Institute
of Certified
Public Accountants
in Israel

לשכת
רואי חשבון
בישראל

1906/32159

April 9, 2013

International Accounting Standards Board
30 Cannon Street
London EC4M6XH
United Kingdom

Dear Sir/Madam,

Re: **Exposure Draft – Equity Method: Share of Other Net Asset Changes**

We appreciate the opportunity to respond to the Exposure Draft "Equity Method: Share of Other Net Asset Changes" issued by the International Accounting Standards Board (IASB). This response represents the views of the Institute of Certified Public Accountants in Israel.

Please note that when we refer in our response to changes in the equity of an equity-method investee, we mean changes other than those attributed to profit or loss, OCI or distributions of the investee.

Question 1

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

Response

We disagree with the proposed revision for the following reasons:

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The ED differentiates between direct and indirect disposal of interests in the investee

In substance, a dilution of holdings in an investee as a result of additional share issuance to third parties ("indirect disposal") is equivalent to a direct disposal of shares owned by the holding entity. In both cases, the entity's share of interests in the investee declines, except that in a direct disposal the investor receives cash (or other assets) in consideration for the disposed interests and simultaneously the value of its investment in the investee decreases, while in an indirect disposal the same net amount is recorded as a change in the investment.

Although in substance both cases are similar, and thus should be treated in the same manner, the proposed amendment aims to establish a different accounting treatment for these cases.

We would also like to mention that such a differentiation would be inconsistent with the treatment proposed in IFRS 10, where changes in ownership interests, that do not result in a loss of control, are treated equally the same, regardless of the way they were constructed (i.e., whether through direct or indirect disposal). See below other inconsistencies with IFRS 10.

The ED is inconsistent with IFRS 10

According to paragraph BC6 of the proposal, "some IASB members noted that the application of the equity method is consistent with view … that equity method accounting is a one-line consolidation and including the investor's share of the investee's equity transactions in profit or loss would be inconsistent with that view".

However, paragraph BCZ169 of IFRS 10 states that "The Board reached this conclusion [*that no gain or loss from changes in ownership interests, that do not result in a loss of control, should be recognized in profit or loss*] because it believed that the approach adopted in the proposed amendments was consistent with its previous decision that non-controlling interests are <u>a separate component of equity</u>".

Since an equity-method investee is not part of the group (as defined in IFRS 10) and therefore <u>is not a separate component of equity</u> in the investor's financial statements, the reasons for such treatment in consolidated financial statements is irrelevant for an equity-method investment, and thus should not be followed.

The ED is inconsistent with IAS 1 and the Conceptual Framework

IAS 1 defines "Total comprehensive income" as follows: "the change in equity during a period resulting from transactions and other events, <u>other than</u> those changes resulting from transactions with owners in their capacity as owners".

From the investor's perspective, transactions between the investee and its investors <u>are not</u> transactions with "owners in their capacity as owners" ("owners" – as defined in IAS 1). Therefore, the proposed amendment, if approved, would constitute a direct inconsistency between IAS 28 and IAS 1, because changes in the equity of an equity-method investee are clearly within the definition of "Total comprehensive income". Consequently, when such changes are reflected in the investor's financial statements, they must be recognized either in Profit or Loss or in other comprehensive income.

Furthermore, paragraph 4.25 of the Conceptual Framework for Financial Reporting states that: "Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants". Expenses are defined in that paragraph using the same principle.

Accordingly, we believe that although some changes in an equity-method investee's equity may not reflect performance in the investee's financial statements, they might constitute an income or expense in accordance with the Conceptual Framework in the investor's financial statements, as they might constitute enhancements or decreases of an asset that result in increases or decreases in equity, other than those relating to contributions from equity participants or distributions to them.

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 recognized when the investor discontinues the use of the equity method. Do you agree? Why or why not?

Response

As mentioned in our response to Question 1, we oppose the concept of deferring gains or losses through equity. Moreover, we would like to stress that this would be the first time that the IASB introduces a "recycling" concept to equity components, which did not originate from other comprehensive income. We believe that this might cause major inconsistencies with other IFRSs (and the conceptual framework) as well as unwarranted confusion among users of financial statements. We also believe that such a conceptual and fundamental change to IFRSs should be considered thoroughly and not in an expeditious short-term amendment.

Conclusion

Primarily, we believe that the issues related to the aforementioned questions should not be addressed in an expeditious short-term solution, but rather in a more comprehensive revision of IAS 28. The reason is that the proposed amendment involves major changes to current practice, will result in inconsistencies with other IFRSs and will cause unwarranted confusion among users of financial statements, such that undermines the understandability of financial statements.

Alternatively, if the IASB is determined to set a short-term solution (because of potential diversity in the current practice), we prefer the solution proposed by the IFRS IC (as presented in paragraph BC2 of the ED) as a better solution. Such a solution would also have the benefit of a lesser impact on current practice, while achieving a relatively significant convergence with US GAAP.

Sincerely yours,

A. Inbar

Adir Inbar
Chair of the Professional Council

Arnon Ratzkovsky
Chair of the Financial Reporting Standards Committee