Project	**IAS 21 *The Effects of Changes in Foreign Exchange Rates***
Topic	**CTA Recycling in IAS 27R Transactions**

Introduction

1. In November 2009, the staff received a request for the Board to consider an issue in IAS 21 *The Effects of Changes in Foreign Exchange Rates* related to whether the separate foreign currency equity reserve related to the retranslation of the net assets of an investor's net investment in a subsidiary (often referred to as 'CTA') should be recycled and if so, when recycling is appropriate.

2. The submission requests the Board address this issue as part of the *Annual Improvements* project (AIP). However, given the recent changes to AIP and the IFRIC's involvement, this issue is being presented first for deliberation by the IFRIC. This is a preliminary discussion to assist the staff in its research and analysis of this issue (and related issues).

3. The purpose of this Agenda Paper includes:

    (a) **Background** of the issue;

    (b) **Staff analysis and recommendations**; and

    (c) **Questions for the IFRIC**.

Background

4. In the staff's opinion, the primary issue being asked focuses on the question of when should the separate foreign currency equity reserve related to the retranslation of the net assets of a net investment (NI) (often referred to as

This paper has been prepared by the technical staff of the IASCF for discussion at a public meeting of the IFRIC.

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 IFRIC or 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.

Decisions made by the IFRIC are reported in IFRIC *Update*.

Interpretations are published only after the IFRIC and the Board have each completed their full due process, including appropriate public consultation and formal voting procedures. The approval of an Interpretation by the Board is reported in IASB *Update*.

‘CTA’) be recycled. More specifically, should CTA be recycled for transactions in which there is a reduction in:

(a) **View 1 –** the **proportionate** (relative) equity ownership interest in a foreign operation; or

(b) **View 2 –** the **absolute** interest of an entity’s ownership interest in a foreign operation, but no reduction in the proportionate equity ownership interest in a foreign operation.

5. The issue arises because, in the submitter’s opinion, the guidance in paragraphs 48–49 of IAS 21 is unclear. Specifically the guidance in paragraph 48D states that, (emphasis added) ‘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…’

6. In interpreting or clarifying the meaning of ‘reduction in an entity’s ownership interest’, the staff has considered the effect on the parent’s/ investor’s ownership in the following different scenarios:

Scenario	**Effect on ownership**	
	Percentage ownership	Absolute ownership
1. Repayment of capital – disproportionately larger to reporting entity	reduction	reduction
2. Repayment of capital – disproportionately larger to other equity holders	increase	reduction
3. Issue of new shares – to other equity holders	reduction	no change
4. Pro-rata repayment of capital to all equity holders	no change	reduction

7. The guidance in paragraphs 48 – 49 of IAS 21 address a number of different changes in ownership structure involving the reduction of an ‘interest’ in a subsidiary/ joint venture/ associate. In the staff’s opinion, the following transactions or events should apply the accounting guidance as noted:

Transaction/ Event	**Accounting Guidance**
Change in percentage ownership of a subsidiary without loss of control	Reallocate CTA to NCI without recycling to the statement of comprehensive income [21.48C]
Change in percentage ownership of a subsidiary/ joint venture/ associate that results in loss of control/ joint control/ significant influence	Recycle all of the parent's/ investor's CTA to the statement of comprehensive income [21.48A and 28.19A]
Change in percentage ownership of a joint venture/ associate that does not result in loss of joint control/ significant influence	Recycle proportionate amount of CTA to the statement of comprehensive income [21.48C and 28.19A]
Reduction of net investment in subsidiary/ joint venture/ associate without a change in percentage ownership (and no loss of control/ joint control/ significant influence) (i.e. Scenario 4 above)	PRIMARY ISSUE OF THIS AGENDA PAPER: Should there be any recycling of CTA in this situation?

Other 'investments' in the foreign operation

8. The staff analysis included in this Agenda Paper presumes the amount of the entity's 'investment' in the foreign operation is made up exclusively of the entity's ownership of equity interests in the foreign operation. To the extent the entity has additional investments in the foreign operation, for example loans between the parent/ investor and the net investment (ie subsidiary/ joint venture/ associate), the reporting entity will be required to separately track and separately account for any foreign currency effects related to those additional 'investments'.

IFRIC submission

9. The submission is included in Appendix A without modification for reference (except for removal of submitter contact information).

Staff Analysis and Recommendations

General information

10. IAS 27 (revised 2008) states, in part:

Disposal or partial disposal of a foreign operation

48 **On the disposal of a foreign operation, the cumulative amount of the exchange differences relating to that foreign operation, recognised in other comprehensive income and accumulated in the separate component of equity, shall be reclassified from equity to profit or loss (as a reclassification adjustment) when the gain or loss on disposal is recognised (see IAS 1 *Presentation of Financial Statements* (as revised in 2007)).**

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 deferred foreign exchange gain or loss recognised in other comprehensive income is reclassified to profit or loss at the time of a write-down.

View 1 – Recycle CTA when proportionate reduction

11. View 1 supports that amounts recognised in CTA related to a foreign operation are recycled only when there is a reduction in the entity's proportionate ownership interest in the foreign operation.

12. Conversely, if all holders of 'ownership interests' are reduced by the same nominal amount (so they all have absolute reductions, but none have proportionate reductions) the future attribution process (as discussed in paragraph 28 of IAS 27) from the subsidiary, joint venture or associate to the parent or investor, respectively, will continue to be the same.

13. IFRS 3 (revised 2008) and IAS 27 (revised 2008) described for the first time the fundamental concept that an entity can gain or lose control as a result of the purchase or sale of an ownership interest or by other means, such as when a subsidiary issues new ownership interests (either to the reporting entity or to other equity holders). An event that results in the gain or loss of control can also occur in the absence of a transaction. It may, for example, occur on the expiry of an agreement that previously allowed an entity to control a subsidiary, such as currently exercisable options on equity instruments of the subsidiary/ joint venture/ associate.

14. As a result of the revisions to IAS 27 (and consistent with the revisions to IFRS 3), the Board made a consequential amendment to IAS 21 that added paragraphs 48A-48D and amended paragraph 49. This incorporated into IAS 21 the Board's overall concepts on how control is gained or lost. This consequential amendment included guidance on how the reporting entity should account for CTA related to the proportionate ownership interest in the entity that is lost.

15. In the staff's opinion, paragraph 48D was intended to capture the concept that the gain or loss of control can occur in several different ways. It was not intended to introduce a bright line rule that results in differences from the underlying principles within paragraphs 48–49.

View 2 – Recycle CTA when absolute reduction

16. View 2 supports that amounts recognised in CTA related to a foreign operation are recycled any time there is a reduction in the entity's absolute ownership interest in the foreign operation.

17. This view closely follows the wording in paragraph 48D of IAS 21 in that '<u>any reduction</u> in an entity's ownership interest in a foreign operation' (emphasis added) is deemed to be a partial disposal. Based on the guidance in paragraph 48C for partial disposals of subsidiaries, 'the the entity shall re-attribute the proportionate share' of the CTA recognised in other comprehensive income (OCI) to the non-controlling interests. Based on the guidance in paragraph 48C for any other partial disposal [of joint ventures or associates], 'the entity shall reclassify to profit or loss only the proportionate share' of CTA recognised in OCI.

18. Additionally, for View 2 the submitter states, in part:

> …view A [View 1 of this Agenda Paper] seems to give an odd result in the case of a liquidation or abandonment in stages, in that nothing is recycled until the very last bit is liquidated/ abandoned, at which time control is lost through having no ownership interest.

19. Finally, the submission includes an 'exception' to View 2 stating, in part:

> …The only exception would be payments of dividends that do not amount to a liquidation or partial liquidation, which now do not result in recycling whether they are from pre- or post-acquisition profits (amendment to IAS 21.49 from the IAS 27 and IFRS 1 amendments)

Application of views

20. The following table provides the results created through the application of View 1 and View 2:

Scenario	**Effect on ownership**		**Effect on CTA**	
	Percentage ownership	Absolute ownership	View 1	View 2
1. Repayment of capital – disproportionately larger to reporting entity	reduction	reduction	Recycle CTA proportionate to reduction in ownership percentage	Recycle CTA proportionate to reduction in overall ownership interest
2. Repayment of capital – disproportionately larger to other equity holders	<u>increase</u>	reduction	**Subsidiary: Reallocate from NCI? JV/ Associate: Do nothing?**	Recycle CTA proportionate to reduction in overall ownership interest
3. Issue of new shares – to other equity holders	reduction	no change	Recycle CTA proportionate to reduction in ownership percentage	No recycling
4. Pro-rata repayment of capital to all equity holders	no change	reduction	No recycling	Recycle CTA proportionate to reduction in overall ownership interest

21. In the staff's opinion, the first two scenarios (1 and 2) should be seen as the net impact of two separate transactions. This staff opinion is consistent with the staff's opinion of circumstances where the parent/ investor has 'other investments' in the subsidiary/ joint venture/ associate in addition to ownership of the entity's equity instruments. Scenarios 1 and 2 above can be separated into their two component transactions being the:

    (a) Repayment of capital that is proportionate for all equity holders, and

    (b) Repayment of capital to one (or more) equity holders that is not proportionate for all equity holders.

22. The two separate component transactions included within each of Scenarios 1 and 2 should then apply the applicable accounting to each of the separate component transactions.

Submission example

23. The submission includes an example:

> Consider the following case that involves a parent (P) and its net investment (NI).
>
> > P owns 100% of NI and controls it. NI liquidates 50% of its assets and pays the cash to P (eg by repaying a quasi equity loan from P or repurchasing share capital). After the transaction, P continues to own 100% of NI and continues to control it.
>
> The issue is whether the separate foreign currency equity reserve related to the retranslation of the net assets of NI (often referred to as 'CTA') should be recycled in the above case.

24. In the staff's opinion, the example provided should be viewed as two separate decisions made by management including the:

    (a) decision to liquidate 50% of the net assets of the subsidiary, and

    (b) decision to repatriate/ repay a portion of the parent's net investment in the subsidiary in cash (as the submitter notes 'by repaying a quasi equity loan from P or repurchasing share capital').

25. In the staff's opinion, CTA can broadly be seen as representing the 'unrealised gains/ losses' related to changes foreign exchange rates that a parent/ investor has with respect to its net investment in the subsidiary/ joint venture/ associate. As long as that net investment remains in the foreign currency in any form (property, plant and equipment, financial assets, cash, etc.) the parent/ investor remains subjected to the changes in foreign exchange rates. Consistent with this rationale, there is no recycling of CTA for the partial disposal through sale or liquidation/ abandonment in stages. [In the staff's opinion, the interrelated second transaction of repatriating those funds is discussed below.]

26. In the staff's opinion, the rationale of CTA as representing the unrealised gains/ losses then follows that the decision and event of repatriating/ repaying a portion of the parent's/ investor's original investment results in that proportionate share of CTA being 'locked in' at the foreign exchange rate at that date. That is, that portion of the CTA gain/ loss is 'realised' when the parent/ investor receives that value in the parent's / investor's functional currency. The parent/ investor is no

longer subjected to changes in foreign exchange rates (for the portion of its original investment that was repatriated).

Interaction with prior decisions

27. The staff believes the issues underlying this submission interact with other recent changes to paragraph 49 of IAS 21. As a result of the Board's decision to delete the requirement in IAS 27 to distinguish dividends paid out of pre-acquisition earnings from dividends paid out of post acquisition earnings, the Board included a consequential amendment to IAS 21 to preclude reclassification of CTA from other comprehensive income into the statement of comprehensive income in these circumstances. This consequential amendment is included in the *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* (Amendments to IFRS 1 and IAS 27) issued May 2008.

Staff recommendations

28. As of the posting of this paper, the staff is continuing to work on its analysis of this issue as well as the potential interaction with current other IFRSs and prior decisions. However, the staff sees a benefit from briefing the IFRIC on the issue and work performed to date, and seeks the views from the IFRIC.

Questions for the IFRIC

29. The staff requests the IFRIC to address the following question:

Question 1 – Preliminary views
Does the IFRIC have any preliminary views on this issue?

Appendix A – Original Submission

A1. The original submission received by the staff has been included below without modification (except for removal of submitter contact information).

When should CTA be recycled under IAS 21 (revised) as amended by IAS 27R?

Consider the following case that involves a parent (P) and its net investment (NI).

P owns 100% of NI and controls it. NI liquidates 50% of its assets and pays the cash to P (eg by repaying a quasi equity loan from P or repurchasing share capital). After the transaction, P continues to own 100% of NI and continues to control it.

The issue is whether the separate foreign currency equity reserve related to the retranslation of the net assets of NI (often referred to as 'CTA') should be recycled in the above case. There appear to be two views:

View A: CTA should **not** be recycled. Since P continues to have 100% of NI, there has been no change in its 'ownership interest' and hence no disposal or partial disposal under IAS 21 paras 48D and 49. Under this view, 'ownership interest' refers to the percentage interest held and hence a partial disposal under para 49 can only arise for an associate or joint venture (see case 3 above), but never for a subsidiary. Those who support this view believe it is consistent with IAS 27 (revised) under which a gain or loss on disposal arises only when a parent loses control and not if its ownership interest is reduced (in either percentage or absolute terms) without a loss of control. This view is also consistent with the recent amendment to IAS 21 which removed a distinction between pre-acquisition and post-acquisition dividends (ie the payment of pre-acquisition dividend is not considered a partial disposal of a net investment).

View B: A pro rata share (ie 50%) of CTA should be recycled. The transaction is a partial disposal per IAS 21.49 as there has been a reduction in P's ownership interest. Under this view' ownership interest' refers to both the percentage and the absolute interest held in a net investment, and hence a partial disposal under para 49 can arise for all of a subsidiary, associate or joint venture. Those who support this view point out that para 49 was not amended by IAS 27, and believe the above situation is different to the specific situations added to the standard by IAS 27 that deal only with transactions between a parent and a minority. Furthermore, view A seems to give an odd result in the case of a liquidation or abandonment in stages, in that nothing is recycled until the very last bit is liquidated/ abandoned, at which time control is lost through having no ownership interest.

This issue arises for all transactions in which there is a reduction in the amount of a net investment in a subsidiary, but no percentage change in the ownership interest and no loss of control. The only exception would be payments of dividends that do not amount to a liquidation or partial liquidation, which now do not result in recycling whether they are from pre- or post-acquisition profits (amendment to IAS 21.49 from the IAS 27 and IFRS 1 amendments).

Excerpts from IAS 21 - Disposal or partial disposal of a foreign operation

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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.