



30 Cannon Street, London EC4M 6XH, United Kingdom
Phone: +44 (0)20 7246 6410, Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: <http://www.iasb.org>

**International
Accounting Standards
Board**

This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.

These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting: **January 2006, London**

Project: **Business Combinations II: Proposed Amendments to IAS 27
Consolidated and Separate Financial Statements -- Comment
Letter Summary (Agenda Paper 6C)**

INTRODUCTION

1. The comment period on the Exposure Drafts of Proposed Amendments to IFRS 3 *Business Combinations* and IAS 27 *Consolidated and Separate Financial Statements* ended on 28 October 2005. The comments received on the proposed amendments to IFRS 3 are summarised in Attachment A of Agenda Paper 6. This paper summarises the comments received on the proposed amendments to IAS 27.
2. In total, the Board received comment letters on issues related to IAS 27 from 95 respondents, including preparers, accounting firms, analysts, academics, and standard setters. The staff also considered relevant comments made by participants at the business combinations round-tables held in London on 9 November 2005.

[Paragraph 3 not reproduced in the observer notes]

SUMMARY OF COMMENTS RECEIVED

4. Significant comments received relate primarily to the following issues:
 - a. Nature of non-controlling interests
 - b. Economic entity vs. parent entity perspective
 - c. Changes in ownership interests in subsidiaries that do not result in loss of control
 - d. Loss of control of a subsidiary
 - e. Treating multiple transactions as a single transaction
 - f. Attribution of losses
 - g. Transitional provisions
 - h. Due process

Nature of non-controlling interests

5. Respondents' views on the nature of non-controlling interests vary. Most respondents agree that non-controlling interests are not a liability and agree with the classification of non-controlling interests as equity for presentation purposes. However, several respondents object to extending the decision reached in the improvements project to classify non-controlling interests as equity to the accounting treatment of transactions involving non-controlling interests. Most respondents stated that non-controlling interests should be classified as a component of equity separate from that of parent entity shareholders, which receives different treatment than "pure" equity.
6. Other respondents stated that the *Framework* should be expanded to define non-controlling interests as a new element separate from liabilities and the equity of parent entity shareholders.

7. Many respondents agree with the dissenting Board members' view that non-controlling interests represent equity claims that are restricted to particular subsidiaries, whereas the controlling interests are affected by the performance of the entire group. Therefore non-controlling interests bear risks and benefit from rights of the group in a different degree than owners of the parent entity.

[Paragraphs 8-9 not reproduced in the observer notes]

Economic entity perspective vs. parent entity perspective

10. Most of the comments submitted by respondents were in respect to the Board's decision to adopt the economic entity perspective as opposed to the parent entity perspective. Respondents' views on that issue often shape their views on related issues in IFRS 3 and IAS 27 including the recognition of full goodwill, the treatment of transactions with non-controlling interests as equity transactions, and the attribution of losses to non-controlling interests. This section summarises respondents' general concerns whilst comments related to specific issues in IAS 27 are addressed in the following sections.
11. Most respondents disagree with the Board's use of the economic entity perspective and support the parent entity perspective. Those respondents stated that:
 - a. the primary purpose of consolidated financial statements is to provide useful information for the principal users of consolidated financial statements—shareholders (current and potential) of the parent entity.
 - b. non-controlling interests have different information needs than controlling interests. The information needs of non-controlling interests are best served by the financial statements of the entity in which they have an interest.
 - c. the parent entity perspective provides the most relevant information for users of consolidated financial statements. Parent entity shareholders are interested in information about the financial performance and position of the group from the parent's perspective to evaluate the stewardship of entity management and the return on the entity's invested capital.

[Paragraph 12 not reproduced in the observer notes]

Changes in ownership interests in subsidiaries that do not result in loss of control

13. The Exposure Draft proposes that:

30A Changes in the parent's ownership interest in a subsidiary after control is obtained that do not result in a loss of control shall be accounted for as transactions between equity holders in their capacity as equity holders. No gain or loss shall be recognised in profit or loss on such changes. The carrying amount of the non-controlling interest shall be adjusted to reflect the change in the parent's interest in the subsidiary's net assets. Any difference between the amount by which the non-controlling interest is so adjusted and the fair value of the consideration paid or received, if any, shall be recognised directly in equity and attributed to equity holders of the parent.

14. Several respondents welcomed guidance in this area as divergent practice has resulted from the current lack of guidance. Respondents noted that as many as five different methods of accounting for increases in ownership interests after control of a subsidiary has been obtained are being used in practice. Respondents also requested guidance on accounting for additional acquisitions of interests in associates when such additional acquisitions do not result in obtaining control over the investee.

15. However, most respondents disagree with the proposal. Consistent with their views on the economic entity and parent entity perspectives, many respondents stated that changes in ownership interests in subsidiaries that do not result in a loss of control should be considered from the perspective of parent entity shareholders. Those respondents stated that parent entity shareholders view purchases and sales of non-controlling interests as transactions with third parties that produce significant economic effects that should be recognised in profit or loss. Purchases of additional interests are investments of available resources for which parent entity shareholders expect to realise economic returns.

16. Respondents also expressed the following concerns with the proposal:

- a. When an additional interest in a successful subsidiary is acquired some time after control was first obtained, the accounting for this transaction can result in a significant reduction in reported equity. This accounting treatment does not reflect economic reality.
- b. The proposals will result in “gaming” to achieve desired accounting results, even with the additional guidance on treating multiple transactions as a single transaction.

17. Respondents proposed several alternatives for the accounting for transactions between controlling and non-controlling interests after control is obtained. The alternatives proposed generally were based on the respondents’ views on the proposed amendments to IFRS 3 (i.e. agreement or disagreement with the full goodwill method). Many respondents agree with the alternative view in the Exposure Draft.

AV3 ...the acquisition of additional equity in a subsidiary would give rise to the recognition of additional purchased goodwill, measured as the excess of the purchase consideration over the book value of the separately identified assets in the subsidiary attributable to the additional interest acquired. On reducing the equity stake in a subsidiary, without loss of control, a gain or loss attributable to the controlling interest would be recognised. This would be measured as the difference between the consideration received and the proportion of the book value of the subsidiary’s assets (including purchased goodwill) attributable to the holding disposed of...

18. Other respondents proposed that:

- a. The net assets associated with the additional percentage of the subsidiary acquired should be recorded at fair value at the acquisition date. Goodwill would be recognised for any difference between (1) the cost of the additional interest acquired and (2) the percentage of the fair value of the identifiable assets and liabilities associated with the newly acquired interest.
- b. In addition to recognising gains or losses on a decrease in ownership interests in a subsidiary without loss of control, certain transactions (e.g. foreign exchange differences) recognised in equity related to the non-controlling interests sold should also be recycled through profit or loss.

[Paragraphs 19-23 not reproduced in the observer notes]

Loss of control of a subsidiary

24. The Exposure Draft proposes that on loss of control of a subsidiary any non-controlling equity investment remaining in the former subsidiary should be remeasured to its fair value in the consolidated financial statements at the date control is lost. The Exposure Draft also proposes that the gain or loss on such remeasurement be included in the determination of the gain or loss arising on loss of control.
25. Several respondents support remeasurement at fair value because the loss of control is a significant economic event. Those respondents noted that the proposal is consistent with the proposal in IFRS 3 to remeasure previously-held non-controlling interests to fair value at the date control is obtained.
26. However, most respondents disagree with the proposal to remeasure any retained interest to fair value at the date control of a subsidiary is lost. Most respondents stated that any remaining non-controlling equity investment should be accounted for under the provisions of IAS 28, *Investments in Associates*, IAS 31, *Interests in Joint Ventures*, or IAS 39, *Financial Instruments: Recognition and Measurement*, as follows:
- a. Under IAS 28 or IAS 31, an investment in an associate or joint venture is initially recognised at cost. Accordingly, the retained interest should be recorded at the appropriate proportion of the original cost of the acquisition plus the appropriate proportion of post-acquisition profits or losses.
 - b. Under IAS 39, financial assets are initially recognised at fair value. Accordingly, the retained interest should be measured at fair value at the date control is lost. However, if the retained interest is classified as available-for-sale, the gain or loss on remeasurement should be recognised in equity, not profit or loss.

Accordingly, those respondents stated that measurement of the retained interest at the date control is lost should affect profit or loss only if the retained interest is classified

as a financial asset at fair value through profit or loss under IAS 39 or if the holder deems the retained interest to be impaired.

27. The respondents who disagreed with the proposal did so for a variety of reasons, including:

- a. No exchange transaction has occurred for the retained interest.
- b. The accounting for associates and joint ventures involves recognition of the underlying net assets. Since the entity's investment is continuing, remeasurement is not warranted. If remeasurement is allowed, any change in value is comparable to the revaluation of property, plant and equipment and should be presented within equity.
- c. The proposed accounting is inconsistent with IAS 38 *Intangible Assets* because it leads to recognising through profit or loss, the revaluation of internally generated goodwill. This also contradicts the principles of IFRS 3 whereby goodwill is established once and in total when control is obtained.
- d. Remeasuring the retained investment loses the record of the invested capital along with the basis for evaluating the performance of that investment.
- e. It is inappropriate to remeasure the retained investment to fair value twice when ownership interests are decreased gradually (once when control is lost and once when significant influence is lost). The proposal to remeasure at fair value should not be extended to events or transactions in which an investor loses significant influence or joint control over an entity.

28. Several respondents also suggested that transactions between controlling and non-controlling interests which were recorded previously in equity under the proposals, should be recycled into profit or loss when control is lost.

[Paragraphs 29-30 not reproduced in the observer notes]

Treating multiple transactions as a single transaction

31. Paragraph 30F of the Exposure Draft proposes that it be presumed that multiple transactions that result in a loss of control of a subsidiary should be accounted for as a single transaction when one or more of the following indicators are present:

- (a) the transactions are entered into at the same time or as part of a continuous sequence and in contemplation of one another.
- (b) the transactions form a single arrangement that achieves, or is designed to achieve, an overall commercial effect.
- (c) the occurrence of one transaction or arrangement is dependent on the occurrence of the other transaction(s) or arrangement(s).
- (d) one or more of the transactions considered on their own is not economically justified, but they are economically justified when considered together.

32. Many respondents agree with that proposal. However, several respondents noted that the fact that the guidance is needed indicates a weakness in the proposed amendments to IAS 27 and the guidance would be unnecessary under their proposed models (e.g. if gains or losses on disposals of non-controlling interests which do not result in loss of control were recognised in the income statement or if transactions between parents and non-controlling interests, which have been previously recorded in equity, were recycled after the loss of control).

33. Respondents also requested guidance on:

- a. Accounting for individual transactions if the series of transactions is partially-complete at a period end. It may not always be evident that a specific transaction is part of a sequence until a later transaction in that sequence.
- b. The point at which the single accounting entry should be recorded.
- c. Determining the fair value of consideration received on disposal when multiple arrangements should be accounted for as a single arrangement.

- d. Accounting for complex single-agreement structures likely to be seen in practice, such as agreements that involve a forward or an option.

34. In addition, several respondents suggested that the guidance should be more principles-based and the issue of linking transactions should be discussed more broadly, rather than only in respect to this particular situation. Several of those respondents noted that they could still envision transactions that could be structured around the additional guidance. Respondents suggested that the Standard should include examples of indicators that multiple transactions should be treated as a single transaction, but those examples should not be considered a closed list.

[Paragraphs 35-36 not reproduced in the observer notes]

Attribution of losses

37. Paragraph 35 of the Exposure Draft proposes that losses applicable to the non-controlling interest in a subsidiary should be allocated to the non-controlling interest even if such losses exceed the non-controlling interest in the subsidiary's equity.

38. Several respondents agree with that proposal, noting that non-controlling interests share proportionately in the risks and rewards of the investment in the subsidiary and that the proposal is consistent with the classification of non-controlling interests as equity.

39. Respondents offered the following suggestions to improve the guidance:

- a. The Board should provide guidance on the accounting for guarantees and similar arrangements between controlling and non-controlling interests, in particular (1) an arrangement that involves a floor on the non-controlling interest holders' losses in the subsidiary, and (2) an arrangement that requires the parent to provide additional funding to the subsidiary in the event of subsidiary losses.
- b. The Basis of Conclusions should be expanded to emphasise that, if the losses are in excess of the subsidiary's equity, the controlling interest would have to consider whether it should recognise a liability under either

IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* or IAS 39 to fund the losses.

- c. The Board should require disclosures on inter-company guarantees and the extent of deficits, if any, of non-controlling interests.

40. Other respondents disagree with the proposal, often because they prefer the parent entity perspective and do not think that controlling and non-controlling interests should be treated similarly. Many respondents stated that the current guidance in IAS 27 does not need to be changed (i.e. that excess losses should be allocated to the controlling interest unless the non-controlling interest has a binding obligation and is able to make an additional investment to cover the losses).

41. The respondents who disagreed with the proposal did so for a variety of reasons, including:

- a. The proposal does not reflect the economics of the situation. The non-controlling interests is not compelled to cover the deficit (unless otherwise specifically agreed) and it is reasonable to assume that, should the subsidiary call for additional capital in order to continue operations, the non-controlling interests would prefer to abandon their investment. On the other hand, the controlling interest has an implicit obligation to maintain the subsidiary as a going concern.
- b. Recording guarantees or other support arrangements separately without any effect on the way losses are attributed to the controlling and non-controlling interests would not reflect the underlying economics, which are that one party would absorb the losses of the subsidiary. It is misleading for financial statements to imply that the non-controlling interest has an obligation to make additional investments.
- c. Loss allocation should take into account legal, regulatory or contractual constraints which may prevent entities from recognising negative non-controlling interests, especially for regulated businesses (banks and insurers).
- d. Recognising guarantees separately is contrary to the principle of the non-recognition of transactions between equity holders.

[Paragraph 42 not reproduced in the observer notes]

Transitional provisions

43. The transitional provisions in the Exposure Draft propose that all of its requirements should apply retrospectively, except that an entity shall, due to practicability and cost concerns, apply prospectively the requirements for (1) the accounting for increases in ownership interests in a subsidiary after control is obtained and (2) the remeasurement to fair value of any retained investment in accounting for decreases in ownership interests in a subsidiary that result in a loss of control. Most respondents agree with that proposal.
44. Several respondents requested guidance on the transitional provisions for ownership interests that straddle the proposed effective date of the amendments to IAS 27 and IFRS 3. For example, respondents requested guidance on whether:
- a. There should be any additional goodwill recorded for an additional acquired interest where IFRS 3 (2004) or IAS 22 has been applied to the original acquisition.
 - b. Profit or loss in respect of part disposals in which control is not lost recognised in advance of applying IFRS 3 (revised) should be reversed where such transactions form part of a sequence of part disposals spanning the date of adoption of IFRS 3 (revised).
45. In addition, several respondents suggested that prospective application be expanded to all or some of the other proposed amendments to IAS 27. For example, respondents stated that:
- a. Prospective application should apply to decreases as well as increases in ownership interests in a subsidiary.
 - b. Paragraph 30B (which describes the measurement of non-controlling interests) should be applied prospectively, because retrospective application would contradict the prospective application requirements in proposed amended IFRS 3.

[Paragraph 46 not reproduced in the observer notes]

Due process

47. Many respondents object to the Board's implementation of a proposal as significant as the use of the economic entity perspective rather than the parent entity perspective without a broad debate of the issue. Respondents stated that the broad debate should take place in the conceptual framework project, rather than solely in the context of business combinations. Respondents also stated that decisions made in the business combinations project should not prejudice the outcome of decisions made in other projects, including the performance reporting and liabilities and equity projects.
48. Respondents stated that the Board should thoroughly research the issues and seek input from interested parties (specifically users and preparers) before making any fundamental changes. Specifically, respondents requested that the Board:
- a. **address the purpose of consolidated financial statements.** See respondents' comments in the section above on the economic entity vs. parent entity perspective.
 - b. **discuss the nature of non-controlling interests** and other types of securities that have features that provide holders with an economic interest or participation in only a portion of the consolidated entity.
 - c. **describe thoroughly the economic entity and parent entity perspectives**, including implications for the accounting treatment of transactions involving non-controlling interests, **and explain why the economic entity perspective is superior to the parent entity perspective.** Several respondents stated that the Board has not demonstrated that the proposed economic entity perspective is superior to the existing parent entity perspective or otherwise justified the need for the proposed changes. Respondents stated that users and preparers have not expressed significant concerns about the existing guidance, which is well-understood and generally accepted, and that there are no fatal flaws in the parent entity perspective which would warrant reconsideration.

[Paragraphs 49-50 not reproduced in the observer notes]