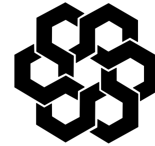

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International Accounting Standards Board

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:	**22 February 2007, London**
Project:	**Business Combinations II**
Subject:	**Proposed Amendments to IAS 27: Consequential Amendments (Agenda Paper 2C(iii))**

This agenda paper has been prepared for the IASB.
It has been given to the FASB for information purposes only.

INTRODUCTION

1. The following analysis focuses only on comment letters received with respect to the proposed consequential amendments in ED IAS 27. The Board received comment letters on the following consequential amendments:

   a. IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures*;

   b. IAS 21 *The Effects of Changes in Foreign Exchange Rates*;

   c. IAS 33 *Earnings Per Share*.

2. Constituents requested also further guidance on:

    a. the deconsolidation principles in IAS 27; and

    b. the interaction between IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and IAS 27.

IAS 28 INVESTMENTS IN ASSOCIATES AND IAS 31 INTERESTS IN JOINT VENTURES

3. During initial deliberations, the IASB observed that the loss of control of a subsidiary, the loss of significant influence over an associate and the loss of joint control in a joint venture are economically similar events; thus should be accounted for similarly. The loss of control as well as the loss of significant influence or joint control represents a significant economic event that changes the nature of an investment and therefore should give rise to the remeasurement of that investment. Therefore, the IASB decided to amend paragraphs 18 and 19 of IAS 28 *Investments in Associates* as follows (paragraph A6 of ED IAS 27):

> An investor shall discontinue the use of the equity method from the date that it ceases to have significant influence over an associate and shall account for the investment in accordance with IAS 39 from that date, provided the associate does not become a subsidiary or a joint venture as defined in IAS 31. On loss of a significant influence, any investment remaining in a former associate shall be remeasured to its fair value with a gain or loss recognised in profit or loss.
>
> When any remaining investment in a former associate is accounted for in accordance with IAS 39, ~~T~~the ~~carrying amount~~ fair value of the remaining investment at the date it ceases to be an associate shall be regarded as its fair value on initial ~~measurement~~ recognition as a financial asset in accordance with IAS 39.

4. Similarly, paragraph A7 of ED IAS 27 amends paragraph 45 of IAS 31 *Joint Ventures* as follows:

> When a venturer ceases to have joint control over a jointly controlled entity it shall account for any remaining investment in accordance with IAS 39 from that date, provided that the former jointly controlled entity does not become a subsidiary or associate. From the date on which a jointly controlled entity becomes a subsidiary of a venturer, the venturer shall account for its interest in accordance with IAS 27. From the date on which a jointly controlled entity becomes an associate of a venturer, the venturer shall account for its interest in accordance with IAS 28. On loss of joint control, any investment

remaining in a former joint venture shall be remeasured to its fair value with a gain or loss recognised in profit or loss.

5. During initial deliberations the FASB considered whether to address the same issue as part of phase II of the business combinations project. At that time, the FASB staff argued:

> The accounting for an investment that no longer qualifies for equity method accounting is outside the scope of the business combinations project.
>
> > The staff is concerned that by addressing issues relating to the equity method of accounting on a piecemeal basis, we may be doing more harm than good. We are concerned that the equity method of accounting is an issue that needs to be addressed comprehensively.
> >
> > The FASB decided that obtaining or losing control of an entity is effectively a remeasurement event, and therefore concluded that a new basis was appropriate in that circumstance. The necessity to address losing control of a subsidiary arose out of the business combinations and non-controlling interest projects because in those projects the Board is addressing obtaining control and changes in ownership interests in a subsidiary that do and do not result in a loss of control. The need to distinguish between reductions in ownership interest that are capital transactions and those that are not—loss of control—is necessary. However, the staff sees no compelling reason to start looking for other remeasurement (new basis) events that clearly are outside the scope of this project.
>
> The IASB has only addressed if an investor loses significant influence or joint control of an associate or joint venture. The IASB did not address the reverse situation—if an investor obtains significant influence or joint control of an associate or joint venture. The staff sees no reason to address one side of transaction without comprehensively addressing both, when and how to use equity method accounting and when and how to cease using that method, which are matters outside the scope of this project.
>
> If an investor loses significant influence and a retained investment is either available-for-sale or trading (with readily determinable fair values), the retained investment would be remeasured to fair value on that date under the requirements of FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (although if the investment is classified as available-for-sale, the remeasurement would be recognized in other comprehensive income rather than net income.) Therefore, many investments would be required to be remeasured regardless.

6. During initial deliberations, the FASB decided that the accounting for investments that no longer qualify for equity method accounting under APB Opinion No. 18,

The Equity Method of Accounting for Investments in Common Stock, is outside the scope of phase II of its business combinations project.

7. Consistent with the FASB staff's assessment that the IASB proposal would effectively mean addressing issues surrounding the equity method and proportionate consolidation on a piecemeal basis, some constituents requested further guidance on:

    a. how to account for the achievement of significant influence or joint control; and

    b. how to account for subsequent transactions between shareholders of an associate or joint venture once significant influence or joint control has been achieved.

8. For example the Accounting Standards Board of Israel wrote:

> Except for step acquisitions of a subsidiary covered in IFRS 3 (para 21 and 55-56) there are no answers in the exposure draft regarding all other situations of step acquisitions. We are of the opinion that IAS 27, IAS 28 and IAS 31 should provide for the accounting treatment in the following situations:
>
> > (1) On achieving of significant influence in an investee, what happens to the previous investments in that investee that had been carried at cost (or at fair value with changes in fair value included in equity) – should there be a remeasurement to fair value with a corresponding recognition in profit or loss (or a transfer from equity to profit) or should there remain separate layers of the investment with each layer being accounted at its cost. If the latter should be the answer, the question is what happens to the profits accumulated and not distributed during the period until significant influence has been achieved.
> >
> > (2) After achieving significant influence what happens to additional investments increasing the holdings in the investee, but not changing the status of significant influence, should there be some step up of the previous investments or separate layers remain.
> >
> > (3) If separate layers are maintained in an investee, how should the investor account for partial sales in that investee, should the accounting be based on FIFO or some other basis.

9. The staff has meanwhile sought further input from constituents on that matter and has been made aware that there is diversity in practice in the accounting for the

achievement or loss of significant influence or joint control. There is also diversity in the accounting for subsequent transactions between shareholders of an associate or joint venture once significant influence or joint control has been achieved. The staff understands why constituents want and need further guidance in this area. However, the staff is not convinced that these proposed amendments should have been included with the rest of the Bus Com package. That said, the proposed amendments are likely to be helpful to those applying IFRSs—by clarifying how to account for a step down. The staff therefore recommends to affirm the proposed guidance in paragraphs A6 and A7 of ED IAS 27 on how a loss of significant influence or joint control should be accounted for.

10. The staff acknowledges that the proposal provides only part of the guidance which has been requested by constituents. However, we believe that it is out of the scope of the business combinations project to provide guidance on this issue on a more comprehensive basis and that providing such guidance would likely result in a significant delay in issuing a final business combinations standard.

Does the Board agree that IAS 28 and 31 should be amended so to include guidance according to which, on loss of significant influence or joint control, any investment remaining in a former associate or joint venture shall be remeasured to its fair value with a gain or loss recognised in profit or loss?

Does the Board agree that further research on the achievement of significant influence or joint control and transactions between shareholders once significant influence or joint control has been achieved should not be done as part of the business combinations project?

AMENDMENTS TO IAS 21 *THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES*

11. Paragraph A5 of ED IAS 27 amends paragraph 48 of IAS 21 *The Effects of Changes in Foreign Exchange Rates* as follows:

> ~~On the disposal of a foreign operation, t~~The cumulative amount of the exchange differences deferred in the separate component of equity relating to a foreign operation shall be recognised in profit or loss when the gain or loss on the disposal or reduction in the entity's proportionate ownership interest in a foreign operation is recognised. In the case of a partial disposal or reduction in an entity's proportionate ownership in a foreign operation, only the proportionate share of the related accumulated foreign exchange difference is recognised in profit or loss.

12. In addition, a new paragraph 49B is added stating:

> IAS 27 requires a gain or loss to be recognised whenever control of a subsidiary is lost. However, a gain or loss is not recognised as a result of any event, including a partial disposal or a reduction in proportionate ownership interest, if control is not lost. The entire cumulative amount of exchange differences deferred in the separate component of equity relating to a subsidiary that is attributed to equity holders of the parent shall be recognised in profit or loss only if control of that subsidiary is lost.

13. Few constituents commented on the proposal. However, some constituents interpreted paragraph 48 of ED IAS 27 to require in the case of a partial disposal without loss of control to recognise the proportionate share of the related deferred foreign exchange differences in profit or loss. They argued that the proposed treatment would be inconsistent with the requirement in paragraph 30A of ED IAS 27 according to which 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. For example, Deloitte stated:

> We believe there is an inconsistency between certain proposed amendments to IAS 21 and the concepts in the Exposure Draft. Specifically paragraph 48 of IAS 21 (as would be amended by IAS 27) states, in part: In the case of partial disposal or reduction in an entity's proportionate ownership interest in a foreign operation, only the proportionate share of the related accumulated foreign exchange difference is recognised in profit or loss. In the full context of paragraph 48, we have interpreted this guidance as applying to partial disposals or reductions that do not result in loss of control. As such, this treatment is inconsistent with the IASB's conclusion that transactions that do not result in loss of control are accounted for as

> equity transactions. Therefore, we believe this sentence should be modified as follows: In the case of partial disposal or reduction in an entity's proportionate ownership interest in a foreign operation that does not result in loss of control, the related accumulated foreign exchange difference should be reallocated to the controlling and non-controlling interests after the transaction.

14. The staff is concerned that the wording in paragraph A7 of ED IAS 27 might not be sufficiently clear on its intended accounting consequences. We do not believe that the wording in paragraph A7 of ED IAS 27 was intended to provide conceptually different guidance from the wording suggested by Deloitte.

15. The staff believes that the principles underpinning the accounting for deferred foreign exchange differences when there is a change in the parent's ownership in a foreign subsidiary can be summarised as follows:

    a. The loss of control gives rise to recognition in profit or loss of the parent's share of deferred foreign exchange differences recognised directly in equity in accordance with IAS 21 for a net investment in a foreign subsidiary.

    b. The same principle applies when a parent loses control of a subsidiary that was classified as a foreign operation but retains an investment in that foreign operation. Thus, the entire cumulative gain or loss attributable to the parent is recognised in profit or loss on loss of control.

    c. If there is a change in the parent's ownership interest in a subsidiary after control is obtained that does not result in a loss of control deferred foreign exchange differences recognised directly in equity are reattributed between controlling and non-controlling interest without recognising a profit or loss. If the parent subsequently loses control of the subsidiary only the parent's share of deferred foreign exchange differences recognised previously in equity is recognised in profit or loss.

    d. The parent does not recognise a profit or loss on the derecognition of the non-controlling interest's share of the deferred foreign exchange differences.

16. The staff notes that paragraph D8 of the FASB ED might contain clearer guidance on the intended accounting for deferred foreign exchange differences:

> Upon sale or upon complete or substantially complete liquidation of an investment in a foreign entity that results in a loss of control of that entity, the amount attributable to that entity and accumulated in the translation adjustment component of equity shall be removed from the separate component of equity and shall be reported as part of the gain or loss on sale or liquidation of the investment for the period during which the sale or liquidation occurs. If an entity sells part of its ownership interest in, but does not lose control of, a foreign entity, that transactions should be accounted for as an equity transaction in accordance with paragraph 23 of FASB Statement No. 1XX, *Consolidated Financial Statements, Including Accounting and Reporting of Non-controlling Interests in Subsidiaries.* **In accordance with that Statement, the translation adjustment component of equity should be reallocated to the controlling and non-controlling interests in the foreign entity after the transaction.** [Emphasis added]

17. The staff intends to the equivalent words to the proposed amendments to IAS 21. This should make it clear that a change in the parent's ownership interest in a subsidiary that does not result in a loss of control is accounted for as a transaction between shareholders; thus items recognised directly in equity (OCI) such as, deferred foreign exchange differences, are reattributed between controlling and non-controlling interest without recognising a profit or loss.

18. The staff notes that similar principles apply to the recognition of a profit or loss of:

    a. the parent's share of accumulated hedging gains or losses recognised directly in equity in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*; and

    b. any amount that would have been required to be recognised in profit or loss had there been a direct disposal of the subsidiary's individual assets and liabilities (for example, the parent's share of any accumulated gains or losses recognised directly in equity in relation to a subsidiary's available-for-sale financial assets).

19. The staff will also investigate whether the proposed guidance related to the accounting for those items (ie paragraph A9 of ED IAS 27) should be reworded.

Does the Board agree with the staff analysis and intended modification of paragraph A5 of ED IAS 27?

IAS 33 EARNINGS PER SHARE

20. Paragraphs 33 and 34 of IAS 27 require that non-controlling interest shall be presented in the consolidated balance sheet within equity. As a consequence the group's profit or loss is attributed to controlling and non-controlling interest. Because both are equity, the amount attributed to non-controlling interests is not income or expense. However, paragraph 9 of IAS 33 *Earnings Per Share* requires an entity to calculate basic earnings per share amounts for profit or loss attributable to ordinary equity holders of the parent entity only.

21. Many constituents commented that they agree with the calculation of earnings per share under IAS 33, because they prefer a parent entity concept over an economic entity concept. However, some constituents think the proposed calculation of earnings per share is inconsistent with the treatment of non-controlling interests under IAS 27 and ED IAS 27.

22. For example, the Accounting Standards Committee of Germany wrote:

> … the determination of Earnings per Share needs to be adapted as the current version is based on the parent company theory. IAS 33.12 refers to a profit or loss attributable to the parent entity; under the ED the result of the year no longer distinguishes in the same way between the parent company and other shareholders.

23. However, the Board observed in paragraph OB10 of its Discussion Paper *Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics of Decision-useful Financial Reporting Information*:

> However, adopting the entity perspective as the basic perspective underlying financial reporting does not preclude also including in financial reports information that is primarily directed to the entity's owners or to another group of users. For example, financial reports include earning per (ordinary) share, which may be of interest largely

> to holders and potential purchasers of those shares. Financial statements generally also report separately the amount of earnings, which may be termed comprehensive income, profit or loss, or the like, attributable to holders of ordinary shares in the parent entity and the amount attributable to holders of non-controlling interests in subsidiaries. That information, however, is in addition to-not a replacement for-information prepared in accordance with the entity perspective.

24. In January 2006, the Board decided not to investigate further this issue as part of phase II of the business combinations project.

OTHER COMMENTS

25. One constituent asked to clarify the **deconsolidation principles in IAS 27** as part of phase II of the business combinations project. The South African Institute of Chartered Accountants wrote:

> A related issue is the recognition of loss of control. There is no guidance in the existing IAS 27, these proposed amendments to IAS 27, or IFRS 3 (existing or proposed) on the application of derecognition principles for the disposal of a subsidiary. We suggest that there should be a specific cross reference to the derecognition sections in IAS 39 *Financial Instruments: Recognition and Measurement*, which presently scopes out investments and subsidiaries.

26. The staff notes that this issue is being considered as part of the Board's consolidations project.

27. One constituent asked that the interaction between **IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*** and IAS 27 be addressed as part of the business combinations project. Deloitte wrote:

> The proposed amendments do not address assets held for sale considerations under IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*, in situations where an entity makes a decision to sell a portion of its ownership interest in a subsidiary that will result in loss of control, but the entity will retain significant influence over or joint control of the former subsidiary. Entities generally do not classify a subsidiary as assets held for sale upon a decision to sell the subsidiary when an equity method or joint venture investment will be retained. That is, there is a conceptual difference (and resulting accounting difference) between selling a subsidiary or certain assets of a subsidiary and reducing an ownership (equity) interest in a subsidiary. However, in a loss of control scenario under the proposed amendments, an entity is, in essence, selling (and deconsolidating) 100 percent of the subsidiary and acquiring a new, non-controlling investment. As such, a question arises as to whether

> assets held for sale classification may be appropriate at the time the decision to sell the controlling interest is made, assuming the other criteria are required for such classification are met.
>
> For illustrative purposes, assume an entity has an 80% controlling interest in a subsidiary and decides to sell 40% of its interest. The sale will result in loss of control, but the entity will exert significant influence over the former subsidiary (i.e., a resulting 40 percent equity method investment). If the criteria for assets held for sale recognition under IFRS 5 are met, should the entity reclassify the subsidiary's net assets as assets held for sale at the time the decision is made, or wait until the transaction occurs to deconsolidate and record the equity method investment? We do not support deconsolidation based upon an entity's intent to sell its controlling interest. This question should be addressed in the amended standard.

28. The staff notes that the IFRIC is currently debating whether this issue should be added to its agenda. The staff intends to bring this issue back to the Board's attention as soon as the IFRIC's thinking on this issue has developed further.