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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting:	**21 March 2007, London**
Project:	**Business Combinations II**
Subject:	**Loss of control of a business resulting from a non-reciprocal transfer to owners (Agenda Paper 2D)**

1. This paper addresses the accounting for the loss of control of a subsidiary resulting from a non-reciprocal transfer to owners. Paragraph 3 of APB Opinion No. 29, *Accounting for Nonmonetary Transfers,* defines a non-reciprocal transfer as a transfer of assets or services in one direction, either from an enterprise to its owners (whether or not in exchange for their ownership interests) or from owners or another entity to the enterprise. Opinion 29 also provides the following examples of non-reciprocal transfers to owners:

    a. the distribution of non-monetary assets, such as marketable equity securities, to stockholders as dividends;

    b. the distribution of non-monetary assets, such as marketable equity securities, to stockholders to redeem or acquire outstanding capital stock of the enterprise;

    c. the distribution of non-monetary assets, such as capital stock of subsidiaries, to stockholders in corporate liquidations or plans of reorganisations that involve disposing of all or a significant segment of the business (the plans are variously referred to as spin-offs, split-ups, and split-offs); and

    d. the distribution of non-monetary assets to groups of stockholders, pursuant to plans of rescission or other settlements relating to a prior business combination, to redeem or acquire shares of capital stock previously issued in a business combination.

Non-reciprocal transfers to owners include demergers, spin-offs, and in-specie distributions.

2. Paragraph 30C of the proposed amendments to IAS 27 *Consolidated and Separate Financial Statements* (IASB ED) (see also paragraph 27 of the FASB ED) proposes the following guidance for calculating the gain or loss if a parent loses control of a subsidiary:

> If control of a subsidiary is lost, whether through a sale of ownership interests in that subsidiary by the parent or members of the group **or through other means**, any resulting gain or loss shall be recognised in profit or loss. That gain or loss shall be measured as the difference between:
>
> (a) the aggregate of the fair value of the proceeds, if any, from the transaction or event that resulted in the loss of control and the fair value of any investment remaining in the former subsidiary at the date control is lost; and
>
> (b) the aggregate of the parent's interest in the carrying amount in the consolidated financial statements of the former subsidiary's net assets immediately before control is lost, including the parent's share of gains or losses related to the former subsidiary recognised previously in consolidated equity.
>
> [Emphasis added.]

3. The guidance clarifies that control could be lost through the sale of a subsidiary or *through other means.* Some respondents questioned whether that guidance would apply to nonreciprocal transfers to owners (for example, the distribution of a business to owners in a spin-off).

U.S. GAAP

4. APB Opinion No. 29, *Accounting for Nonmonetary Transfers*, provides guidance on the accounting for non-reciprocal transfers to owners. Paragraphs 18 and 23 of APB 29 state:

> 18. … A transfer of a nonmonetary asset to a stockholder or to another entity in a nonreciprocal transfer should be recorded at the fair value of the asset transferred, and a gain or loss should be recognized on the disposition of the asset …
>
> 23. *Nonreciprocal transfers to Owners.* Accounting for the distribution of nonmonetary assets to owners of an enterprise in a spin-off or other form of reorganization or liquidation or in a plant that is in substance the rescission of a prior business combination should be based on the

> recorded amount (after reduction, if appropriate, for an indicated impairment of value of the nonmonetary assets distributed). A prorata distribution to owners of an enterprise of shares of a subsidiary or other investee company that has been or is being consolidated or is being accounted for under the equity method is to be considered to be equivalent to a spin-off. Other nonreciprocal transfers of nonmonetary assets to owners should be accounted for at fair value if the fair value of the nonmonetary asset distributed is objectively measurable and would be clearly realizable to the distributing entity in an outright sale at or near the time of the distribution.

5. Paragraph 23 of APB 29 is further discussed in EITF Issue No. 01-2, 'Interpretations of APB Opinion No. 29'. The EITF reached the following consensus:

   a. the distribution of loans receivable to owners by forming a subsidiary, transferring those loans receivable to the subsidiary, and then distributing the stock of that subsidiary to shareholders of the parent should be reported at fair value because the subsidiary does not constitute a business;

   b. a non-pro-rata split-off of a segment of a business in a corporate plan of reorganisation should be accounted for at fair value; and

   c. a split-off of a targeted business, distributed on a pro-rata basis to the holders of the related targeted stock should be accounted for at historical cost.

IFRSs

6. Accounting for non-reciprocal transfers to owners is not addressed specifically in IFRSs. The IFRIC has received a request for guidance in this area. The IFRIC acknowledged a need to address the issue because of the emergence of diversity in practice in respect of the basis on which non-reciprocal transfers to owners should be recognised. Due to a lack of guidance, three practices have emerged:

   - distributions recorded at the <u>carrying amounts</u> of the assets or businesses distributed;
   - distributions recorded at the <u>fair values</u> of the assets or businesses distributed, with any difference between the fair values and the carrying amounts of the assets or businesses recognised in <u>profit or loss</u>; and
   - distributions recorded at the <u>fair values</u> of the assets or businesses distributed, with any difference between the fair values and the carrying amounts of the assets or businesses recognised in <u>equity</u>.

7. The IFRIC noted that the IASB might address the accounting for those non-reciprocal transfers to owners that result in the loss of control of a subsidiary when it redeliberates the proposed amendments to IAS 27. Therefore, the IFRIC deferred starting a project on the accounting for non-reciprocal transfers to owners until after the IASB's decisions on the accounting for the loss of control of a subsidiary are finalised. The IFRIC is monitoring the IASB's deliberations and will determine the scope of any such project, or whether a project is still required, once business combinations phase II has been completed.

Staff Analysis and Recommendation

8. The question for the Boards is whether:

   a. they want to discuss the measurement basis for non-reciprocal transfers to owners resulting in the loss of control of a business as part of the business combinations project; or

   b. the FASB wants to retain existing U.S. GAAP guidance for non-reciprocal transfers and the IASB wants to address the measurement basis for all non-reciprocal transfers to owners more broadly outside the business combinations project.

9. The staff recommends that this issue not be addressed as part of the business combinations project for the following reasons:

   a. This is a broader issue related to the accounting for all non-reciprocal transfers to owners, not just those that result in the loss of control of a subsidiary.

   b. This issue is outside the scope of the business combinations project. The objective of the business combinations project is to provide guidance on the accounting for the acquisition of a business. The project addressed the disposition of a subsidiary for symmetry, but the accounting for nonreciprocal transfers to owners is clearly outside the scope.

   c. *[Sentence omitted from observer note]*

10. This is an existing issue, not an issue created by the business combinations project. The staff believes that the Boards did not intend to change international practice or U.S. GAAP for the accounting for nonreciprocal transfers to owners as part of the business combination project. As such, the staff believes that the Boards should clarify that nonreciprocal transfers to owners are excluded from the proposed guidance on the accounting for the loss of control of a subsidiary.

11. ***Do the Boards agree that:***

    a. ***the measurement basis for non-reciprocal transfers should not be addressed as part of the business combinations project; and***

    b. ***the proposed guidance on the accounting for the loss of control of a subsidiary should clarify that it excludes non-reciprocal transfers to owners?***