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International
Accounting Standards
Board



**INFORMATION FOR OBSERVERS**

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| **Board Meeting:** | **15 May 2007, London** |
| **Project:** | **Annual Improvements** |
| **Subject:** | **Measurement of subsidiary held for sale in separate financial statements (Agenda paper 5F)** |

1. The staff have identified that the following issue would be most appropriately resolved via the annual improvements process.

   *Issue:* Should the apparent inconsistency between IFRS 5 and IAS 27 on the measurement of a subsidiary classified as held for sale in separate financial statements be removed?

## Staff recommendation

2. The staff recommends that the Board:

   - should add this issue to the annual improvements project; and
   - should amend IAS 27 as proposed in paragraph 20 of this paper.

## Background

3. The staff have been notified of an apparent inconsistency in the guidance in IAS 27 and IFRS 5. It relates to the accounting by a parent in its separate financial statements of a subsidiary that is classified as held for sale. The inconsistency arises when the parent applies a policy of accounting for subsidiaries in accordance with IAS 39 in its separate financial statements.

**IFRS 5 guidance**

4. IFRS 5 is applied in consolidated financial statements and separate financial statements. Assets that fall within the measurement scope of IFRS 5 are measured at the lower of carrying amount and fair value less costs to sell. Certain identified groups of assets are outside the measurement scope of IFRS 5 and continue to be measured in accordance with applicable IFRSs. This includes financial assets within the scope of IAS 39.

5. Paragraph 5 of IFRS 5 sets out the assets that are outside the measurement scope of IFRS 5 and hence continue to be measured in accordance with applicable IFRSs:

> The measurement provisions of this IFRS do not apply to the following assets, which are covered by the Standards listed, either as individual assets or as part of a disposal group:
>
> …
>
> (c) financial assets within the scope of IAS 39 *Financial Instruments: Recognition and Measurement.*
>
> (d) non-current assets that are accounted for in accordance with the fair value model in IAS 40 *Investment Property*.
>
> (e) non-current assets that are measured at fair value less estimated point-of-sale costs in accordance with IAS 41 *Agriculture.*
>
> …

6. The Basis for Conclusions on IFRS 5 explains that the Board decided that non-current assets should be excluded from the measurement scope of IFRS 5

only ‘if (i) they are already carried at fair value with changes in fair value recognised in profit or loss or (ii) there would be difficulties in determining their fair value less costs to sell’ [IFRS5.BC13]. The Board acknowledged in the Basis for Conclusions that not all financial assets within the scope of IAS 39 are recognised at fair value with changes in fair value recognised in profit or loss but it did not want to make any further changes to the accounting for financial assets at that time.

7. IFRS 5 paragraph 5 therefore suggests that a parent that accounts for its investments in subsidiaries in accordance with IAS 39 in its separate financial statements should continue to apply this basis of accounting for a subsidiary that is classified as held for sale.

**IAS 27 guidance**

8. IAS 27 paragraph 37 sets out the basis on which a parent accounts for its investments in subsidiaries in its separate financial statements:

> When separate financial statements are prepared, investments in subsidiaries, jointly controlled entities and associates that are not classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 shall be accounted for either:
>
> (a) at cost, or
>
> (b) in accordance with IAS 39.
>
> The same accounting shall be applied for each category of investments. Investments in subsidiaries, jointly controlled entities and associates that are classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 shall be accounted for in accordance with that IFRS.

9. IAS 27 paragraph 37 provides a choice of accounting for investments in subsidiaries at cost or in accordance with IAS 39. However, this accounting policy choice is provided for subsidiaries that are not classified as held for sale in accordance with IFRS 5. Paragraph 37 of IAS 27 clarifies that a subsidiary classified as held for sale in accordance with IFRS 5 is accounted for in accordance with IFRS 5.

10. IAS 27 paragraph 37 therefore suggests that a parent that accounts for its investments in subsidiaries in accordance with IAS 39 in its separate financial statements should cease to do so for a subsidiary classified as held for sale in accordance with IFRS 5. Such a subsidiary should then be accounted for at the lower of carrying value and fair value less costs to sell.

**Implications**

11. The staff note that the guidance in IFRS 5 (paragraph 7 of this paper) and the guidance in IAS 27 (paragraph 10 of this paper) on this issue appear to conflict.

12. Subsidiaries accounted for under IAS 39 may be classified as available for sale or as at fair value through profit or loss. The implications of continued accounting in accordance with IAS 39 for the different classifications are as follows:

(a) *continued accounting as available for sale in accordance with IAS 39:* Fair value changes will continue to be recognised in equity. The gain on disposal that arises from the recycling of the amount recorded in equity will be reduced by the costs to sell.

(b) *continued accounting as at fair value through profit or loss:* Changes in fair value will continue to be recognised in the income statement until the subsidiary is sold. A loss will be recognised on sale equal to the costs to sell.

13. The implication of a change in the accounting for a subsidiary that was accounted for in accordance with IAS 39 to applying the measurement principles in IFRS 5 is as follows:

(a) *change from accounting as available for sale in accordance with IAS 39:* Immediate recognition of loss in respect of costs to sell. Additional losses will be recognised to the extent that fair value decreases between date classified as held for sale and the date of sale. A gain on disposal will be recognised that will comprise the recycling of the amount included in equity plus any increases in fair value since classification as held for sale.

(b) *change from accounting as at fair value through profit or loss in accordance with IAS 39:* Immediate recognition of loss in respect of costs to sell. Additional losses will be recognised to the extent that fair value decreases between the date classified as held for sale and the date of sale. A gain on disposal will be recognised that will comprise any increases in fair value since classification as held for sale.

14. The constituent that drew our attention to this inconsistency suggested including a statement in IFRS 5 that the measurement provisions of IFRS 5 apply to investments in subsidiaries classified as held for sale in an entity's separate financial statements. The basis for this suggestion is that IAS 27 is clear that investments in subsidiaries that are classified as held for sale are accounted for in accordance with IFRS 5. IFRS 5 should therefore be aligned with this specific requirement of IAS 27.

15. The staff agrees that this is an appropriate analysis of the current literature. However, the staff believes that, when an entity has elected to account for investments in subsidiaries in accordance with IAS 39, a better accounting treatment is to require a continuation of this accounting. This approach will be consistent with the accounting for other assets that are accounted for at fair value and therefore outside the measurement scope of IFRS 5. This will require a revision to paragraph 37 of IAS 27.

16. The staff notes that these proposals do not affect the accounting by a parent that chooses to account for subsidiaries at cost in accordance with IAS 27 in its separate financial statements. Such subsidiaries will fall within the measurement scope of IFRS 5 if classified as held for sale and be measured at the lower of carrying amount and fair value less costs to sell.

17. The same issue exists for investments in associates and jointly controlled entities in separate financial statements. The staff believes that the conclusions the Board reaches in respect of accounting for subsidiaries on this matter should also be applied to accounting for investments in associates and jointly controlled entities.

## Staff recommendation

18. IAS 27 should be amended as proposed in paragraph 20.

19. **Does the Board agree?**

## Drafting

20. The staff recommend that IAS 27 should be amended as follows:

### Accounting for investments in subsidiaries, jointly controlled entities and associates in separate financial statements

37 When separate financial statements are prepared, investments in subsidiaries, jointly controlled entities and associates that are not classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 shall be accounted for either:

(a) at cost, or

(b) in accordance with IAS 39.

The same accounting shall be applied for each category of investments. Those investments that were accounted for at cost shall be accounted for in accordance with IFRS 5 on classification as held for sale (or inclusion in a disposal group that is classified as held for sale). Those that were accounted for in accordance with IAS 39 until classification as held for sale (or inclusion in a disposal group that is classified as held for sale) shall continue to be accounted for in accordance with IAS 39. ~~Investments in subsidiaries, jointly controlled entities and associates that are classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 shall be accounted for in accordance with that IFRS~~.

## Basis for Conclusions on Proposed Amendments to IAS 27 Consolidated and Separate Financial Statements

*This Basis for Conclusions accompanies, but is not part of, the draft amendments.*

### Accounting for investments in subsidiaries, jointly controlled entities and associates in separate financial statements

BC1 The Board has identified an apparent inconsistency in the guidance in IAS 27 and IFRS 5 for the accounting by a parent in separate financial statements when a subsidiary that was accounted for at fair value in accordance with IAS 39 is classified as held for sale in accordance with IFRS 5. The guidance in IAS 27 specifies that a subsidiary that is classified as held for sale (or included in a disposal group that is classified as held for sale) in a parent's separate financial statements is accounted for in accordance with IFRS 5. However, IFRS 5 specifies that financial assets that are accounted for in accordance with IAS 39 are not within the measurement scope of IFRS 5.

BC2 The Board has decided to address this inconsistency by requiring investments in subsidiaries that are accounted for in accordance with IAS 39 in the parent's separate financial statements to continue to be accounted for on that basis when classified as held for sale (or included in a disposal group that is classified as held for sale).

BC3 The same accounting treatment will be required for investments in associates and jointly controlled entities in separate financial statements.

BC4 The Basis for Conclusions on IFRS 5 explains that the Board decided that non-current assets should be excluded from the measurement scope of IFRS 5 only 'if (i) they are already carried at fair value with changes in fair value recognised in profit or loss or (ii) there would be difficulties in determining their fair value less costs to sell' [IFRS5.BC13]. The Board acknowledged in the Basis for Conclusions that not all financial assets within the scope of IAS 39 are recognised at fair value with changes in fair value recognised in profit or loss but it did not want to make any further changes to the accounting for financial assets at that time. This [proposed] amendment brings the accounting for these investments into line with the accounting for other assets that are accounted for at fair value prior to classification as held for sale.