interests in joint ventures and associates. We support the IASB's view, that the resulting information is not sufficiently useful to users of eligible subsidiaries' financial statements and does not outweigh the costs of providing the information.

Question 9 – Transition (Paragraphs C3–C10 of [draft] IAS 28 (revised 202x))

[…]

Do you agree with these proposals?

If you disagree, please explain why you disagree and your suggested alternative.

We **generally agree** with the IASB´s proposals to require an entity:

(a) to apply retrospectively the requirement to recognise the full gain or loss on all transactions with associates or joint ventures;
(b) to apply the requirements on contingent consideration by recognising and measuring contingent consideration at fair value at the transition date - generally the beginning of the annual reporting period immediately preceding the date of initial application - and adjusting the carrying amount of its investments in associates or joint ventures accordingly; and
(c) to apply prospectively all the other requirements from the transition date.

However, we note that the removal of the 'significant or prolonged' criterion for the decline in the fair value of an investment in paragraph 41c of IAS 28 will likely result in impairments, which would have to be recognised in profit or loss at the time of transition, even though the changes in value would be attributable to prior periods, which could be misleading.

We also think that the wording of para. C8 should be reviewed, as it could be interpreted as only being relevant if an impairment test has already been performed at the transition date ('If […] and estimated the recoverable amount of that investment at the transition date ...'). Para. C8 has to be applied in any case, however, if the carrying amount of an investment in an associate or joint venture increases according to paras. C4-C7.

Question 10 – Expected effects of the proposals

Paragraphs BC217–BC229 of the Basis for Conclusions explain the IASB's analysis of the expected effects of implementing its proposals. Do you agree with this analysis? If not, which aspects of the analysis do you disagree with and why?

With regard to the expected effects of the proposals on the quality of financial reporting, **we agree** that improved and more understandable IAS 28 requirements should reduce diversity in practice and increase comparability. At the same time, **however**, uncertainty and inconsistency remain largely due to the still unresolved question of the interpretation of the equity method as a measurement or consolidation method. Answering this question would have significantly contributed to an improvement in the consistency of the requirements and hence the quality of financial reporting. Unfortunately, the IASB missed this opportunity.

With regard to the expected cost of implementing and applying the proposals, we note that the most significant cost reduction could have been achieved by eliminating the equity method. When implementing and applying the proposals, **we concede** that some costs to preparers, auditors and regulators may be reduced by the IASB providing answers to application questions arising in practice for entities applying the Equity Method. **Nevertheless**, companies will incur costs due to the implementation of the new requirements and the need to update their accounting policies and systems, among other things. In terms of application costs, the significant costs associated with purchase price allocations for acquisitions (see our answer to Question 3) and the changes to the impairment triggers were criticized, particularly by preparers. The removal of the 'significant or prolonged' criterion for the decline in the fair value of an investment will likely lead to significantly more frequent impairment tests and thus a considerable increase in the associated costs and effort (see our answer to Question 5).

Question 11 – Other comments

Do you have any comments on the other proposals in this Exposure Draft, including Appendix D to the Exposure Draft or the Illustrative Examples accompanying the Exposure Draft?

Do you have any comments or suggestions on the way the IASB is proposing to re-order the requirements in IAS 28, as set out in [draft] IAS 28 (revised 202x)?

We **support** the way the IASB is proposing to re-order the requirements in IAS 28, as set out in [draft] IAS 28 (revised 202x), as we think that this will improve the understandability and thus also the application of the standard.

As for any other comments or suggestions we portend to our cover letter detailing our view on the Equity Method in its entirety and recommendable proceedings.