International Accounting Standards Board
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Japanese Bankers Association

## Comments on the International Accounting Standards Board's Exposure Draft *Equity Method of Accounting–IAS 28 Investments in Associates and Joint Ventures*

The Japanese Bankers Association (the "JBA")[1] is pleased to provide comments on the Exposure Draft Equity Method of Accounting – IAS 28 Investments in Associates and Joint Ventures (the "ED") issued by the International Accounting Standards Board (the "IASB").

The JBA appreciates the work of the IASB and would like to express our views based on comments received from member banks on several of the questions raised in the ED.

## General Comments

We would like to express our respect to the IASB's efforts to improve comparability and understandability for users of financial statements by reducing diversity in practice through additions and clarifications to the method of applying the equity method, by answering stakeholders' questions regarding the application of IAS 28 "Investments in Associates and Joint Ventures".

However, some of the proposals go beyond the purpose of the equity method project, which is to clarify by answering questions of application, and hence require careful consideration. Specifically, the proposal to recognise full gains or losses on transactions with associates is closely related to the discussion on the nature of the equity method (a one-line consolidation or a measurement method) and it would not be appropriate to fundamentally change the standard without consideration of this method.

We also believe that proposals that could significantly increase the practical burdens and costs for preparers of financial statements should be carefully considered, weighing the impact on users benefit against the preparer's burden in relation to impairment testing.

In the following, we provide our comments on each of the questions provided in the ED and omit those questions for which we do not have a specific comment.

We hope that our comments will contribute to further discussions at the IASB.

[1] The Japanese Bankers Association is an organisation that represents the banking industry in Japan. Its members are banks and bank holding companies operating in Japan.

## Comments on specific questions

| **Question 3—Recognition of the investor's share of losses**<br>**(Paragraphs 49–52 of [draft] IAS 28 (revised 202x))** |
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| 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:<br>(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<br>(b) recognises separately its share of each component of the associate's comprehensive income.<br><br>The IASB is proposing an investor:<br>(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.<br>(b) recognise and present separately its share of the associate's profit or loss and its share of the associate's other comprehensive income.<br><br>Paragraphs BC47–BC62 of the Basis for Conclusions explain the IASB's rationale for these proposals.<br>Do you agree with these proposals?<br>If you disagree, please explain why you disagree and your suggested alternative. |

We agree with the proposal "(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".

Since the investor makes additional investment in an associate in anticipation that the future earning potential of the associate will allow the investor to recover the amount of such additional investment, we believe that requiring the investor to bear unrecognised losses arising from past events all at once at the time of additional investment ("catch up") is not consistent with the actual situation of the investment.
We also believe that if the IASB were to require a "catch up" adjustment, this could have a negative impact on the economy as this may reduce the number of investments in associates with future potentials but with unrecognised losses.

| **Question 4—Transactions with associates**<br>**(Paragraph 53 of [draft] IAS 28 (revised 202x))** |
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| 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 disagree with the proposal. We believe that it would be appropriate to resolve application questions by providing interim guidance, for example, illustrative examples and educational materials, that “the basic principles for transactions with an associate shall follow IAS 28, but IFRS 10 shall prevail for transactions involving the loss of control of a subsidiary as a result of the sale of the subsidiary to its associate” rather than making fundamental changes to the existing IAS 28.

First, we believe that it is not appropriate for an investor to recognise full gains or losses resulting from transactions with an associate because it may give the investor room for earnings management by adjusting the transaction price with the associate through the exercise of significant influence.

Second, accounting for transactions with associates is closely related to the discussion about the nature of the equity method (a one-line consolidation or a measurement method), and we believe that it is not appropriate to propose fundamental changes without such consideration.
Specifically, it is considered to be consistent for gains or losses resulting from transactions with associates to be partially recognised under a one-line consolidation approach and fully recognised under a measurement method. Therefore, this proposal to change from partial recognition to full recognition may in effect imply that the nature of the equity method is a measurement method.

Third, we believe that the inconsistency between the requirements in IFRS 10 and IAS 28 is not so significant as to require a significant revision of the requirement in paragraph 28 of IAS 28.
In other words, IFRS 10 requires an investor to recognise, in full, the gains or losses on the loss of control of a subsidiary, and does not necessarily reject the partial recognition approach of IAS 28 for transactions other than the sale of a subsidiary to its associate. Therefore, it is highly questionable whether it is appropriate to

fundamentally review IAS 28.

In this regard, the basic principles for transactions with an associate shall follow IAS 28, but IFRS 10 shall prevail for transactions involving the loss of control of a subsidiary as a result of the sale of the subsidiary to its associate, which would resolve the inconsistency between the requirements in IFRS 10 and IAS 28.

| **Question 5—Impairment indicators (decline in fair value)**<br>**(Paragraph 57 of [draft] IAS 28 (revised 202x))** |
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| 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.<br><br>The IASB proposing:<br>(a) to replace 'decline…below cost' of an investment in paragraph 41C of IAS 28 with 'decline…to less than its carrying amount';<br>(b) to remove 'significant or prolonged' decline in fair value; and<br>(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.<br><br>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.<br><br>Paragraphs BC94–BC106 of the Basis for Conclusions explain the IASB's rationale for these proposals.<br>Do you agree with these proposals?<br>If you disagree, please explain why you disagree and your suggested alternative. |

We disagree with the proposal in the ED because we believe that it does not adequately address the application question and may significantly increase the burden on preparers of financial statements.

The ED proposes to remove the phrase "significant or prolonged" for a decline in the fair value of an investment in an associate's equity instrument from paragraph 41C of IAS 28, but we believe that removing only this phrase would make the requirements and timing for identifying a decline in fair value below the carrying amount of a net investment unclear. In our view, this would not achieve the objective of the ED, which is to improve comparability and understandability by reducing diversity in practice.

If such a revision is made, preparers of financial statements may be required to test for impairment if the fair value of an investment falls below its carrying amount, either temporarily or by a small amount. In general, the impairment testing of investments in associates and goodwill requires complex estimates, often involves the use of external experts, etc., and is expected to incur significant costs to companies, including the practical burden. Therefore, we believe that careful consideration should be given to how this revision would affect the benefits to users of financial statements and the burden on preparers in relation to impairment testing. If the IASB were to remove the phrase "significant or prolonged", we request the IASB to consider adding a proviso such as "excluding temporary or immaterial declines" or to follow the requirements of IAS 36 and setting the timing for determining a decline in fair value as "at the end of each reporting period".

In addition, we believe that the existing IAS 28 does not clarify the unit of account for measuring the fair value of investments in associates, which creates issues in determining whether there is objective evidence of impairment in respect of investments at a premium to the market share price. In other words, whether a premium should be added to the market share price in the fair value measurement depends on whether the scope of fair value measurement is considered to be the individual shares issued by the associate or the entire investment (business interest), which may affect the determination of whether there is objective evidence of impairment. However, the ED does not address this point, leaving this application issue unresolved. Therefore, clarification of the treatment is requested.

In this regard, we believe that the unit of fair value measurement should be the entire investment (business interest) including the premium, as investments in associates are generally business investment nature and paragraph 32 of IAS 28 provides for the capitalisation of the premium (goodwill equivalent). If the unit of measurement were the individual share, the market price of the share would be the fair value and therefore objective evidence of impairment would incur immediately after the purchase of an investment in an associate with a premium added, even if there is no change in the external environment or in the circumstances of the company. This is considered to be inappropriate as it is inconsistent with paragraph 41A of IAS 28, which states that objective evidence of impairment is the result of one or more events that occurred after the initial recognition of the net investment.

| **Question 7—Disclosure requirements**<br>**(Paragraphs 20(c), 21(d)–21(e) and 23A–23B of IFRS 12 and paragraph 17A of IAS 27)** |
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| 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:<br>(a) gains or losses from other changes in its ownership interest;<br>(b) gains or losses resulting from 'downstream' transactions with its associates or joint ventures;<br>(c) information about contingent consideration arrangements; and<br>(d) a reconciliation between the opening and closing carrying amount of its investments.<br><br>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.
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> Paragraphs BC137–BC171 of the Basis for Conclusions explain the IASB’s rationale for these proposals.
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> Do you agree with these proposals?
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> If you disagree, please explain why you disagree and your suggested alternative.

With respect to “(b) gains or losses resulting from ‘downstream’ transactions with its associates or joint ventures”, we disagree with the change in accounting method, as noted in our response to “Question 4—Transactions with associates”. Therefore, we also disagree with the disclosure requirement based on such a change in accounting method.

(End)