29 January 2014

Our ref: ICAEW Rep 12/14

Your ref: ED/2013/10

Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

Dear Hans

ED/2013/10 *Equity Method in Separate Financial Statements*

ICAEW is pleased to respond to your request for comments on ED/2013/10 *Equity Method in Separate Financial Statements.*

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

ED/2013/10 EQUITY METHOD IN SEPARATE FINANCIAL STATEMENTS

Memorandum of comment submitted in January 2014 by ICAEW, in response to IASB's exposure draft ED/2013/10 *Equity Method in Separate Financial Statements* published in December 2013.

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the exposure draft ED/2013/10 *Equity Method in Separate Financial Statements* published by the IASB on 2 December 2013, a copy of which is available from this link.

WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 140,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

4. The Financial Reporting Faculty is recognised internationally as a leading authority on financial reporting. The Faculty's Financial Reporting Committee is responsible for formulating ICAEW policy on financial reporting issues, and makes submissions to standard setters and other external bodies. The faculty also provides an extensive range of services to its members, providing practical assistance in dealing with common financial reporting problems.

MAJOR POINTS

We do not agree with proposed amendments to IAS 27

5. As discussed further in our response to question 1 below, we do not support the proposals as they not only lack any conceptual basis but also set a dangerous precedent of incorporating local GAAP or accounting regulations into IFRS.

6. We recommend that the board sets aside these proposals until such time as its research project into the equity method is complete.

RESPONSES TO SPECIFIC QUESTIONS

Question 1 – Use of the equity method

The IASB proposes to permit the equity method as one of the options to account for an entity's investments in subsidiaries, joint ventures and associates in the entity's separate financial statements.

Do you agree with the inclusion of the equity method as one of the options? If not, why?

7. The basis for conclusions explains that some respondents to the board's 2011 agenda consultation strongly supported the inclusion of the equity method as one of the options for measuring investments in subsidiaries, joint ventures and associates in an entity's separate financial statements and that this exposure draft has been issued as a direct response to their requests. The proposed amendments would enable entities in certain jurisdictions to simultaneously comply with local regulations that require the use of the equity method for such investments and IFRS.

8. However, in 2003 the board removed the option of using the equity method to account for investments in subsidiaries, joint ventures and associates in separate financial statements because it felt that the focus of such financial statements should be 'upon the performance of the assets as investments' and that they should therefore be measured using either the fair value method or the cost method.

9. We agree with the position taken by the board at that time as the distinguishing feature of separate financial statements is that interests in other entities are treated as investments. We believe that valuing such investments using the equity method is inappropriate as doing so will not only result in confusion as to the nature of separate financial statements but also create additional diversity and reduce comparability.

10. There is, we believe, no technical merit in restoring the option of using the equity method to measure such investments. Moreover, we do not believe that it is appropriate to amend IFRS solely to incorporate local GAAP or accounting regulations. We do not, therefore, support the proposals as they not only lack any conceptual basis but also set a dangerous precedent.

11. The board is also undertaking a research project into the equity method which 'will involve a fundamental assessment of the equity method in terms of its usefulness to investors and difficulties to preparers'. It seems inappropriate to restore the equity method to separate financial statements in advance of the conclusion of this project. Indeed, it could be argued that these proposals inappropriately prejudice the outcome of the research project as, having just restored the equity method as an option in an entity's separate financial statements, it would seem unlikely that the board would conclude shortly thereafter that it should be removed once again.

12. We recommend that the board sets aside these proposals until such time as its research project into the equity method is complete.

13. Our responses to the questions that follow assume that the board will nevertheless proceed with its proposals.

Question 2 – Transition provisions

The IASB proposes that an entity electing to change to the equity method would be required to apply that change retrospectively, and therefore would be required to apply IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Do you agree with the proposed transition provisions? If not, why and what alternative do you propose?

14. We are generally supportive of full retrospective application of the proposed changes. However, it may not always be easy to use the information that is used to account for a subsidiary in the consolidated financial statements to derive its carrying amount under the equity method. Establishing the carrying amount under the equity method may, in some instances, involve considerable additional time and effort.

Question 3 – First-time adopters

The IASB does not propose to provide any special relief for first-time adopters. A first-time adopter electing to use the equity method would be required to apply the method from the date of transition to IFRSs in accordance with the general requirements of IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

Do you agree that a special relief is not required for a first-time adopter? If not, why and what alternative do you propose?

15. It may prove costly – or even impossible – for first-time adopters that elect to use the equity method to account for investments in subsidiaries, joint ventures and associates to do so retrospectively. We therefore believe that some relief should be provided for first-time adopters.

Question 4 – Consequential amendment to IAS 28 *Investments in Associates and Joint Ventures*

The IASB proposes to amend paragraph 25 of IAS 28 in order to avoid a conflict with the principles of IFRS 10 *Consolidated Financial Statements* in situations in which an entity loses control of a subsidiary but retains an ownership interest in the former subsidiary that gives the entity significant influence or joint control, and the entity elects to use the equity method to account for the investments in its separate financial statements.

Do you agree with the proposed consequential amendment? If not, why?

16. The basis of conclusions explains in BC11 that the proposed consequential amendment to IAS 28 is designed to avoid a conflict with the principles of IFRS 10 by requiring an entity to recognise any investment retained in a former subsidiary at its fair value when control is lost. However, the amendment as drafted does not seem to achieve this objective at all and needs to be revised to make the board's intention clearer.

17. Paragraph 25 of IAS 28 should clearly state that although the equity method should continue to be applied when an entity's ownership interest in an associate or joint venture is reduced, it should cease to be applied when an entity loses control of a subsidiary that it has elected to account for using the equity method. This paragraph should expressly state that in such circumstances the investment should be remeasured to fair value in line with the equivalent requirements of IFRS 10.

18. Moreover, the proposed treatment appears to apply only when a subsidiary is accounted for under the equity method. It is unclear whether the treatment would apply when there is loss of control of a subsidiary that is accounted for at cost or fair value.

Question 5 – Other comments

Do you have any other comments on the proposals?

19. The revised paragraph 10 of IAS 27 would currently permit a parent entity to choose different methods (ie, cost, fair value or equity accounting) for different categories of investments. For example, in theory an entity could choose the equity method for subsidiaries and the cost basis for associates. This leads to uncertainty over how to account for a change of status. For example, if an equity-accounted subsidiary becomes a cost-accounted associate should 'cost' be interpreted as original cost or the proportionate share of the equity-accounted carrying value? What if a fair value accounted joint venture becomes an equity-accounted associate? Guidance to address all possible permutations should not be developed, as this would over-complicate what is intended to be a facilitative amendment. However, the board should be aware of these complexities in evaluating the pros and cons of this proposal: we believe that they reinforce the view that the proposed change should not be made.

20. Paragraph BC 10 of the exposure draft mentions one situation in which consolidating a subsidiary would yield a different amount of net assets and profit or loss attributable to the equity holders of the investor compared to use of the equity method. Another important example is when the subsidiary has net liabilities. The final version of the basis for conclusions might usefully refer to this.

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