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20 January 2025

International Accounting Standards Board
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Board Members,

RESPONSE TO EXPOSURE DRAFT *Equity Method of Accounting – IAS 28 Investments in Associates and Joint Ventures (“ED”)*

ISCA sought views from its members through a 2-month public consultation and from the ISCA Financial Reporting Committee which comprises experienced technical professionals from audit firms, preparers of financial statements and other stakeholders.

We are supportive of the approach taken by the Board to address specific application questions which would provide solutions to long-standing application difficulties, reduce diversity in practice and lead to more comparable and understandable information for users. However, we note that further clarifications and guidance might be required to ensure consistent application of the proposed amendments.

Our detailed comments to specific questions in the ED are set out below.

Question 1 - Measurement of cost of an associate (Appendix A and paragraphs 13, 22, 26 and 29 of [draft] IAS 28 (revised 202x))
Paragraph 32 of IAS 28 requires an investor that obtains significant influence to account for the difference between the cost of the investment and the investor’s share of the net fair value of the associate’s identifiable assets and liabilities either as goodwill (included in the carrying amount of the investment) or as a gain from a bargain purchase (recognised in profit or loss). However, IAS 28 does not include requirements for how an investor measures the cost of the investment on obtaining significant influence – for example: (a) whether to measure any previously held ownership interest in the associate at fair value; or (b) whether and if so how to recognise and measure contingent consideration. The IASB is proposing an investor: (a) measure the cost of an associate, on obtaining significant influence, at the fair value of the consideration transferred, including the fair value of any previously held interest in the associate. (b) recognise contingent consideration as part of the consideration transferred and measure it at fair value. Thereafter:

(i) not remeasure contingent consideration classified as an equity instrument; and

(ii) measure other contingent consideration at fair value at each reporting date and recognise changes in fair value in profit or loss.

Paragraphs BC17–BC18 and BC89–BC93 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals?

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

We generally agree with these proposals but would like to seek clarification on the following:

1) Proposed definition of "Cost of the associate or joint venture"

   The proposed definition is silent on whether cost of the associate or joint venture include expenditure directly attributable to the acquisition of the investment. We note that in the IFRIC July 2009 Update, there was a decision that the cost of an investment in an associate at initial recognition determined in accordance with IAS 28 paragraph 10 comprises its purchase price and any directly attributable expenditures necessary to obtain it.

   We recommend that IASB clarify the accounting treatment for expenditures directly attributable to the acquisition of an associate or a joint venture.

2) Classification of remeasurement gain/loss in accordance with IFRS 18

   a) For the remeasurement of a previously held interest to fair value upon gaining significant influence, we recommend that IASB clarify the classification of such gain/loss for consistency in the application of IFRS 18 *Presentation and Disclosure in Financial Statements* in relation to remeasurement gain/loss.

      If there is a main business activity of investing in assets, should this remeasurement gain/loss be presented in operating (IFRS 18 paragraph 58) because it relates to derecognition of financial assets or should it be classified as investing (IFRS 18 paragraph 55(a)) because it relates to acquisition of equity method accounted investee?

   b) For the remeasurement of contingent consideration, we recommend IASB to clarify whether such gain/loss should always be presented in investing, financing or operating under IFRS 18, given that changes on remeasurement of contingent consideration under IFRS 3 *Business Combinations* is presented within 'operating' in the consolidated financial statements.

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

IAS 28 does not include requirements on how an investor accounts for changes in its ownership interest in an associate, while retaining significant influence, that arise from:

(a) the purchase of an additional ownership interest in the associate;

(b) the disposal of an ownership interest (partial disposal) in the associate; or

(c) other changes in the investor's ownership interest in the associate.

The IASB is proposing to require that an investor:

(a) at the date of purchasing an additional ownership interest in an associate:

(i) recognise that additional ownership interest and measure it at the fair value of the consideration transferred;

(ii) include in the carrying amount the investor's additional share of the fair value of the associate's identifiable assets and liabilities; and

(iii) account for any difference between (i) and (ii) either as goodwill included as part of the carrying amount of the investment or as a gain from a bargain purchase in profit or loss.

(b) at the date of disposing of an ownership interest:

(i) derecognise the disposed portion of its investment in the associate measured as a

percentage of the carrying amount of the investment; and

(ii) recognise any difference between the consideration received and the amount of the

disposed portion as a gain or loss in profit or loss.

(c) for other changes in its ownership interest in an associate:

(i) recognise an increase in its ownership interest, as if purchasing an additional ownership interest. In (a)(i), 'the fair value of the consideration transferred' shall be read as 'the investor's share of the change in its associate's net assets arising from the associate's redemption of equity instruments'.

(ii) a decrease in its ownership interest, as if disposing of an ownership interest. In (b)(ii) 'the consideration received' shall be read as 'the investor's share of the change in its associate's net assets arising from the associate's issue of equity instruments'.

Paragraphs BC20–BC44 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals?

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

We generally agree with these proposals but would like to provide the following comments.

a) We suggest IASB to clarify whether upon purchasing an interest in an associate, there should be a distinction in treatment for an associate with a business and one without a business. Under IFRS 3, acquisition of a subsidiary without a business do not lead to recognition of goodwill or a gain on bargain purchase. . For example, an associate may only hold a single asset such as a building or vessel and it is unclear if recognition of bargain purchase gain should apply to such transactions. We suggest that IASB clarify the accounting treatment in the revised IAS 28.

b) Similar to our response in Question 1, we suggest IASB to clarify if directly attributable costs should be included as cost of the associate for the purchases of additional ownership interest without change in significant influence as the proposed paragraph 30(a) currently refers to measurement at 'fair value of the consideration transferred'. In addition, we recommend that the the revised IAS 28 explicitly states that the previously held interest is not remeasured as concluded in BC23. (similar to the renumbered paragraph 35 in IAS 28).

c) We have concerns with the costs and benefits of preparing a purchase price allocation exercise whenever additional equity interest is acquired. We recommend that IASB consider if there is an alternative approach that balances cost and usefulness of information.

Question 3 - Recognition of the investor's share of losses (Paragraphs 49–52 of [draft] IAS 28 (revised 202x))
Paragraph 38 of IAS 28 requires that if an investor's share of losses equals or exceeds its interest in the associate, the investor discontinue recognising its share of further losses. However, IAS 28 does not include requirements on whether an investor that has reduced the carrying amount of its investment in an associate to nil: (a) on purchasing an additional ownership interest, recognises any losses not recognised as a 'catch up' adjustment by deducting those losses from the cost of the additional ownership interest; or (b) recognises separately its share of each component of the associate's comprehensive income. The IASB is proposing an investor: (a) on purchasing an additional ownership interest, not recognise its share of an associate's losses that it has not recognised by reducing the carrying amount of the additional ownership interest. (b) recognise and present separately its share of the associate's profit or loss and its share of the associate's other comprehensive income. Paragraphs BC47–BC62 of the Basis for Conclusions explain the IASB's rationale for these proposals. Do you agree with these proposals? If you disagree, please explain why you disagree and your suggested alternative.

We agree with the proposal for not requiring the investor to "catch-up" on its share of past losses when additional interests are acquired which is consistent with the principle in paragraph 38 of IAS 28 that requires an investor or joint venturer to discontinue recognising its share of further losses when they exceed the carrying amount of the investment in the associate or joint venture.

The following are some suggestions for IASB's consideration.

a) For purchase of an additional ownership interest, we propose that the new standard clarify subsequent accounting for profits and losses. There is lack of clarity whether profits and losses should be separately tracked for the new layer of interest and previous interest, ie would the new layer's share of profits be restricted from recognition due to unrecognised losses of the old layer of interest. We are of the view that these should be treated separately to be consistent with the accumulation of purchase approach.

b) On separate recognition and presentation, we have concerns that the underlying principles included in the proposals are not sufficiently clear to be applied to other scenarios beyond the two scenarios as described in the proposed paragraphs 48 and 52 respectively. Additionally, it seems there is a disconnect between paragraphs 45-48, which refer to total comprehensive income without distinguishing between P&L and OCI, and paragraphs 50-52, which require a split of these amounts.

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

Paragraph 28 of IAS 28 requires an investor to recognise gains and losses resulting from transactions between itself and an associate only to the extent of unrelated investors' interests in the associate. This requirement applies to both 'downstream' transactions (such as a sale or contribution of assets from an investor to an associate) and 'upstream' transactions (such as a sale of assets from an associate to an investor).

If an investor loses control of a subsidiary in a transaction with an associate, the requirement in IAS 28 to recognise only a portion of the gains or losses is inconsistent with the requirement in IFRS 10 to recognise in full the gain or loss on losing control of a subsidiary.

The IASB is proposing to require that an investor recognise in full gains and losses resulting from all 'upstream' and 'downstream' transactions with its associates, including transactions involving the loss of control of a subsidiary.

Paragraphs BC63–BC84 of the Basis for Conclusions explain the IASB's rationale for this proposal.

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 investors to recognise in full the gains and losses arising from all 'upstream' and 'downstream' transactions with associates and joint ventures. This approach would improve consistency for transactions involving loss of control of subsidiaries and we expect this approach would reduce costs for preparers by removing the need to identify and track when transactions are settled with third parties.

We recommend IASB to consider the following for the proposed paragraph 54:

a) Clarification on whether to regard the gain or loss as unrealised in its entirety when a contribution lacks commercial substance.
b) Some transactions may involve non-monetary items received and given up (eg, non-monetary asset exchanged for shares). Hence, IASB could clarify on which fair value to use for measuring such transactions (fair value of asset given up or fair value of assets received) so as to help drive consistency in practice.
c) In some cases, no additional ownership/equity interest or consideration is received in exchange and it is unclear whether and how to apply paragraph 54. Some examples include i) all investors contribute non-monetary assets in kind, ii) Investor A contributes non-monetary asset in kind and other investors contribute cash, iii) only one investor contributes non-monetary assets in kind (ie, not pro-rata contribution by all investors).

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

Paragraphs 41A–41C of IAS 28 describe various events that indicate the net investment in an associate could be impaired. Paragraph 41C of IAS 28 states that a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is objective evidence of impairment. One of the application questions asked whether an investor should assess a decline in the fair value of an investment by comparing that fair value to the carrying amount of the net investment in the associate at the reporting date or to the cost of the investment on initial recognition.

The IASB is proposing:

(a) to replace 'decline…below cost' of an investment in paragraph 41C of IAS 28 with 'decline…to less than its carrying amount';
(b) to remove 'significant or prolonged' decline in fair value; and
(c) 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.

The IASB is also proposing 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.

Paragraphs BC94–BC106 of the Basis for Conclusions explain the IASB's rationale for these proposals.

Do you agree with these proposals?

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

We generally agree with the proposals but would like to seek further clarification as follows.

a) It is unclear how paragraph 57(h) would be applied in the absence of the examples of fair value provided in the paragraph (eg, for associates that have no traded shares and recent transactions). In the absence of the examples of fair value, would regular valuation exercise be required in order to assess this indicator? Requiring a valuation every reporting date would increase the cost of reporting and should be balanced with other indicators to consider if a valuation is required to support narrower situations where risk of impairment is significant, and valuation may inevitably be required. In IAS 36 paragraph 12(d), the impairment indicator is written as *'the carrying amount of the net assets of the entity is more than its market capitalisation'*, which is clearer as there is no ambiguity on whether a fair value calculation is required if 'market capitalisation' is not available.

b) Paragraph 57(h) may be difficult to apply in general to property owning entities whose shares/units are listed. It is not uncommon for an entity holding real estate properties as its main assets (which are recognised at fair value of the properties based on independent valuations) to have its net asset value (NAV) per share exceed the traded share price. Purchasing an associate interest in such an entity (at the fair value of the shares) tends to lead to bargain purchase gain (after applying the guidance discussed in Question 1). We recommend that paragraph 57(h) be clarified whether at initial recognition (after recognising bargain purchase), there is an immediate indicator of impairment as fair value is lower than

the carrying amount or it should be read that there was no 'decline' as the fair value was below carrying amount at initial recognition.

To illustrate (ignoring tax effect for simplicity), assume that the traded price (fair value) of the associate acquired is $5/share and the NAV is $7/share. The initial recognition of the associate would be at $7/share (with $2 bargain purchase gain/share). The fair value is lower than the carrying amount at initial recognition but it technically did not 'decline' because this is the initial state.

Question 9 – Transition (Paragraphs C3–C10 of [draft] IAS 28 (revised 202x))
The IASB is proposing 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. The IASB is also proposing relief from restating any additional prior periods presented. Paragraphs BC178–BC216 of the Basis for Conclusions explain the IASB's rationale for these proposals. Do you agree with these proposals? If you disagree, please explain why you disagree and your suggested alternative.

We recommend that transition relief is to be provided for retrospective recognition of full gain or loss on all transactions with associates, as it may be challenging to perform retrospective adjustments, for example in scenarios where there have been restrictions of losses recognised (i.e. unrecognised share of losses) or impairment of associate.

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)?

Distinction between business and asset

The proposal to include deferred tax effects related to fair value adjustments highlights a fundamental existing question about whether an investor considers whether an investee meets the definition of a business and the implications if it does not meet this definition. Current IAS 28 requirements and the proposal for deferred taxes seem to assume that the investee is a business (e.g. with goodwill or a gain on bargain purchase recognised). However, we are aware of practice

where an investor evaluates if the investee meets the definition of a business and depending on the outcome of this assessment applies either:

- the principles of IFRS 3 (i.e. fair value measurement with goodwill or gain on bargain purchase), including deferred taxes; or
- the asset acquisition principles (i.e. no goodwill or gain on bargain purchase), including the initial recognition exemption in IAS 12.

We recommend that the IASB address this fundamental question as part of this project. In addition to the proposal for deferred taxes, we believe this question / principle should also be considered and clarified in the context of the other proposals that apply IFRS 3 principles, including measurement and allocation of cost and increases in ownership interests. We also recommend that the IASB consider allowing the asset concentration test to be extended to associates for consistency.

First-time adopters

We note that the ED does not address IFRS 1 *First-time Adoption of International Financial Reporting Standards*. We recommend that the IASB evaluate whether any specific relief should be provided for first-time adopters. An example where such relief may be required is related to the proposals for increases in ownership interests while continuing to apply the equity method prior to date of adoption of IFRS, where IFRS 3 principles are applied (e.g. fair value measurement and contingent consideration). Other practical transition reliefs may also be considered (at transition date) to minimise the burden of revisiting the accounting of past transactions, such as those in our response to Question 9.

Reordering

We support the reordering of IAS 28 and agree that this change improves the understandability of the standard. We believe that these changes will ultimately lead to improved consistency in the application of IAS 28 across different entities and jurisdictions.

However, we have identified a potential unintended consequence from the reordering, particularly concerning the recognition of gains from a bargain purchase. With the removal of the existing text related to the recognition of a bargain purchase gain (previously included in paragraph 32), it is now unclear where such gains should be presented in profit or loss. We recommend that the IASB provide additional clarity on the treatment of a bargain purchase gain and its presentation to ensure consistent application.

Should you require any further clarification, please feel free to contact Ms Jezz Chew at jezz.chew@isca.org.sg or Ms Felicia Tay at felicia.tay@isca.org.sg.

Yours faithfully,

Mr Terence LAM
Director, Advocacy & Professional Standards