STAFF PAPER

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IASB Meeting

Project	**Implementation matters**
Paper topic	Sale of a single asset entity containing real estate (IFRS 10)

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Introduction

1. At its meeting in June 2019, the IFRS Interpretations Committee (Committee) discussed a submission about the sale of a single asset entity containing real estate. In the submission, the submitter asked about the accounting for a transaction in which an entity, as part of its ordinary activities, enters into a contract with a customer to sell real estate by selling its equity interest in a single asset entity that is a subsidiary.

2. In particular, the submitter asked whether the transaction described in the submission (described in detail in paragraph 8 of this paper) is within the scope of IFRS 10 *Consolidated Financial Statements* or IFRS 15 *Revenue from Contracts with Customers* (Question A).

3. The submitter also asked follow-up questions depending on the answer to Question A:

   (a) Question B—If IFRS 10 applies, does the entity present the resulting gain or loss on a gross or net basis?

   (b) Question C—If IFRS 15 applies, would that conclusion continue to apply if, in addition to the real estate and any related tax asset or liability, the single asset entity has other assets or liabilities (for example, a financing liability)?

4. At its June 2019 meeting, the Committee did not reach a decision on how to proceed on this matter. The Committee's discussion involved consideration of possible narrow-scope standard-setting to address the question.

5. In the light of the Committee's discussion, we are now asking the Board for its views on possible narrow-scope standard-setting on this topic.

Structure of the paper

6. This paper includes:
   (a) background information (paragraphs 8);
   (b) outreach (paragraphs 9–10);
   (c) staff analysis and Committee discussion (paragraphs 11–23);
   (d) standard-setting options (paragraphs 26–40); and
   (e) staff recommendation (paragraphs 41–42).

7. The paper has one appendix—Appendix A, which includes a detailed summary of responses to the Committee's outreach.

Background information

8. The submission outlines the following fact pattern:
   (a) An entity builds and sells real estate as part of its ordinary activities (ie the entity enters into contracts for the sale of real estate before, during or after construction of a building).
   (b) The entity establishes a legal entity (Real Estate) for each real estate asset (land and/or a building) when it acquires the land and before it enters into contracts with customers.
   (c) Real Estate holds only the real estate asset and any related tax asset or liability.
   (d) At the time Real Estate is established, the entity concludes that Real Estate is a subsidiary as defined in IFRS 10.

(e) In selling the real estate to a customer, the entity transfers its 100% equity interest in Real Estate to the customer; ie legally, the entity sells shares and not the real estate.

(f) As a consequence of the transaction, the entity loses control of Real Estate.

Outreach

9. To obtain information about this question we sent requests to members of the International Forum of Accounting Standard-Setters, securities regulators and large accounting firms.

10. Appendix A to this paper includes full details of the responses. In summary, responses indicated that:

    (a) the fact pattern is common in Germany, Norway, Sweden, Singapore and the UK; and

    (b) there is mixed practice—some entities apply IFRS 10 to the fact pattern described in the submission and some apply IFRS 15.

Staff analysis and Committee discussion

Staff analysis of existing requirements in IFRS Standards

11. Paragraphs 18–39 and 46–48 of Agenda Paper 6 to the Committee's June 2019 meeting contain an in-depth staff analysis. The following paragraphs provide Board members with an overview.

Question A

12. The submitter asks whether, in the fact pattern described in the submission, the entity applies IFRS 10 or IFRS 15 to the sale of Real Estate.

13. Paragraph 5 of IFRS 15 defines the scope of the Standard:

> An entity shall apply this Standard to all contracts with customers, except the following: …
>
> (c) financial instruments and other contractual rights or obligations within the scope of IFRS 9 *Financial Instruments*, IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*; …

14. In the fact pattern submitted, Real Estate is a subsidiary as defined in IFRS 10. The entity therefore applies IFRS 10 in accounting for its interest in Real Estate from the date that it obtains control of Real Estate until the date of losing control. Consequently, the entity applies IFRS 10 to the transaction described in the submission; IFRS 10 includes requirements setting out the accounting applied when an investor loses control of a subsidiary. The transaction described in the submission is excluded from the scope of IFRS 15 by paragraph 5(c) of that Standard.

Question B

15. Question B is applicable when the entity applies IFRS 10 to the transaction described in the submission. Question B asks whether the entity presents:

    (a) the gain or loss on disposal of Real Estate in only one line item in the statement of profit or loss; or

    (b) the proceeds from the disposal of Real Estate in one line item in the statement of profit or loss, and the net assets of Real Estate disposed of in another line item. In this case, the entity might present the proceeds as revenue and the net assets disposed of in an operating expense line item, such as cost of sales.

16. Paragraph 25(c) of IFRS 10 requires an entity to recognise the gain or loss associated with the loss of control of a subsidiary. Paragraph B98 specifies how an entity calculates and recognises that gain or loss (**bold added**):

> B98 If a parent loses control of a subsidiary, it shall:
>
> (a) derecognise:

(i) the assets (including any goodwill) and liabilities of the subsidiary at their carrying amounts at the date when control is lost; and

(ii) the carrying amount of any non-controlling interests in the former subsidiary at the date when control is lost (including any components of other comprehensive income attributable to them).

(b) recognise:

(i) the fair value of the consideration received, if any, from the transaction, event or circumstances that resulted in the loss of control;

(ii) if the transaction, event or circumstances that resulted in the loss of control involves a distribution of shares of the subsidiary to owners in their capacity as owners, that distribution; and

(iii) any investment retained in the former subsidiary at its fair value at the date when control is lost.

(c) reclassify to profit or loss, or transfer directly to retained earnings if required by other IFRSs, the amounts recognised in other comprehensive income in relation to the subsidiary on the basis described in paragraph B99.

(d) **recognise any resulting difference as a gain or loss in profit or loss attributable to the parent**.

17. Paragraph B98(d) requires the recognition of the resulting gain or loss associated with the loss of control of a subsidiary in profit or loss. Paragraph B98(a) and (b) require the recognition or derecognition of the component parts of the gain or loss (for example, the recognition of the consideration received and the derecognition of the assets and liabilities of the subsidiary) in the statement of financial position. However, paragraph B98(d) does not specify the recognition of the component parts of the gain or loss in profit or loss—only the *resulting* gain or loss is recognised in profit or loss after having recognised and derecognised the appropriate items in the statement of financial position.

18. Consequently, in applying IFRS 10 to the transaction described in the submission, in our view there is only one amount recognised in profit or loss—the gain or loss associated with the loss of control of the subsidiary. In considering presentation in the statement of profit or loss, the entity therefore determines the line item within which to present that gain or loss applying IAS 1 *Presentation of Financial Statements*. The transaction does not result in the recognition of the component parts of the gain or loss in profit or loss that the entity might then present in separate line items.

19. Consequently, we conclude that, for the transaction described in the submission, the entity is required to present any gain or loss associated with the loss of control of the subsidiary within one line item in the statement of profit or loss.

Question C

20. Question C is applicable only if IFRS 15 applies to the transaction described in the submission. We have not analysed this question because the transaction described in the submission is not within the scope of IFRS 15.

Committee discussion

21. A majority of Committee members agreed with the staff analysis for Question A—ie that an entity applies IFRS 10 in accounting for the transaction described in the submission.

22. However, the Committee did not conclude on Question B—ie whether an entity presents any gain or loss from disposal of the single asset entity on a ‘gross’ or ‘net’ basis.

23. Some Committee members expressed concerns that presenting the gain or loss from disposal of the single asset entity on a ‘net’ basis would not provide a faithful representation of the transaction because the transaction is part of the entity’s ordinary activities. Some Committee members noted that an entity would present no revenue from contracts with customers if the entity’s only ordinary activity is to sell real estate and it conducts all of that activity through the disposal of single asset entities as described in the submission.

24. Some Committee members noted that it would be difficult to say the 'corporate wrapper' around the real estate has no substance—there is a business reason (for example, related to tax) for selling the real estate inside a legal entity structure (instead of transferring legal title of the real estate to the customer), and thus the corporate wrapper changes the nature and substance of the transaction. Nonetheless, they questioned whether that difference in legal form and substance should result in the entity not recognising revenue for transactions within its ordinary activities.

25. Some Committee members noted that US GAAP requires an entity to apply the requirements in Topic 606, Revenue from Contracts with Customers, to the derecognition and deconsolidation of entities, the substance of which are directly addressed in Topic 606 (see further discussion in paragraphs 34–35 of this paper).

Standard-setting options

26. In the light of the Committee's discussion, we have considered whether the Board could (or should):

    (a) undertake narrow-scope standard-setting to address the fact pattern described in the submission (paragraphs 27–30); or

    (b) consider the matter more broadly, either as part of the Post-Implementation Review (PIR) of IFRS 10 or as part of its forthcoming Agenda Consultation (paragraphs 31–40).

Narrow-scope standard-setting

27. The Board could decide to add a targeted, narrow-scope standard-setting project to its work plan to address the fact pattern described in the submission—either instead of considering the matter more broadly or as a short-term fix.

28. If the Board were to pursue such an approach, we think the Board could consider adding a scope exception to IFRS 10 and IFRS 15 that would require an entity to apply IFRS 15 to a transaction that has all the following characteristics:

(a) the entity contracts with a customer for goods or services that are an output of the entity's ordinary activities in exchange for consideration;

(b) the contract is structured as the sale of the entity's 100% interest in a subsidiary; and

(c) the subsidiary contains only inventory as defined in IAS 2 *Inventories* and any related income tax asset or liability as defined in IAS 12 *Income Taxes*.

29. Making such a narrow-scope exception to the requirements in IFRS 10 and IFRS 15 would address the concerns raised by Committee members—it would do so by requiring an entity to apply IFRS 15 to transactions with the characteristics listed in paragraph 28 above. Accordingly, the entity would recognise revenue to depict the transfer of the inventory to the customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for that inventory.

30. If the Board were to undertake narrow-scope standard-setting, we would recommend this very narrow-scope, rules-based exception from a cost-benefit perspective. Expanding the scope to consider other fact patterns (see paragraphs 36-40 of this paper for more information) would both:

(a) add complexity to the project, which in turn raises the risk of unintended consequences; and

(b) from our limited consideration of the matter to date, we would see no basis on which to support the recognition of revenue for other fact patterns that, legally, involve the sale of shares rather than the sale of goods or services. When an entity transfers its 100% interest in inventory to a party that meets the description of a customer in IFRS 15, we understand why some Committee members would suggest that, in such a case, the recognition of revenue (and cost of sales) might provide useful information to users of financial statements. However, if the entity sells only part of its interest in a subsidiary holding inventory, or sells its interest in an entity with various assets and liabilities, at this stage we see no basis on which to create an exception to the requirements that otherwise apply when an entity loses control of a subsidiary.

Post-Implementation Review of IFRS 10 or Board's Agenda Consultation

31. If the Board wished to consider this matter more broadly, we think it would be best considered as part of the Post-Implementation Review (PIR) of IFRS 10 given that the transaction is, in our view, within the scope of IFRS 10.

32. Equally the Board could seek to obtain more information on this matter as part of its forthcoming Agenda Consultation. The following factors to consider would be equally applicable if the Board were to consider this matter as part of its Agenda Consultation.

33. In considering the matter more broadly, the Board could consider:

    (a) requirements in US GAAP (see paragraphs 34–35 of this paper); and

    (b) other fact patterns (see paragraphs 36–40 of this paper).

Requirements in US GAAP

34. US GAAP requires an entity to account for disposals of specific types of entities applying its revenue recognition standard (Topic 606), instead of its deconsolidation requirements (Topic 810). In particular, it refers to disposals of subsidiaries for which the 'substance of the transaction' is addressed directly by Topic 606. We note that Topic 606 applies to disposals of such subsidiaries to both customers and non-customers.

35. Paragraph 810-10-40-4A states:

> 810-10-40-3A The deconsolidation and derecognition guidance in this Section applies to the following:
>
> …
>
> c. A subsidiary that is not a nonprofit activity or a business if the substance of the transaction is not addressed directly by guidance in other Topics that include, but are not limited to, all of the following:
>
> 1. Topic 606 on revenue from contracts with customers

Other fact patterns

36. If the Board were to consider the matter more broadly, there are two fact patterns we think the Board would need to consider:

    (a) an entity selling less than 100% of the shares in the single asset subsidiary. For example, an entity could decide to sell 80% of its 100% equity interest in a subsidiary to a customer.

    (b) a subsidiary with assets or liabilities in addition to inventory and a related tax asset/liability. For example, the subsidiary could also have a financing liability, such as a bank loan.

37. In those fact patterns, proposing amendments to IFRS Standards to permit or require an entity to componentise any gain or loss on disposal of the subsidiary (and present revenue and cost of sales separately) would raise additional questions.

38. To illustrate, consider the following example:

> Real Estate is an entity that has an inventory asset. An entity (Seller) owns 100% of the share capital of Real Estate, and consolidates Real Estate applying IFRS 10. Seller agrees to sell Real Estate to a customer for CU110, and in doing so loses control of Real Estate. On the date that control is lost, the carrying amount of Real Estate's inventory asset is CU90 in Seller's consolidated financial statements. Consequently, applying paragraph 25 of IFRS 10 to the transaction, Seller recognises a gain associated with the loss of control of Real Estate of CU20 (proceeds of CU110, less net assets of CU90).

39. If Seller were to sell only 80% of the shares in Real Estate for CU88, at the date of losing control of Real Estate, Seller would recognise its 20% retained interest in Real Estate at CU22 (ie the fair value of the retained interest at the date of losing contract calculated as CU110 *20%), applying paragraph B98(b) of IFRS 10. As a consequence, Seller would recognise a resulting gain of CU20 (proceeds of CU88, plus retained interest of CU22, less net assets of CU90). In this example, should Seller be permitted or required to recognise (a) revenue for an amount of CU110 that represents the fair value of 100% of Real Estate, and (b) an expense for an amount of

(CU90) that represents the carrying amount of Real Estate's net assets at the date of losing control, even though Seller has sold only 80% of Real Estate? Alternatively, should the amount of revenue (and expense) recognised be restricted to reflect that Seller has, in effect, sold only 80% of its 100% interest in Real Estate's inventory to the customer?

40. Similarly, using the example in paragraph 38 of this paper, assume the same facts except that (a) Real Estate also has a bank loan outstanding of CU30, and (b) Seller sells 100% of its equity interest in Real Estate for CU80. Seller again would recognise a resulting gain of CU20 (proceeds of CU80, less net assets of CU60) on losing control of Real Estate. In this example, should Seller be permitted or required to componentise the gain of CU20 into amounts of revenue and expense related to the transfer of inventory and, if so, on what basis?

Staff recommendation

41. In our view, if the Board wished to address the transaction described in the submission, it would be feasible to undertake a targeted, narrow-scope amendment that would require an entity to apply IFRS 15 (rather than IFRS 10) on disposal of a single asset entity with the characteristics described in paragraph 28 of this paper. However, in our view we have insufficient evidence at this stage to suggest that such a project should be a priority for the Board, ahead of other projects already on the Board's work plan or research pipeline.

42. We recommend that the Board consider the matter as part of the PIR of IFRS 10. This would allow the Board obtain more evidence of the prevalence of the matter, and for example whether any narrow-scope standard-setting in this respect might raise new questions or have unintended consequences.

Question for the Board
Do Board members agree with the staff recommendation to consider this matter as part of the Board's PIR of IFRS 10?

Appendix A—Outreach

A1. We sent information requests to members of the International Forum of Accounting Standard-Setters, securities regulators and large accounting firms.

A2. The request asked those participating to provide information based on their experience about:

(a) the prevalence of the fact pattern; and

(b) whether entities typically apply IFRS 10 or IFRS 15 in accounting for the sale of Real Estate.

A3. We also asked those participating whether variations to the fact pattern described in paragraph 8 of this paper are common. In particular, we asked about fact patterns in which:

(a) an entity disposes of less than 100% of the share capital of Real Estate; or

(b) Real Estate contains additional assets and/or liabilities.

A4. We received 13 responses—six from large accounting firms, five from national standard-setters and two from organisations representing groups of regulators. The views received represent informal opinions, rather than formal views of those responding.

Prevalence

A5. Responses to our outreach indicated that the fact pattern described in paragraph 8 of this paper is common in some jurisdictions but not in others. Respondents said it is common in Germany, Norway, Sweden, Singapore and the UK. The fact pattern has been observed, but is not common, in Australia, Belgium, Canada, Hong Kong, Israel, Japan, the Netherlands, Poland and South Africa. One Committee member noted that the fact pattern is common in China.

A6. Some respondents said the fact pattern is common for other assets or in other industries—for example, in the construction and sale of renewable energy plants, undeveloped land and extractive industries.

A7. Respondents said a fact pattern in which an entity disposes of less than 100% of the share capital of Real Estate is not common. However, some respondents said that they had observed such a fact pattern in Denmark, Germany, Israel, Japan and the UK.

A8. Respondents also said a fact pattern in which Real Estate contains additional assets and/or liabilities is not common.

Accounting

A9. Respondents reported mixed practice—some entities apply IFRS 10 to the fact pattern described in the submission and some apply IFRS 15. Respondents said entities that apply IFRS 15 typically do so because:

(a) the transaction is part of the entity's ordinary activities; or

(b) Real Estate is not a business as defined by IFRS 3 *Business Combinations*.

A10. Some respondents also said entities may decide to apply IFRS 15 because they think:

(a) it would better reflect the 'substance' of the transaction—ie the entity is 'in substance' selling the real estate and not the shares;

(b) presenting a net gain or loss on disposal would not faithfully represent the entity's activities; or

(c) the transaction was structured within a separate legal entity for legal, tax or risk reasons, which should not affect the recognition of revenue.

A11. Some respondents said they had not observed practice applying IFRS 15, but had done so applying IAS 18 *Revenue*.