Project	**Agenda decisions**
Topic	**IAS 28 – Potential effect of IFRS 3 (as revised in 2008) and IAS 27 (as amended in 2008) on equity method accounting**

Introduction

1. In May 2009, the IFRIC published a tentative agenda decision not to add to its agenda an issue to provide guidance on two issues considered by the US Emerging Issues Task Force (EITF) addressing issues resulting from the joint project by the IASB and FASB on accounting for business combinations and accounting and reporting for non-controlling interests that culminated in the issue of IFRS 3 (as revised in 2008) and IAS 27 (as amended in 2008) and SFAS 141(R) and SFAS 160. The two issues are:

   (a) How the initial carrying value of an equity method investment should be determined

   (b) How an equity method investee's issue of shares should be accounted for.

2. Two comment letters were received.

Summary of comments from respondents

3. Both comment letters agree with the tentative agenda decision not to add these issues to its agenda. Both comment letters also suggest additional clarification in the agenda decision wording.

4. The first comment letter notes greater clarification would be helpful around the determination of the initial carrying value of an equity method investment, with respect to the following points:

(a) How contingent consideration is reflected in the initial carrying value.

(b) How gaining significant influence via step acquisitions are reflected in the initial carrying value.

5. With respect to how contingent consideration is reflected in the initial carrying value, the commenter believes wording similar to that included in paragraph 10 of the May 2009 IFRIC agenda paper 7 would be helpful. The staff agrees with this comment and has incorporated clarifying wording in the proposed draft agenda decision noting that the initial cost of an investment in an associate includes all amounts paid or payable or liabilities assumed and any directly attributable expenditures necessary to obtain it.

6. With respect to how gaining significant influence via step acquisitions are reflected in the initial carrying value, the commenter states:

> We believe the reference to a 'purchase price' provides some clarify that in the case of a step acquisition, this will be the cumulative amounts actually paid. However, this conflicts with the approach taken within IFRS 3 Business Combinations and IAS 27 Consolidated Financial Statements when there is a loss of control while maintaining an ownership interest. The key reason for the approach taken in IFRS 3 and IAS 27 is that the change from a subsidiary to an associate, and vice versa, is a significant change in the nature of, and economic circumstances surrounding, the investment. That is, the existing investment is 'given up' as consideration for acquiring a different type of investment. We believe that this rationale is just as relevant when determining cost as it is when applying a fair value approach under IFRS 3.

7. The staff agrees with the comment in paragraph 6 and has incorporated a clarifying paragraph in the draft agenda decision stating 'The IFRIC noted that when an investor obtains significant influence by accumulating equity interests in the associate, the initial carrying value of the associate is the accumulation of the costs described above for each purchase. IFRSs provide explicit guidance on all other significant economic events including the loss of control, joint control or significant influence and the acquisition of control,'

8. The second comment letter states:

> We agree that the cost of an investment in an associate determined in accordance with paragraph 11 of IAS 28 would comprise its purchase price and any directly attributable expenditures necessary to obtain it. However, we believe that, on the basis of the words in paragraph 20 and by analogy to IFRS 3 (revised 2008) (and without

> more explicit words from the IFRIC to the contrary), an alternative view of expensing acquisition-related costs is possible. Therefore, we suggest that IFRIC should be more explicit in their wording.

9. The staff disagree that additional wording is needed to clarify that IAS 27 (amended 2008) is not applicable. In the staff's opinion, IAS 28 and the current agenda decision wording provide sufficient clarification that the initial cost of an equity method investment should be all amounts paid and payable and liabilities assumed. This clarification precludes the expensing of acquisition-related costs by analogy to IFRS 3 (revised 2008). Therefore, the staff recommends no change as a result of this comment.

Staff recommendation

10. With respect to the two comment letters received, the staff proposes to amend the agenda decision to include clarifications that:

    (a) The cost of an investment in an associate at initial recognition includes all amounts paid or payable or liabilities and any directly attributable expenditures necessary to obtain it.

    (b) The IFRIC noted that when an investor obtains significant influence by accumulating equity interests in the associate, the initial carrying value of the associate is the accumulation of the costs described above for each purchase. IFRSs provide explicit guidance on all other significant economic events including the loss of control, joint control or significant influence and the acquisition of control.

11. For the reasons noted above, the staff recommends that the IFRIC finalise the agenda decision with the clarifications suggested in paragraph 10. The staff has set out the proposed wording in Appendix A.

Question
Does the IFRIC agree with the staff's recommendation and the wording of the final agenda decision?

Appendix A – proposed wording for agenda decision

A1. The staff proposes the following wording as published in *IFRIC Update* for the final agenda decision. (New text is underlined, deleted text struck through.)

IAS 28 *Investments in Associates* — Potential effect of IFRS 3 *Business Combinations* (as revised in 2008) and IAS 27 *Consolidated and Separate Financial Statements* (as amended in 2008) on equity method accounting

The IFRIC staff noted that the FASB's Emerging Issues Task Force (EITF) had added to its agenda EITF Issue No. 08-6 Equity Method Investment Accounting Considerations. EITF 08-6 addresses several issues resulting from the joint project by the IASB and FASB on accounting for business combinations and accounting and reporting for noncontrolling interests that culminated in the issue of IFRS 3 (as revised in 2008) and IAS 27 (as amended in 2008) and SFAS 141(R) and SFAS 160.

At its meeting in May 2009 the IFRIC deliberated two of the issues considered in EITF 08-6:

- How the initial carrying value of an equity method investment should be determined
- How an equity method investee's issue of shares should be accounted for.

The IFRIC noted that IFRSs consistently require assets not measured at fair value through profit or loss to be measured at initial recognition at cost. Generally stated, cost includes the purchase price and other costs directly attributable to the acquisition or issuance of the asset such as professional fees for legal services, transfer taxes and other transaction costs. Therefore, the cost of an investment in an associate <u>at initial recognition</u> determined in accordance with paragraph 11 of IAS 28 ~~comprises its purchase price~~ <u>includes all amounts paid or payable or liabilities assumed</u> and any directly attributable expenditures necessary to obtain it.

<u>The IFRIC noted that when an investor obtains significant influence by accumulating equity interests in the associate, the initial carrying value of the associate is the accumulation of the costs described above for each purchase. IFRSs provide explicit guidance on all other significant economic events including the loss of control, joint control or significant influence and the acquisition of control,</u>

The IFRIC noted that paragraph 19A of IAS 28 provides guidance on the accounting for amounts recognised in other comprehensive income when the investor's ownership interest is reduced, but the entity retains significant influence. The IFRIC noted that there is no specific guidance on the recognition of a gain or loss resulting from a reduction in the investor's ownership interest resulting from the issue of shares by the associate. However, the IFRIC also noted that reclassification of amounts to profit or loss from other comprehensive income is generally required as part of determining the gain or loss on a disposal. Paragraph 19A of IAS 28 applies to all reductions in the investor's ownership interest, no matter the cause.

The IFRIC concluded that the agenda criteria were not met mainly because, given the guidance in IFRSs, it did not expect divergent interpretations in practice. Therefore, the IFRIC decided not to add these issues to its agenda.