Project: **New items for initial consideration**

Topic: **IAS 27 *Consolidated and Separate Financial Statements* - Contributions to a jointly controlled entity or an associate**

Introduction

1. The IFRS Interpretations Committee (the Committee) received three requests asking for clarification of the accounting when a parent loses control over a subsidiary and that subsidiary becomes (part of) a jointly controlled entity (JCE) or an associate. In particular, does the parent recognise the full gain or loss resulting from the transaction or only to the extent of the interests of the other equity holders in the JCE or the associate?

2. First of all, submitters are concerned about transactions where a parent contributes interests in a subsidiary to a JCE and this contribution results in a loss of control in the subsidiary by the parent.

3. For ease of reference, the text of the submissions are reproduced in Appendices A-C to this paper.

4. The Board discussed the issue at its December 2009 meeting[1] and the following was reported in IASB Update:

    (a) not to resolve the inconsistency between IAS 27 *Consolidated and Separate Financial Statements* and SIC-13 *Jointly Controlled Entities –*

[1] http://www.ifrs.org/NR/rdonlyres/26D750E8-816B-4F8C-A919-5B78991A1913/0/JV1209B11Bobs.pdf

This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IFRS Interpretations Committee or the IASB. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination.

Decisions made by the IFRS Interpretations Committee are reported in IFRIC *Update*.

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

Non-Monetary Contributions by Venturers within the joint venture project, but to deal with it separately;

(b) 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.*

Purpose of the paper

5. This paper:

   (a) provides background information on the issue;

   (b) provides an analysis of the issue;

   (c) makes a recommendation that the proposed amendment should be made through the annual improvements process;

   (d) asks whether the Interpretations Committee agrees with the staff's recommendation.

Background information

Summary analysis presented in the submissions

6. All submissions agree with the conclusion reached by the Board in its December 2009 meeting that there is an inconsistency between the guidance in IAS 27 on the one hand and IAS 31 together with SIC-13 on the other hand when interests in a subsidiary are contributed to a JCE and this contribution results in a loss of control in the subsidiary. While SIC-13 restricts gains and losses arising from contributions of non-monetary assets to a JCE to the extent of the interest attributable to the other equity holders in the JCE, IAS 27 requires full profit or loss recognition on the loss of control.

7. All submitters believe that a similar conflict would arise between IAS 27 and IAS 28 if the requirements in SIC-13, and any guidance related to the equity

method for joint ventures, are incorporated into IAS 28 as a consequential amendment. *[We can confirm that one of the consequential amendments to IFRS 11 Joint Arrangements will be the incorporation of the guidance in SIC-13 into IAS 28.]*

8. All submissions conclude that the current inconsistency between the guidance in IAS 27 on the one hand and IAS 31 together with SIC-13 on the other hand results in an accounting policy choice for preparers of financial statements.

9. All submissions ask the Committee to clarify this inconsistency.

10. One submission (see Appendix C) considers the partial gain or loss recognition approach set out in SIC-13 to be the most appropriate (ie should take precedence over the guidance in IAS 27). This submission also advocates that this approach should also apply when, instead of interests in a subsidiary being contributed to a JCE, the subsidiary itself becomes a JCE, eg by the parent selling part of its interest in the subsidiary to the other venturers.

11. All the submissions highlight the significance of this inconsistency, but there is less consistency in their proposals on how to deal with the issue:

    (a) One submission (see Appendix A) only focuses on the inconsistency in the guidance between IAS 27 and in IAS 31 together with SIC-13. Accordingly, the submitter proposes that the IASB should resolve the inconsistency simply by dealing with the issue in its annual improvements project 2009-2011 cycle.

    (b) The other two submissions (see Appendices B and C) outline a broader issue:

        (i) They also consider scenarios where a JCE is established other than by contributing interests in a subsidiary. The submitters have scenarios in mind where the parent sells shares to the other venturers or dilutes its interest in the subsidiary by the subsidiary issuing new shares to the other venturers.

(ii) One submitter (Appendix B) asks whether the same approach should be applied when the interest in the subsidiary is not replaced by an interest in a JCE but by an interest in an associate, because IAS 28 includes the same principle as IAS 31, ie gains and losses on upstream and downstream transaction are restricted to the portion that is attributable to the interest of the other investors.

(iii) The same submitter also asks whether it makes a difference if the subsidiary is a business (as defined in IFRS 3 *Business Combinations*) rather than a single asset entity.

According to their wider focus, both submitters ask the Committee to put the issue onto its agenda and assess it against the agenda-setting criteria.

(c) However, one of these two submitters (see Appendix B) acknowledges that the annual improvements project would be appropriate for only resolving the inconsistency in the guidance between IAS 27 and SIC-13.

12. The two submissions asking the Committee to put the issue onto its agenda outline the prevalence of this issue in practice. One submitter (see Appendix C) had experienced that the issue is particularly relevant for the oil and gas industry. The other one (see Appendix B) considers the issue to be widespread, particularly in the Far East and in industries such as real estate, construction, extractive industries and life sciences.

Prior discussions by the Board

13. The staff presented a paper at the Board's December 2009[2] meeting analysing the inconsistency between the guidance in IAS 27 and IAS 31 together with

[2] http://www.ifrs.org/NR/rdonlyres/26D750E8-816B-4F8C-A919-5B78991A1913/0/JV1209B11Bobs.pdf

SIC-13. Following the discussion on that paper, the Board made the following two tentative decisions:

(a) not to resolve the inconsistency within the joint ventures project, but to deal with it separately; and

(b) 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.*

14. **For ease of reference, the staff's analysis is reproduced below. Paragraphs 15-34 are an extract from agenda paper 11B presented by the IASB staff in the December 2009 Board meeting:**

Current requirements

15. The accounting for transactions between a venturer and a joint venture is currently set out in IAS 31 and SIC-13. IAS 31 has the following requirements for transactions between a venturer and a joint venture:

> 48. When a venturer contributes or sells assets to a joint venture, recognition of any portion of a gain or loss from the transaction shall reflect the substance of the transaction. While the assets are retained by the joint venture, and provided the venturer has transferred the significant risks and rewards of ownership, the venturer shall recognise only that portion of the gain or loss that is attributable to the interests of the other venturers. The venturer shall recognise the full amount of any loss when the contribution or sale provides evidence of a reduction in the net realisable value of current assets or an impairment loss.
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> 49. When a venturer purchases assets from a joint venture, the venturer shall not recognise its share of the profits of the joint venture from the transaction until it resells the assets to an independent party. A venturer shall recognise its share of the losses resulting from these transactions in the same way as profits except that losses shall be recognised immediately when they represent a reduction in the net realisable value of current assets or an impairment loss.
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> 50. To assess whether a transaction between a venturer and a joint venture provides evidence of impairment of an asset, the venturer determines the recoverable amount of the asset in accordance with IAS 36 Impairment of Assets. In determining value in use, the venturer estimates future cash flows from the asset on the basis of continuing use of the asset and its ultimate disposal by the joint venture.

16. SIC-13 addresses non-monetary contributions to a jointly controlled entity (JCE) in exchange for an equity interest in the JCE that is accounted for using either the equity method or proportionate consolidation. The Interpretation states:

> 5. In applying IAS 31.48 to non-monetary contributions to a JCE in exchange for an equity interest in the JCE, a venturer shall recognise in profit or loss for the period the portion of a gain or loss attributable to the equity interests of the other venturers except when:
>
> (a) the significant risks and rewards of ownership of the contributed non-monetary asset(s) have not been transferred to the JCE; or
>
> (b) the gain or loss on the non-monetary contribution cannot be measured reliably; or
>
> (c) the contribution transaction lacks commercial substance, as that term is described in IAS 16.[1]
>
> If exception (a), (b) or (c) applies, the gain or loss is regarded as unrealised and therefore is not recognised in profit or loss unless paragraph 6 also applies.
>
> 6. If, in addition to receiving an equity interest in the JCE, a venturer receives monetary or non-monetary assets, an appropriate portion of gain or loss on the transaction shall be recognised by the venturer in profit or loss.
>
> 7. Unrealised gains or losses on non-monetary assets contributed to JCEs shall be eliminated against the underlying assets under the proportionate consolidation method or against the investment under the equity method. Such unrealised gains or losses shall not be presented as deferred gains or losses in the venturer's consolidated statement of financial position.

17. Therefore both IAS 31 and SIC-13 require that gains and losses resulting from transactions between the reporting entity and its JCE be recognised only to the extent of the interests of the other equity holders. SIC-13 also specifies some factors to consider before the gains and losses are considered to be 'realised' (SIC-13.5 (a)-(c)). These specific factors are not included in IAS 31.

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[1] IAS 16.25: 'An entity determines whether an exchange transaction has *commercial substance* by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if: (a) the configuration (risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or (b) the entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and (c) the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.'

Inconsistency between SIC-13 and IAS 27

18. There is an inconsistency between SIC-13 and IAS 27 when a subsidiary is contributed to a JCE. As mentioned above, SIC-13 requires gains or losses arising from contributions of non-monetary assets to a JCE to be recognised only to the extent of the interests attributable to the other equity holders in the JCE, if the gain or loss is regarded as 'realised'. Contributions are described in SIC-13 as follows:

> SIC-13.2 Contributions to a JCE are transfers of assets by venturers in exchange for an equity interest in the JCE. Such contributions may take various forms.

19. A non-monetary contribution could include a subsidiary that is contributed to a JCE in exchange for an equity interest in the JCE.

20. The application of paragraph 34 of IAS 27 to the contribution of non-monetary assets housed in a subsidiary would result in the contributing party:

> (a) derecognising the assets (including any goodwill) and liabilities of the subsidiary at their carrying amounts at the date when control is lost;
>
> (b) derecognising the carrying amount of any non-controlling interests in the former subsidiary at the date when control is lost (including any components of other comprehensive income attributable to them);
>
> (c) recognising:
>
> (i) the fair value of the consideration received, if any, from the transaction, event or circumstances that resulted in the loss of control; and
>
> (ii) if the transaction that resulted in the loss of control involves a distribution of shares of the subsidiary to owners in their capacity as owners, that distribution;
>
> (d) recognises any investment retained in the former subsidiary at its fair value at the date when control is lost […].

21. This accounting requirement is supported by the following explanation in paragraph 55 of the Basis of Conclusions of IAS 27:

> 'any investment the parent has in the former subsidiary after control is lost should be measured at fair value at the date that control is lost and […] **any resulting gain or loss should be recognised in profit or loss.** […] Measuring the investment at fair value reflects the Board's view that the loss of control of a subsidiary is a **significant economic event**. The parent-subsidiary relationship ceases to exist and an investor-investee relationship begins that differs significantly from the former parent-subsidiary relationship. Therefore, the new

investor-investee relationship is recognised and measured initially at the date when control is lost.'

22. The following example illustrates this inconsistency.

23. An entity holds a 100 per cent interest in a subsidiary that has net assets with a carrying amount of CU4,000. The entity contributes its interest in the subsidiary in exchange for a 50 per cent interest in a new joint arrangement. The parties agree that the total value of the new joint arrangement is CU10,000.

    (a) Applying SIC-13 to the transaction above:

	Dr	(Cr)
Investment in joint arrangement	4,500	
Net assets of subsidiary contributed		4,000
Gain on disposal		500

    (b) Applying IAS 27 to the transaction above:

	Dr	(Cr)
Investment in joint arrangement	5,000	
Net assets of subsidiary contributed		4,000
Gain on disposal		1,000

24. A similar inconsistency would arise if a party contributed an interest in a subsidiary to a joint arrangement and this contribution did not result in the loss of control of the subsidiary. In this case an entity using IAS 27 would account for any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration received directly in equity.

25. The following example illustrates this inconsistency.

26. An entity holds a 100 per cent interest in a subsidiary that has net assets of CU4,000. The entity contributes a 10 per cent interest in the subsidiary in exchange for a 50 per cent interest in a new joint arrangement. The parties agree that the total value of the new joint arrangement is CU1,000.

(a) Applying SIC-13 to the transaction above:

	Dr	(Cr)
Investment in joint arrangement	450	
Non-controlling interest (CU 4,000 X 10%)		400
Gain on disposal		50

(b) Applying IAS 27 to the transaction above:

	Dr	(Cr)
Investment in joint arrangement	500	
Non-controlling interest (CU 4,000 X 10%)		400
Entity's other reserves		100

Accounting requirements proposed by ED 9

27. ED 9 includes the following accounting requirements for transactions between the parties and the joint arrangement:

> 27. When a venturer enters into a transaction with a joint venture, it recognises gains or losses resulting from the transaction in accordance with paragraph 22 of IAS 28. Those transactions would include, for example, the sale, purchase or contribution of assets, including the contribution of a non-monetary asset to a joint venture in exchange for an equity interest in the joint venture.

28. IAS 28.22 states:

> 22. Profits and losses resulting from 'upstream' and 'downstream' transactions between an investor (including its consolidated subsidiaries) and an associate are recognised in the investor's financial statements only to the extent of unrelated investors' interests in the associate. […].'

29. ED 9 would not resolve the inconsistency between IAS 27 and SIC-13 when accounting for contributions of non-monetary assets described in paragraphs 18-26 above.

Staff analysis [reproduction from agenda paper 11B for the December 2009 Board meeting]

Some background information

30. Some of the big audit firms have also observed the tension between SIC-13 and IAS 27 and have told us that this will become a problem in practice (please note that the accounting requirements in IAS 27 relating to the 'loss of control' only came into effect for annual periods beginning on or after 1 July 2009).

31. There are currently different interpretations relating to the application of the standards for those cases when a party contributes an interest in a subsidiary to a JCE resulting in the loss of control of the subsidiary:

    (a) Some interpret that the requirements of IAS 27 should be applied first (ie full recognition of gains and losses) and then SIC-13 should be applied (ie elimination of gain and losses relating to the party's interest).

    (b) Some interpret that the final accounting is a company's accounting policy matter (ie using IAS 27 or SIC-13 depends on the accounting policies of the entity).

    (c) A third interpretation is that if the non-monetary assets contributed are in a subsidiary then IAS 27 shall be applied, whereas if the non-monetary assets are not placed within a subsidiary the requirements of SIC-13 are the ones that shall be applied.

32. Before analysing the different options available to us, we note that the following discussions have already been held with the Board:

    (a) In May 2009 the staff pointed out the different requirements in IAS 27 and IAS 31/SIC-13 to account for the contribution of a subsidiary to a JCE (see Agenda Paper 13K *Amendments to IFRS 3 and IAS 27 – Other Issues*). The staff recommended that this issue be addressed in a revision of Equity Accounting or as part of other current projects such

as Joint Ventures and Consolidation. At the Board meeting in May 2009 the Board agreed to the staff recommendation.

(b) Also in May 2009, the staff informed the Board about the FASB deliberations relating to the amendment of the scope of SFAS 160 *Noncontrolling Interests in Consolidated Financial Statements* (see Agenda Paper 13J *Information on EITF 08-10 and FASB Proposal on Scope of SFAS 160*). In a meeting in April 2009 the FASB addressed the matters raised in EITF 08-10 *Selected Statement 160 Implementation Questions*. One of those matters was 'how an entity should account for the transfer of an interest in a subsidiary in exchange for a joint venture interest that results in deconsolidation of the subsidiary'.[2] The FASB decided that Statement 160 should apply when a subsidiary that is a business or non-profit activity is transferred to an equity method investee or joint venture (ie an entity deconsolidates a subsidiary when it ceases to control that subsidiary; upon deconsolidation, the entity recognises a gain or loss in profit or loss attributable to the parent and measures any retained interest in the subsidiary at fair value). The requirements proposed in the Exposure Draft *Accounting and Reporting for Decreases in Ownership of a Subsidiary—a Scope clarification* issued in August 2009 by the FASB are aligned with the FASB's decision described above.

[2] Issue 3 of EITF 08-10 *Selected Statement 160 Implementation Questions*.

Analysis [reproduction from agenda paper 11B for the December 2009 Board meeting]

33. The inconsistency between SIC-13 and IAS 27 is closely related to the following topics:

    (a) the definition of 'group' and its implications in the measurement requirements of investments outside the group boundaries such as joint arrangements and associates;[3]

    (b) the current equity method itself, which requires recognition of gains and losses resulting from 'upstream' and 'downstream' transactions between an investor and an associate only to the extent of unrelated investors' interests in the associate; and

    (c) the initial inconsistency between the principle that loss of control is a 'significant economic event' that triggers *full* recognition of gains and losses, while SIC-13 requires only *partial* recognition of gains and losses;

34. Dealing with these topics would require, among other things:

    (a) A review of the measurement requirements for interests held in joint ventures and associates and their consistency with the Group definition, which would imply a thorough review of the 'equity method';

    (b) A thorough review not only of the accounting for contributions of non-monetary assets to joint arrangements but also a review of the accounting for upstream and downstream transactions to joint arrangements and associates, taking into consideration the accounting treatment of unrealised gains and losses resulting from these transactions;

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[3] According to IAS 27, 'a *group* is a parent and all its subsidiaries'.

(c) Clarification of the scope and interaction between IFRS 3 *Business Combinations*, IAS 27, IAS 31, SIC-13 and IAS 28 - The review of the accounting for transactions between the parties and the joint arrangements or investors and associates should provide consistent guidance in the following different situations:

   (i) Sale/contribution of subsidiaries (subsidiaries might house a business or assets that do not qualify as a business);

   (ii) Sale/contribution of businesses (not housed within a subsidiary);

   (iii) Sale/contribution of assets (not housed within a subsidiary).

(d) Clarification of the interaction between IFRS 3 *Business Combinations*, IAS 27, IAS 31, SIC-13 and IAS 28 – The accounting for acquisitions and for step-acquisitions of equity accounted investments poses the following challenges:

   (i) IAS 28.11 requires that 'the investment in an associate is initially recognised at cost […]'and IAS 28.20 states '[…] the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for an investment in an associate'. The question is whether entities should analogise fully to IFRS 3 (ie expense transaction cost, include contingent consideration based on its fair value with subsequent changes in profit and loss), or should entities instead retain a cost approach (ie analogising to other standards, transaction and directly attributable costs are included in the initial measurement of cost)?

   (ii) Is gaining 'significant influence' or 'joint control' a significant event in the same way that gaining 'control' is

a significant event?[4] Should those step-acquisitions in joint ventures and associates fully analogise with IFRS 3?[5] How should gains and losses be measured and recognised?

(e) Clarification of the accounting for changes in ownership interests in joint arrangements and in associates: how should changes in ownership interests in joint arrangements and associates be accounted for? Should the accounting for decreases in ownership interest fully analogise with the accounting proposed in IAS 27.30 for changes in a parent's ownership interest in a subsidiary that do not result in a loss of control (ie equity transactions)? Should the accounting for increases in ownership interest fully analogise with the step acquisition in IFRS 3 (ie subsequent increases in the investment trigger remeasurement of the underlying assets and liabilities of the joint arrangement or the associate) or should measurement distinguish between the new interest based on the new cost and the old interest at the original cost?

(f) Consideration of the requirements under US GAAP in order to assess how convergent would the new IFRS requirements be compared to the US GAAP ones. Please note that a similar inconsistency to the one discussed in this paper currently exists under US GAAP as addressed by paragraph 13 of the Basis for Conclusions of the Exposure Draft *Accounting and Reporting for Decreases in Ownership of a Subsidiary —a Scope Clarification:*

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[4] Please note that the loss of 'control', 'joint control' and 'significant influence' are considered to be economically similar events that change the nature of the investment. Consequently the accounting guidance on the loss of control, joint control or significant influence in IAS 27, IAS 31 and IAS 28 is consistent (ie the investor measures any retained interest at fair value and any difference between the carrying amount of the investment when control, joint control or significant influence is lost, the disposal proceeds (if any) and the fair value of any retained interest is recognised in profit or loss).

[5] IAS 28.11 states that 'the investment in an associate is initially recognised at cost', however, when accounting for acquisition of an investment in an associate, IAS 28.20 states '[…] the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for the acquisition of an investment in an associate'. Should step acquisitions of equity-accounted investments fully analogise to IFRS 3 or should they be accounted for by using a cost accumulation approach (ie cost of an associate achieved in stages would include the consideration paid for each purchase)?

BC13. The Board also clarified that Subtopic 810-10[6] applies if an entity transfers a subsidiary or group of assets that is a business or nonprofit activity to an equity method investee or joint venture. Constituents questioned whether Subtopic 810-10 should apply to these situations because Topic 323[7] provides guidance on accounting for transactions with an equity method investee including joint ventures. That Topic prohibits recognition of gain or loss on transactions with an equity method investee until the gain or loss has been realized through transactions outside of the group. That guidance conflicts with the accounting required by Subtopic 810-10. The Board noted that Subtopic 810-10 explicitly requires that a subsidiary be deconsolidated and that a gain or loss be recognized in earnings if the entity loses control of the subsidiary, including any gain or loss associated with a retained investment. The Board believes that inherent in that conclusion is that a retained investment could subsequently be accounted for as an equity method investment. Accordingly, the Board does not believe that the accounting treatment should differ on the basis of whether the transaction was with a new or existing equity method investee or joint venture. *[End of reproduction of prior staff analysis from December 2009.]*

Staff analysis and recommendation

Update on the staff analysis from December 2009

35. We believe that the analysis prepared by the staff in December 2009 is still valid, inasmuch as:

    (a) there is still an inconsistency between the guidance in IAS 27 on the one hand and IAS 31 together with SIC-13 on the other hand when a

[6] Subtopic 810-10-40.4 and 40.5 state: 40.4 A parent shall deconsolidate a subsidiary as of the date the parent ceases to have a controlling financial interest in the subsidiary. 40.5 If a parent deconsolidates a subsidiary through a nonreciprocal transfer to owners, such as a spinoff, the accounting guidance in Subtopic 845-10, applies. Otherwise, a parent shall account for the deconsolidation of a subsidiary by recognizing a gain or loss in net income attributable to the parent, measured as the difference between:
a. The aggregate of all of the following: 1. The fair value of any consideration received 2. The fair value of any retained noncontrolling investment in the former subsidiary at the date the subsidiary is deconsolidated 3. The carrying amount of any noncontrolling interest in the former subsidiary (including any accumulated other comprehensive income attributable to the noncontrolling interest) at the date the subsidiary is deconsolidated.
b. The carrying amount of the former subsidiary's assets and liabilities.

[7] Topic 323 deals with *Investments – Equity Method and Joint Ventures*.

subsidiary is contributed to a JCE and this contribution results in a loss of control in the subsidiary;

(b) the (consequential amendments to the) new IFRS on joint arrangements and the new consolidation standard will not resolve the inconsistency. Considering the Board's discussions since December 2009, we do not expect the forthcoming IFRS 10 *Consolidated Financial Statements* or the forthcoming (consequential amendments to IAS 28 from) IFRS 11 *Joint Arrangements* to resolve this inconsistency;

(c) clarifying the scope and interaction between IFRS 3, IAS 27, IAS 28, IAS 31 and SIC-13 and developing consistent principles for status changes between subsidiaries, joint ventures and associates would require a broad review of the interaction of the principles underlying these standards (see paragraphs 33 and 34 above).

36. We think that such a review, addressing the broader issue as outlined in paragraph 11 of this paper and the related issues presented in paragraphs 33 and 34 of this paper, goes beyond the scope of a Committee project. Instead, it would require a separate Board project.

37. However, on the subject of the narrow issue of the contribution of a subsidiary to a JCE or associate, we agree with the submitters that:

(a) financial reporting would be improved by simply resolving the inconsistency between IAS 27 and SIC-13 for transactions where a parent contributes interests in a subsidiary to a JCE (or to an associate) and this contribution results in a loss of control in the subsidiary for the parent; and

(b) the IASB could do such a narrow and well-defined amendment in its annual improvements project.

Staff recommendation

38. Given that the guidance in paragraph 34 of IAS 27 reflects the Board's more recent thinking than is the guidance in SIC-13, we believe that the approach outlined in paragraph 34 of IAS 27 (ie full recognition of gains and losses) should take precedence when a subsidiary is contributed to a JCE and this contribution results in a loss of control in the subsidiary.

39. Considering the limited scope of the annual improvements project, any proposed amendment addressed through annual improvements should be narrow in scope and well-defined. We think that the most significant concern relates to the contribution of interests in a subsidiary to a joint arrangement or associate. We therefore think that an annual improvement should be limited to these circumstances. An interest in a subsidiary in this context would be every interest in an entity that is controlled by the parent, no matter whether subsidiary is a business (as defined in IFRS 3 *Business Combinations*) or a single-asset entity. If the parent contributes this interest to a JCE together with other assets, eg licences or items of property, plant and equipment (PPE), the full gain or loss should only be recognised for the interest in the subsidiary. The partial recognition approach set out in SIC-13 should remain applicable to all the other assets contributed to a JCE.

40. Considering, however, the prevalence of this issue in practice and the significant impact that it has upon the financial statements, such a limited amendment from the annual improvements project will not negate the need for the broader issue to be considered as part of the Board's future agenda.

41. In February 2011 the Board tentatively decided that the forthcoming IFRS 11 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures* (as revised in 2011) will become effective 1 January 2013. We also note that any annual improvement would not become effective earlier than 1 January 2013 based on the normal timeline. Consequently, we propose to amend the forthcoming IAS 28 *Investments in Associates and Joint Ventures* (as revised in 2011) instead of current IAS 31/SIC-13.

42. If the Committee agrees with our recommendations, we would present a draft amendment for the annual improvements project at a future meeting after the forthcoming IFRSs have been issued.

Annual improvements criteria assessment

43. We have assessed the proposed amendment against the enhanced annual improvements criteria, which is reproduced in full below. In planning whether an issue should be addressed by amending IFRSs within the annual improvements project, the IASB assesses the issue against the following criteria. All the criteria (a)-(d) must be met to qualify for inclusion in annual improvements:

New annual improvements criteria	Staff assessment of the proposed amendment
(a) The proposed amendment has one or both of the following characteristics: (i) clarifying—the proposed amendment would improve IFRSs by: • clarifying unclear wording in existing IFRSs, or • providing guidance where an absence of guidance is causing concern. A clarifying amendment maintains consistency with the existing principles within the applicable IFRSs. It does not propose a new principle, or a change to an existing principle. (ii) correcting—the proposed amendment would improve IFRSs by: • resolving a conflict between existing requirements of IFRSs and providing a straightforward rationale for which existing requirement should be applied, or • addressing an oversight or relatively minor unintended consequence of the existing requirements of IFRSs. A correcting amendment does not propose a new principle or a change to an existing	(a) The proposed amendment resolves an inconsistency between existing requirements of IFRSs when a subsidiary is contributed to a JCE and this contribution results in a loss of control in the subsidiary. By giving precedence to the full gain or loss recognition approach outlined in IAS 27 the proposed amendment provides a straightforward rationale for which of the existing requirements should be applied.

principle, but may create an exception from an existing principle.	
(b) The proposed amendment is well-defined and sufficiently narrow in scope such that the consequences of the proposed change have been considered.	(b) We believe that the proposed amendment is well-defined and sufficiently narrow in scope such that the consequences of the proposed change have been considered—it ensures consistent accounting when interests in subsidiaries are contributed to a JCE.
(c) It is probable that the IASB will reach conclusion on the issue on a timely basis. Inability to reach conclusion on a timely basis may indicate that the cause of the issue is more fundamental than can be resolved within annual improvements.	(c) We think the IASB will reach a conclusion on this issue on a timely basis, if it limits the amendment to simply resolving the inconsistency between IAS 27 and IAS 31/SIC-13 for the contribution of interests in subsidiaries to a JCE that result in a loss of control.
(d) If the proposed amendment would amend IFRSs that are the subject of a current or planned IASB project, there must be a need to make the amendment sooner than the project would.	(d) In its December 2009 meeting the Board tentatively decided not to resolve the inconsistency within the joint ventures project, but instead to deal with it separately. This decision has not been changed by the Board since then.

44. Following the analysis in the table above, in our opinion, the proposed amendment satisfies the annual improvements criteria.

Questions for the Committee
(a) Does the Committee agree with the staff's analysis in paragraphs 35-37? (b) Does the Committee agree that resolving the inconsistency between IAS 27 and IAS 31/SIC-13 would improve consistent application and financial reporting? (c) Does the Committee agree with our recommendation that the approach outlined in paragraph 34 of IAS 27 should take precedence when a subsidiary is contributed to a JCE and this contribution results in a loss of control in the subsidiary? (d) Does the Committee agree that the proposed amendment should be limited to the contribution of the interest in the subsidiary itself? The approach set out in SIC-13 would remain applicable for all other assets contributed to the JCE. (e) Does the Committee agree with our proposal that the Committee recommend that the Board addresses this issue through the annual improvements process?

(f) If the Committee agrees with our proposal that the Committee recommend that the Board addresses this issue through the annual improvements process, does the Committee agree that the forthcoming IAS 28 *Investments in Associates and Joint Ventures* (as revised in 2011) and not current IAS 31/SIC-13 should be amended?

(g) Does the Committee want to ask the Board to add the broader issue to its post-2011 agenda?

Appendix A—Interpretations Committee potential agenda item request: Contributions to a jointly controlled entity or associate

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.

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 remeasurement 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 B—Interpretations Committee potential agenda item request: Contributions to a jointly controlled entity or associate

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.

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 C—Interpretations Committee potential agenda item request: The formation of a joint venture by contractual arrangement, where an existing subsidiary becomes a Jointly Controlled Entity through a sale of shares by the parent (or dilution), does IAS 27 or SIC-13 take precedence

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.

The formation of a joint venture by contractual arrangement, where an existing subsidiary becomes a Jointly Controlled Entity through a sale of shares by the parent (or dilution), does IAS 27 or SIC-13 take precedence

[The submitter] requests the IFRS Interpretations Committee to address the issue regarding the interaction between IAS 27 *Consolidated and Separate Financial Statements,* SIC-13 *Jointly Controlled Entities – Non-Monetary Contributions by Vendors,* and IAS 31 *Interests in Joint Ventures* where an interest in a subsidiary is replaced by an interest in a jointly controlled entity (JCE). We have seen that this item is on the Outstanding issues list for the agenda for the March 2011 meeting under reference IAS 27-12 “Interests in Joint Ventures: Contributions to a jointly controlled entity or associate” based on two submissions received. We believe that this topic is particularly relevant for the oil and gas industry and we wished to express our view on the topic.

Issue:

In the oil and gas industry, forming partnerships or joint ventures is a common industry practice. In order to reduce an upstream company’s exploration and development risk exposure, one or several partners are often brought together to share the total risk and reward under a joint control arrangement. When this occurs, the original owner may retain an interest well over 50% in the arrangement. A joint venture is formed by a contractual arrangement between the parties involved, often in a joint operating or similar shareholder agreement. The legal form of such jointly controlled arrangements may vary. A subsidiary can be turned into a jointly controlled entity (“JCE”) in many different ways. The joint ownership may be established for example (i) by the sale of part of the shares in the subsidiary to a joint venture partner, or (ii) by the dilution of ownership in the subsidiary through the issuance of shares by the subsidiary to a joint

venture partner, or (iii) by selling or contributing the shares in the subsidiary to a jointly controlled entity, or (iv) by selling or contributing the business of the subsidiary to a jointly controlled entity. In all cases the substance is the same, only the form differs.

The requirements of IAS 27 and IAS 31 and SIC-13 for gain recognition are, in our opinion, currently inconsistent. The inconsistency relates to the accounting for gains and losses resulting from contributions of non-monetary assets to joint arrangements. IAS 27 addresses the accounting for a loss of control of a subsidiary, while SIC-13 addresses non-monetary contributions, which are transfers of assets to a jointly controlled entity (JCE) in exchange for an equity interest in the JCE.

Depending on whether one looks at the substance or the form of the transaction, the transaction could receive a different accounting treatment. By looking at the form, the sale of the shares of a subsidiary to form a JCE under IAS 27 would result in 100% gain recognition and the establishment of a new cost base for the retained interest (which may exceed a 50% interest). However, applying the accounting of SIC-13 by analogy to the same transaction, there would be partial gain recognition and the retained interest would remain at its carrying value prior to the transaction.

The issue is whether a subsidiary that becomes a joint venture by other than a contribution should be accounted for differently than one formed with a contribution.

It is our understanding that there are three alternative interpretations for the appropriate accounting treatment. There are to 1) follow the guidance of IAS 27 with full gain recognition; 2) by analogy, follow the guidance of IAS 31 and SIC-13 with partial recognition; or 3) either view is acceptable and, therefore, it is policy choice by each company.

Interpretation 1:

IAS 27 (R) is applicable for accounting periods beginning on or after 1 July 2009. In accordance with paragraph 34 of IAS 27, the contribution of non-monetary assets housed in a subsidiary would result in the contributing party:

(a) Derecognising the assets (including any goodwill) and liabilities of the subsidiary at their carrying amounts at the date when control is lost;

(b) Derecognising the carrying amount of any non-controlling interests in the former subsidiary at the date when control is lost (including any components of other comprehensive income attributable to them);

(c) Recognising:

- *(i) The fair value of the consideration received, if any, from the transaction, event or circumstances that resulted in the loss of control; and*
- *(ii) If the transaction that resulted in the loss of control involves a distribution of shares of the subsidiary to owners in their capacity as owners; that distribution;*

(d) Recognises any investment retained in the former subsidiary at its fair value at the date when control is lost […].

In Basis for Conclusion paragraph 55 of IAS 27 it is stated that

> *Any investment the parent has in the former subsidiary after control is lost should be measured at fair value at the date control is lost and […] any resulting gain or loss should be recognised in profit or loss. […] Measuring the investment at fair value reflects the Board's view that the loss of control of a subsidiary is a significant economic event. The parent-subsidiary relationship ceases to exist and an investor-investee relationship begins that differs significantly from the former parent-subsidiary relationship. Therefore, the new investor-investee relationship is recognised and measured initially at the date when control is lost.*

Accordingly IAS 27 specifies that when control is lost, any retained interest should be re-measured to its fair value with any resulting gain or loss recognized in profit and loss. As such, under IAS 27, when a business is contributed to joint venture in exchange for a jointly controlled interest, a gain or loss is recognized on the portion retained in addition to the gain or loss on the portion no longer owned.

Interpretation 2:

Accounting for transactions between a venturer and a joint venture is at present set out in IAS 31 and SIC-13. IAS 31.48 provides that:

> *48. When a venturer contributes or sells assets to a joint venture, recognition of any portion of a gain or loss from the transaction shall reflect the substance of the transaction …*

SIC-13 specifically addresses non-monetary contributions to a jointly controlled entity (JCE) in exchange for an equity interest in the JCE that is accounted for using either the equity method or proportionate consolidation. In addition, it addresses situations when a venturer receives monetary or non-monetary assets, in addition to receiving an equity interest in that JCE. In paragraph 5 and 6 of the Consensus to the Interpretation states that:

(e) In applying IAS 31.48 to non-monetary contributions to a JCE in exchange for an equity interest in the JCE, a venturer shall recognise in profit or loss for the period the portion of a gain or loss attributable to the equity interests of the other venturers …

(f) If, in addition to receiving an equity interest in the JCE, a venturer receives monetary or non-monetary assets, an appropriate portion of gain or loss on the transaction shall be recognised by the venturer in profit or loss.

In other words SIC-13 (and IAS 31) require that gains and losses resulting from transactions between a reporting entity and its JCE to be recognized only to the extent of the interests of the other equity holders.

Further, SIC-13 paragraph 2 acknowledges that contributions to a JCE can take many forms as follows:

2. *Contributions to a JCE are transfers of assets by venturers in exchange for an equity interest in the JCE. Such contributions may take various forms. Contributions may be made simultaneously by the venturers either upon establishing the JCE or subsequently. The consideration received by the venturer(s) in exchange for assets contributed to the JCE may also include cash or other consideration that does not depend on future cash flows of the JCE ('additional consideration').*

Interpretation 3:

Given the known inconsistency by the Board neither of the interpretations takes precedence, and therefore, either interpretation is acceptable. Accordingly, it is a policy decision of the company.

Accounting policy and our view:

By virtue of entering the Joint Venture Agreements, the substance of the transaction is the establishment of a joint venture. We believe whether the establishment is accomplished by the sale of shares in a subsidiary to a new venturer and entering into a joint control agreement; or through the contribution of assets or shares to a newly formed jointly controlled entity, the substance is the same and, accordingly, the accounting should reflect this.

Our conclusion is that since there is currently an inconsistency between IAS 27 and SIC-13, a preparer has an accounting policy choice but the accounting treatment selected should faithfully reflect the underlying substance of the transaction and be consistently applied.

We believe when a parent contributes a subsidiary to a JCE by the sale of shares to another venture, this is analogous to paragraph 6 of SIC-13 in that the parent receives monetary assets (or additional consideration as discussed in paragraph 2 of SIC-13) in addition to maintaining an equity interest in the JCE. Thus, we believe the substance is the same when a JCE is formed by way of a parent selling shares, through dilution by the subsidiary issuing new shares for cash contributions or when the venturers sell non-monetary assets to or make non-monetary contributions into a JCE. Therefore, we believe that the analogy to the guidance of SIC-13 also applies when a subsidiary becomes a jointly controlled entity other than by a contribution.

Since, in our view, the substance of the transaction is the formation of a joint venture we believe that the accounting treatment that would best reflect the economics and the

substance should by analogy follow SIC-13. This would result in the partial gain recognition related to the percentage of the underlying assets sold to the new venturer and the use of carryover basis in our remaining interest in the joint venture. In our industry, it is possible to maintain over 50% interest in the underlying assets in a corporate entity which will be governed as a JCE while transferring less than 50% of the risks and rewards to the new venturer. In such situations, full gain recognition seems particularly inconsistent with the substance of the transaction to form a joint venture.

We believe that applying IAS 27 literally to these facts might encourage preparers to structure the legal form of a transaction solely for the purpose of achieving a desired accounting result which would not appear to have been the intention of the standard setter. The choice of legal structure should not give rise to a different accounting treatment when the substance of forming a joint venture is identical. For example, by selling 10% of the shares in a subsidiary when forming a JCE, a gain corresponding to a 100% sale would be recognized. However, by selling 100% of the shares of a subsidiary owning a 10% share of an underlying operation (and remaining a 100% subsidiary owning a 90% share of the same operation) when the venturers simultaneously form a JCE, would result in only a 10% gain being recognized.

Having carefully considered the alternative methods of accounting for the transaction described above, we believe accounting for the sales transaction when forming a JCE by analogy to the approach in SIC-13 provides the most understandable, relevant and faithful representation of the substance of the transaction.

<u>Reasons for the IFRIC to raise the issue</u>

- **Is the issue widespread and practical?**

In the oil and gas industry, forming partnerships or joint ventures are particularly common. One way of doing this is for the oil company to contribute a subsidiary to a jointly controlled entity (JCE) either by the sale of shares or through dilution by the subsidiary issuing new shares for cash contributions. We believe that this is particularly important for this industry.

- **Does the issue involve significantly divergent interpretations (either emerging or already existing in practice)?**

The inconsistency has been and is debated by the users and in the accounting profession and has been raised in an IASB Staff Paper, *Transactions between a party and a joint arrangement: inconsistency between IAS 27 and SIC-13,* in December 2009. Even so the Board tentatively decided not to resolve the inconsistency.

- **Would financial reporting be improved through elimination of the diversity?**

The reason for the problem in practice is that deliberate choice of legal corporate structure will give rise to different accounting treatment even when the substance is identical. In the oil and gas industry, it would not be uncommon for the original owner to retain well over 50% interest in establishing a JCE. As we illustrated above, this opens for full recognition when a subsidiary becomes a JCE with the transfer of a very limited interest and allows for structuring a transaction to achieve a desired results. This seems inconsistent with the objectives of IFRS.

- **Is the issue sufficiently narrow in scope to be capable of interpretation 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 apply the interpretation process?**

We believe interpretative guidance on which of the existing literature that takes precedence is within the confines of IFRSs and the Framework.

- **If the issues relates to a current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project?**

It is our understanding the resolution of this inconsistency is not currently scheduled on the Boards agenda.