January 19, 2025

IFRS Foundation
7 West ferry Circus
Canary Wharf
London E14 4HD, United Kingdom

RE: Equity Method of Accounting; IAS 28 Investments in Associates and Joint Ventures (revised 202x)

Dear Colleagues,

The Saudi Organization for Chartered and Professional Accountants (SOCPA) appreciates the efforts of the IASB and welcomes the opportunity to comment on the Exposure Draft, *Equity Method of Accounting; IAS 28 Investments in Associates and Joint Ventures (revised 202x).*

Our detailed comments on the questions raised in the Exposure Draft are attached in the appendix to this letter.

Please feel free to contact Dr. Abdulrahman Alrazeen at (razeena@socpa.org.sa) for any clarification or further information.

Sincerely,

Dr. Ahmad Almeghames

SOCPA Chief Executive Officer

Appendix: Equity Method of Accounting;
IAS 28 Investments in Associates and Joint Ventures (revised 202x)

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.

SOCPA Comments:

SOCPA believes measuring the cost of the associate, on obtaining significant influence, at the fair value of the consideration transferred (including the fair value of any previously held interest) aligns with IFRS principles. This approach is consistent with IFRS 3 for business combinations and provides relevant information for financial statement users. However, SOCPA believes that IAS 28 should also specify the basis on which "Acquisition-related costs" should be accounted. IFRS 3 specifically addresses acquisition-related costs. As IAS 28 does not address how to account for acquisition related costs, it has created a lot of ambiguity. We believe the accounting for acquisition-related costs in IAS 28 should be consistent with IFRS 3.

Additionally, SOCPA agrees that including contingent consideration in the initial measurement at fair value ensures that the total consideration is appropriately captured at the acquisition date. Further,

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SOCPA believes not remeasuring equity-classified contingent consideration after initial recognition and measuring other contingent consideration at fair value at each reporting date and recognising changes in fair value in profit or loss is consistent with IFRS principles.

However, SOCPA suggests IAS 28 provides additional guidance on the definition of contingent consideration from an investor perspective obtaining significant influence since IFRS 3 *Business Combinations* provides such guidance from a controlling shareholder perspective. We also suggest that the IASB clarify whether a 12-month time limit to remeasure contingent consideration is allowed under IAS 28.

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:
(a) derecognise the disposed portion of its investment in the associate measured as a percentage of the carrying amount of the investment; and
(b) 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) recognise 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.

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SOCPA Comments:

The purchase of an additional ownership interest in the associate

The exposure draft suggests that each acquisition of an additional ownership interest in an associate should be treated as a separate unit of account. Consequently, goodwill or bargain purchase gains/losses would be calculated separately for each acquisition. There is no remeasurement of the previously held interest at the point of acquiring a subsequent stake.

This approach could result in scenarios where goodwill from an initial acquisition remains in the carrying amount of the investment in the associate, while subsequent acquisitions could result in a gain on a bargain purchase being recognised in profit or loss. This creates potential inconsistencies in the carrying amount of the investment in the associate and undermines the logical representation of the investment as a single economic unit. This view is also reflected in BC34 and BC35 of the Basis for Conclusions of the ED.

SOCPA therefore believes measuring each acquisition separately might not reflect the substance of the transaction. Investors typically view their stake in an associate as a single investment, not as a collection of independently measured acquisitions.

SOCPA therefore suggests upon acquiring an additional ownership interest, the previously held stake should be remeasured at fair value, with any gain or loss recognized in profit or loss. The gain or loss would be the difference between the equity accounted balance as at that date and the fair value of the previously held stake. This method ensures, a unified approach to measuring the investment as well as a transparent and logical mechanism in accounting of goodwill or a gain on bargain purchase. This approach will also be consistent with IFRS 3 principles for step acquisitions.

The disposal of an ownership interest (partial disposal) in the associate

The exposure draft proposes that when there is a partial disposal of an ownership interest in an associate, the disposed portion should be derecognized as a percentage of the total carrying amount of the investment. SOCPA believes while this approach is acceptable when an entity directly holds an interest in an associate, it could lead to inconsistencies when a parent entity holds no interest in the associate directly but holds an interest through one or multiple subsidiaries.

The carrying amount of the associate's investment at the parent level reflects the aggregation of investments from its subsidiaries. Treating a partial disposal as a reduction from the total consolidated interest could result in an inaccurate allocation of gains or losses, particularly when the investments were acquired at different times and costs.

Example: Subsidiary A acquires 25% in Associate X in 20X1 and Subsidiary B acquires 15% in Associate X in 20X5. Subsidiary A accounts for its interest in associate A as an associate from the date of acquiring the 25%. The parent initially has the 25% interest in the consolidated financial statements and then in 20X5 accounts for the additional 15% interest.

If subsidiary A was to dispose 5% in Associate X in 20X8, as per the proposed paragraph 32 of the exposure draft the parent entity would derecognize the disposed portion as a percentage of the total carrying amount (i.e 25% +15% = 40) while Subsidiary A would derecognize the 5% from the 25% it holds.

By applying the proposed treatment, gains or losses on disposal may be incorrectly measured, failing to reflect the economic reality of the transaction within the subsidiary and introducing misalignment between the parent's and subsidiary's financial statements.

SOCPA believes as entities currently do, adjusting the carrying amount based on the specific subsidiary's stake provides a more accurate and transparent approach and represent the economic consequences of the disposal more faithfully.

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In order to ensure no complications arise in consolidated financial statements specific guidance on how to overcome the above in consolidated financial statements should be included. Such guidance could provide examples when it would be appropriate to consider disposals specific to an investor within a group in isolation from the parent's total holding. Such consideration could be also appropriate when the holding percentage is related to different classes of ordinary shares and the time between the acquisition and disposal is very short.

Other changes in the investor's ownership interest in the associate

SOCPA believes while the proposal is acceptable when an entity directly holds an interest in an associate, as with t*he disposal of an ownership interest (partial disposal) in the associate*, it could lead to inconsistencies when a parent entity holds no interest in the associate directly but holds an interest through one or multiple subsidiaries. In order to ensure no complications arise in consolidated financial statements, specific guidance on how to overcome this in consolidated financial statements should be included. As stated above SOCPA suggests the IASB to include guidance on when it would be appropriate for a Group to consider the disposal of ownership interest in isolation or per se specific to a particular investor's interest within the Group.

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.

SOCPA Comments:

(a) SOCPA agrees that on purchasing an additional ownership interest, the investor should not recognise its share of an associate's losses that it has not recognised, by reducing the carrying amount of the additional ownership interest as deducting previously unrecognized losses from the cost of additional ownership could imply an impairment of the new investment, which may not align with the economic reality at the acquisition date.

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(b) SOCPA supports the proposal that when an investor has reduced the carrying amount of its investment in an associate to nil, the investor shall separately recognise and present its share of the associate's profit or loss and its share of the associate's other comprehensive income in accordance with the exposure draft paragraph 50-52. This would be the consistent approach and would be in line with what is proposed in (a).

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.

SOCPA Comments:

SOCPA believes that recognizing full gains or losses from transactions with associates could lead to overstated profits when goods or assets remain unsold or unused at the reporting date. These profits are unrealized within the investor-associate relationship since no transaction has occurred with an unrelated third party. Recognizing such profits inflates the investor's reported performance, as the economic benefit has not been realized externally. Similar to how unrealized profits are eliminated in subsidiary-parent relationship to avoid double-counting, a comparable issue exists in the investor-associate context, even though consolidation is not applied.

Additionally, SOCPA agrees with the stakeholders (as given in the Basis for Conclusions BC111) who have raised concerns that requiring a joint venturer to recognize the full gain or loss on transactions with a joint venture could create opportunities for earnings management transaction structuring and roundtrip transactions. Given the joint control relationship, there is a heightened risk that transactions may not occur on arm's length terms, potentially distorting the financial performance reported by the joint venturer. Therefore, SOCPA strongly recommends the IASB to provide clear guidance on how the new requirements will be applied to transactions which lack commercial substance since the new requirements will be a significant amendment to the current practice and could provide opportunities for earnings management.

Question 5—Impairment indicators (decline in fair value)

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(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.

SOCPA Comments:

SOCPA agrees with the proposed changes on impairment as it improves clarity, consistency, and alignment with broader IFRS principles. Reorganizing the guidance and aligning it with IAS 36 simplifies application and ensures consistency <u>with other IFRSs</u> (such as IFRS 9 *Financial Instruments*). However, SOCPA highlights that the unit of account for acquisitions differs from the unit of account for the impairment testing (i.e. whole investment).

Question 6—Investments in subsidiaries to which the equity method is applied in separate financial statements

Paragraph 10 of IAS 27 permits a parent entity to use the equity method in IAS 28 to account for investments in subsidiaries, joint ventures and associates in separate financial statements.

The IASB is proposing 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.

Paragraphs BC112–BC127 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.

SOCPA Comments:

The exposure draft proposes that for transactions between an investor and an associate the investor should recognize the full gains or losses from such transactions. However, under IFRS 10, for

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transactions between a parent and its subsidiary, gains or losses are only recognized to the extent of the non-controlling interest (NCI). SOCPA believes this raises a potential inconsistency if subsidiaries are accounted for using the equity method in separate financial statements.

Question 7—Disclosure requirements

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

The IASB is proposing amendments to IFRS 12 in this Exposure Draft. For investments accounted for using the equity method, the IASB is proposing to require an investor or a joint venturer to disclose:

(a) gains or losses from other changes in its ownership interest;
(b) gains or losses resulting from 'downstream' transactions with its associates or joint ventures;
(c) information about contingent consideration arrangements; and
(d) a reconciliation between the opening and closing carrying amount of its investments.

The IASB is also proposing an amendment to IAS 27 to require a parent—if it uses the equity method to account for its investments in subsidiaries in separate financial statements—to disclose the gains or losses resulting from its 'downstream' transactions with its subsidiaries.

Paragraphs BC137–BC171 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.

SOCPA Comments:

SOCPA believes while the proposal to disclose downstream transaction gains or losses for subsidiaries in separate financial statements (IAS 27) is logical, it could result in inconsistencies if subsidiaries are accounted for using the equity method in separate financial statements while consolidated in group financial statements.

SOCPA believes specific disclosures (highlighting the difference between inter-company transactions in the separate financial statements and consolidated financial statements) should be included in separate financial statements if a subsidiary is accounted for using equity method and if the final version of IAS 28 goes ahead requiring transactions between an investor and an associate to recognize the full gains or losses from transactions between them.

Question 8—Disclosure requirements for eligible subsidiaries

(Paragraphs 88(c), 91A and 240A of IFRS 19)

IFRS 19 permits eligible subsidiaries to apply IFRS Accounting Standards with reduced disclosure requirements. It specifies the disclosure requirements an eligible subsidiary applies instead of the disclosure requirements in other IFRS Accounting Standards.

As part of developing proposed amendments to the disclosure requirements in other IFRS Accounting Standards, the IASB regularly considers which of those proposed amendments should be included in IFRS 19, based on the IASB's principles for reducing disclosure requirements for eligible subsidiaries.

The IASB is proposing amendments to IFRS 19 to require an eligible subsidiary:

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(a) to disclose information about contingent consideration arrangements; and
(b) to disclose gains or losses resulting from 'downstream' transactions with its associates or joint ventures.

The IASB is also proposing an amendment to IFRS 19 to require a subsidiary that chooses to apply the equity method to account for its investments in subsidiaries in separate financial statements to disclose gains or losses resulting from 'downstream' transactions with those subsidiaries.

Paragraphs BC172–BC177 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, taking into consideration the principles for reducing disclosure requirements for eligible subsidiaries applying IFRS 19 (see paragraph BC175 of the Basis for Conclusions).

SOCPA Comments:

SOCPA agrees and has no further comments regarding the proposals relating to disclosure requirements for eligible subsidiaries that apply IFRS 19.

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.

SOCPA Comments:

While agreeing to proposals (b) and (c), SOCPA believes for entities with numerous historical transactions, retrospective application required in (a) could impose significant costs and effort. SOCPA therefore suggests allowing entities the option of prospective application of the requirement to recognise the gains or losses on transactions with associates or joint ventures that occurred prior to the application date.

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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?

> SOCPA Comments:
>
> SOCPA agrees the IASB’s analysis of the expected effects of implementing its proposals is generally sound and well-justified. SOCPA has raised its concerns in our response to the individual questions in the exposure draft. Except for these concerns SOCPA believes the anticipated benefits, including enhanced transparency, improved comparability, and alignment with other IFRS standards, will provide value to users of financial statements.

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)?

> SOCPA Comments:
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> SOCPA has no comments regarding other proposals in the Exposure Draft.

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