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ED/2012/3 Equity Method: Share of Other Net Asset Changes - Proposed amendments to IAS 28

Grant Thornton International Ltd is pleased to comment on the International Accounting Standards Board's (the Board) Exposure Draft ED/2012/3 Equity Method: Share of Other Net Asset Changes - Proposed amendments to IAS 28 (the ED). We have considered the ED, as well as the accompanying draft Basis for Conclusions.

We welcome clarification on the issues addressed in the ED. On balance, however, our preference is that investor should report the effect of dilution-type transactions on its share of an equity-accounted investee's net assets in profit or loss rather than in equity.

In stating this preference we acknowledge that the ED is intended to provide a short-term, practical solution to an issue that has led to diversity in practice. It is challenging to build a compelling argument for any approach before addressing broader conceptual issues around the equity method.

Our responses to the Invitation to Comment are set out in the Appendix to this letter.

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If you have any questions on our response, or wish us to amplify our comments, please contact our Executive Director of International Financial Reporting, Andrew Watchman (andrew.watchman@uk.gt.com or telephone + 44 207 391 9510).

Yours sincerely,

Kenneth C. Sharp

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Responses to Invitation to Comment questions

Question 1 - the IASB proposes to amend IAS 28 so that an investor should recognise in the investor's equity its share of the changes in the net assets of the investee that are not recognised in profit or loss or OCI of the investee, and that are not distributions received. Do you agree? Why or why not?

We welcome clarification in this area.

We recognise that the ED is intended to provide a short-term, pragmatic solution to an issue that has led to diversity in practice. It is nonetheless difficult to form a view of the most appropriate solution without first addressing the fundamental issue of whether the equity method is primarily a 'one-line consolidation' or simply a method of re-measuring a single investment. The issue of how the investor should account for other changes in the net assets of the investee is only one of a number of problems that stem, in part at least, from a lack of clarity on this conceptual question. A broader review of the equity method is therefore called for and we are pleased to note that this has been identified as a priority research project in the Board's Feedback Statement on its 2011 Agenda Consultation.

Given the lack of conceptual clarity, views on the best accounting approach are likely to differ, based partly on somewhat subjective assessments of the substance of these types of transaction.

We note that most transactions within the scope of paragraph 10(d) lead to changes in both:

- the investee's net assets; and
- the investor's proportionate ownership interest in the investee's net assets.

For the relatively few types of transaction in which only the first bullet point applies (eg issuance by the investee to a third party of a fixed-for-fixed call option over its own shares) we agree that recognition within equity by the investor is appropriate.

However, we feel that transactions that the effect of changes in the investor's proportionate ownership interest (eg resulting for example from the investee issuing shares to third parties, as illustrated in the example following paragraph 10(d)) should be presented in profit or loss. This is consistent with Mr Ochi's views as explained in AV2.

Question 2 - the IASB also proposes that an investor shall reclassify to profit or loss the cumulative amount of equity that the investor had previously recognised when the investor discontinues the use of the equity method. Do you agree? Why or why not?

We agree with the reclassification approach if these transactions are recognized in the investor's equity in the first place.

We note that this issue becomes irrelevant if these transactions are presented in profit or loss.

Question 3 - do you have any other comments on the proposals?

We have comments on an investor's accounting for an investee's equity-settled share-based payment plan, and some other minor comments and drafting suggestions.

Equity-settled share-based payments of the investee

The reference in paragraph 10(d) to an equity-settled share-based payment transaction should be clarified. The proposed wording of this paragraph could imply that the investor's share of an investee's share-based payment expense should be recognised in equity instead of profit or loss. We think that this amount should be recognized in profit or loss (which also seems to be the Board's view based on the wording of BC5). We assume the intention is either that the investor should recognize the credit entry in equity, and/or that paragraph 10(d) applies when the investee issues shares pursuant to an equity-settled scheme.

In our view:

- an investor should recognize its share of an equity-accounted investee's equity-settled share-based payment plan expense in profit or loss, with a corresponding credit to its investment
- a dilution adjustment should be determined when the related shares are issued to employees (or other third parties), also in profit or loss. This adjustment should be calculated net of the credit already recorded against the investment in the first step.

We think that this approach addresses the concerns in BC5.

Other comments and drafting suggestions

It is not clear whether the investor should reclassify a proportionate amount accumulated other comprehensive income (OCI) when its interest is diluted along the lines of the example illustrating paragraph 10(d). Without a proportionate reclassification an issue arises as to how much to reclassify if the investor subsequently sells some of its investment but continues to apply the equity method. In the example, the investor's ownership interest is reduced from 30% to 25%. Prior to the dilution event the investor would have accumulated its 30% of the investee's OCI. If at a later date the investor sells shares equivalent to a 5% interest, would it reclassify $1/5^{th}$ (5/25) or $1/6^{th}$ (5/30) of the accumulated OCI?

We suggest the title above paragraph 25 should be changed to 'Other reductions in ownership interest' (because this guidance addresses only reductions and not increases).

Paragraph 25 might also be expanded to clarify that, on a partial disposal of an equity-accounted investee, a gain or loss is recognized for the difference between proceeds and proportionate share of the carrying value.