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|---|---|
| Project | **IFRS Interpretations Committee Work In Progress** |
| Topic | **Outstanding issues list** |

## Introduction

### *Objective of this paper*

1. The objective of this paper is to update the Committee on the current status of issues that are yet to be discussed by the Committee and the progress we have made.

2. We have received the following submissions and we expect to bring these to a future meeting:

| Ref. | Topic | Brief description | Progress |
|---|---|---|---|
| IFRS 2-16 | *Share-based Payment*: modifications that affect classification of the award | Request for clarification on the accounting for a modification of a share-based payment that changes the classification of the award from cash-settled to equity-settled. | The staff are in the progress of conducting their research and analysis of this issue and expect to present it at a future meeting. See Appendix A for the submission received. |

| | | | |
|---|---|---|---|
| IFRS 3-9 | *Business combinations*: Business combinations involving newly formed entities: Factors affecting identification of the acquirer | Request for clarification on the identification of the acquirer in a business combination involving a newly formed entity (newco). The submission considers the sale of a sub-group through an Initial Public Offering (IPO), involving a newco as both the parent of the sub-group and the listing vehicle, but under conditions in which the newco acquires the sub-group only if the IPO takes place. Specifically:<br><br>a) If the business combination is conditional on a future event occurring, does this affect the identification of the acquirer?<br><br>b) Is the identity of the party that formed the newco relevant for identifying the acquirer? | The staff are in the progress of conducting their research and analysis of this issue and expect to present it at a future meeting. See Appendix B for the submission received. |
| IAS 19-16 | *Employee benefits*: Defined contribution plans with vesting conditions | Request for clarification on the impact of vesting conditions on the timing of expense of contributions made to defined contribution plans. | The staff are in the progress of conducting their research and analysis of this issue and expect to present it at a future meeting. See Appendix C for the submission received. |
| IAS 27-12 | *Interests in Joint Ventures*: Contributions to a jointly-controlled entity or associate | Two submissions have been received in respect of the principal issue identified. The submitters have noted the conflict between IAS 27 and IAS 31 / SIC-13 *Jointly Controlled Entities – Non-monetary Contributions by Venturers*, in respect of gain recognition or elimination on such contributions. The conflict relates to whether or not a gain on contribution from an investor to a jointly-controlled entity or associate should be eliminated in part or not. | The staff are in the progress of conducting their research and analysis of this issue and expect to present it at a future meeting. See Appendices D and E for the two submissions received. |

| | | | |
|---|---|---|---|
| IAS 27-13 | *Consolidated and separate financial statements*: Group reorganisations in separate financial statements | Request for clarification on whether the amendments made to IAS 27 in 2008 relating to the cost of investment in a subsidiary, jointly controlled entity or associate, relating to group reorganisations can be applied to group reorganisations in which a newly incorporated entity inserted into a group, rather than added on top of a group, and has several direct subsidiaries rather than just one direct subsidiary. | The staff are in the progress of conducting their research and analysis of this issue and expect to present it at a future meeting. See Appendix F for the submission received. |
| IAS 28-6 | *Investment in Associates*: Accounting for share of changes in associate's net assets that do not relate to profit or loss or other comprehensive income | Request for clarification on whether and how an investor in an associate should recognise its share of the associate's changes in net assets that are not part of the associate's profit or loss or part of the associate's other comprehensive income. The issue has arisen as a result of consequential changes to IAS 28 from the revisions to IAS 1 *Presentation of Financial Statements* in 2007. | The staff are in the progress of conducting their research and analysis of this issue and expect to present it at a future meeting. See Appendix G for the submission received. |
| IFRIC 6-1 | *Liabilities from participating in a specific market*: Use of IFRIC 6 by analogy | Request for clarification of whether IFRIC 6 should be applied by analogy to levies and taxes that are payable if certain conditions are met on a particular date. | The staff are in the progress of conducting their research and analysis of this issue and expect to present it at a future meeting. See Appendix H for the submission received. |

3. This paper does not include requests on issues that are still at a preliminary research stage, including where further information is being sought from the submitter, or other parties, to define more clearly the issue.

| Question |
|---|
| Does the Committee have any questions or comments on the Committee Outstanding Issues List? |

# Appendix A – Modifications that affect classification of the award

Mr Robert Garnett
Chairman
IFRS Interpretations Committee
30 Cannon Street
London
EC4M 6XH

1 March 2011

Dear Mr Garnett,

**Potential Interpretations Committee Agenda Item Request**

This letter describes an issue that we believe should be considered for the Interpretations Committee's agenda, potentially as an annual improvement clarification. We have included a summary of the issue, alternative views and an assessment of the issue against the Interpretations Committee criteria.

**The issue**

**There is diversity in practice regarding how to account for a modification of a share-based payment (SBP) that changes its classification from cash-settled to equity-settled. The total amount recognised can differ depending upon whether the cash-settled SBP is considered to be settled or whether the general requirements for modification accounting and whether the guidance in the example for modifications that reclassify an award from equity-settled to cash-settled are applied.**

Types of change: modification of terms of the arrangement.

Consider the following fact pattern:

On 1 January 2010 Company M grants 100 share appreciation rights (SARs) to its CFO, subject to a four-year service condition. The grant-date fair value of a SAR is 1; the total grant-date fair value is 100. The share price at the end of 2010 is unchanged. At the end of 2011 the original grant has a fair value of 120. M cancels the grant and in its place grants 100 share options at a fair value of 132, i.e. with an incremental fair value of 12 at that date. The new equity-settled grant is identified as a replacement of the original cash-settled grant.

If the modification example is applied by analogy then measurement of the replacement award is based on the grant date fair value of the original award plus any incremental fair value. If that guidance is not applied by analogy then two alternative approaches result in the modified award being accounted for based on the modification date fair value of the replacement award. More detailed analysis of the different vies and illustrations of the accounting are attached in Appendix A.

**Reasons for the IFRIC to address the issue**

(a) There are at least three different approaches supported by the published guidance of the major networks of audit firms. The difference between two of these approaches is only a timing difference. The total expense however would be different under one approach.
(b) Financial reporting would be improved if similar events were accounted for on a consistent basis.
(c) The issue is capable of interpretation or annual improvement within the confines of IFRSs and the *Framework for the Preparation and Presentation of Financial Statements.*
(d) IFRS 2 *Share-based Payment* is not currently within the scope of any of the Board's projects.

## Appendix A

**Current practice**

We have identified three different views in practice on how to account for such an event.

**View 1: Analogy to modification from equity-settled share-based payment to cash-settled share-based payment**

The principles for modification and cancellation of equity-settled share-based payments should be applied by analogy to such changes in classification. IFRS 2 IG 2 illustrates that the requirements of IFRS 2.27 and IFRS 2 B42 - 44 apply to a modification that triggers a change from an equity-settled classification to a cash-settled classification. Under view 1 those principles should be applied by analogy to the opposite change in classification. Accordingly, a modification of an existing cash-settled arrangement in which the classification is changed from cash settled to equity settled should be accounted for as follows:

Distinguish between the grant-date fair value of the original cash-settled share-based payment arrangement (first component) and the remeasurement of that liability (second component). At the date of modification, the liability recognised to the extent that services have been received as of that date is reclassified to equity.
The incremental fair value of the modification is calculated as:

- the fair value of the new grant, measured at the date of modification; less
- the fair value of the original grant, measured at the date of modification; and
- any payments made to the employees on cancellation of the original grant.

Recognise the remaining grant-date fair value of the original grant (unrecognised portion of the first component only) in addition to the incremental fair value, if any, over the remaining vesting period.

This is illustrated as follows:

| | Liability | | | Equity | | |
|---|---|---|---|---|---|---|
| | In current period | | | In current period | | |
| End of: | Recognition of grant-date fair value of liability | Remeasure-ment | Cumulative | Unrecognised grant-date fair value of liability | Incremental fair value | Cumulative |
| 2010 | 25 | - | 25 | - | - | - |
| 2011 | 25 | 10 | 60 | | | 60 |
| 2012 | - | - | - | 25 | 6 | 91 |
| 2013 | - | - | - | 25 | 6 | 122 |

M accounts for the transaction as follows:

| | *Debit* | *Credit* |
|---|---|---|
| **2010** | | |
| Expenses | 25 | |
| Liability | | 25 |
| *To recognise 1/4 of grant-date fair value of the liability, no remeasurement* | | |
| **2011** | | |
| Expenses | 35 | |
| Liability | | 35 |
| *To recognise 1/4 of grant-date fair value of the liability of 25 and remeasurement of 10* | | |
| Liability | 60 | |
| Equity | | 60 |
| *To recognise reclassification from liability to equity* | | |
| **2012** | | |
| Expenses | 31 | |
| Equity | | 31 |

*To recognise ½ of the unrecognised grant-date fair value of the original cash settled share-based payment arrangement of 25 and ½ of the incremental fair value as of modification date of 6 ((132-120)/2) as an increase in equity*

| | Debit | Credit |
|---|---|---|
| **2013** | | |
| Expenses | 31 | |
| Equity | | 31 |

*To recognise ½ of the unrecognised grant-date fair value of the original cash settled share-based payment arrangement of 25 and ½ of the incremental fair value as of modification date of 6 ((132-120)/2) as an increase in equity*

**Cumulative effects:**

| | | |
|---|---|---|
| Expenses | 122 | |
| Equity | | 122 |
| Liability | | 0 |

**View 2: No analogy to modification from equity-settled share-based payment to cash-settled share-based payment**

View 2 is to measure the equity-settled award at modification date. There are two sub-views as to when the incremental value should be expensed.

View 2 is that the requirments of IFRS 2 relating to cash-settled awards do not include guidance relating to modifications on the grounds that the liability is remeasured to its fair value and therefore any modifications would be reflected in the carrying value of the liability. If an entity cancelled a cash-settled award then, in contrast to the treatment of a cancellation for an equity-settled award, the expense would be reversed.

Under this view when a cash-settled award is "cancelled" and "replaced" by an equity-settled award the appropriate accounting would be to reverse the expense recognised up to the date of cancellation and then start to recognise an equity-settled award with a new grant date. However, this would not give an expense recognition in line with the receipt of services. Furthermore, reversal of the recognised expense would be appropriate only if the liability had been extinguished; in fact the liability has been "settled" by a promise to issue equity instruments; *therefore, the appropriate treatment for the accrued liability is to transfer it to equity*. The grant date for an equity-settled award is defined in IFRS 2 as:

> "The date at which the entity and another party (including an employee) agree to a share-based payment arrangement, being when the entity and the counterparty have a shared understanding of the terms and conditions of the arrangement. At grant date the entity confers on the counterparty the right to cash, other assets, or equity instruments of the entity, provided the specified vesting conditions, if any, are met. If that agreement is subject to an approval process (for example, by shareholders), grant date is the date when that approval is obtained."

At the original grant date of the award the shared understanding was that there would be a cash payment. It is only after the "modification" date that the entity is obligated to issue equity instruments and that the shared understanding is based on issue of equity instruments. Therefore the grant date for the purpose of measuring the equity settled award is the date of modification rather than the original award date. Another way of looking at this would be in line with IFRS 2 B43(b), prior to the modification the number of equity instruments expected to vest was zero, therefore all the equity instruments are incremental and under B43(b) the incremental expense would be measured based on the fair value at the modification date.[1]

[1] Also ASC 718-20-55sets out the US GAAP treatment which measures the expense based on the fair value at the time that the award is modified to equity settled. View 2 would be converged with this whilst View 1 would lead to a GAAP difference.

*<u>View 2A:</u> Consider the original cash-settled liability to be settled by conversion (reclassification to equity) and account for the difference between the modification date fair value of the replacement equity-settled share-based payment arrangement and the amount reclassified to equity over the remaining vesting period.*

Under this sub-view when a modification changes the classification of a share-based payment arrangement from cash-settled to equity-settled, the entity immediately reclassifies the carrying amount of the liability at the date of modification to equity. The expense recognised over the remaining vesting period is based on the modification date fair value of the replacement equity-settled share-based payment arrangement and not the grant date fair value of the original arrangement.

Taking the same fact as outline above the example below illustrates the accounting entries that arise under this view.

| | Liability | | | Equity | | |
|---|---|---|---|---|---|---|
| | In current period | | | In current period | | |
| End of: | Recognition of grant-date fair value of liability | Remeasurement | Cumulative | Reclassification from liability | Unrecognised modification-date fair value of equity replacement | Cumulative |
| 2010 | 25 | - | 25 | - | - | - |
| 2011 | 25 | 10 | 60 | 60 | | 60 |
| 2012 | - | - | - | - | 36 | 96 |
| 2013 | - | - | - | - | 36 | 132 |

M accounts for the transaction as follows:

| | *Debit* | *Credit* |
|---|---|---|
| **2010** | | |
| Expenses | 25 | |
| Liability | | 25 |
| *To recognise 1/4 of grant-date fair value of the liability, no remeasurement* | | |
| | | |
| **2011** | | |
| Expenses | 35 | |
| Liability | | 35 |

*To recognise 1/4 of grant-date fair value of the liability of 25 and remeasurement of 10*

| | *Debit* | *Credit* |
|---|---|---|
| Liability | 60 | |
| Equity | | 60 |
| *To recognise reclassification from liability to equity* | | |

**2012**

| | | |
|---|---|---|
| Expenses | 36 | |
| Equity | | 36 |

*To recognise 1/2 of the unrecognised modification-date fair value of the replacement equity settled share-based payment arrangement of 36 as an increase in equity (132-60)/2*

**2013**

| | | |
|---|---|---|
| Expenses | 36 | |
| Equity | | 36 |

*To recognise 1/2 of the unrecognised modification-date fair value of the replacement equity settled share-based payment arrangement of 36 as an increase in equity*

**Cumulative effects:**

| | | |
|---|---|---|
| Expenses | 132 | |
| Equity | | 132 |
| Liability | | 0 |

*View 2B: Account for settlement of the cash-settled share-based payment on date of modification*

Under this view, the change from cash-settled award to equity-settled is viewed as a settlement of the cash-settled award and any excess of the fair value of the equity instruments used to settle the liability over the amount reclassified is recognised immediately in profit or loss. That is, the fair value of the modification award is compared to the fair value of the original award, and any positive difference is expensed immediately to the extent that services have been received. This is consistent with what is required by IFRS 2.43 (c) when an entity elects the settlement alternative with a higher fair value.

| | Liability | | | Equity | | |
|---|---|---|---|---|---|---|
| | In current period | | | In current period | | |
| End of: | Recognition of grant-date fair value of liability | Remeasurement | Cumulative | Settlement of cash-settled award | Unrecognised modification-date fair value of equity replacement | Cumulative |
| 2010 | 25 | - | 25 | - | - | - |
| 2011 | 25 | 10 | 60 | 6 | - | 66 |
| 2012 | - | - | - | - | 33 | 99 |
| 2013 | - | - | - | - | 33 | 132 |

M accounts for the transaction as follows:

| | *Debit* | *Credit* |
|---|---|---|
| **2010** | | |
| Expenses | 25 | |
| Liability | | 25 |
| *To recognise 1/4 of grant-date fair value of the liability, no remeasurement* | | |
| **2011** | | |
| Expenses | 35 | |
| Liability | | 35 |
| *To recognise 1/4 of grant-date fair value of the liability of 25 and remeasurement of 10* | | |

| | Debit | Credit |
|---|---|---|
| Employee costs | 6 | |
| Liability | 60 | |
| Equity | | 60 |

*To recognise reclassification from liability to equity plus the effect of settlement of the cash-settled award (6=((132-120)/2) to the extent of services provided as an increase in equity*

**2012**

| | | |
|---|---|---|
| Expenses | 33 | |
| Equity | | 33 |

*To recognise 1/2 of the unrecognised modification-date fair value of the replacement equity settled share-based payment arrangement of 33*

**2013**

| | | |
|---|---|---|
| Expenses | 33 | |
| Equity | | 33 |

*To recognise 1/2 of the unrecognised modification-date fair value of the replacement equity settled share-based payment arrangement of 33 as an increase in equity*

**Cumulative effects:**

| | | |
|---|---|---|
| Expenses | 132 | |
| Equity | | 132 |
| Liability | | 0 |

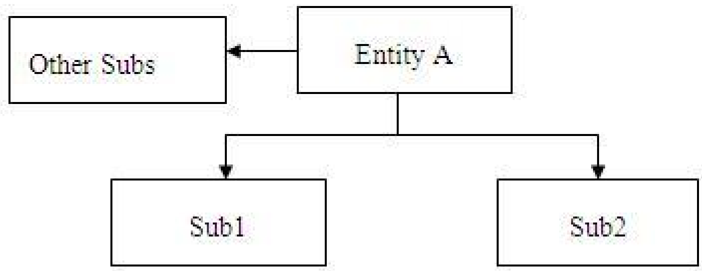
The total expense reflects the settlement of the original cash-settled award (66), plus the expense related to the modification equity-settled award (66).

# Appendix B – Business combinations involving newly formed entities: Factors affecting identification of the acquirer

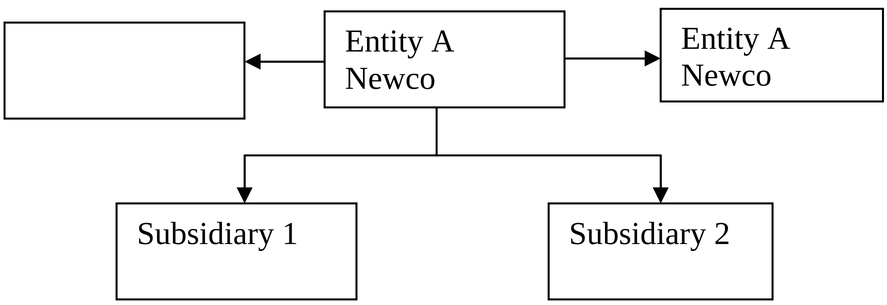
[The submitter] requests IFRIC to address the following issue with respect to the application of IFRS 3 *Business Combinations* where a newly formed entity (Newco) is established to acquire another entity, where the acquisition is conditional on the occurrence of another event that results in a loss of control of Newco.

**The issue:**

It is common practice for a group to spin-off a part of its business in an Initial Public Offering (IPO). In some jurisdictions, this is done via the group establishing a Newco, which will be the listing entity. However, Newco will only acquire that part of the group being spun-off at the time that the IPO occurs – the same time that there is a change in ownership of Newco and therefore a change in control. The typical arrangement is set out below:

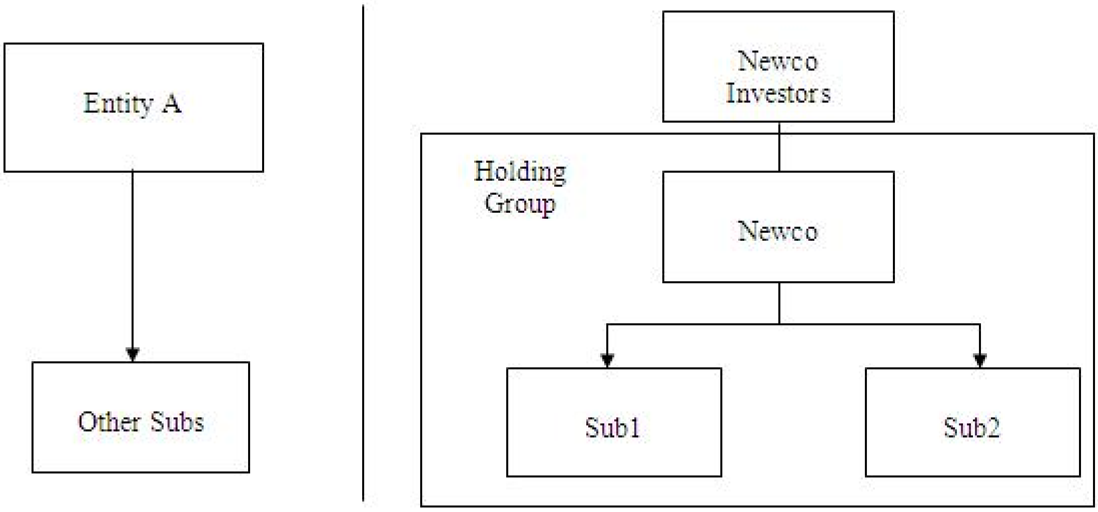



- To facilitate the spin-off, Entity A incorporates a new company (Newco) with nominal equity and appoints independent directors to the Board of Newco.




- Newco signs an agreement to acquire Sub1 and Sub2 from Entity A conditional **upon** on the IPO occurring. If the IPO does not occur the transaction is dissolved.
- Newco issues a prospectus offering to issue shares for cash to provide Newco with funds to acquire Sub1 and Sub2.
- The IPO occurs and Newco acquires Sub1 and Sub2 for cash.
- Because Entity A holds only nominal equity, virtually 100% ownership in Newco is held by the new investors.

- After the IPO occurs, the respective group structures of Entity A and Newco appear as follows:




Paragraph B18 of Appendix B to IFRS 3 states that a newly formed entity (Newco) that transfers cash or other assets as consideration **may be** the acquirer in a business combination. Whenever a newly formed entity (Newco) is formed to effect a business combination other than through the issuance of shares, Newco can be considered an extension of one of the transacting parties.

What role does the conditionality of the acquisition have in determining who the acquirer is?

**Current practice:**
Different views exist as to the role that the conditionality of the acquisition has as to whether or not this is a business combination under common control.

*View 1: Conditionality is a critical feature and Newco is representative of the new shareholders*

The conditionality of the transaction means that the transaction cannot be considered complete until all conditions have been removed. That is, as the whole transaction dissolves if the IPO does not proceed, it cannot be accounted for as occurred until this possibility is resolved. Because the condition relates to the IPO, upon which the change in shareholders occurs, the change in ownership and control must be considered an integral element of the transaction.

However, this is only relevant when the establishment of Newco creates a new reporting unit/group that previously did not exist. Thus, Newco has a purpose for the new shareholders and can be considered to represent them even though the existing Parent (Entity A) establishes Newco.

*View 2: Conditionality is not a critical feature and Newco is an extension of the party that formed Newco*

Which party establishes Newco is the critical feature in assessing whether Newco is the acquirer, and the fact that the acquisition is conditional on another event is not relevant. Determining who establishes the Newco is also dependent on who initiated the transaction.

Therefore, in most cases where the conditionality is the occurrence of an IPO, the Parent (Entity A) made the strategic and operational decisions to create the Newco and structure the arrangement to facilitate the disposal, which will be considered for the Parent's (Entity A's) benefit and not that of the new shareholders. In such cases the Newco is considered to represent the existing owners and further assessment is then needed to determine whether it is an extension of the Parent (Entity A) or one of the subsidiaries involved in the spin-off (in the scenario noted).

**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.*

This issue is widespread, and has a significant impact on the financial statements of the newly formed entity, because when view 1 is taken, the acquisition method is applied by Newco and both Sub1 and Sub 2 are recognised at fair value; however, when view 2 is taken, only Sub 1 or Sub 2 would be recognised at fair value.

(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.*

There are diverse views regarding the circumstances under which a newly formed entity is regarded as the acquirer. 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.*

Yes, given the significant divergence in practice, 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.*

Yes, we believe that the process can be resolved efficiently within the confines of IFRS 3.

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

Yes, we believe that the process can be resolved efficiently within the confines of IFRS 3.

(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.*

While the Board has stated that it intends to perform a post-implementation review of IFRS 3, work on this project has not yet commenced and is not expected to commence until three years after IFRS 3 became effective (or 1 July 2012). 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:

What circumstances or factors are relevant when assessing whether a newly formed entity is the acquirer in a business combination? In particular:

- When a transaction is conditional upon an event occurring, is the conditionality relevant to the assessment of identifying the acquirer?
- When a new entity is formed, is the identity of the party that formed the new entity relevant?

# Appendix C – Defined contribution plans with vesting conditions

**The issue:**

There is diversity in practice about the impact of vesting conditions on the timing of recognition as an expense of contributions made to a defined contribution plan.

IAS 19 *Employee benefits* paragraph 43 contains the following text: “accounting for defined contribution plans is straightforward because the reporting entity’s obligation for each period is determined by the amounts to be contributed for that period. …”

Paragraph 44 of the standard sets out the recognition requirements for contributions to defined contribution plans:

*When an employee has rendered service to an entity during a period, the entity shall recognise the contribution payable to a defined contribution plan in exchange for that service:*

*(a) as a liability (accrued expense), after deducting any contribution already paid. If the contribution already paid exceeds the contribution due for service before the end of the reporting period, an entity shall recognise that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund; and*

*(b) as an expense, unless another Standard requires or permits the inclusion of the contribution in the cost of an asset (see, for example, IAS 2 Inventories and IAS 16 Property, Plant and Equipment).*

The words of paragraph 44 (a) suggest that it is necessary to identify the contribution due for service before the end of the reporting period, such that any excess contribution may properly be recognised as a prepayment if the asset recognition criteria are met (including in the ways set out in that paragraph).

For example, an entity makes contributions to a defined contribution plan in respect of its employees. If the employee leaves within two years of commencing service with the entity, he is not entitled to any benefits under the plan and the contributions are refunded to the entity. Should the contributions paid in year one be considered (i) due for service solely in year one; or (ii) due in part for service in year one and in part for service in year two, the remaining vesting period?

In a more complex example:

| *Vesting condition* | *Vested interest in the accumulated contributions* |
|---|---|
| Employment terminates after age 60 | 100% |
| Employment terminates after age 55 | 75% |
| Employment terminates before age 55 | 50% |

Contributions are paid to the plan in respect of each employee each year. Should a year’s contributions be considered as relating solely to service before the end of the reporting period in which the contribution is made? Or, alternatively, for an employee below 60 years of age should the contribution be spread in part over the period through to the age of 55 or 60, depending on his current age?

Any attribution of contributions to a future period of vesting might be seen as somewhat of a contradiction of the statement in paragraph 43 that accounting for defined contribution plans is straightforward.

**Current practice:**

We understand that various types of defined contribution plan with vesting conditions exist around the world. We understand further that the accounting treatment of contributions made to such plans varies, in some cases being expensed in the year that they are made and in other cases being spread over a vesting period.

The views of the large networks of accounting firms are understood to be mixed. For example, the published guidance of one includes an example in which amounts are forfeited by participants who leave the entity before vesting and revert to the employer. The conclusion, without consideration of the possibility of forfeiture, is that all of the contributions relate to service before the end of the reporting period and that the entire amount of the contributions therefore should be expensed in the year that they are made. The published guidance of another gives the second example shown above and states that the contributions should be spread over the period of vesting.

**Reasons for the Interpretations Committee to address the issue:**

We believe that:

- This issue is widespread and practical, particularly in view of a general shift globally from defined benefit to defined contribution plans.
- As noted above, it involves significantly divergent interpretations, both emerging (as further countries move to adopt IFRSs) and already existing in practice.
- Financial reporting would be improved through elimination of this diversity.
- The issue is sufficiently narrow in scope as to be capable of resolution within the confines of IFRSs and the *Framework for the Preparation and Presentation of Financial Statements* but not so narrow that it is inefficient to seek to resolve it.
- The IASB has stated that it does not intend to commence a comprehensive review of IAS 19 at this stage. In the Basis for Conclusions to ED/2010/3 it stated that it “will not begin further work on future phases of this project until after mid-2011 [and] has made no tentative decisions about the scope and directions of any such future phases. Consequently, any decisions made in [the ED/2010/3 phase] will remain in place for several years.”

# Appendix D – Contributions to a jointly-controlled entity or associate

At its December 2009 meeting, the Board made the following tentative decisions:

- not to resolve the inconsistency between IAS 27 and SIC-13 relating to the accounting for gains and losses resulting from contributions of non-monetary assets to jointly controlled entities within the Joint Ventures project, but to deal with it separately; and
- to incorporate the requirements in SIC-13 and any guidance relating to the equity method for joint ventures as a consequential amendment to IAS 28 Investments in Associates.

We would like to highlight the significance of this inconsistency in situations where an entity contributes its equity interest in a subsidiary to a joint venture or an associate which results in a loss of control of that subsidiary. We believe that the IASB should resolve this issue in its Annual improvements project 2009-2011.

*Issue*

It is common for an entity to enter into an arrangement whereby it contributes its equity interest in a subsidiary to a joint venture or an associate. The entity relinquishes control of the subsidiary and in exchange receives an equity interest in a joint venture or an associate and may also receive other consideration as part of the arrangement. There is a conflict between the requirements of IAS 27 (revised) and IAS 31 together with SIC 13 in how the entity would account for this type of transaction. Additionally, incorporating SIC 13 requirements into IAS 28 would introduce a similar conflict between IAS 27 and IAS 28, as explained further below.

*Accounting guidance*

According to paragraph 34 of IAS 27 (revised 2008), upon loss of control of a subsidiary, a parent derecognises the assets and liabilities of the subsidiary (including non-controlling interests) in full and measures any investment retained in the former subsidiary at its fair value. A re-measurement gain or loss that forms part of the total gain or loss on the disposal of the subsidiary is recognised in profit and loss. In contrast, paragraph 48 of IAS 31 together with SIC-13 only permits the recognition of “that portion of the gain or loss attributable to the interests of the other venturers” provided that the risks and rewards of ownership have been transferred to the joint venture (IAS 31.48).

Until this conflict is addressed, we believe diversity in practice will exist because entities will in effect have a choice of applying either the approach in revised IAS 27 (2008) or the approach in IAS 31/SIC-13 since both standards have equal status in the IFRS literature.

As stated above, we believe a similar conflict would arise between IAS 27 and IAS 28 Interests in Associates if SIC-13’s requirements are incorporated into the current version of IAS 28. Currently, an investor that retains an associate interest in a former subsidiary would be required to recognise the gain or loss on disposal of a subsidiary in accordance with IAS 27. However, if the IASB decides to incorporate the SIC-13 guidance into IAS 28, a conflict would be created that is similar to the one discussed above between IAS 27 and IAS 31.

We believe there would be immediate benefit for preparers and users of financial statements if the IASB could resolve this issue in its Annual improvements project 2009-2011.

# Appendix E – Contributions to a jointly-controlled entity or associate

[The submitter] requests the IFRS Interpretations Committee to address the following issue with respect to the interaction between IAS 27 *Consolidated and Separate Financial Statements,*SIC-13 *Jointly Controlled Entities – Non-Monetary Contributions by Vendors,* and IAS 28 *Investments in Associates* where an interest in a subsidiary is replaced by an interest in a jointly controlled entity (JCE) or an associate, respectively.

**Issue**

It is common for a parent to contribute a subsidiary to a jointly controlled entity (JCE), and to receive an ownership interest in that JCE or associate in exchange. It is also common for a parent to lose control over a subsidiary, and that subsidiary becomes a JCE or an associate. This may occur if a parent sells shares to the other venturer/investor, or by dilution (that is, through the subsidiary issuing new shares to the other venturer/investor). Under IAS 31/SIC-13, upon the contribution of a non-monetary asset to a jointly controlled entity, the gain or loss is restricted to the amount related to the other venturers. Similarly, in IAS 28, the gain or loss on an upstream or downstream transaction is restricted to the amount related to the other investors. In contrast, IAS 27 requires that when a parent loses control of a subsidiary, the parent recognises a gain or loss, without restriction (that is, the full gain or loss would be recognised). Accordingly, there appears to be a conflict between the requirements of IAS 31/SIC-13 and IAS 28, and IAS 27.

The issues are:

1. When a subsidiary is contributed to a JCE, does either IAS 27 or SIC-13 take precedence, or is there an accounting policy choice?

2. If SIC 13 is considered applicable, when a subsidiary becomes a JCE other than through contribution, that is, through a sale of shares by the parent, or by dilution, is this in substance the same as a contribution and therefore the same questions arise?

3. If SIC 13 is considered applicable for question 1, when a subsidiary is contributed to an associate, does the similar requirements of IAS 28 apply in an analogous assessment?

4. If IAS 28 is considered applicable for question 3. when a subsidiary becomes an associate other than through contribution, that is, through a sale of shares by the parent, or by dilution, is this in substance the same as a contribution and therefore the same questions arise?

5. Does it make a difference if the subsidiary is a business (as defined in IFRS 3 *Business Combinations*), or is a single-asset entity?

**Current practice**

**Issue 1 – Contribution to a JCE**

*View A – IAS 27 takes precedence*

The requirements of IAS 27 for accounting for the loss of control of a subsidiary apply, rather than IAS 31/SIC 13. Therefore, any gain recognised on the loss of control is **not** restricted to the amount attributable to the other party to the JCE. This is because although IAS 31/SIC-13 provides a general principle relating to the accounting for a contribution of assets to a JCE, it applies to the contribution of assets generally (for example, an item of property, plant and equipment or intangible asset).

However, IAS 27 specifies the accounting for the loss of control of a subsidiary and requires that any retained interest be restated to fair value when calculating the gain or loss. IAS 27 is a specific standard dealing with the loss of control of a subsidiary, and therefore the contribution of one particular type of asset (an interest in a subsidiary) into a JCE. Given that IAS 27 revised is a more recent standard than IAS 31/SIC-13, and deals more specifically with this issue, IAS 27 takes precedence.

*View B – IAS 31 and SIC-13 apply*

Paragraph 48 of IAS 31 and SIC-13 provide a general principle relating to the accounting for contributions to a JCE. They restrict the amount of the gain arising from the exchange of its interest in the subsidiary for an interest in the JCE to the amount attributable to the other party to the JCE. While IAS 31 and SIC 13 are focusing on contributions to a joint venture rather than the creation of a joint venture by way of a contribution, they are in substance the same, hence the more specific requirements of SIC 13 apply.

*View C– Accounting policy choice*

Because both IAS 27 and IAS 31/SIC-13 provide guidance, an entity has a choice as to which accounting method to apply.

**Issue 2 – Subsidiary that becomes a joint venture other than by contribution**

If either View B or View C is appropriate for Issue 1, the second question is whether when a subsidiary becomes a joint venture other than by way of contribution, does SIC 13 still apply.

*View A – No, therefore IAS 27 applies*

SIC-13 addresses transactions that involve contributions to a JCE in exchange for equity of the JCE. When a subsidiary becomes a JCE through issuance of new shares by the venturer, the transaction does not involve a contribution of shares in exchange for equity instruments of the JCE. That is, the former parent continues to hold shares in the same entity (the former subsidiary) before and after the transaction. Therefore, SIC-13 does not apply.

The scope of paragraph 48 of IAS 31 is limited to contributions and sales of assets to JCEs and does not cover other forms of transactions involving the venture and the JCE.

Paragraph 7 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires that when an IFRS specifically applies to a transaction, the accounting policy shall be determined by applying that IFRS. Since paragraphs 34 to 37 of IAS 27 specifically address transactions where an investor loses control but retains an interest in the former subsidiary, the entity must apply IAS 27 in accounting for the transaction described above.

*View B – Yes, therefore IAS 31/SIC-13 applies or is permitted*

Regardless of whether the transaction is effected through a contribution or sale of a subsidiary to a JCE or by the sale/issue of shares to a new venturer along with the signing of an agreement that results in joint control, the result is the same, and therefore the transactions have the same substance.

Paragraph 2 of SIC-13 recognises that the contribution to a JCE may take various forms. In the absence of a difference in the substance of the transaction, the same accounting treatment should apply. The fact that a parent contributes a monetary asset (the shares of the former subsidiary) to a JCE and receives the interest in the JCE in exchange should not affect the accounting, because the parent could have simply contributed the underlying assets held by the subsidiary.

**Issue 3 – Contribution to an associate**

Paragraphs 20 and 22 of IAS 28 indicate that the application of the equity method is similar to the consolidation procedures in IAS 27, and states that profits and losses from upstream and downstream transactions between an investor and an associate are only recognised to the extent of unrelated investors' interests in the associate. This is the same concept that exists in IAS 31/SIC 13, hence the question arises if SIC 13 applies in either issue 1 or 2 above, does this same concept apply in the case of an associate.

*View A – No IAS 27 takes precedence*

The requirements of IAS 27 for accounting for the loss of control of a subsidiary apply, rather than IAS 28. Therefore, any gain recognised on the loss of control is **not** restricted to that amount attributable to the unrelated investors' interests in the associate. Paragraphs 20 and 22 of IAS 28 apply to transactions between an investor and an associate more generally (for example, a sale of inventory from the parent to the associate).

However, IAS 27 specifies the accounting for the loss of control of a subsidiary and requires that any retained interest be restated to fair value when calculating the gain or loss. IAS 27 is a specific standard dealing with the loss of control of a subsidiary, and therefore the contribution of one particular type of asset (an interest in a subsidiary) into an associate. Given that this accounting in IAS 27 was considered more recently by the Board (when it was issued as a consequential amendment of IFRS 3), and deals more specifically with this issue, IAS 27 takes precedence over IAS 28.

*View B – Yes IAS 28 applies or is permitted*

IAS 28 provides guidance relating to the accounting for eliminations of transactions between an investor and an associate. Paragraph 20 and 22 of IAS 28 could be read to restrict the amount of the gain arising from the exchange of its interest in the subsidiary for an interest in an associate, to the extent of unrelated investors' interests in the associate.

**Issue 4 – Subsidiary that becomes an associate other than by contribution**

**As for issue 2 above, if view B is accepted for Issue 3, the similar question arises when the subsidiary becomes an associate other than by way of a contribution – eg sale of shares.**

*View A – No IAS 27 applies*

IAS 28 addresses upstream and downstream transactions, which are transactions between an investor and an associate. When a subsidiary becomes an associate through issuance of new shares by the associate (former subsidiary), that is a transaction between the associate (former subsidiary) and the new investors, and **not** a transaction between the former parent and the associate (former subsidiary). Similarly, when a subsidiary becomes an associate through the sale of existing shares to a new investor, the transaction does **not** involve the former subsidiary, so it is not a transaction between the investor and the investee. Therefore, IAS 28 does not apply in either of these cases.

Paragraph 7 of IAS 8 requires that when an IFRS specifically applies to a transaction, the accounting policy shall be determined by applying that IFRS. Since paragraphs 34 to 37 of IAS 27 specifically address transactions where an investor loses control but retains an interest in the former subsidiary, the entity must apply IAS 27 in accounting for the transaction described above.

*View B – Yes IAS 28 applies or is permitted*
Regardless of whether the transaction is effected through a contribution of a subsidiary to an associate or by the sale/issue of shares to a new investor, which results in the former parent having significant influence, the result is the same. In the absence of a difference in the substance of the transaction, the same accounting treatment should apply. Hence, the above conclusion for a contribution to an associate must also apply to these situations.

**Issue 5 - Business vs. Asset**

*View A – Nature of subsidiary is irrelevant*

Regardless of whether the subsidiary contains a business, as defined in IFRS 3, or contains only a single asset (or a group of assets that do not meet the definition of a business), IAS 27 continues to take precedence over SIC-13/IAS 28. This is because IAS 27 does not distinguish between subsidiaries that contain a business and subsidiaries that contain only assets in specifying the accounting for the loss of control for a subsidiary.

*View B – Consider the nature of the subsidiary*

When selecting how to account for a transaction, paragraph 10 of IAS 8 requires an entity to select an accounting policy that results in information that reflects the economic substance of the transaction, and not merely the legal form. Although both IAS 27 and SIC-13/IAS 28 provide guidance, because there is a question as to which takes precedence, an entity must consider paragraph 10 of IAS 8.

The accounting for the partial disposal and therefore calculation of the gain/loss on disposal depends on an analysis of the type of investment that is retained, which is determined by considering all facts and circumstances. One must assess whether the investor retained in substance:

1. An indirect interest in the underlying asset (for example, because the JCE cannot sell, pledge the asset or change the overall use of the asset without the former parent's permission; or

2. An investment in a JCE.

In (1), there is no difference in substance between contributing a single-asset entity to a JCE/associate, and contributing an asset that is not in a separate legal entity to a JCE/associate. Since SIC-13/IAS 28 clearly applies in the latter case, it should also apply in the former, since the substance is the same. In (2), when the subsidiary is not a single-asset entity, but rather contains a business, it is appropriate to apply IAS 27, since IAS 27 specifically applies to loss of control of a subsidiary.

**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.*

This issue is widespread, particularly in the Far East, where jointly controlled entities are common, and in industries such as real estate, construction, extractive, and life sciences. It has practical relevance because of the significant impact on the financial statements of the parent. When the parent applies IAS 27, the parent recognises the full gain or loss upon the contribution to the JCE/associate, that is, it includes any gain or loss related to the assets held by the subsidiary that were contributed to the JCE/associate . However, when SIC- 13/IAS 28 is applied, the gain or loss recognised by the parent is limited to the amount attributable to the other party to the JCE/associate.

(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.*

There is a known difference between SIC-13 and IAS 27, which was acknowledged by the Board in its deliberations on the comments received on ED 9 *Joint Arrangements*, but which the Board decided not to address (December 2009). Accordingly, 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.*

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. However, we acknowledge that eliminating one of the views may require a limited amendment to either IAS 27 or SIC-13/IAS 28, which could be included as part of the Annual Improvements project.

(d) *The issue can be resolved efficiently within the confines of existing IFRSs and the*

*Framework, and the demands of the interpretation process.*

Yes, we believe that the process can be resolved efficiently within the confines of IAS 27, SIC-13, IAS 28 and IAS 8. As noted above, we acknowledge that resolving this interaction may require a limited amendment to either IAS 27 or SIC-13/IAS 28.

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

Yes, we believe that the Committee will be able to reach a consensus on a timely basis.

(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.*

In December 2009, the Board "tentatively decided not to resolve the inconsistency within the Joint Ventures project, but to deal with it separately." However, the Board has not yet decided on its post-2011 agenda and work on this project by the IASB has not yet commenced, and that the Board specifically decided not to resolve the issue when issuing IFRS 11 *Joint Arrangements. Therefore,* it is not clear when this project will commence.

We are also greatly concerned that if the Board proceeds with amending IAS 28 *Investments in Associates* to include the accounting for joint ventures (previously JCEs), and incorporates the requirements of SIC-13 into IAS 28, as has been proposed, that the inconsistency that currently exists between IAS 27 and SIC-13 for JCEs will be explicitly extended for contributions of a subsidiary to an associate.

This issue is currently arising in practice and is expected to increase as the number of joint ventures increases, particularly as entities that currently apply IFRS create joint ventures in emerging economies (e.g., China). Therefore, there is a need to address this issue.

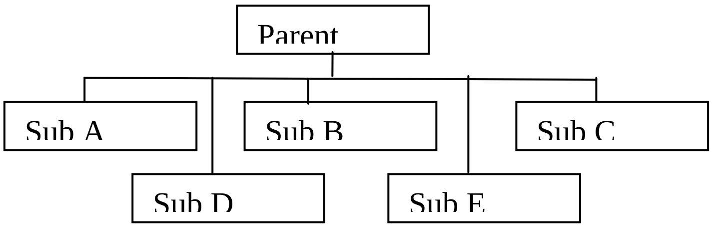
# Appendix F – Group reorganisations in separate financial statements

[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.

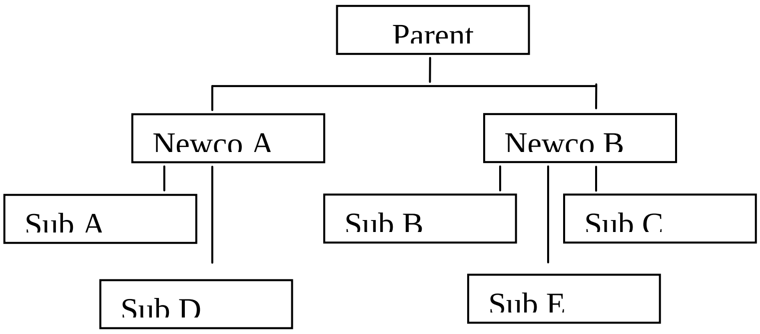
**Issue**

It 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.

Before the reorganisation:




After the reorganisation:




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

- Whether the new parents (Newco A and Newco B in the diagrams 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"?
- 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**
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*

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)

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.

Substituting 'a parent' and 'the original parent' by 'Sub A' and 'new entity' and 'the new parent' by 'Newco A' 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...

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.

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, i.e. the shares issued.

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 the scope of Paragraph 38B, but analogy thereto is permitted*

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.

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:

- 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.
- 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*

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

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...

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.*
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.*
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.*
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.*
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.*
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.*
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.

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:

- 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?
- 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*?*

# Appendix G – Accounting for share of changes in associate’s net assets that do not relate to profit or loss or other comprehensive income

**The issue:**

The revisions to IAS 28 *Investments in Associates* para 11 and IAS 1 *Presentation of Financial Statements* have given rise to a contradiction with the definition of equity accounting in IAS 28 para 2 by narrowing the changes in the net assets of the associate that may be recognised by the investor.

IAS 28.2 defines the equity method as:

*a method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor’s share of net assets of the investee*.

This definition indicates that all changes in the net assets of the associate should be recognised by the investor.

IAS 1 *Presentation of Financial Statements* (as revised in 2007) made a consequential amendment to IAS 28.11. This amendment is effective for annual periods beginning on or after 1 January 2009.

IAS 28 (previous version) para 11 referred to changes in equity and required the following in applying the equity method:

*Under the equity method, the investment in an associate is initially recognised at cost and the carrying amount is increased or decreased to recognise the investor’s share of the profit or loss of the investee after the date of acquisition. The investor’s share of the profit or loss of the investee is recognised in the investor’s profit or loss. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the investor’s proportionate interest in the investee arising from changes in the investee’s equity that have not been recognised in the investee’s profit or loss. Such changes include those arising from the revaluation of property, plant and equipment and from foreign exchange translation differences. The investor’s share of those changes is recognised directly in equity of the investor.*

IAS 28 (as amended) - para 11 no longer refers to changes in equity, but only changes in other comprehensive income (OCI):

*Under the equity method, the investment in an associate is initially recognised at cost and the carrying amount is increased or decreased to recognise the investor’s share of the profit or loss of the investee after the date of acquisition. The investor’s share of the profit or loss of the investee is recognised in the investor’s profit or loss. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the investor’s proportionate interest in the investee arising from changes in the investee’s other comprehensive income. Such changes include those arising from the revaluation of property, plant and equipment and from foreign exchange translation differences. The investor’s share of those changes is recognised in other comprehensive income of the investor (see IAS 1 Presentation of Financial Statements (as revised in 2007))*

As a result, para 11 no longer states whether and where the investor should account for its share in the changes in the investee’s equity (other than profit or loss, OCI and distributions) in applying the equity method. Such changes include for example:

- Gains and losses arising on associate’s transactions with non-controlling interest (NCI) of its subsidiaries (recorded directly in equity in the associate’s books)
- Liabilities recognised in respect of put options to NCI (recognised as a deduction of equity in the associates books)

- Movements in the share based payment reserves of the associate Furthermore, IAS 1 (as revised in 2007) seems to preclude such items from being recognized directly in equity or OCI of the investor.

IAS 1.106 requires that changes in equity arising from transactions with owners in their capacity as owners be presented separately from non-owner changes in equity and that only owner changes in equity be presented in the statement of changes in equity. An associate is not part of the group as defined in IAS 27 and therefore any changes in its statement of changes in equity would not be regarded as transactions with owners from the investor's perspective.

IAS 1.7 defines other comprehensive income as *items of income and expense (including reclassification adjustments) that are not recognised in profit or loss as required or permitted by other IFRSs.* IAS 28 is currently silent on the treatment of changes in equity of an associate from the investor's perspective and therefore it does not permit recognition of these items in other comprehensive income of the investor.

As a result, IFRS currently do not provide guidance on the accounting and presentation of changes in equity of an associate (other than profit or loss, OCI and distributions) from the investor's perspective when applying the equity method.

**Current practice:**

Various views currently exist to account for the investor's share in the changes in the equity of its associate:

View 1: Recognise the changes in the statement of changes in equity

View 2: Recognise the changes in the statement of other comprehensive income

View 3: Recognise the changes in the income statement

View 4: Do not account for the changes

Each of those views seems to have conflicts with some IFRS requirements as summarized below:

| | Conflicts with other IFRS requirements |
|---|---|
| View 1 – recognize changes in investor's equity | This is not a transaction with the owners of the group and thus there is no justification to recognize it directly in SOCIE in accordance with IAS 1.106 and IAS 1.109. |
| View 2 – recognize changes in investor's OCI | This is not an OCI item in accordance with the definition of OCI and the list of OCI items in IAS 1.7. |
| View 3 – recognize changes in investor's profit or loss | It is arguable whether this is in line with IAS 28.11. |
| View 4 – No transaction is recorded | Not in accordance with the definition of equity method in IAS 28.2, according to which the cost of the investment is adjusted thereafter for post-acquisition change in the investor's share of net assets of the investee. |

**Reasons for the IFRIC / IASB to address the issue:**

There seems to be an unintended contradiction between the requirements of IAS 28.2, IAS 28.11 and IAS 1 that could result in inconsistent treatment in applying the equity method. The issue is relatively widespread and causes divergent treatments in practice. On the other hand, it could be relatively easily fixed by improving the wording of IAS 28.11.

One possible way to resolve the conflict would be to clarify in IAS 28.11 that all other transactions of the investee that adjust the net assets of the investee without adjusting the investor's proportionate share in the net assets shall be recognised in the investor's profit or loss.

# Appendix H – Use of IFRIC 6 by analogy

**IAS 37, Provisions – Identification of the obligating event**

**IFRIC 6, Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment: Application by analogy to levies charged for participation in a market on a specified date**

**Background**

Several jurisdictions have recently introduced levies on entities operating in specific industries, for example banking, insurance and railways. A common feature of several of these levies is that they are payable only if an entity participates in its market on a specified date ("the specified date"). For example, some levies are calculated as a percentage of revenues in Year 1 but are payable only if the entity participates in its market on the first day of Year 2. Others are determined by reference to the carrying value of assets or liabilities at the end of the financial year. The specified date, which determines whether the tax is paid, is usually at the beginning or the end of a calendar or financial year.

The levies addressed in this request are not determined by reference to taxable or net profit and are therefore not in the scope of IAS 12. The obligation to pay the levy is recognised and measured in accordance with IAS 37.

**The issue**

There are different views about whether the obligating event is participation in the market during the period prior to the specified date or being in business on the specified date. There is consequently diversity in views about when the obligation to pay the levy is recognised and whether the guidance in IFRIC 6 should be applied by analogy.

There is concern that applying IFRIC 6 by analogy disconnects the recognition of the liability from the activities to which the levy relates, particularly when the entity has no realistic alternative but to remain in the market on the specified date. For example, a railway operator might be required to pay a levy based on revenues in Year 1, but only if the entity participates in its market on 1 January Year 2. Applying IFRIC 6 by analogy would delay recognition of the obligation until 1 January Year 2. This does not appear to reflect the substance of the levy as the operator has no realistic alternative but to continue in the market. There are also many situations in which an entity expects and intends to remain in the market until the specified date and has created an expectation that it will continue in the market.

**The alternative views**

<u>View 1A: Analogy to IFRIC 6; provision recognised in full on the specified date</u>

IFRIC 6.9 states that 'participation in the market during the measurement period is the obligating event in accordance with paragraph 14(a) of IAS 37.' Therefore there is no obligation to pay the levy until the entity participates in the market on the specified date, which is when the levy is recognised, even though the levy might be measured by reference to revenues in the previous period.

Some argue that an entity might not be able to avoid participating in the market at the specified date or might intend and expect to continue operating. The entity therefore has a constructive obligation at an earlier date. IFRIC 6.BC10 rejects this argument, stating that 'a provision can be recognised only in respect of an obligation that arises independently of the entity's future actions...Consequently, no obligation exists...until the entity participates in the market during the measurement period.'

IAS 37.14 therefore precludes recognition of a liability for the levy until the specified date, even if this is after the end of the period in which activities on which the levy is based occurred. A provision for the full amount of the levy is recorded as a liability and an expense on the specified date.

<u>View 1B: Analogy to IFRIC 6; provision recognised prospectively over the subsequent accounting period</u>

Consistent with view 1A, the obligating event is participation in the market on the specified date. However, the substance of the levy is an annual charge for participation in the market and the expense is therefore recognised over the accounting period beginning on the specified date.

A prepayment is recognised at the same time as the liability and is amortised over the subsequent twelve months, reflecting consumption of the economic benefits to which the entity is entitled by being allowed to participate in the market. The prepayment is recognised even if the levy is not refundable because the substance is an annual charge for the right to do business.

<u>View 2: No analogy to IFRIC 6; provision recognised progressively throughout the period</u>

IFRIC 6 applies specifically to liabilities for waste management under the EU directive on waste electrical and electronic equipment. It should not be applied by analogy in different circumstances.

An entity might have no realistic alternative but to remain in its market until the specified date (and possibly beyond). For example, an entity might be bound by the terms of a license or other contractual terms to continue to operate. The costs of exiting the market might be so high that the entity cannot realistically exit the market and continue as a going concern. The requirement to participate in the market on the specified date is not substantive in these circumstances, so the entity creates a constructive obligation to pay the levy as it operates.

An entity should recognise a constructive obligation to pay the levy if it cannot realistically exit the market or if it intends and expects to remain in the market and has made that intention clear. The substance of the levy is a charge on entities operating during the period prior to the specified date. The obligation to pay the levy and the related expense are therefore recognised progressively throughout the year and reflect the measurement basis for the levy at each interim reporting date. The obligation for a levy based on revenue is measured by reference to revenues earned in an interim period. The liability for a levy based on assets or liabilities is measured by reference to the expected carrying values on the balance sheet at the specified date, time apportioned by reference to the interim period.

**Reasons for the IFRS IC to address the issue:**

We believe that the IFRS Interpretations Committee should clarify the extent to which IFRIC 6 should be applied by analogy because:

- there are diverse interpretations and approaches in practice; and
- accounting by analogy to IFRIC 6 does not reflect the economic substance of some obligations.

The approach required by IFRIC 6 is simple, but does not recognise that in many cases an entity has no realistic opportunity to withdraw from a market before the legal obligation arises.

When an entity has no realistic alternative but to remain in the market or expects and intends to remain in the market and incur the levy, IFRIC 6 does not reflect the substance of the levy. Progressive recognition throughout the reporting period under view 2 results in recognition of an expense in the period to which it relates and would be better understood by users.

**Appendix: Illustrative examples**

1. Railway turnover levy in France

A new tax was implemented in France just before 31 December 2010. The tax only applies to railway activities. It is payable by entities that are in the market on 1 January 2011 and is a percentage of the prior year's turnover. This tax is a recurring tax and will be charged each financial year.

2. Turnover levy for all activities in France (Contribution sociale de solidarité des sociétés)

This levy was introduced in 1970. It is payable by entities that realise an annual turnover higher than 760 000€ in year Y and that exist on 1 January. The levy is determined as a percentage of turnover.

3. UK banking levy

The UK government has introduced legislation for a levy on banks and other financial institutions. For banks and building societies, the levy is based on the sum of certain categories of financial liabilities and equity ("chargeable liabilities"). A fixed percentage is applied to the total of the chargeable liabilities at the entity's balance sheet date. As a matter of practicality, the levy is collected as part of the corporation tax regime and is therefore paid in 4 instalments falling due in months 7, 10, 13 & 16 after the start of the financial year to which the levy relates.

This levy is a recurring levy, charged each financial year to all entities within a defined sector whose chargeable liabilities meet certain size criteria. If an entity's financial year is longer or shorter than 12 months (for example, where a change in financial year occurs), the levy is pro-rated to reflect the increased or decreased number of days in the reporting period.

4. Hungarian bank tax

On 22 July 2010, the Hungarian Parliament passed a Bill introducing a special tax (or "bank tax", as it is generally known), which is payable by a wide range of financial organisations, including banks, insurance companies, investment funds, and other financial services companies.

The calculation base and percentages vary between types of entities. For example for banks, taxes are payable based on adjusted balance sheet total, while the tax base for insurers is the adjusted premium income. The tax was introduced for three years and is currently scheduled to expire as of 1 January 2013. The tax for all three years is calculated using 2009 financial data. Any financial services company that is in operation as of 1 January 2011 and 2012 is liable for payment of the full amount of banking tax for the respective years, even if they terminate all activities later during the year. In some highly regulated industries (for example, banking and insurance) exiting the Hungarian market is extremely complicated and time consuming, therefore in most cases avoiding the tax payment by exiting the market is not a practical option.