Project **Amendments to IFRS3 and IAS27**

Topic **Transaction cost for NCI**

Introduction

1. The IFRIC has received requests to clarify the treatment of transaction costs relating to acquisitions and disposals of non-controlling interests (NCI) that do not result in a loss of control of the entity. Paragraph 30 of IAS 27 *Consolidated and Separate Financial Statements* (as amended in 2008) requires those transactions to be accounted for as equity transactions. However, the standard does not contain explicit requirements for transaction costs incurred in relation to the acquisition or disposal of NCI. Therefore, some constituents have asked the IFRIC to clarify whether an entity should either expense those transaction costs or deduct them from equity.

Background

2. Paragraph BC366 of IFRS 3 *Business Combinations* (as issued in 2008) (IFRS 3R) states that transaction costs (acquisition-related costs) in a business combination are not part of the fair value exchange between the buyer and seller for the business. Rather they are separate transactions in which the buyer pays for the fair value of services received. Therefore, paragraph 53 of IFRS 3R requires transaction costs to be accounted for as expenses in the periods in which the costs are incurred and the services are received. However, costs to issue debt or equity securities are recognised in accordance with IAS 32 and 39.

3. Some constituents ask whether it is appropriate to analogise the accounting treatment of transaction costs incurred in a transaction with NCI that does not result in the loss of control of an entity to the requirements for transaction costs in a business combination. They believe that the arguments that these costs are separate from the related transaction and are reflective of the fair value of services received, are equally applicable in this case. According to that interpretation, transaction costs relating to the acquisition of NCI or the sale of shares to NCI would be expensed in the consolidated financial statements.

Staff analysis

4. The staff believes that a transaction with non-controlling interests that does not result in the loss of control should not be analogised to a business combination because the transactions are economically different. IFRS 3R defines a business combination as a transaction or event in which an acquirer obtains control of one or more businesses. In contrast, IAS 27 describes the acquisition or disposal of NCI as equity transactions of an entity.

5. Because transactions with NCI are equity transactions we believe that the requirements in paragraphs 35 and 37 of IAS 32 on the accounting for the transaction costs of an equity transaction are applicable. According to those requirements, an entity deducts incremental transaction costs that are directly attributable to the equity transaction from equity. The costs of an equity transaction that is abandoned are recognised as an expense.

6. In September 2008, the IFIRC discussed the extent of transaction costs to be accounted for as a deduction from equity in accordance with paragraph 37 of IAS 32 and how the requirements of paragraph 38 of IAS 32 to allocate transaction costs that relate jointly to one or more transaction should be applied. The IFRIC noted that only incremental costs directly attributable to issuing new equity instruments or acquiring previously outstanding equity instruments would be related to an equity transaction in accordance with IAS 32. The IFRIC also noted that judgement will be required to determine which costs are related solely to other activities undertaken at the same time as issuing equity, such as

becoming a public company or acquiring an exchange listing, and which are costs that relate jointly to both activities that must be allocated in accordance with paragraph 38.

Staff recommendation and question to the IFRIC

7. The staff recommends that the IFRIC not add a project to its agenda to clarify how an entity should account for transaction costs that it incurs in a transaction with NCI that does not result in the loss of control of a subsidiary. Relevant guidance already exists in IFRSs. Directly attributable transaction costs that are incurred in an acquisition or disposal of NCI that does not result in the loss of control of an entity should be deducted from equity.

8. Proposed wording for the tentative agenda decision is set out in Appendix A.

Question to the IFRIC
Does the IFRIC agree that the issue should not be added to its agenda? If not, why? Does the IFRIC have any comments on the proposed wording for the tentative agenda decision?

[Appendix A has been omitted from this Observer note]