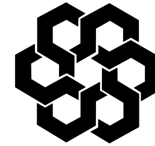

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International Accounting Standards Board

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: **July 2007, London**

Project: **Short-term convergence: Joint ventures**

Subject: **Sweep issues – Loss of joint control (Agenda paper 11)**

Introduction

1. This paper discusses the accounting when an investor ceases to have joint control over a joint venture but retains an interest in that venture. The issue was raised by one Board member on review of the pre-ballot draft of the proposed amendments to IAS 31 *Interests in Joint Ventures*.

Remeasurement based on a change in the nature of an investment versus a change of the basis of accounting

2. The Board added the following paragraphs to IAS 31 as consequence of its amendments to IAS 27 (as part of Business Combinations II),:

   " When an investor ceases to have joint control over a joint venture, it shall account for any remaining investment in accordance with IAS 39 from that date, provided that the former joint venture does not become a subsidiary or associate. From the date on which a joint venture becomes a subsidiary of an investor, the investor shall account for its interest in accordance with IAS 27 and IFRS 3 *Business Combinations* (where applicable). From the date on which a joint venture becomes an associate of an investor, the investor shall account for its interest in accordance with IAS 28. On the loss of joint control, the investor shall measure at fair value any investment the investor retains in the former joint venture. The investor shall recognise in profit or loss any difference between:

   (a) the fair value of the retained investment and any proceeds from disposing of a part interest in the joint venture; and

(b) the carrying amount of the investment at the date joint control is lost.

When an investment ceases to be a joint venture and is accounted for in accordance with IAS 39, the fair value of the investment when it ceases to be a joint venture shall be regarded as its fair value on initial recognition as a financial asset in accordance with IAS 39.

If an investor loses joint control of a joint venture, all amounts recognised in other comprehensive income and accumulated as a separate component of equity in relation to that joint venture shall be recognised by the investor on the same basis that would be required if the joint venture had disposed of the related assets or liabilities directly. Therefore, if a gain or loss recognised previously in other comprehensive income would be reclassified to profit or loss on the disposal of the related assets or liabilities, the investor reclassifies the gain or loss from the separate component of equity to profit or loss (as a reclassification adjustment) when an investment ceases to be a joint venture. For example, if a joint venture has available-for-sale financial assets and the investment ceases to be a joint venture, the investor shall reclassify to profit or loss the gain or loss recognised previously in other comprehensive income in relation to those assets. If an investor's ownership interest in a joint venture is reduced, but the investment continues to be a joint venture, the investor shall reclassify to profit or loss only a proportionate amount of the gain or loss recognised previously in other comprehensive income."

3. The Board gave the following reason for the consequential amendments to IAS 31 in the Basis for Conclusions on IAS 27 (extract from the ballot draft):

"The Board 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 jointly controlled entity are economically similar events; thus they 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. Therefore, the Board concluded that the accounting guidance on the loss of control of a subsidiary should be extended to events or transactions in which an investor loses significant influence over an associate or joint control of a jointly controlled entity. Thus, the investor's investment after significant influence or joint control is lost should be recognised and measured initially at fair value and the amount of any resulting gain or loss should be recognised in profit or loss. The FASB considered whether to address that same issue as part of this project. The FASB concluded that the accounting for investments that no longer qualify for equity method accounting was outside the scope of the project."

Consequence of the Board's decision combined with the proposed changes to IAS 31 as part of short-term convergence

4. A venturer is currently permitted to recognise its interest in a jointly controlled entity using the equity method or proportionate consolidation. The Board's decision about measuring any remaining investment when joint control is lost ensures that the initial measurement of that investment is the same regardless of the basis of accounting used before the loss of joint control.

5. However, the exposure draft of proposed amendments to IAS 31 will propose to require the use of the equity method for interests in joint ventures. The loss of joint control will therefore not necessarily result in a change of basis of accounting—if an investor loses joint control but retains significant influence, it would recognise its investment in the entity, both before and after the loss of joint control, using the equity method. The Board's decision when amending IAS 27

means that in such situations, the investor would remeasure to fair value its investment in the entity (and recognise a gain or loss) at the time of the loss of joint control, regardless of whether it recognises its investment using the equity method both before and after remeasurement.

6. A Board member has questioned whether, in light of the proposed elimination of proportionate consolidation, it is appropriate to remeasure the investment to fair value (and recognise a gain or loss) without a change in the basis of accounting.[1]

View 1 – Loss of joint control is a significant economic event

7. The wording of the Board's decision when amending IAS 27 supports the view that it is appropriate to remeasure an investment in a joint venture whenever the investor loses joint control, regardless of whether the basis of accounting changes at that time. The loss of joint control is a significant economic event that changes the nature of an investment. Joint control is established by contractual arrangement. For a venturer to lose joint control, the venturers must change the terms of the contractual arrangement. That change of contractual terms would represent a significant economic event, and therefore, it is appropriate to remeasure any remaining investment in the venture, even if that investment continues to be accounted for using the equity method.

View 2 – Remeasurement should result from a change in basis of accounting

8. IAS 31 (as proposed) gives guidance on how to determine whether a joint arrangement is a joint asset, joint operation or joint venture, or a combination of these. If, according to IAS 31, a venturer has an interest in a joint venture the venturer applies the equity method as described in IAS 28. It would appear inappropriate to require remeasurement of that investment (and the recognition of a gain or loss) when the change in the nature of an investment does not result in any change in the basis for accounting. Put another way, why would an investor remeasure to fair value an investment that it accounts for in accordance with IAS 28 when it continues to apply IAS 28 after the change in nature of the investment?

9. Supporters of view 2 would not require remeasurement of the residual interest in a joint venture if the investor retains significant influence and continues to recognise its investment using the equity method. They would argue that the accounting treatment that the Board has chosen should reflect the nature of the investment. In the IAS 31 project the Board is proposing that the nature of significant influence and joint control are not sufficiently different to justify a different accounting treatment. Therefore it is difficult to argue that a change in the nature of the investment (from joint control to significant influence and vice versa) is sufficient to justify fresh start accounting for that investment. Consequently, those supporters would only require remeasurement of the retained investment when an economic event occurred that caused a change in the basis of accounting.

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[1] Note that, when amending IAS 27, if the Board had proposed that remeasurements occur only when there is a change in the basis of accounting, investors that lost joint control and retained significant influence could recognise different amounts for their retained investment in associates, solely because of differing accounting bases when they previously had joint control. That is, the retained investment in an associate would be measured to fair value if the investor had previously used proportionate consolidation but not measured at fair value if it had previously used the equity method.

Staff recommendation

10. The staff places more weight on the arguments given in paragraph 9, and therefore recommends that the revised IAS 31 propose that an investor should continue to apply equity accounting if the investment changes from a joint venture to an associate. That is to say, the investor would not measure the investment at fair value at the date the change in the nature of that investment changes.

Question for the Board

11. **Does the Board support view 1 or 2?**