Project	**New items for initial consideration**
Topic	**IAS 27 *Consolidated and Separate Financial Statements*—Group reorganisations in separate financial statements**

Introduction

1. The IFRS Interpretations Committee (the Committee) received a request to address the accounting for investments in subsidiaries by an intermediate parent that is newly established in a specific kind of reorganisation. In particular, the submitter is concerned about such newly established intermediate parents that account for their investments in subsidiaries in their separate financial statements at cost in accordance with paragraph 38(a) of IAS 27 *Consolidated and Separate Financial Statements* (as amended in May 2008).

2. For ease of reference, the text of the submission is reproduced in Appendix C to this paper.

Purpose of the paper

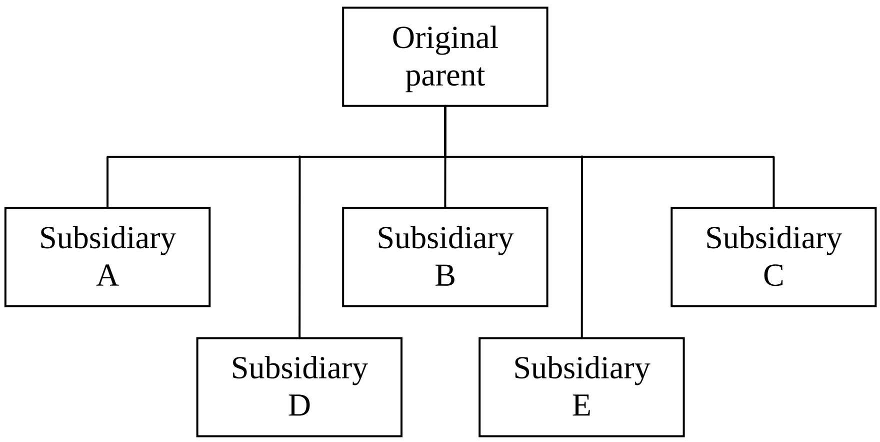
3. This paper:
   (a) provides background information on the issue;
   (b) analyses the issue within the context of IFRSs;
   (c) assesses the issue against the Committee's agenda criteria;
   (d) includes the staff recommendation not to add this issue to the Committee's agenda; and
   (e) asks questions to the Committee.

Background information

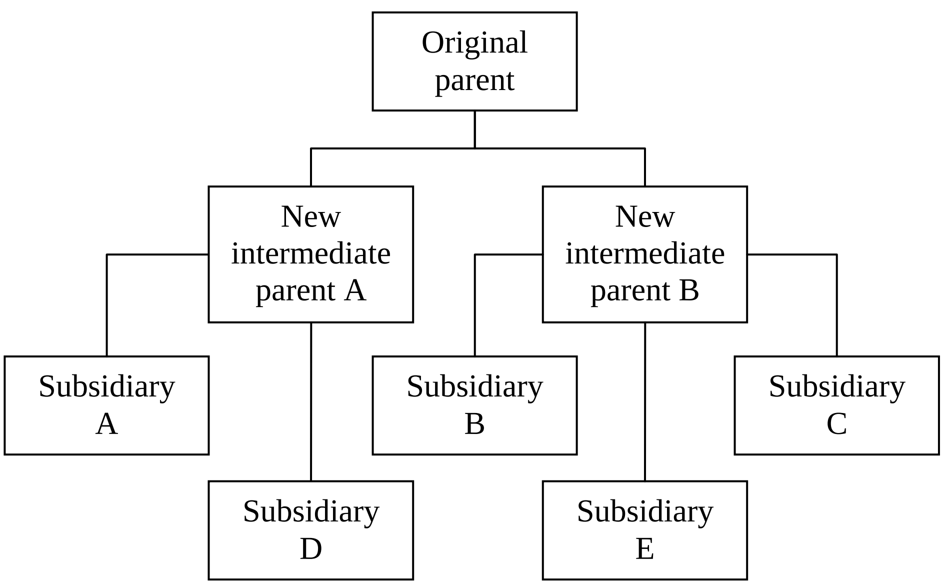
The issue

4. The request addresses group reorganisations in which the original parent with multiple subsidiaries establishes new intermediate parents between itself and several subsidiaries in a share-for-share exchange, often referred to as a 'one-to-many' parent-subsidiary relationship, as illustrated below. Such reorganisations typically occur before an initial public offering (IPO).

   (a) Before the reorganisation:



   (b) After the reorganisation:



5. In such reorganisations, a new intermediate parent typically acquires the original parent's interests in the subsidiaries in exchange for its own equity instruments, ie equity instruments that it issues to the original parent. In other words, the new intermediate parent A, for example, acquires, in the scenario presented above, the original parent's shareholdings in subsidiary A and subsidiary D in exchange for the new equity instruments that it issues to the original parent as part of this reorganisation.

6. IAS 27 does not define cost. However, we note that based on analogy to other IFRSs (eg IAS 16 *Property, Plant and Equipment*, IAS 38 *Intangible Assets* and IAS 40 *Investment Property*), it is generally understood that cost is the fair value of the consideration given.

7. In the exchange transactions presented above, the consideration given by a new intermediate parent is the equity instruments that it issued to the original parent. The fair value of these equity instruments is measured by reference to what was received (ie the investments in the subsidiaries) if the net assets of the new intermediate parent only consist, in substance, of the investments in the subsidiaries. This is typically true for the type of reorganisations presented above. Accordingly, the consideration given and the investments in the subsidiaries are measured at the fair value of the subsidiaries, when the new intermediate parents accounts for these investments in its separate financial statements at cost in accordance with paragraph 38(a) of IAS 27 (amended 2008).

8. For certain reorganisations, however, paragraphs 38B and 38C of IAS 27 (amended 2008) require a different approach for determining the cost of the investments. Instead of determining the cost of the investments by the fair value of the consideration given, these paragraphs require a new intermediate parent to measure cost at the carrying amount of its share of the equity items shown in the separate financial statements of the subsidiaries at the date of the reorganisation (**previous carrying amount basis**).

9. As explained in paragraphs BC66K, BC66L and BC66N of IAS 27 (amended 2008), the reorganisations addressed in paragraphs 38B and 38C of IAS 27 (amended 2008) share the following characteristics:

   (a) the reorganisation involves the establishment of a new entity as a parent of an original entity or an original group;

   (b) the new entity obtains control of the original entity or the original group by issuing equity instruments in exchange for existing equity instruments of the original entity or the original group;

   (c) the assets and liabilities of the new group and the original entity or the original group are the same immediately before and after the reorganisation; and

   (d) the owners of the original parent have the same relative and absolute interests in the net assets of the original entity or the original group immediately after the reorganisation as they had in the net assets of the original entity or the original group before the reorganisation.

10. We think the third characteristic (see paragraph 9(c)) is most critical for the application of the previous carrying amount basis for the type of reorganisations addressed in this agenda paper (see paragraph 4 of this paper):

   (a) Looking at it from the perspective of the original parent it is apparent that the group of the new intermediate parent A (the new group) only includes the assets and liabilities of subsidiary A and subsidiary D, whereas the group of the original parent (the original group) also included the assets and liabilities of subsidiaries B, C and E.

   (b) Looking at it from the perspective of the subsidiary A it is apparent that the group of the new intermediate parent A (the new group) also includes the assets and liabilities of subsidiary D, whereas subsidiary A (the original entity) did not.

Summary analysis presented in the submission

11. The submitter notes that three different views have emerged in practice on whether the previous carrying amount basis can be applied to the type of reorganisations presented above, ie reorganisation with 'one-to-many' parent-subsidiary relationships:

    (a) **View 1 *Measure by fair value of consideration given*:** proponents of this view believe that new intermediate parents must determine the cost of their investments in the subsidiaries by the fair value of the equity instruments they have issued to the original parents in exchange for the investments in the subsidiaries. For the type of reorganisations addressed in this paper, the fair value of the issued equity instruments typically equals the new intermediate parents' interest in the subsidiaries (see paragraph 7 of this paper). They consider this approach to be the application of the general principle which is to determine cost by the fair value of the consideration given and the application of the previous carrying amount basis under paragraphs 38B and 38C of IAS 27 (amended 2008) an exception to that general principle. Proponents of this view reject the application of the previous carrying amount basis for the following two reasons:

        (i) the type of reorganisations presented above is not in the scope of paragraphs 38B and 38C of IAS 27 (amended 2008): and

        (ii) it is not appropriate to apply an exception to a general principle by analogy.

(b) **View 2 *measure by previous carrying amount basis*:** proponents of this view believe that new intermediate parents must apply the previous carrying amount basis to determine the cost of their investments in the subsidiaries in the type of reorganisations presented above (see paragraph 4 in the paper). They reach this conclusion because they consider such reorganisations to be in the scope of paragraphs 38B and 38C of IAS 27 (amended 2008).

(c) **View 3 *accounting policy choice*:** proponents of this view believe that new intermediate parents have an accounting policy choice whether they determine the cost of their investments in the subsidiaries at the fair value of the consideration given or at the previous carrying amount basis in the type of reorganisations presented above (see paragraph 4 in the paper). They agree with the proponents of view 1 that such reorganisations are not in the scope of paragraphs 38B and 38C of IAS 27 (amended 2008). Unlike the proponents of view 1 however, they consider it possible to apply the previous carrying amount basis by analogy to such reorganisations. This leads them to either applying the general principle, ie determining cost by the fair value of the consideration given, or applying the previous carrying amount basis by analogy. Proponents of this view accept the application of the previous carrying amount basis by analogy for the following two reasons:

   (i) they highlight that according to paragraph BC66Q of IAS 27 (amended 2008) there is no specific guidance for accounting for other common control transactions in separate financial statements; and

   (ii) they see no convincing argument to have different accounting for reorganisations of groups that result in the new parent having only one subsidiary or more than one.

12. It may be noted that all the views presented in the submission are in agreement that paragraph 38B of IAS 27 (amended 2008) does not require the application of the previous carrying amount basis for reorganisations that result in the new

intermediate parent having more than one subsidiary. Instead, all of them deliberate whether paragraph 38C of IAS 27 (amended 2008) leads to the application of the previous carrying amount basis to such reorganisations.

Prevalence of the issue in practice

13. The submitter states that the issue is widespread, particularly in the Far East and Oceania, and is particularly common given the increasing number of IPOs in that region.

Relevant literature

14. In May 2011, the Board issued IAS 27 *Separate Financial Statements* (IAS 27, revised 2011), which replaces IAS 27 *Consolidated and Separate Financial Statements* as amended in May 2008 (IAS 27, amended 2008). IAS 27 (revised 2011) must be applied for annual periods beginning on or after 1 January 2013. Consequently, the following analysis addresses the issue under both versions of IAS 27.

15. For ease of reference, the guidance and explanations in paragraphs 38B, 38C and BC66K-BC66Q of IAS 27 (amended 2008) are contrasted in Appendix B with the revised guidance and explanations in paragraphs 13, 14 and BC21-BC27 of IAS 27 (revised 2011).

Staff analysis

16. Notwithstanding all the revisions to IAS 27 (amended 2008) that were issued in May 2011, none of the amendments to the standard and the Basis for Conclusions affect the issues addressed in this agenda paper. Because of this, the following analysis makes reference only to the guidance and explanations in IAS 27 (amended 2008), ie only to the edition of the standard and the Basis for Conclusions that the submission makes reference to and that has been the basis for discussions on this issue so far. However, it should be kept in mind that this

is simply to ease the reading of the paper and the following analysis also applies under IAS 27 (revised 2011).

17. The different views presented in the submission (see paragraph 11 in the paper) results from different conclusions on the following two issues that must be examined separately:

    (a) are the new intermediate parents A and B **required** to measure the cost for their investments in the subsidiaries at the carrying amount of their shares of the equity items shown in the separate financial statements of the subsidiaries at the date of the reorganisation because they are **within the scope** of paragraphs 38B and 38C of IAS 27? Or

    (b) are the new intermediate parents A and B:

        (i) **permitted** to measure the cost for their investments in the subsidiaries at the carrying amount of their shares of the equity items shown in the separate financial statements of the subsidiaries at the date of reorganisation, because they apply the guidance in paragraphs 38B and 38C of IAS 27 **by analogy**, using the hierarchy in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* or

        (ii) **required** to apply the general principle and determine the cost by reference to the fair value of the consideration given in exchange for the investments in the subsidiaries?

Scope of paragraphs 38B and 38C of IAS 27

18. We agree with the submitter that paragraph 38B of IAS 27 does not require the application of the previous carrying amount basis to the scenario presented in the submission. Paragraph 38B of IAS 27 only applies if the original parent would establish the new entity as its parent (‘when a parent reorganises the structure of its group by establishing a new entity as its parent’). The new

intermediate parents A and B are instead established as subsidiaries of the original parent.

19. Furthermore, we agree with the submitter that divergence in views results from differences in the interpretation of which reorganisations are addressed by paragraph 38C of IAS 27 and consequently proponents of the various views read paragraph 38B of IAS 27 as amended[1] by paragraph 38C of IAS 27 in different ways (see paragraphs C11 and C18 of this paper).

20. We believe that it is the purpose of paragraph 38C of IAS 27 to require the application of previous carrying amount basis also for reorganisations in which the entity (eg subsidiary A in the example presented in paragraph 4 of this paper) that establishes a new entity as its parent is not a parent prior to the reorganisation (see paragraph BC66N(b) of IAS 27). Paragraph 38B of IAS 27 instead only applies, if this entity is already a parent prior to the reorganisation.

21. We read paragraph 38B of IAS 27 as amended by paragraph 38C of IAS 27 as follows[1]:

> 38B. When ~~a parent~~an entity that is not a parent reorganises the structure of its group by establishing a new entity as its parent in a manner that satisfies the following criteria:
>
> (a) the new parent obtains control of the original ~~parent~~entity by issuing equity instruments in exchange for existing equity instruments of the original ~~parent~~entity;
>
> (b) the assets and liabilities of the new group and the original ~~group~~entity are the same immediately before and after the reorganisation; and
>
> (c) the owners of the original ~~parent~~entity before the reorganisation have the same absolute and relative interests in the net assets of the original ~~group~~entity and the new group immediately before and after the reorganisation
>
> and the new parent accounts for its investment in the original ~~parent~~entity in accordance with paragraph 38(a) in its separate financial statements, the new parent shall measure cost at the carrying amount of its share of the equity items shown in the separate financial statements of the original ~~parent~~entity at the date of the reorganisation.

[1] Paragraph 38C of IAS 27 requires the substitution of certain terms in paragraph 38B of IAS 27 with certain other terms. We have illustrated that substitution.

22. This reading of paragraph 38C of IAS 27 is consistent with the one presented in the submission as the reading of paragraph 38C of IAS 27 by the proponents of view 1 (see paragraph C11 of this paper). This becomes apparent if one substitutes in the wording presented in the previous paragraph:

    (a) 'an entity that is not a parent' and 'the original entity' by 'Sub A';

    (b) 'a new entity' and 'the new parent' by 'Newco A'; and

    (a) 'the new group' by 'Newco A's group' or 'the group of Newco A'.

23. Consequently, we agree with the proponents of view 1 and view 3 that reorganisations of groups that result in the new intermediate parent having more than one subsidiary are not within the scope of paragraph 38B and 38C of IAS 27, because criterion (b) (see paragraph 9(b)) is not met. The new group of intermediate parent A also includes, for example, the assets and liabilities of 'Subsidiary D', whereas the original entity 'Subsidiary A' did not.

Applying paragraph 38B of IAS 27 by analogy

24. IAS 27 does not define cost and we agree with the submission that there is no specific guidance other than paragraph 38B and 38C of IAS 27 on how entities that are established as intermediate parents within a group should determine the cost of their investments in subsidiaries, when they account for these investments in their separate financial statements at cost in accordance with paragraph 38(a) of IAS 27.

25. An entity is therefore required to determine an appropriate accounting policy based on the requirements in paragraphs 10-12 of IAS 8. In making the judgement required, an entity, shall, among other things, refer to, and consider the applicability of, the requirements in IFRSs dealing with similar and related issues.

26. We agree with the proponents of view 1 that the general principle for determining cost of an investment in the scope of paragraph 38(a) of IAS 27 is the fair value of the consideration given for the investment.

27. This general principle also respects the concept underlying separate financial statements, namely that such financial statements reflect the boundaries between separate legal entities. Accordingly, paragraph 4 of IAS 27 (amended 2008) defines separate financial statements as those financial statements of an entity in which the investments are accounted for on the basis of the direct equity interest, rather than on the basis of the reported results and net assets of the investments.

28. Moreover, we agree with the proponents of view 1 that it is not appropriate to apply the guidance in paragraph 38B of IAS 27 by analogy, if it is an exception to a general principle. However, this is not true if the principles and characteristics underlying the exception are also relevant for the scenario that is considered for an application of the exception by analogy.

29. The scenario presented in the submission, on the contrary, does not share the characteristic of reorganisations addressed by paragraphs 38B and 38C of IAS 27, namely that the assets and liabilities of the new group and the original entity or the original group are the same immediately before and after the reorganisation (see paragraph 9(c) of this paper).

30. Furthermore, we believe that the Board explains in paragraph BC66Q of IAS 27 that it did not want the guidance in paragraphs 38B and 38C of IAS 27 to be considered in determining an appropriate accounting policy:

    '… Therefore, the Board expects that entities would **continue** to account for transactions that do not satisfy the criteria in paragraphs 38B and 38C in accordance with their accounting policies for such transactions ...' (emphasis added).

31. The use of 'continue' indicates that the Board expects entities to use accounting policies that had been determined before paragraphs 38B and 38C were added to IAS 27. Consequently, the guidance in paragraphs 38B and 38C of IAS 27 was not available when these accounting policies were determined and the Board did not expect entities to develop new accounting policies based on the new guidance in paragraphs 38B and 38C of IAS 27.

32. Consequently, we agree with view 1 that the previous carrying amount basis cannot be applied by analogy to reorganisation of groups that result in the new intermediate parent having more than one subsidiary. Such parents have to measure their investments in the subsidiaries at the fair value of the consideration given, ie the fair value of the equity instruments they have issued to the original parent which usually equals the new intermediate parents' share in the fair value of the subsidiaries in the type of reorganisations analysed in this paper (see paragraph 7 of this paper).

Agenda criteria assessment

33. The staff's assessment of the Interpretations Committee's agenda criteria is as follows:

(a) *The issue is widespread and has practical relevance.*

Yes. Group reorganisations whereby a new entity is established as a parent above multiple entities in a share-for-share exchange occur very often before an IPO.

(b) *The issue indicates that there are significantly divergent interpretations (either emerging or already existing in practice). The Committee will not add an item to its agenda if IFRSs are clear, with the result that divergent interpretations are not expected in practice.*

Yes. We note from the submission that there are currently differing views as to whether the guidance in paragraph 38B and 38C of IAS 27 can be applied either directly or by analogy to reorganisations of groups that result in the new intermediate parent having more than one subsidiary.

(c) *Financial reporting would be improved through elimination of the diverse reporting methods.*

Yes. The different views are likely to lead to significantly different results for the separate financial statements of new parents.

(d) *The issue can be resolved efficiently within the confines of existing IFRSs and the Framework, and the demands of the interpretation process.*

No. We think that IAS 27 is clear on the following two issues:

- reorganisations of groups that result in the new intermediate parent having more than one subsidiary are not within the scope of paragraphs 38B and 38C of IAS 27; and
- the guidance in paragraphs 38B and 38C of IAS 27 cannot be applied by analogy to such reorganisations of groups in determining an appropriate accounting policy under paragraphs 10-12 of IAS 8.

(e) *It is probable that the Committee will be able to reach a consensus on the issue on a timely basis.*

No. There is already sufficient guidance; see the previous subparagraph 33(d).

(f) *If the issue relates to current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project? (The IFRIC will not add an item to its agenda if an IASB project is expected to resolve the issue in a shorter period than the IFRIC would require to complete its due process.)*

No. 'Business combinations between entities under common control' was added to the agenda, but was suspended until resources became available. It will now be reconsidered in the light of the forthcoming agenda consultation on the Board's agenda. In addition, it is not predictable at the moment whether this project will also address the accounting for such transactions in the separate financial statements.

Staff recommendation

34. Based on the assessment of the agenda criteria, we recommend that the Committee should not take the issue onto its agenda.

35. We propose a draft wording for a tentative agenda decision in Appendix A to this paper.

Questions to the Interpretations Committee

Questions for the Committee
1. Does the Committee agree with the staff's analysis in paragraphs 16-32?
2. Does the Committee agree with the staff's recommendation not to take the issue onto its agenda?
3. Does the Committee have any comments on the proposed wording for the tentative agenda decision in Appendix A?

Appendix A—proposed wording for tentative agenda decision

A.1 We propose the following wording for the tentative agenda decision:

> The Committee received a request asking for clarification on how entities that are established as new intermediate parents within a group determine the cost of their investments in subsidiaries when they account for these investments in their separate financial statements at cost in accordance with paragraph 38(a) of IAS 27 (amended 2008) or paragraph 10(a) of IAS 27 (revised 2011). The request addresses reorganisations of groups that result in the new intermediate parent having more than one subsidiary.
>
> The Committee noted that the guidance in paragraphs 38B and 38C of IAS 27 (amended 2008) or paragraphs 13 and 14 of IAS 27 (revised 2011) cannot be applied directly to reorganisations of groups that result in the new intermediate parent having more than one subsidiary because the assets and the liabilities of the new group and the original entity or the original group are not the same immediately before and after the reorganisation. In addition, the Committee noted that the guidance in paragraphs 38B and 38C of IAS 27 (amended 2008) or paragraphs 13 and 14 of IAS 27 (revised 2011) cannot be applied to such reorganisations by analogy because this guidance is an exception to the general principle of determining cost by the fair value of the consideration given.
>
> Consequently, the Committee [decided] not to add this issue to its agenda.

Appendix B—guidance and explanations in IAS 27 on the measurement of cost in the separate financial statements of the new parent

The guidance and explanations in paragraphs 38B, 38C and BC66K-BC66Q of IAS 27 (amended 2008) are contrasted with the revised guidance and explanations in paragraphs 13, 14 and BC21-BC27 of IAS 27 (revised 2011) below for ease of reference (new text is underlined and deleted text is struck through):

~~38B.~~13. When a parent reorganises the structure of its group by establishing a new entity as its parent in a manner that satisfies the following criteria:

(a) the new parent obtains control of the original parent by issuing equity instruments in exchange for existing equity instruments of the original parent;

(b) the assets and liabilities of the new group and the original group are the same immediately before and after the reorganisation; and

(c) the owners of the original parent before the reorganisation have the same absolute and relative interests in the net assets of the original group and the new group immediately before and after the reorganisation,

and the new parent accounts for its investment in the original parent in accordance with paragraph ~~38~~10(a) in its separate financial statements, the new parent shall measure cost at the carrying amount of its share of the equity items shown in the separate financial statements of the original parent at the date of the reorganisation.

~~38C.~~14. Similarly, an entity that is not a parent might establish a new entity as its parent in a manner that satisfies the criteria in paragraph ~~38B~~13. The requirements in paragraph ~~38B~~13 apply equally to such reorganisations. In such cases, references to 'original parent' and 'original group' are to the 'original entity'.

~~BC66K.~~BC21. In 2007 the Board received enquiries about the application of paragraph ~~38~~10(a) when a parent reorganises the structure of its group by establishing a new entity as its parent. The new parent obtains control of the original parent by issuing equity instruments in exchange for existing equity instruments of the original parent.

~~BC66L.~~BC22. In this type of reorganisation, the assets and liabilities of the new group and the original group are the same immediately before and after the reorganisation. In addition, the owners of the original parent have the same relative and absolute interests in the net assets of the new group immediately after the reorganisation as they had in the net assets of the original group before the reorganisation. Finally, this type of reorganisation involves an existing entity and its shareholders agreeing to create a new parent between them. In contrast, many transactions or events that result in a parent-subsidiary relationship are initiated by a parent over an entity that will be positioned below it in the structure of the group.

~~BC66M.~~BC23. Therefore, the Board decided that in applying paragraph ~~38~~10(a) *in the limited circumstances in which a parent establishes a new parent in this particular manner*, the new parent should measure the cost of its investment in the original parent at the carrying amount of its share of the equity items shown in the separate financial statements of the original parent at the date of the reorganisation. In December 2007 the Board published an exposure draft proposing to amend IAS 27 to add a paragraph with that requirement.

~~BC66N.~~BC24. In response to comments received from respondents to that exposure draft, the Board modified the drafting of the amendment (paragraphs ~~38B~~13 and ~~38C of the Standard~~14) to clarify that it applies to the following types of reorganisations when they satisfy the criteria specified in the amendment:

(a) reorganisations in which the new parent does not acquire all ~~of~~ the equity instruments of the original parent. For example, a new parent might issue equity instruments in exchange for ordinary shares of the original parent, but not acquire the preference shares of the original parent. In addition, a new parent might obtain control of the original parent, but not acquire all ~~of~~ the ordinary shares of the original parent.

(b) the establishment of an intermediate parent within a group, as well as the establishment of a new ultimate parent of a group.

(c) reorganisations in which an entity that is not a parent establishes a new entity as its parent.

~~BC66O.~~BC25. In addition, the Board clarified that the amendment focuses on the measurement of one asset—the new parent's investment in the original parent in the new parent's separate financial statements. The amendment does not apply to the measurement of any other assets or liabilities in the separate financial statements of either the original parent or the new parent or in the consolidated financial statements.

~~BC66P.~~BC26. The Board included the amendment in Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate issued in May 2008.

~~BC66Q.~~BC27. The Board did not consider the accounting for other types of reorganisations or for common control transactions more broadly. Accordingly, paragraphs ~~38B~~13 and ~~38C~~14 apply only when the criteria in those paragraphs are satisfied. Therefore, the Board expects that entities would continue to account for transactions that do not satisfy the criteria in paragraphs ~~38B~~13 and ~~38C~~14 in accordance with their accounting policies for such transactions. The Board plans to consider the definition of common control and the accounting for business combinations under common control in ~~its~~a future project on common control transactions.

Appendix C—Interpretations Committee potential agenda item request

C1. The staff received the following request. All information has been copied without modification, except for details that would identify the submitter of the request and details that are subject to confidentiality.

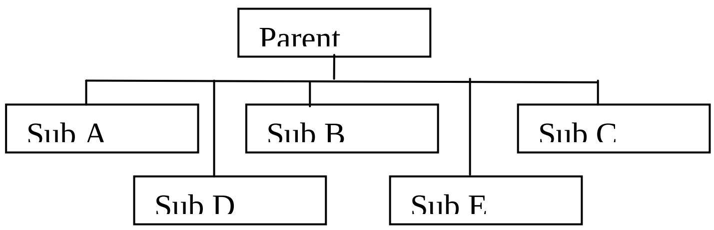
Reorganisations in Separate Financial Statements

C2. [The submitter] requests the IFRS Interpretations Committee to address the following issue with respect to the application of IAS 27 *Consolidated and Separate Financial Statements* where a parent reorganises the structure of its group by establishing a new entity as its parent.

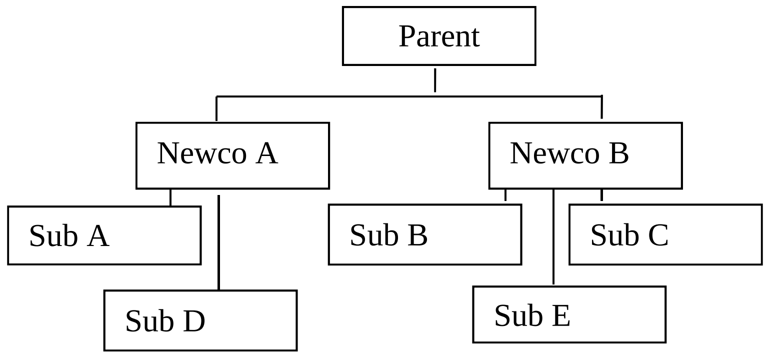
Issue

C3. It is common for a group reorganisation to occur whereby a Newco is established as a parent above multiple entities in share for share exchange, (often referred to as a 'one-to-many' parent-subsidiary relationship) typically before an IPO. This is illustrated in the following diagrams.

C4. Before the reorganisation:



C5. After the reorganisation:



C6. Pre- and post-reorganisation, the parent has the same absolute and relative interests in the net assets of its subsidiaries.

C7. The issues are:

(a) Whether the new parents (Newco A and Newco B in the diagram above) are within the scope of paragraph 38B of IAS 27, and "shall measure cost at the carrying amount of its share of the equity items shown in the separate financial statements of the original parent at the date of the reorganisation"?

(b) If the new parents are not within the scope of paragraph 38B of IAS 27, are the new parents permitted to apply paragraph 38B of IAS 27 by analogy, using the hierarchy in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors?*

Current practice

C8. Different views exist as to whether the new parents may apply paragraph 38B of IAS 27, and measure cost at the carrying amount of its share of the equity items shown in the separate financial statements of the original parent at the date of the reorganisation.

View 1 – Not in the scope of Paragraph 38B, and no analogy thereto

C9. Paragraph 38B of IAS 27 is restrictive and refers to a one-to-one parent-subsidiary relationship through the reorganisation, rather than a one-to-many parent-subsidiaries relationship being established. This view is also supported by paragraph BC66L of the Basis for Conclusions to IAS 27, which states:

> "In this type of reorganisation, the assets and liabilities of the new group and the original group are the same immediately before and after the reorganisation. In addition, the owners of the original parent have the same relative and absolute interests in the net assets of the new group immediately after the reorganisation as they had in the net assets of the original group before the reorganisation. Finally, this type of reorganisation involves **an existing entity** and **its shareholders** agreeing to create a new parent **between them**. In contrast, many transactions or events that result in a parent-subsidiary relationship are initiated by a parent over an entity that will be positioned below it in the structure of the group." (Emphasis added)

C10. The use of 'an existing entity' and 'between them' illustrates that this guidance applies very narrowly, that is, only in a one-to-one situation where there is a Newco established between the existing parent and each subsidiary. This is further emphasised in paragraph BC66Q of the Basis for Conclusions to IAS 27, which states that the exception granted in paragraphs 38B and 38C of IAS 27 applies only to transactions meeting those specific criteria.

C11. Substituting 'a parent' and 'the original parent' by 'Sub A' and 'new entity' and 'the new parent' by 'Newco' on the basis of paragraph 38C of IAS 27, 38B is read as follows:

> When **Sub A** reorganises the structure of its group by establishing **Newco A** as its parent in a manner that satisfies the following criteria:
> (a) **Newco A** obtains control of **Sub A** by issuing equity instruments in exchange for existing equity instruments of **Sub A**;
> (b) the assets and liabilities of **Newco A's group** and **Sub A** are the same immediately before and after the reorganisation; and
> (c) **The owners of Sub A** before the reorganisation have the same absolute and relative interests in the net assets of **Sub A** and the **group of Newco A** immediately before and after the reorganisation...

C12. It is clear that criterion (b) is not met in the fact pattern, because Newco A also includes Sub D whereas Sub A did not. Therefore, Newco A is **not** able to apply paragraph 38B of IAS 27. This illustrates that when a reorganisation creates a one-to-many parent-subsidiary relationship, paragraph 38B of IAS 27 may **not** be applied.

C13. Proponents of this view further note that since paragraph 38B of IAS 27 does **not** apply to this fact pattern, an entity is therefore required to determine an appropriate accounting policy using IAS 8. In this fact pattern, the most appropriate method for determining the cost of the subsidiaries in Newco's financial statements is based on the fair value of the shares received as a proxy for the fair value of the consideration given up, ie the shares issued.

C14. It is not appropriate to develop an accounting policy that would use the cost of the investments in the parent's separate financial statements, by analogising to paragraph 38B of IAS 27, because paragraph 38B is clearly an exception to the general principle of determining cost. Under IAS 8, it is not appropriate to analogise to an exception to a general principle.

View 2 – Not in scope of Paragraph 38B, but analogy thereto is permitted

C15. Paragraph 38B of IAS 27 is restrictive and refers to a one-to-one parent-subsidiary relationship through the reorganisation, rather than a one-to-many parent-subsidiaries relationship being established, for the reasons noted in View 1.

C16. However, although paragraph 38B of IAS 27 does not apply in this fact pattern, it is possible to analogise to this fact pattern and apply paragraph 38B of IAS 27 anyway. This is because:

(a) It is clear in paragraph BC66Q of the Basis for Conclusions to IAS 27 that there is no specific guidance for accounting for other common control transactions in the separate financial statements.

(b) A one-to-many exchange is similar in principle to the one-to-one exchange, and therefore it is appropriate to apply paragraph 38B of IAS 27, by analogy using the hierarchy in IAS 8, since it is not clear why the rule is restricted to only a one-to-one exchange.

View 3 – Application of Paragraph 38B

C17. Paragraph 38B of IAS 27 is an exception that can be applied in a many-to-one situation.

C18. Proponents of this view would apply the substitutions provided in paragraph 38C of IAS 27 to this fact pattern as follows:

> When **Parent** reorganises the structure of its group by establishing **Newco A** as a parent to **Sub A** in a manner that satisfies the following criteria:
> (a) **Newco A** obtains control of the **Sub A** by issuing equity instruments in exchange for existing equity instruments of **Sub A**;
> (b) the assets and liabilities of **the Parent's group** are the same immediately before and after the reorganisation; and
> (c) **Parent** before the reorganisation has the same absolute and relative interests in the net assets of **Sub A** and the **group of Newco A** immediately before and after the reorganisation. ...

C19. Since all three criteria are met, Newco A **is** able to apply paragraph 38B of IAS 27. This illustrates that when a reorganisation creates a one-to-many parent-subsidiary relationship, paragraph 38B of IAS 27 **may** be applied.

Reasons for the IFRIC to address the issue

Our assessment of the agenda criteria is as follows:

(a) The issue is widespread and has practical relevance.

C20. This issue is widespread, particularly in the Far East and Oceania, and is particularly common given the increasing numbers of IPOs in that region. It has practical relevance because of the significant impact on the financial statements of the Newco group, because when view 1 is taken, the cost of the subsidiaries is recognised at fair value as of the date of the reorganisation. However, when view 2 is taken, the cost of the subsidiaries is recognised at carryover basis of the parent as of the date of the reorganisation.

(b) The issue indicates that there are significantly divergent interpretations (either emerging or already existing in practice. The Committee will not add an item to its agenda if IFRSs are clear, with the result that divergent interpretations are not expected in practice.

C21. There are diverse views regarding which amount to recognise as the cost basis of the subsidiaries in separate financial statements in a reorganisation. We are aware of preparers, auditors, and regulators that hold each of the views above.

(c) Financial reporting would be improved through elimination of the diverse reporting methods.

C22. Yes, given the significant divergence in views, and the significant impact on the financial statements, as noted in (a) and (b), financial reporting would be improved through elimination of one of the views.

(d) The issue can be resolved efficiently within the confines of existing IFRSs and the Framework, and the demands of the interpretation process.

C23. Yes, we believe that the process can be resolved efficiently within the confines of IAS 27 and IAS 8.

(e) It is probable that the Committee will be able to reach a consensus on the issue on a timely basis.

C24. Yes, we believe that the Committee will be able to reach a consensus by taking one of the two views above.

(f) If the issue relates to a current or planned IASB project, there is a need to provide guidance sooner than would be expected from the IASB's activities. The Committee will not add an item to its agenda if an IASB project is expected to resolve the issue in a shorter period than the Committee requires to complete its due process.

C25. While the Board has stated that it intends to have a project on common control transactions, the Board has not yet decided on its post-2011 agenda, work on this project by the IASB has not yet commenced, and it is not clear whether this project will extend to cover separate financial statements. We do not expect this issue to be resolved if the Board proceeds with issuing IFRS 10 *Consolidated Financial Statements,* because we do not expect any consequential amendments regarding the portions of IAS 27 that relate to separate financial statements.

C26. This issue is currently arising in practice and is expected to increase as the number of IPOs increases as the economy strengthens. Therefore, there is a need to address this issue before the Board will otherwise address it.

Specifically, we request that the Committee address the following questions:

C27. Whether a reorganisation that results in a Newco parent having many subsidiaries (that is, there is not a one-to-one relationship), is within the scope of paragraph 38B of IAS 27, and the Newco parent shall measure cost at the carrying amount of its share of the equity items shown in the separate financial statements of the original parent at the date of the reorganisation?

C28. If the Newco parent is **not** within the scope of paragraph 38B of IAS 27, when read literally, is the Newco parent permitted to apply paragraph 38B of IAS 27 by analogy, using the hierarchy in IAS 8?