STAFF PAPER

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September IASB Meeting

Project	**IAS 27 *Consolidated and Separate Financial Statements*** **IAS 28 *Investments in Associates and Joint Ventures***
Paper topic	Accounting for the sale or contribution of assets between an investor and its associate or joint venture

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Introduction

1. The Interpretations Committee received a request to clarify whether a business meets the definition of a 'non-monetary asset'. The question was asked within the context of identifying whether the requirements of SIC-13 *Jointly Controlled Entities—Non-Monetary Contributions by Venturers* and IAS 28 I*nvestments in Associates and Joint Ventures* (revised in 2011) apply where a business is contributed to:

   (a) a jointly controlled entity (JCE) as defined in IAS 31 *Interests in Joint Ventures*; or to:

   (b) a joint venture (JV) as defined in IFRS 11 *Joint Arrangements*; or to:

   (c) an associate

   in exchange for an equity interest in that JCE/JV or associate.

2. At the January 2012 Interpretations Committee meeting, the Committee noted that this matter is related to the issues arising from the acknowledged inconsistency between the requirements in IAS 27 *Consolidated and Separate Financial Statements* (revised in 2008) and SIC-13, in dealing with the loss of control of a subsidiary that is contributed to a JCE/JV or an associate. SIC-13 restricts gains and losses arising from contributions of non-monetary assets to a JCE to the

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extent of the interest attributable to the other equity holders in the JCE. IAS 27 (2008) requires full profit or loss recognition on the loss of control of the subsidiary.

3. This inconsistency between IAS 27 (2008) and SIC-13 will remain when IFRS 10 *Consolidated Financial Statements* replaces IAS 27 (2008), at which time SIC-13 will be withdrawn. In fact, the requirements in IFRS 10 on the accounting for the loss of control of a subsidiary are similar to the requirements in IAS 27 (2008), and the requirements in SIC-13 are incorporated in IAS 28 (2011).

4. At the May 2012 IASB meeting, the IASB discussed three alternatives that would address the inconsistency that had been noted:

   (a) Alternative 1: account for all contributions in accordance with the rationale developed in IAS 27 (2008) (ie full gain recognition);

   (b) Alternative 2: account for all contributions of businesses (whether housed in a subsidiary or not) in accordance with the rationale developed in IAS 27 (2008) (ie full gain recognition) and account for all other contributions in accordance with the rationale developed in SIC-13 (ie partial gain recognition); and

   (c) Alternative 3: account for all contributions to a JCE/JV or associate in accordance with the rationale developed in SIC-13 (ie partial gain recognition).

5. A majority of IASB members considered that Alternative 1 is the most robust alternative from a conceptual point of view, but acknowledged that it requires addressing multiple cross-cutting issues. Some IASB members were concerned that the Committee would not be able to address those cross-cutting issues on a timely basis. As a result, the IASB expressed support for Alternative 2. One IASB member suggested that the Committee should also consider Alternative 3 when it decides which alternative to follow.

6. At the July 2012 Committee meeting, the Committee decided to propose some amendments to IAS 28 (2011) and IFRS 10 in accordance with Alternative 2. The Committee also decided that the proposed amendments should affect the sale or contribution of all types of assets between an investor and its associate or joint venture.

Structure of the paper

7. This agenda paper includes the following sections:

   (a) The Committee's discussions at the January, March and July 2012 meetings (see introduction above);

   (b) The IASB's discussions at the May 2012 meeting (see introduction above);

   (c) The Committee's and staff's recommendations to address the inconsistency between SIC-13 and IAS 27 (2008);

   (d) Transition requirements;

   (e) Post-implementation review of IFRS 3/IAS 27;

   (f) Next steps; and

   (g) Appendix A: Proposed amendments to IFRS 10 and IAS 28 (2011).

Committee's and Staff's recommendation: apply Alternative 2

Standards affected by the proposed amendments

8. The Committee decided to propose some amendments to IAS 28 (2011) and IFRS 10. The Committee noted that IAS 27 (2008) and SIC-13 do not need to be amended, because IAS 27 (2008) and SIC-13 will be superseded before any amendments could become effective.

Proposed amendments to IAS 28 (2011) and IFRS 10

9. This section summarises past discussions and decisions of the IASB and the Interpretations Committee. In dealing with the conflict between the requirements in IFRS 10 and IAS 28 (2011), the IASB and the Interpretations Committee were concerned that the existing requirements could result in the accounting for a transaction being driven by its form rather than by its substance. For example, different accounting might be applied to a transaction involving the same underlying assets depending on whether those assets were transferred in asset or

entity form, or on whether those assets were sold in exchange for cash or contributed in exchange for an equity interest.

10. The IASB and the Interpretations Committee concluded that:

    (a) the accounting for the loss of control of a business as defined in IFRS 3 *Business Combinations* should be consistent with the latest thinking developed in the Business combinations project; and

    (b) a full gain or loss should therefore be recognised on the loss of control of a business, whether the business is housed in a subsidiary or not.

11. Because groups of assets that do not constitute a business were not part of the Business combinations project, the IASB and the Interpretations Committee concluded that:

    (a) the current requirements in IAS 28 (2011) regarding the partial gain or loss recognition for transactions between an investor and its associate or joint venture should only apply to the gain or loss resulting from the sale or contribution of assets that do not constitute a business; and

    (b) a partial gain or loss should also be recognised in accounting for the sale or contribution to an associate or joint venture of a subsidiary that does not constitute a business.

12. In order to give effect to the decisions described above, we recommend amending IAS 28 (2011) so that:

    (a) the current requirements regarding the partial gain or loss recognition for transactions between an investor and its associate or joint venture only apply to the gain or loss resulting from the sale or contribution of assets that do not constitute a business as defined in IFRS 3; and

    (b) the gain or loss resulting from the sale or contribution to an associate or a joint venture of assets that constitute a business as defined in IFRS 3 is recognised in full.

13. We also recommend amending IFRS 10 so that the gain or loss resulting from the sale or contribution of a subsidiary that does not constitute a business as defined in IFRS 3 to an associate or a joint venture is recognised only to the extent of unrelated investors' interests in the associate or joint venture.

14. The consequence of these proposed amendments is that a full gain or loss would be recognised on the loss of control of a subsidiary that constitutes a business as defined in IFRS 3, including cases in which the investor retains joint control of, or significant influence over, the investee. The proposed amendments are shown in Appendix A.

15. We also propose to add a reminder that when determining whether a group of assets or a subsidiary that is sold or contributed constitutes a business as defined in IFRS 3, an entity should consider whether that sale or contribution is part of multiple arrangements that should be accounted for as a single transaction in accordance with the current requirements in paragraph B97 of IFRS 10 *Consolidated Financial Statements*.

Considerations regarding 'upstream' transactions

16. It should be noted that both 'upstream' and 'downstream' transactions would be affected by the proposed amendments in Appendix A. As a result, the current requirements in IAS 28 (2011) regarding the partial gain or loss recognition would apply to 'upstream' transactions involving assets that do not constitute a business (such as the sale of assets that do not constitute a business from an associate or a joint venture to the investor), but would not apply to 'upstream' transactions involving assets that constitute a business.

17. The Committee acknowledged that the issue raised initially only dealt with 'downstream' transactions (such as the sale or contribution of assets from the investor to its associate or its joint venture). However, the Committee noted that if assets that constitute a business were to be sold by an associate or a joint venture to the investor with the result that the investor takes control of that business, the investor would account for this transaction as a business combination in accordance with IFRS 3. In that case, the Committee think that the investor should:

    (a) recognise the assets and liabilities acquired at their fair values; and

    (b) recognise its share in the associate's or joint venture's gains or losses resulting from the disposal of the business.

We note that this accounting treatment is consistent with the requirements in IFRS 3 regarding a business combination achieved in stages.

Considerations regarding the sale or contribution of monetary assets

18. The Committee discussed whether the proposed amendments should only affect the sale or contribution of non-monetary assets or should also affect the contribution of monetary assets (such as receivables). The Committee noted that paragraph 28 of IAS 28 (2011) refers to sales or contributions of assets from the investor to its associate or its joint venture. Consequently, the current requirements in IAS 28 (2011) regarding the partial gain or loss recognition apply to all types of assets (ie to both monetary and non-monetary assets). The Committee also noted that the distinction between monetary asset versus non-monetary asset is only relevant in paragraph 30 of IAS 28 (2011) when assessing whether the contribution of a non-monetary asset lacks commercial substance (as that term is described in IAS 16 *Property, Plant and Equipment)*. Consequently, paragraph 30 should only deal with the contribution of a non-monetary asset. As a result, the proposed amendments in paragraph 28 of IAS 28 (2011) would affect the sale or contribution of all types of assets (ie to both monetary and non-monetary assets). In particular, the gain or loss resulting from the sale or contribution of a portfolio of receivables (determined in accordance with the derecognition requirements in IAS 39) to an associate or joint venture would be recognised only to the extent of the unrelated investors' interests in the associate or joint venture.

Disclosures

19. We do not think that additional disclosures are required. The proposed amendments do not introduce any new requirements, but clarify in which situations the requirements in IAS 27/ IFRS 10 should be applied (and in which situations the requirements in SIC-13/IAS 28 (2011) should be applied).

Transition requirements

20. We note that the inconsistency between IAS 27 and SIC-13 arose when IAS 27 (2008) became effective. It should be noted that the requirements in IAS 27 (2008) regarding the loss of control of a subsidiary (paragraphs 34-37) were applied prospectively for annual periods beginning on or after 1 July 2009. According to the transition requirements of IAS 27 revised in 2008 (paragraph 45 (c)), entities did not have:

    (a) to restate the carrying amount of an investment in a former subsidiary if control was lost before the new requirements were applied; or

    (b) to recalculate the gain or loss on the loss of control of a subsidiary that occurred before the new requirements were applied.

21. The requirements regarding the loss of control of a subsidiary (including the transition requirements) were carried forward in IFRS 10 (paragraphs B97-B99 and C6 of IFRS 10). We think that the proposed amendments to IFRS 10 and IAS 28 (2011) should not be applied before the amendments regarding the loss of control of a subsidiary in IAS 27 (2008) became effective (ie before 2010 for a calendar year-end entity). As a result, the following transition requirements could be proposed:

    (a) Alternative 1: apply the proposed amendments prospectively to contributions or sales occurring in annual periods beginning on or after the date that the proposed amendments would become effective.

    (b) Alternative 2: apply the proposed amendments prospectively to contributions or sales occurring after the beginning of the earliest comparative period of the financial statements in which the proposed amendments would be applied for the first time.

    (c) Alternative 3: Apply the proposed amendments prospectively to contributions or sales occurring in annual periods beginning on or after 1 July 2009 (ie from the date that the requirements in IAS 27 (2008) regarding the loss of control of a subsidiary were applied).

22. We do not think that an entity would have to restate a lot of transactions if it were required to apply the proposed amendments prospectively to contributions or sales

occurring in annual periods beginning on or after 1 July 2009 (ie Alternative 3). Indeed, transactions that might be restated only deal with the loss of control of a subsidiary or a business between an investor and its associate or joint venture. The proposed amendments do not affect the requirements in IAS 28 (2011) on the accounting for the gain or loss resulting from the sale or contribution between an investor and its associate or joint venture of assets that do not constitute a business.

23. Furthermore, we do not think that restating those transactions would be impracticable. The entity would not need to recalculate the gain resulting from the loss of control of the subsidiary or the business. It would only need to determine whether a full gain or a partial gain should be recognised. As a result, we recommend following Alternative 3 (see the proposed transition requirements in Appendix A).

24. We do not think that there should be any consequential amendments to IFRS 1 *First-time Adoption of International Reporting Standards*. We note that first-time adopters apply specific transition requirements. In particular, a first-time adopter shall apply prospectively the requirements in paragraphs B97-B99 of IFRS 10 regarding the loss of control of a subsidiary from the date of transition to IFRSs (see paragraph B7 (c) of IFRS 1).

Post-implementation review of IFRS 3/IAS 27

25. The IASB carries out a post-implementation review of each new IFRS or major amendment. This is normally carried out two years after the new requirements have become mandatory and been implemented. A review will be performed on IFRS 3/IAS 27 in 2013. The review may lead to items being added to the IASB's agenda.

26. Although this review will begin in 2013, we think that the IASB should propose the amendments to IFRS 10 and IAS 28 (2011) immediately without waiting for the review to deal with the current diversity in practice.

Next steps

27. We think that the proposed amendments to IFRS 10 and IAS 28 (2011) should be part of a narrow-scope IASB project. If the IASB agrees with the proposals in this paper, a ballot draft will be prepared for IASB members to approve. We intend to publish an Exposure Draft in December 2012 with a 120-day comment period.

28. A draft of the proposed amendments is shown in Appendix A. We think that this draft will help the IASB members to form an idea of what the proposed amendments would look like. We are not asking the IASB members to comment during the September IASB meeting on the wording of the proposed amendments. Any comments on the wording should be sent directly to the staff.

Questions for the IASB
1. Does the IASB agree with the proposed amendments to IFRS 10 and IAS 28 (2011) presented in this paper? 2. Does the IASB agree with the proposed transition requirements in this paper? 3. Does the IASB agree to publish an Exposure Draft with a 120-day comment period based on the proposed amendments presented in Appendix A of this paper?

Appendix A: [Draft] Amendments to IFRS 10 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*—Accounting for the sale or contribution of assets between an investor and its associate or joint venture

In IAS 28 (2011), paragraphs 28, 30 and 31 are amended and paragraphs 31A,31B and 45A are added. New text is underlined and deleted text is struck through. Paragraph 29 is reproduced for ease of reference, but is not proposed for amendment.

28 Gains and losses resulting from 'upstream' and 'downstream' transactions involving assets that do not constitute a business as defined in IFRS 3 *Business Combinations* between an entity (including its consolidated subsidiaries) and its associate or joint venture are recognised in the entity's financial statements only to the extent of unrelated investors' interests in the associate or joint venture. 'Upstream' transactions are, for example, sales of assets that do not constitute a business as defined in IFRS 3 from an associate or a joint venture to the investor. 'Downstream' transactions are, for example, sales or contributions of assets that do not constitute a business as defined in IFRS 3 from the investor to its associate or its joint venture. The investor's share in the associate's or joint venture's gains or losses resulting from these transactions is eliminated.

29 When downstream transactions provide evidence of a reduction in the net realisable value of the assets to be sold or contributed, or of an impairment loss of those assets, those losses shall be recognised in full by the investor. When upstream transactions provide evidence of a reduction in the net realisable value of the assets to be purchased or of an impairment loss of those assets, the investor shall recognise its share in those losses.

30 The gain or loss resulting from the ~~The~~ contribution of ~~a~~ non-monetary assets that do not constitute a business as defined in IFRS 3 to an associate or a joint venture in exchange for an equity interest in the associate or joint venture shall be accounted for in accordance with paragraph 28, except when the contribution lacks commercial substance, as that term is described in IAS 16 *Property, Plant and Equipment*. If such a contribution lacks commercial substance, the gain or loss is regarded as unrealised and is not recognised unless paragraph 31 also applies. Such unrealised gains and losses shall be eliminated against the investment accounted for using the equity method and shall not be presented as deferred gains or losses in the entity's consolidated statement of financial position or in the entity's statement of financial position in which investments are accounted for using the equity method.

31 If, in addition to receiving an equity interest in an associate or a joint venture, an entity receives monetary or non-monetary assets, the entity recognises in full in profit the portion of the gain or loss on the ~~non-monetary~~ contribution relating to the monetary or non-monetary assets received.

31A The gain or loss resulting from the sale or contribution of assets that constitute a business as defined in IFRS 3 between an investor (including its consolidated subsidiaries) and its associate or joint venture is recognised in full in the investor's financial statements (ie the investor's interest in the gains or losses resulting from these transactions is not eliminated).

31B When determining whether assets that are sold or contributed constitute a business as defined in IFRS 3, an entity shall consider whether the sale or contribution of those assets

is part of multiple arrangements that should be accounted for as a single transaction in accordance with the requirements in paragraph B97 of IFRS 10.

45A *[Draft] Amendments to IFRS 10 and IAS 28—Accounting for the sale or contribution of assets between an investor and its associate or joint venture*, issued in [date], amended paragraphs 28, 30 and 31 and added paragraphs 31A and 31B. An entity shall apply those amendments for annual periods beginning on or after [1 January 2014] prospectively to the sale or contribution of assets occurring in annual periods beginning on or after [1 July 2009].

In IFRS 10, paragraph 26 is amended and paragraphs B99A, B99B and C1B are added. New text is underlined and deleted text is struck through. Paragraphs 25 and B97-B99 are reproduced for ease of reference, but are not proposed for amendment.

Loss of control

25 If a parent loses control of a subsidiary, the parent:

(a) derecognises the assets and liabilities of the former subsidiary from the consolidated statement of financial position.

(b) recognises any investment retained in the former subsidiary at its fair value when control is lost and subsequently accounts for it and for any amounts owed by or to the former subsidiary in accordance with relevant IFRSs. That fair value shall be regarded as the fair value on initial recognition of a financial asset in accordance with IFRS 9 or, when appropriate, the cost on initial recognition of an investment in an associate or joint venture.

(c) recognises the gain or loss associated with the loss of control attributable to the former controlling interest.

26 Paragraphs B97–B99B set out guidance for the accounting for the loss of control of a subsidiary.

Loss of control

B97 A parent might lose control of a subsidiary in two or more arrangements (transactions). However, sometimes circumstances indicate that the multiple arrangements should be accounted for as a single transaction. In determining whether to account for the arrangements as a single transaction, a parent shall consider all the terms and conditions of the arrangements and their economic effects. One or more of the following indicate that the parent should account for the multiple arrangements as a single transaction:

(a) They are entered into at the same time or in contemplation of each other.

(b) They form a single transaction designed to achieve an overall commercial effect.

(c) The occurrence of one arrangement is dependent on the occurrence of at least one other arrangement.

(d) One arrangement considered on its own is not economically justified, but it is economically justified when considered together with other arrangements. An example is when a disposal of shares is priced below market and is compensated for by a subsequent disposal priced above market.

B98 If a parent loses control of a subsidiary, it shall:

(a) derecognise:

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

(ii) 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).

(b) recognise:

(i) the fair value of the consideration received, if any, from the transaction, event or circumstances that resulted in the loss of control;

(ii) if the transaction, event or circumstances that resulted in the loss of control involves a distribution of shares of the subsidiary to owners in their capacity as owners, that distribution; and

(iii) any investment retained in the former subsidiary at its fair value at the date when control is lost.

(c) reclassify to profit or loss, or transfer directly to retained earnings if required by other IFRSs, the amounts recognised in other comprehensive income in relation to the subsidiary on the basis described in paragraph B99.

(d) recognise any resulting difference as a gain or loss in profit or loss attributable to the parent.

B99 If a parent loses control of a subsidiary, the parent shall account for all amounts previously recognised in other comprehensive income in relation to that subsidiary on the same basis as would be required if the parent had directly disposed of the related assets or liabilities. Therefore, if a gain or loss previously recognised in other comprehensive income would be reclassified to profit or loss on the disposal of the related assets or liabilities, the parent shall reclassify the gain or loss from equity to profit or loss (as a reclassification adjustment) when it loses control of the subsidiary. If a revaluation surplus previously recognised in other comprehensive income would be transferred directly to retained earnings on the disposal of the asset, the parent shall transfer the revaluation surplus directly to retained earnings when it loses control of the subsidiary.

B99A The gain or loss resulting from the sale or contribution of a subsidiary that does not constitute a business as defined in IFRS 3 between an investor (including its consolidated subsidiaries) and its associate or joint venture is recognised in the investor's financial statements only to the extent of the unrelated investors' interests in the associate or joint venture (ie the investor's interest in the gains or losses resulting from these transactions is eliminated).

B99B When determining whether a subsidiary, over which control is lost, is a business as defined in IFRS 3, an entity shall consider whether the loss of control of that subsidiary is part of multiple arrangements that should be accounted for as a single transaction in accordance with the requirements in paragraph B97.

C1B *[Draft] Amendments to IFRS 10 and IAS 28—Accounting for the sale or contribution of assets between an investor and its associate or joint venture*, issued in [date], added paragraphs B99A and B99B. An entity shall apply those amendments for annual periods beginning on or after [1 January 2014] prospectively to the sale or contribution of a subsidiary occurring in annual periods beginning on or after [1 July 2009].