IASB Meeting

Staff Paper

Agenda reference **17B**

Date **February 2010**

Project **Joint Venture**

Topic **Loss of Joint Control**

1. The objective of this Agenda Paper is to discuss the section on loss of joint control in the new standard on Joint Arrangements.

2. This Agenda Paper is structured as follows:

   (a) Overview of the proposed requirements in ED 9 *Joint Arrangements*

   (b) Subsequent analysis performed by the staff

Proposed requirements for the loss of joint control in ED 9

3. ED 9 carried forward the requirements in IAS 31 *Interests in Joint Ventures* in relation to the loss of joint control, with one exception. ED 9 proposed a change in the requirements when an entity has an investment that changes from being a joint venture and becomes an associate.

4. IAS 31 states:

> IAS 31. 45. […] From the date when a jointly controlled entity 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 jointly controlled entity. The investor shall recognise in profit or loss any difference between: (a) the fair value of any retained investment and any proceeds from disposing of the part interest in the jointly controlled entity; and (b) the carrying amount of the investment at the date when joint control is lost.

5. The proposal in ED 9 is:

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The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRIC or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

> ED 9. 29. […] When a joint venture becomes an associate of an entity, the entity shall continue to account for its interest using the equity method in accordance with IAS 28.
>
> 30. Except when it continues to use the equity method, an entity shall on the loss of joint control, measure at fair value any interest it retains in the former joint venture. The entity shall recognise in profit or loss any difference between: (a) the fair value of any retained interest and any proceeds from disposing of a part interest in the jointly venture; and (b) the carrying amount of the interest at the date joint control is lost.

6. The proposals of ED 9 (ie no remeasurement of the remaining interest in a joint venture when the entity retains significant influence) were supported in the Basis for Conclusions of ED 9 as follows:

> ED 9. BC19. If an investor loses joint control but retains significant influence, the Board's proposals mean that the investor accounts for its investment using the equity method both before and after the loss of joint control. The Board proposes, for practical reasons, that in such circumstances an investor should not measure at fair value the investment it retains on the loss of joint control. The Board will readdress this proposal at such time as it reconsiders the use of the equity method.

7. The proposals in ED 9 are simpler and potentially less costly than the current requirements in IAS 31, but they are inconsistent with the assertion that loss of joint control is a 'significant economic event' that changes the nature of an investment, as stated in IAS 27 *Consolidated and Separate Financial Statements*:

> IAS27. BC64. 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 over 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 over 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. Therefore, the Board decided to amend IAS 21 *The Effects of Changes in Foreign Exchange Rates*[1], IAS 28 and IAS 31, accordingly. The FASB considered whether to address that same issue as part of this project. The FASB

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[1] IAS 27 (as amended in 2008) added paragraphs 48A-48D and amended paragraph 49 of IAS 21.

> concluded that the accounting for investments that no longer qualify for equity method accounting was outside the scope of the project.

8. A few respondents to ED 9 stated that they agreed that the approach was practical but pointed out that it introduced an inconsistency with other standards.[2] One respondent stated that 'the fact that the accounting method remains unchanged does not mean that the economic event is less significant'.[3]

Staff analysis

9. Characterising the change from 'joint control' to 'significant influence' as a 'significant economic event' means that the proposal in ED 9 is an exception. In the Annual Improvement project (ie, '*Proposed amendment to IFRS 5 Non-current Assets Held for Sale and Discontinued Operations*'), the amendments proposed are also supported by referring to the Board's conclusions relating that the loss of joint control is a 'significant economic event':[4]

ED *Annual Improvements to IFRSs*. *Proposed amendment to IFRS 5*.

> BC2. 'The Board concluded in the second phase of its project on business combinations that the loss of control of an entity and the loss of significant influence/joint control over an entity are economically similar events and thus should be accounted for similarly […]. The Board therefore clarified that all the interest an entity has in an associate or jointly controlled entity is classified as held for sale if the entity is committed to a sale plan involving loss of significant influence or joint control.'

10. We are questioning the characterisation of these events in the level of an investor's influence over the investee as 'significant economic events' and recommending that the Board not continue to classify them as such. The analysis that follows supports this recommendation.

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[2] CL 36 (Norwegian Accounting Standards Board), CL 39 (Ernst & Young).

[3] CL 16 (Conseil National de la Comptabilité (CNC)).

[4] The amendment to IFRS 5 proposed in the ED is as follows: 8A 'An entity that is committed to a sale plan involving loss of control of a subsidiary <u>or loss of significant influence of an associate or loss of joint control of a jointly controlled entity</u> shall classify all the assets and liabilities of that subsidiary <u>or all the interests in an associate or a jointly controlled entity</u> as held for sale when the criteria set out in paragraphs 6–8 are met, regardless of whether the entity will retain a non-controlling interest in its former subsidiary <u>or an interest in the former associate or jointly controlled entity</u> after the sale'.

Requirements in IAS 27, IAS 28 and IAS 31

11. The requirements in the current IAS 27, IAS 31 and IAS 28 relating to the loss of control, joint control and significant influence (ie 'significant economic events' that change the nature of the investments) are as follows:

> IAS 27.34 If a parent loses control of a subsidiary, it:
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> (a) derecognises the assets (including any goodwill) and liabilities of the subsidiary at their carrying amounts at the date when control is lost;
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> (b) derecognises the carrying amount of any non-controlling interests in the former subsidiary at the date when control is lost (including any components of other comprehensive income attributable to them);
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> (c) recognises:
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> (i) the fair value of the consideration received, if any, from the transaction, event or circumstances that resulted in the loss of control; and
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> (ii) if the transaction that resulted in the loss of control involves a distribution of shares of the subsidiary to owners in their capacity as owners, that distribution;
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> (d) recognises any investment retained in the former subsidiary at its fair value at the date when control is lost;
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> (e) reclassifies to profit and loss, or transfers directly to retained earnings if required in accordance with other IFRSs, the amounts identified in paragraph 35[5]; and
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> (f) recognises any resulting difference as a gain or loss in profit or loss attributable to the parent.
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> IAS 31 / IAS 28 […] On the loss of joint control/significant influence, the investor shall measure at fair value any investment the investor retains in the former jointly controlled entity/associate. The investor shall recognise in profit or loss any difference between: (a) the fair value of any retained investment and any proceeds from disposing of the part interest in the jointly controlled entity/associate; and (b) the carrying amount of the investment at the date when joint control/significant influence is lost.[6]
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> If an investor loses joint control/significant influence of an entity/over an associate, the investor shall account for all amounts recognised in

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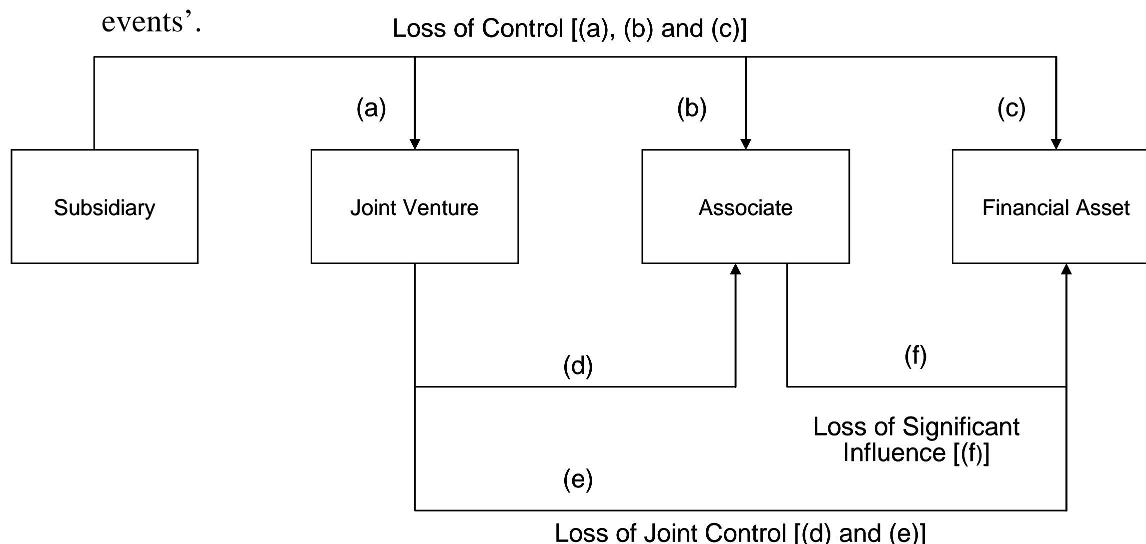
[5] These amounts refer to 'all amounts recognised in other comprehensive income in relation to that subsidiary on the same basis as would be required if the parent had directly disposed of the related assets or liabilities.'

[6] This requirement can be found in IAS 31.45 and IAS 28.18.

other comprehensive income in relation to that entity/associate on the same basis as would be required if the jointly controlled entity/associate had directly disposed of the related assets or liabilities.[7]

12. The graph below shows the cases [(a) to (f)] where, according to the current requirements in IAS 27, IAS 31 and IAS 28, a 'significant economic event' takes place. For each of these instances, we analyse below how much each of these changes in circumstances warrant the label of 'significant economic events'.



Loss of Control ((a), (b) and (c))

13. In each of the instances represented above with the letters (a), (b) and (c), loss of control causes an entity to derecognise assets and liabilities and to recognise the retained investment (ie the new investment) at its fair value at the date when control is lost. Paragraph 37 of IAS 27 states that:

'The fair value of any investment retained in the former subsidiary at the date when control is lost shall be regarded as the fair value on initial recognition of a financial asset in accordance with IFRS 9 *Financial Instruments* or, when appropriate, the cost on initial recognition of an investment in an associate or jointly controlled entity'.

14. In the case of loss of control, the parent-subsidiary relationship ceases, which causes the derecognition of assets and liabilities and the exclusion from the Group boundaries of any retained investment in the former subsidiary. The new

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[7] This requirement can be found in IAS 31.45B and IAS 28.19A.

relationship reporting entity-non-controlling investment (ie investor-investee) is recognised and measured initially at fair value at the date when control is lost.

15. We note that leaving the Group boundaries (ie losing control) is considered as a 'significant economic event' as entering the Group boundaries (ie gaining control). This is expressed in the Basis of Conclusions of IFRS 3 *Business Combinations* as follows (BC.384):

> '[…] The boards concluded that a change from holding a non-controlling investment in an equity to obtaining control of that entity is a significant change in the nature of and economic circumstances surrounding that investment. That change warrants a change in the classification and measurement of that investment'.

16. We note that the accounting requirements in IFRS 3 for gaining control are symmetric to the ones for losing control (ie, 'the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss').[8]

17. On the basis of the changes that loss of control causes to the relationship investor-investee (ie the change affects the Group boundaries) and to its accounting consequences (ie derecognition of assets and liabilities), we think the term 'significant economic event' is appropriate in this case. We note that this is aligned to the event of gaining control (ie gaining control is a 'significant economic event' that affects the Group boundaries and that has symmetric accounting consequences as losing control).

Loss of Joint Control (instances (d) and (e))

18. When an investor loses joint control over its JCE, any remaining investment can be either an associate or a financial asset.

19. We note that when the jointly controlled investment (JCE) becomes an associate the nature of the investment changes, however, losing joint control and gaining significant influence does not represent a change in the Group boundaries. We also note that in terms of the accounting consequences triggered by the event,

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[8] This requirement is included in paragraph 42 of IFRS 3.

both investments (ie, JCEs – we are referring to those joint arrangements that will become 'joint ventures' under the new standard – and associates) are measured using the equity method. Consequently there is no derecognition of assets and liabilities but a new relationship investor-investee based on new governance terms that is measured using the same measurement method.

20. In this situation we wonder whether the event (ie loss of joint control) would warrant the qualification of 'significant economic event' and consequently, whether the accounting requirements for the loss of joint control when significant influence is maintained should mirror the accounting implications triggered by a 'significant economic event' (ie remeasurement of the retained interest in the associate).

21. Another situation where loss of joint control takes place is when an interest in a JCE becomes an interest in a financial asset. The investor-investee relationship changes, however, this does not represent a change affecting the Group boundaries either. The accounting implications of this event are detailed in IAS 31.45 as included in paragraph 4 above.

22. We note that upon the loss of joint control, the recognition of the retained interest (ie a financial asset) at fair value is independent on whether the event is a 'significant economic event' or not, since 'fair value' is indeed the measurement requirement for this type of investments in accordance with IFRS 9 *Financial Instruments*. This case, evidences, even more clearly than when the accounting method does not change, that the meaningfulness of the term 'significant economic event' is limited since the measurement requirement of the new investment itself (ie a financial asset in this case) would have led to the same accounting result.

23. We note that 'gaining joint control' is not currently defined as a 'significant economic event' and no accounting guidance is provided. We note that this event (ie gaining joint control) does not represent a change in the Group boundaries either. Gaining joint control, when the investment was previously an associate, would not result in a different measurement method for the new investment (ie a joint venture). This would warrant not requiring

remeasurement of the previously interest held in the associate. We are not proposing to implement this requirement, however, preparers might analogise the accounting for the loss of joint control when an investment in an associate is retained with the accounting for the gain of joint control when the initial investment was an associate. We think that if this happened, this would not be a necessarily unwanted accounting practice.

24. In the case the investment before gaining of joint control was a financial asset, the 'old' base of the joint venture would have been at fair value which would match the measurement of the 'new' acquired portion (ie the new portion would be measured at fair value). Consequently, in this case the entire investment in the joint venture would have a 'deemed cost' which would equate to its fair value at the date of gaining joint control. Once again, this accounting treatment is not due to the fact that the event is a 'significant economic event' but to applying existing requirements.

Loss of Significant Influence (instance (f))

25. The analysis of whether or not the loss of significant influence would warrant the category of 'significant economic event' is equivalent to the analysis performed for loss of joint control of a joint venture when the investment retained is a financial asset. In that case, we concluded that the fact that the event is considered a 'significant economic event' is not by itself impacting in what the accounting of the event would be otherwise.

Conclusion relating to the requirements in IAS 27, IAS 31 and IAS 28

26. We think that the term 'significant economic event' should only refer to those cases that trigger changes in the Group boundaries (ie losing control and gaining control). This is because:

    (a) This approach would be aligned to the Group definition (ie losing joint control and losing significant influence, do not represent a change in the Group boundaries);

    (b) For the following events (ie loss of joint control to financial asset and loss of significant influence to financial asset), the measurement

requirement of the retained investment would already trigger the same accounting result than the effect of a 'significant accounting event';

(c) The event of loss of joint control when significant influence is maintained does not trigger any change in the measurement of the new investment, and we think that in this case, even though the nature of the investment changes, it does not warrant by itself the remeasurement of the retained interest.

27. If the Board agrees with this proposal, the following requirements should be amended:

(a) Redefine 'significant economic event' as an event that changes the nature of the involvement and affects the Group boundaries;

(b) Remove all descriptions that associate loss of joint control and loss of significant influence in the current standards to 'significant economic events'; and

(c) The accounting requirements for the loss of joint control in IAS 31 when significant influence is maintained to make them consistent with the proposals in ED 9.

Question 1
Does the Board agree with the proposals in paragraph 27 of this Agenda Paper?

Other requirements where the term 'significant economic event' is included: IAS 21 The Effects of changes in Foreign Exchange Rates

28. IAS 27 (as amended in 2008) added paragraphs 48A-48D and amended paragraph 49 of IAS 21. These paragraphs are as follows:

48A In addition to the disposal of an entity's entire interest in a foreign operation, the following are accounted for as disposals even if the entity retains an interest in the former subsidiary, associate or jointly controlled entity:

(a) the loss of control of a subsidiary that includes a foreign operation;

(b) the loss of significant influence over an associate that includes a foreign operation; and

(c) the loss of joint control over a jointly controlled entity that includes a foreign operation.

48B On disposal of a subsidiary that includes a foreign operation, the cumulative amount of the exchange differences relating to that foreign operation that have been attributed to the non-controlling interests shall be derecognised, but shall not be reclassified to profit or loss.

48C On the partial disposal of a subsidiary that includes a foreign operation, the entity shall re-attribute the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income to the non-controlling interests in that foreign operation. In any other partial disposal of a foreign operation the entity shall reclassify to profit or loss only the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income.

48D A partial disposal of an entity's interest in a foreign operation is any reduction in an entity's ownership interest in a foreign operation, except those reductions in paragraph 48A that are accounted for as disposals.

49 An entity may dispose or partially dispose of its interest in a foreign operation through sale, liquidation, repayment of share capital or abandonment of all, or part of, that entity. A write-down of the carrying amount of a foreign operation, either because of its own losses or because of an impairment recognised by the investor, does not constitute a partial disposal. Accordingly, no part of the foreign exchange gain or loss recognised in other comprehensive income is reclassified to profit or loss at the time of a write-down.

BC33 In the second phase of the business combinations project the Board decided that the loss of control, significant influence or joint control of an entity is accounted for as a disposal for the purposes of IAS 21. Accordingly, a former parent accounts for the loss of control over a subsidiary as a disposal of the subsidiary, even if the former subsidiary becomes an associate or jointly controlled entity of the former parent. Similarly an investor accounts for the loss of significant influence over an associate or the loss of joint control over a jointly controlled entity as a disposal. The Board decided that the change in the nature of the investment is a significant economic event.

BC34 The Board also decided in the second phase of the business combinations project that:

(a) changes in the parent's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions (ie transactions with owners in their capacity as owners);

(b) if a parent loses control of a subsidiary, the parent reclassifies from equity to profit or loss (as a reclassification adjustment) the parent's share of the exchange differences recognised in other comprehensive income relating to a foreign operation in that subsidiary; and

(c) if an investor loses significant influence over an associate or loses joint control over a jointly controlled entity, the investor

> reclassifies from equity to profit or loss (as a reclassification adjustment) the exchange differences recognised in other comprehensive income relating to a foreign operation in that associate or jointly controlled entity.

29. We propose aligning the requirements in IAS 21 with our first recommendation. This means that a change from joint control to an associate would be a 'partial' disposal rather than deemed to be an 'entire' disposal. As a consequence, only the proportionate amount of the reduced interest is reclassified to profit or loss. IAS 28.19A states that when an entity reduces its interest in an associate but the investment continues to be an associate only a proportionate amount of the accumulated foreign currency amounts are reclassified to profit or loss. The change we are proposing is consistent with that requirement.
30. In any case when the investment changes from being an associate or joint venture to a financial asset, this would continue to be an 'entire' disposal. Such treatment is appropriate because exchange differences are not separated from the carrying amount of the financial asset.
31. Consequently, in these requirements we also propose to explain, in an addendum to the Basis for Conclusions of IAS 21, that the Board no longer considers these changes to be 'significant economic events'.

Question 2
Does the Board agree that the Joint Arrangement standard should confirm the proposal that a change from joint control to significant influence is a 'partial' disposal rather than an 'entire' disposal and that IAS 21 should be amended accordingly?