Project: **Annual Improvements Project - 2008-2010 cycle**

Topic: **IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* – Application of IFRS 5 to loss of significant influence over an associate or a jointly controlled entity**

Objective of this paper

1. In the August 2009 *Improvements to IFRS* Exposure Draft (the ED), the Board addressed an issue relating to the application of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* to loss of significant influence over an associate or loss of joint control in a jointly controlled entity.

2. The objective of this paper is to analyse the comment letters received on this issue and to propose drafting changes to the wording in the ED to address matters identified by respondents.

Background information

3. This issue was originally discussed in the May 2009 IASB Board meeting during the presentation of agenda paper 13H. The observer notes from the discussion are included at http://www.iasb.org/NR/rdonlyres/9A9E4D1D-8223-4A4B-A9B1-4212C480BFD1/0/IASBUpdateMay09.pdf.

4. The proposed amendment requires an entity to classify as held for sale its interest in an associate or a jointly controlled entity when it is committed to a sale plan involving loss of significant influence or joint control.

5. This reflects the Board's conclusions that the loss of control of an entity, and loss of significant influence or joint control over an entity, are economically similar events and should be accounted for in a similar manner.

Analysis of comments received

6. The Board received 74 comment letters on the ED of which 19 commented on the subject of this paper.

7. The breakdown of the 74 comments received on the proposal to amend IFRS 5 for this issue is as follows:

Yes – agree:	55
Yes – agree, but expressed concern:	14
No – disagree:	5
Total:	**74**

8. Only 5 respondents disagreed with the proposals. This reflected the views of 3 respondents representing standard setters, 1 public organisation and 1 preparer. Of these respondents, 2 represented Germany, 1 the Netherlands, 1 South Korea and 1 Mexico.

Staff Analysis in response to the comments raised

9. Almost all of the respondents agreed with the proposal for an entity to classify as held for sale its interest in an associate or a jointly controlled entity when it is committed to a sale plan involving loss of significant influence or joint control.

10. The most significant comments raised by respondents related to consideration of three exceptions to the principle of classifying all of the interest as held for sale:

    (a) Split accounting approach when an interest is retained.

    (b) Split accounting approach when a portion of the investment qualifies for the scope exception in paragraph 1 of IAS 28 *Investments in Associates*.

    (c) No held for sale classification when the reporting entity loses joint control but retains a significant influence.

Split accounting approach when an interest is retained

11. All of the 5 respondents disagreeing with the proposals argued that a split accounting approach should be adopted when an entity is committed to a sale plan involving loss of significant influence or joint control, but retains an interest.

12. These respondents[1] recommended that, when an entity loses significant influence or joint control, any interest that will be retained should **<u>not</u>** be classified as held for sale.

13. Instead, consistent with the views held by some staff, the interest to be retained would be classified and measured in accordance with other IFRSs (eg IAS 28 or IAS 39 Financial Instruments: *Recognition and Measurement*).

[1] CL 9 (Bundesverband Offentlicher Banken Deutschlands), CL 11 (Dutch Accounting Standards Board (DASB)), CL 22 (KASB), CL 27 (Volkswagen AG), CL62 (Consejo Mexicano para la Investigación y Desarrollo de Normas de Información Financiera (CINIF))

14. The majority of staff believe though that this exception would be **<u>inconsistent</u>** with IFRS 5.8A which states that an entity:

> shall classify *all* the assets and liabilities of that subsidiary as held for sale … regardless of whether the entity will retain a non-controlling interest. (emphasis added)

15. They acknowledge that the accounting for a retained interest following loss of control may be viewed differently from the accounting for a retained interest following loss of significant influence or joint control.

16. Specifically, they note the argument that the change in nature of an investment is more pronounced in a loss of control situation because the presentation of the retained interest changes to being shown as a single line item in the statement of financial position.

17. However they believe that a split accounting approach to address these retained interest situations would be inconsistent with the Board's conclusions that the loss of control of an entity, and loss of significant influence or joint control over an entity, should be accounted for in a similar manner.

18. As a result the staff recommend that the proposed amendment is not adjusted to allow, or require, split accounting.

Split accounting approach when a portion of the investment qualifies for the scope exception in paragraph 1 of IAS 28 Investments in Associates

19. A related question raised by one respondent[2] was to clarify interaction with Issue 12 of the ED which proposes an amendment to IAS 28. This amendment was discussed in the January 2010 IFRIC meeting during the presentation of agenda paper 11. The observer notes from the discussion are included at http://www.iasb.org/NR/rdonlyres/CEC731D3-7466-4E77-9B1D-5D8188B0BAF/0/1001ap11obsAIPIAS28Partialuseoffairvalue.pdf

[2] CL 49 EFRAG

20. This IAS 28 amendment clarifies the accounting for an investee when an entity has significant influence, but a portion of the investment is designated as fair value through profit or loss in accordance with IAS 39 by applying the scope exception in IAS 28.1, and the remaining portion accounted for in accordance with IAS 28.

21. That amendment requires an entity to identify all direct and indirect interests held in the associate, but then use the scope criteria in IAS 28 to determine the appropriate accounting treatment for different portions of the investment, consistent with the business purposes for which those portions may be held.

22. The respondent questions when an entity is committed to a sale plan involving loss of significant influence or joint control, but part of its investment is accounted for in accordance with the scope exception in IAS 28.1, whether both portions of the investment should be classified as held for sale.

23. The staff believe that in this situation both portions of the investment should be classified as held for sale.

24. This reflects the views of the staff that this is consistent with the:

    (a) Board's Basis for Conclusions on the IAS 28 amendment which concludes that all interests in the investment should initially be identified together.

    (b) guidance in IFRS 5.2, which requires the **<u>classification and presentation</u>** requirements to apply to **<u>all</u>** non-current assets and disposal groups, but notes exceptions, including financial assets within the scope of IAS 39, to the **<u>measurement</u>** requirements of IFRS 5 may apply.

    (c) August 2009 *Improvements to IFRSs* ED which states in paragraph 8A that

> An entity that is committed to a sale plan involving loss of control of a subsidiary or loss of significant influence of an associate or loss of joint control of a jointly controlled entity shall classify all the assets and liabilities of that subsidiary or *all the interests in an associate or a jointly controlled entity as held for sale* (emphasis added)

Application when the reporting entity loses joint control but retains a significant influence

25. The third potential exception was raised by respondents agreeing with the proposals[3]. Their request was to clarify if an entity should classify as held for sale its interest when it loses joint control, but retains a significant influence.

26. These constituents noted that paragraph 30 of IAS 31 *Interests in Joint Ventures* allows a reporting entity to recognise its interest in a jointly controlled entity using either proportionate consolidation or the equity method.

27. They questioned whether it was appropriate to classify as held for sale an interest when an entity loses joint control, but retains a significant influence, specifically if the reporting entity applies the equity method to its investment before **and** after the sale transaction.

28. Given the Board did not discuss whether the amendment should be applied to this specific situation prior to issuance of the ED, the staff have analysed potential approaches to clarifying the guidance.

29. In doing so, the staff considered the proposals in Exposure Draft ED 9 *Joint Arrangements* (ED 9) which is expected to lead to publication of a final IFRS in the first quarter of 2010.

30. Included within ED 9 is a proposal that **all** joint ventures[4] are accounted for using the equity method. As a result, ED 9 eliminates the alternative of accounting for jointly controlled entities using a proportionate consolidation model.

31. The analysis below reflects the IASB Board deliberations of ED 9 through the date of completion of this agenda paper. The staff will provide an update in the March IFRIC meeting of any subsequent deliberations that impact this analysis.

[3] CL 29 (South African Institute of Chartered Accountants (SAICA)), CL 56 (SFRB)

[4] Defined in ED 9 as a joint arrangement, or part of a joint arrangement, that is jointly controlled by the venturers.

Approaches

32. The staff have identified three approaches for classifying an investment in a situation where an entity loses joint control, but retains a significant influence:

    (a) Approach 1 – **always** classify as held for sale.

    (b) Approach 2 – **never** classify as held for sale.

    (c) Approach 3 – **sometimes** classify as held for sale.

Approach 1

33. Approach 1 would require an entity to **always** classify as held for sale its interest when it loses joint control, **even if** it retains a significant influence. This approach is consistent with:

    (a) IAS 31.BC16 and the Board observations that:

    > the loss of control of an investee and the loss of joint control of an investee are economically similar events; thus they should be accounted for similarly. *The loss of joint control represents an economic event that changes the nature of the investment.* The Board concluded that the accounting guidance on the loss of control of a subsidiary should be extended to events, transactions or other changes in circumstances in which an investor loses joint control of an investee. (emphasis added)

    (b) IAS 28.BC21 which states that:

    > the loss of control of an entity and the loss of significant influence over an entity are economically similar events; thus they should be accounted for similarly.

    (c) analogy to paragraph BC55 of IAS 27 *Consolidated and Separate Financial Statements* which recognises that when control is lost, the parent-subsidiary relationship ceases to exist and an investor-investee relationship begins that differs significantly from the former parent-subsidiary relationship.

34. As a result, Approach 1 would be consistent with the proposed amendment included in the ED and would avoid adding exceptions to the principle that an entity should classify as held for sale its interest in an associate or a jointly controlled entity when it is committed to a sale plan involving loss of significant influence or joint control.

Approach 2

35. Approach 2 would **not** require an entity to classify as held for sale its interest when it loses joint control, **if** it retains a significant influence.

36. This would be consistent with the guidance in paragraph BC19 of ED 9 that:

> 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.

37. Consequently Approach 2 would reflect the view the Board expressed in ED 9 that there are no accounting implications if an investor loses joint control but retains a significant influence. As a result, an exception to the amendment is required when an entity is committed to a sale plan involving loss of significant influence or joint control if the entity retains a significant influence after the sale transaction.

Approach 3

38. Approach 3 would require an entity to **only** classify as held for sale its interest when it loses joint control, but retains a significant influence, **if** it applies proportionate consolidation to the interest when it was jointly controlled.

39. This approach would recognise the principle in Approach 1 that the loss of joint control represents an economic event that changes the nature of the investment.

40. However it would also acknowledge the practical application issue noted in Approach 2 that there should not be any accounting implications if the investor accounts for its investment using the equity method both before, and after, the loss of joint control. Instead classification as held for sale is only required if the method of accounting for the interest changes as result of the sale transaction.

41. The staff believe that Approach 2 should be adopted.

42. An entity should **<u>not</u>** classify as held for sale its interest when it loses joint control, **<u>if</u>** it retains a significant influence because it:

    (a) is consistent with the Board's proposals in ED 9.

    (b) leads to a consistent approach to held for sale classification when the reporting entity loses joint control but retains a significant influence, regardless of how the jointly controlled interest was accounted for prior to the sale transaction.

    (c) is not expected to require further amendment to the guidance on held for sale classification upon publication of a final IFRS on *Joint Arrangements* in 2010 eliminating the alternative of accounting for jointly controlled entities using a proportionate consolidation model.

Other matters

43. Respondents also proposed the following changes:

    (a) The effective date for this improvement of 1 January 2010 should be changed as it is prior to the expected publication date of the final 2008

- 2010 *Improvements to IFRS* [5]. The staff agrees and proposes a revised effective date of 1 January 2011.

(b) The final sentence in BC2 should be revised[6] to clarify its meaning and added to paragraph 8B[7]:

The staff agrees with this proposal.

(c) Minor drafting adjustments which the staff agreed with[8] and comments from three respondents which the staff believe relate to matters outside of the scope of the proposed improvement.

Staff recommendation

44. The staff recommend the proposed amendment be re-drafted as suggested in the appendices to include the following modifications:

(a) Clarify that an entity would **not** be required to classify as held for sale its interest when it loses joint control, **if** it retains a significant influence.

(b) An effective date of 1 January 2011.

(c) Minor drafting amendments.

Question 1 for the IFRIC
Does the IFRIC agree with the staff recommendation in paragraph 44?

Question 2 for the IFRIC
Does the IFRIC agree with the proposed changes set out in Appendix A? If not, what wording would the IFRIC suggest?

[5] CL 6 (German Accounting Standards Committee (DRSC)), CL 7 (Australian Accounting Standards Board), CL 19 (G100), CL 47 (Ernst & Young), CL 49 (EFRAG)

[6] CL 34 (BP Plc),

[7] CL 23 (Deloitte), CL 29 (South African Institute of Chartered Accountants (SAICA)), CL 47 (Ernst & Young), CL 52 (KPMG), CL 61 (FEE)

[8] CL 49 (EFRAG)

Appendix A – Proposed drafting of final amendment to IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

A1. This appendix includes the proposed drafting of the final amendment. It is based on the text included in the Bound Volume as of 1 January 2009. New text is underlined and deleted text is struck through.

Proposed amendment to IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

Paragraphs 8A and 44C are amended and paragraphs 8B and 8C, and BC24F-I are added.

Classification of non-current assets (or disposal groups) as held for sale or as held for distribution to owners

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 that associate or 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.

8B When an entity obtains control, but loses significant influence of an associate or joint control of a jointly controlled entity in a step acquisition transaction, it shall not classify as held for sale its investment in that associate or jointly controlled entity in accordance with IFRS 5.

8C Paragraph 8A shall not be applied when an entity is committed to a sale plan involving loss of joint control of a jointly controlled entity, but will retain a significant influence through a remaining investment after the sale.

Effective date

44C Paragraphs 8A and 36A were added by Improvements to IFRSs issued in May 2008. An entity shall apply those amendments for annual periods beginning on or after 1 July 2009. Paragraph 8A was also amended, and paragraphs 8B and 8C added, by Improvements to IFRSs issued in [date]. An entity shall apply the amendment to paragraph 8A and paragraphs 8B and 8C for annual periods beginning on or after 1 January 2011. Earlier application is permitted. However, an entity shall not apply the amendments for annual periods beginning before 1 July 2009 unless it also applies IAS 27 (as amended in May 2008). If an entity applies the amendments before 1 July 2009 it shall disclose that fact. An entity shall apply the amendments prospectively from the date at which it first applied IFRS 5, subject to the transitional provisions in paragraph 45 of IAS 27 (amended May 2008).

Basis for Conclusions on proposed amendment to IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

Sale plan involving loss of significant influence of an associate or joint control of a jointly controlled entity

BC24F In 2009 the Board considered situations when an entity is committed to a sale plan involving loss of significant influence of an associate or joint control of a jointly controlled entity.

BC24G 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 they should be accounted for similarly, consistent with IAS 28 *Investments in Associates*. 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 and all the criteria set out in paragraphs 6-8 of IFRS 5 are met.

BC24H The Board also concluded that when an entity obtains control, but loses significant influence of an associate or joint control of a jointly controlled entity in a step acquisition transaction, it shall not classify as held for sale its investment in that associate or jointly controlled entity in accordance with IFRS 5. This is because there will be no sale transaction.

BC24I The Board considered the comments received on the proposal set out in its exposure draft of August 2009. In response to the comments received, the Board concluded, consistent with its discussions on Exposure Draft ED 9 *Joint Arrangements*, that for practical reasons, an entity shall not classify as held for sale its investment when it is committed to a sale plan involving loss of joint control of a jointly controlled entity, but will retain a significant influence through a remaining investment after the sale. This is because it may account for its investment using the equity method both before and after the loss of joint control.

Appendix B – Proposed drafting edits from the proposed amendment included in the ED

A2. This appendix includes the proposed drafting edits from the proposed amendment included in the exposure draft of proposed *Improvements to IFRSs* published in August 2009. This appendix presumes all changes proposed in the exposure draft were accepted and only shows incremental changes newly recommended by the staff based on an analysis of the comment letters received. Incremental new text is double underlined and incremental deleted text is double struck through.

Proposed amendment to IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

Paragraphs 8A and 44C are amended and paragraphs 8B and 8C are added.

Classification of non-current assets (or disposal groups) as held for sale or as held for distribution to owners

8A An entity that is committed to a sale plan involving loss of control of a subsidiary or loss of significant influence of an associate or loss of joint control of a jointly controlled entity shall classify all the assets and liabilities of that subsidiary or all the interests in ~~an~~ that associate or ~~a~~ jointly controlled entity 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 or an interest in the former associate or jointly controlled entity after the sale.

8B When an entity obtains control, but loses significant influence of an associate or joint control of a jointly controlled entity in a step acquisition transaction, it shall not classify as held for sale its investment in that associate or jointly controlled entity in accordance with IFRS 5.

8C Paragraph 8A shall not be applied when an entity is committed to a sale plan involving loss of joint control of a jointly controlled entity, but will retain a significant influence through a remaining investment after the sale.

Effective date

44C Paragraphs 8A and 36A were added by Improvements to IFRSs issued in May 2008. An entity shall apply those amendments for annual periods beginning on or after 1 July 2009. Paragraph 8A was also amended, and paragraphs 8B and 8C added by Improvements to IFRSs issued in [date]. An entity shall apply the amendment to paragraph 8A and paragraphs 8B and 8C for annual periods beginning on or after 1 January 201~~0~~1. Earlier application is permitted. However, an entity shall not apply the amendments for annual periods beginning before 1 July 2009 unless it also applies IAS 27 (as amended in May 2008). If an entity applies the amendments before 1 July 2009 it shall disclose that fact. An entity shall apply the amendments prospectively from the date at which it first applied IFRS 5, subject to the transitional provisions in paragraph 45 of IAS 27 (amended May 2008).

Basis for Conclusions on proposed amendment to IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

This Basis for Conclusions accompanies, but is not part of, the proposed amendment.

Disclosures of non-current assets (or disposal groups) classified as held for sale or discontinued operations

BC1 In 2009 the Board considered ~~the applicability of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* to~~ situations when an entity is committed to a sale plan involving loss of significant influence of an associate or joint control of a jointly controlled entity.

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 they should be accounted for similarly, consistent with ~~(see paragraph BC21 of the Basis for Conclusions on~~ IAS 28 *Investments in Associates.* 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 and all the criteria set out in paragraphs 6-8 of IFRS 5 are met.

BC3 The Board also concluded that when an entity obtains control, but loses significant influence of an associate or joint control of a jointly controlled entity in a step acquisition transaction, it shall not classify as held for sale its investment in ~~an~~ that associate or ~~a~~ jointly controlled entity in accordance with IFRS 5. ~~when it is highly probable that control will be obtained~~ This is because there will be no sale transaction.

BC3 The Board considered the comments received on the proposal set out in its exposure draft of August 2009. In response to the comments received, the Board concluded, consistent with its discussions on Exposure Draft ED 9 Joint Arrangements, that for practical reasons, an entity shall not classify as held for sale its investment when it is committed to a sale plan involving loss of joint control of a jointly controlled entity, but will retain a significant influence through a remaining investment after the sale. This is because it may account for its investment using the equity method both before and after the loss of joint control.