STAFF PAPER

IFRS Interpretations Committee Meeting

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Project	**IAS 27 *Consolidated and Separate Financial Statements*— Non-cash acquisition of non-controlling interest**		
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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. 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*. The approval of a final Interpretation by the Board is reported in IASB *Update*.

Introduction

1. In June 2012, the IFRS Interpretations Committee (the Committee) received a request for guidance on the accounting for the purchase of non-controlling interest (NCI) when the consideration includes non-cash items. The submitter asked the Committee to clarify whether the difference between the fair value of the consideration given and the carrying amount of the assets transferred should be recognised in equity or in profit or loss.

2. We performed outreach with national standard-setters and regulators on this topic in order to find out whether the issue raised by the submitter is widespread and whether significant diversity in practice exists. The results of this outreach are included as part of the staff's analysis of this issue.

3. The submission is reproduced in full in Appendix B to this paper.

Objective

4. The objective of this paper is to:

   (a) provide background information on the issue raised in the submission;

(b) provide an analysis of the issue, including a summary of the outreach responses received from national standard-setters and regulators;

(c) present an assessment of the issue against the Committee's agenda criteria and the annual improvements criteria;

(d) make a recommendation that the Committee should not take this issue onto its agenda; and

(e) ask the Committee whether they agree with the staff recommendation.

Background information

5. According to the submission there is an apparent conflict between IAS 27 *Consolidated and Separate Financial Statements* and IFRIC 17 *Distribution of Non-cash Assets to Owners.*

6. Paragraphs 30 and 31 of IAS 27[1] require that after control of an entity is obtained, changes in a parent's ownership interest that do not result in a loss of control are accounted for as an equity transaction. These paragraphs state that:

> **30 Changes in a parent's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions (ie transactions with owners in their capacity as owners).**
>
> 31 In such circumstances the carrying amounts of the controlling and non-controlling interests shall be adjusted to reflect the changes in their relative interests in the subsidiary. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received shall be recognised directly in equity and attributed to the owners of the parent.

[1] The requirements of IFRS 10 *Consolidated Financial Statements* are practically the same. Paragraph 23 and B96 of IFRS 10 state that:

23 Changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (ie transactions with owners in their capacity as owners).

B96 When the proportion of the equity held by non-controlling interests changes, an entity shall adjust the carrying amounts of the controlling and non-controlling interests to reflect the changes in their relative interests in the subsidiary. The entity shall recognise directly in equity any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received, and attribute it to the owners of the parent.

7. However, according to IFRIC 17 the difference between the carrying amount of the non-cash assets distributed to owners and the fair value of those assets is recognised in profit or loss. IFRIC 17 requires that:

   (a) an entity shall measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed (IFRIC 17.11); and

   (b) when the entity settles the dividend payable, it shall recognise the difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable in profit or loss (IFRIC 17.14).

Staff analysis

Description of the issue

8. The submission describes a fact pattern in which a controlling shareholder purchases an NCI transferring a non-cash asset to the non-controlling shareholder. An example of this transaction is the following.

> ***Example 1***
>
> Shareholder A has a 75 per cent controlling interest in Entity X.
>
> Shareholder B has a 25 per cent NCI in Entity X.
>
> The fair value of the 25 per cent NCI is CU[2] 50 million.
>
> The carrying amount of the 25 per cent NCI is CU40 million.
>
> Shareholder A purchases the 25 per cent NCI transferring a plant to Shareholder B.
>
> The fair value of the plant is CU50 million (ie the fair value of the consideration given for the NCI).
>
> The carrying amount of the plant is CU30 million.

The issue is whether the difference (CU20 million in Example 1) between the fair value of the consideration given (CU50 million in Example 1) and the carrying

[2] In this paper, monetary amounts are denominated in "currency units (CU)".

amount of the assets transferred (CU30million in Example 1) should be recognised in equity or in profit or loss.

9. The submitter notes that two views exist in practice:

   (a) View 1—No income statement impact: the purchase of NCI should be accounted for as an equity transaction in accordance with paragraphs 30 and 31 of IAS 27. The accounting entries for Example 1would be:

	Debit	**Credit**
NCI	40	
Equity	10	
Property Plant and Equipment		30
Equity		20

   (b) View 2—with income statement impact: the difference between the fair value of the consideration given and the carrying amount of the assets transferred should be recognised in profit or loss, applying IFRIC 17 by analogy. The accounting entries for Example 1would be:

	Debit	**Credit**
NCI	40	
Equity	10	
Property Plant and Equipment		30
Gain		20

10. We will analyse these views in the following paragraphs.

View 1—No income statement impact

11. Proponents of this view note that:

   (a) the acquisition of NCI is clearly within the scope of IAS 27;

   (b) according to paragraph 30 of IAS 27: *changes in a parent's ownership interest that do not result in a loss of control are accounted for as equity transaction*;

   (c) *this means that no gain or loss from these changes should be recognised in profit or loss* (IAS 27. BC41);

(d) according to paragraph 31 of IAS 27: *Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received shall be recognised directly in equity and attributed to the owners of the parent*.

12. They also note that a non-cash acquisition of NCI is outside the scope of IFRIC 17, because:

    (a) the Interpretation applies only to distributions in which all owners of the same class of equity instruments are treated equally (IFRIC 17.4); and

    (b) the Interpretation should not address exchange transactions between an entity and its owners because that would probably result in addressing all related party transactions (IFRIC 17. BC5).

13. Consequently, under View 1, even though the consideration includes non-cash assets, the difference between the fair value of the consideration given and the carrying amount of the assets transferred should be recognised in equity.

View 2—with income statement impact

14. Proponents of View 2 think that the difference between the fair value of the consideration given and the carrying amount of the assets transferred should be recognised in profit or loss, applying IFRIC 17 by analogy.

15. They acknowledge that a non-cash acquisition of NCI is outside the scope of IFRIC 17, however they think that the following paragraphs of the Basis for Conclusions on IFRIC 17 are applicable to a non-cash acquisition of NCI:

    (a) *the IFRIC noted that the credit balance* (ie CU20 million in Example 1) *did not arise from the distribution transaction. Rather, it represented the cumulative unrecognised gain associated with the asset. It reflects the performance of the entity during the period the asset was held until it was distributed* (IFRIC 17.BC41).

    (b) *the Framework requires an entity to consider the effect of a transaction from the perspective of the entity for which the financial statements are prepared* (IFRIC 17.BC42);

(c) *Moreover, when an entity distributes its assets to its owners, it loses the future economic benefit associated with the assets distributed and derecognises those assets. Such a consequence is, in general, similar to that of a disposal of an asset. IFRSs (eg IAS 16, IAS 38, IAS 39 and IFRS 5) require an entity to recognise in profit or loss any gain or loss arising from the derecognition of an asset* (IFRIC 17.BC50).

(d) *the IFRIC concluded that the credit balance should be recognised in profit or loss. This treatment would give rise to the same accounting results regardless of whether an entity distributes non-cash assets to its owners, or sells the non-cash assets first and distributes the cash received to its owners* (IFRIC 17.BC53).

(e) *The IFRIC decided that the credit balance does not arise from the distribution transaction. Rather, it represents the increase in value of the assets. The increase in the value of the asset does not meet the definition of an owner change in equity in accordance with IAS 1. Rather, it meets the definition of income and should be recognised in profit and loss* (IFRIC 17.BC54).

Staff analysis and view

16. We think that the difference between the fair value of the consideration given and the carrying amount of the assets transferred should be recognised in profit or loss for the reasons mentioned in paragraph 15 of this paper.

17. We think that paragraph 31 of IAS 27 (and paragraph B96 of IFRS 10) deal only with the difference (CU10 million in Example 1) between the carrying amount of NCI (CU40 million in Example 1) and the fair value of the consideration given (CU50million in Example 1). This paragraph, in our view, does not deal with the difference arising from the derecognition of the non-cash asset (ie the difference between the fair value and the carrying amount of the non-cash assets transferred, which is CU20 million in Example 1).

18. In other words, we think there is no conflict between IAS 27 and IFRIC 17, because they deal with different things.

19. We also think that the accounting treatment of a non-cash acquisition of NCI should be consistent with the accounting for the disposal of the non-cash asset and the subsequent purchase of NCI using the cash received from the disposal of the non-cash asset.

20. In Example 2 below, we illustrate our view.

Example 2

Shareholder A has a 75 per cent controlling interest in Entity X.
Shareholder B has a 25 per cent NCI in Entity X.
The fair value of the 25 per cent NCI is CU50 million.
The carrying amount of the 25 per cent NCI is CU40 million.
The fair value of the plant is CU50 million
The carrying amount of the plant is CU30 million.

Scenario A

Shareholder A purchases the 25 per cent NCI transferring a plant to Shareholder B.
Accounting entries:

Purchase the NCI	**Debit**	**Credit**
NCI	40	
Equity	10*	
Property Plant and Equipment		30
Gain (in our view)**		**20**

Scenario B

Entity X sells the plant and then uses the cash received to purchase the 25 per cent NCI
Accounting entries:

Sale of the plant	**Debit**	**Credit**
Cash	50	
Property Plant and Equipment		30
Gain		**20**

Carrying amount of NCI after the sale of the plant (ie the 25 per cent of the gain is attributed to NCI)	45	= 40 + (20x25%)

Purchase of the NCI	**Debit**	**Credit**
NCI	45	
Equity	5*	
Cash		50

* IAS 27 only deals with these amounts.
** The entity recognises the same gain in both scenarios (ie the gain arising from the derecognition of the plant). IAS 27 does not deal with this amount.

Outreach request to national standard-setters and regulators

21. We asked IOSCO, ESMA and national standard-setters to provide us with feedback on whether the issue raised in the submission:
    (a) is widespread and has practical relevance; and
    (b) indicates that there are significant divergent interpretations (either emerging or existing in practice).

22. In our request we included the information that we have reproduced in Appendix B of this paper. We asked regulators and national standard-setters the following two questions:
    (a) *In your jurisdiction, how common is this type of transactions? If it occurs, could you provide us with information that the Committee could use to assess how widespread the issue is?*
    (b) *In your view, is there diversity in practice in accounting for the difference between the fair value of the consideration given and the carrying amount of the assets transferred? Please describe the predominant approach that you observe in your jurisdiction.*

23. We received fifteen responses from the following jurisdictions: Asia (4), Americas (4), Europe (4[3]), Oceania (2) and worldwide (1[4]).

24. Only one respondent considered the issue to be prevalent in its jurisdiction. At the moment the respondent has not observed diversity in practice, because under the local GAAP the difference between the fair value of the consideration given and the carrying amount of the assets transferred shall be recognised in profit or loss. However, the respondent noted that there might be diversity in practice in the future, because next year all listed companies will adopt IFRSs.

25. Fourteen respondents did not consider the issue to be common in their jurisdiction; consequently, they have not observed diversity in practice.

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[3] One of these responses summarises feedbacks received from 9 jurisdictions

[4] This response summarises feedbacks received from 8 jurisdictions.

26. The majority of the respondents supported View 2 (ie with profit or loss impact).

Agenda criteria assessment

27. The staff's preliminary assessment of the agenda criteria is as follows:

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

    No. On the basis of our outreach, we understand that the issue is not widespread.

    (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.*

    No. On the basis of our outreach, even though different views exist, we do not expect significant diversity in practice.

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

    Not applicable. We are not aware of different reporting methods.

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

    Not applicable. We think there is no conflict between IAS 27 and IFRIC 17.

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

    Yes, the Committee could be able to reach a consensus on the issue on a timely basis.

    (f) *If the issue relates to a current or planned IASB project, there is a pressing 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.*

Not applicable. The issue does not relate to a current or planned IASB project.

Assessment against the annual improvements criteria

28. The staff's preliminary assessment of the issue against the annual improvements criteria is as follows:

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 criteria (a)–(d) must be met to qualify for inclusion in annual improvements.

(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 principle.

No. We think that paragraphs 30 and 31 of IAS 27 are clear and that there is no conflict between IAS 27 and IFRIC 17.

(b) The proposed amendment is well-defined and sufficiently narrow in scope such that the consequences of the proposed change have been considered.

Yes, the issue is narrow in scope.

(c) *It is probable that the IASB will reach a conclusion on the issue on a timely basis. Inability to reach a conclusion on a timely basis may indicate that the cause of the issue is more fundamental than can be resolved within annual improvements.*

Yes, we think that the IASB would be able to reach a conclusion on the issue on a timely basis.

(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.*

Not applicable. The issue does not relate to a current or planned IASB project.

Staff recommendation

29. On the basis of our technical analysis, we think that the difference between the fair value of the consideration given and the carrying amount of the assets transferred should be recognised in profit or loss and that the difference between the fair value of the consideration given and the carrying amount of NCI should be recognised in equity.

30. On the basis of our assessment of the Committee's agenda criteria and the annual improvements criteria, we recommend that the Committee should not take this issue onto its agenda, because the issue is not widespread and we think there is sufficient guidance in the standards.

31. Our proposed tentative agenda decision is included in Appendix A of this paper.

Questions for the Committee

1. Does the Committee agree that the difference between the fair value of the consideration given and the carrying amount of the assets transferred should be recognised in profit or loss and that the difference between the fair value of the consideration given and the carrying amount of NCI should be recognised in equity?

2. Does the Committee agree with the staff's recommendation that the Committee should not take this issue onto its agenda?

3. Does the Committee have any comments on the proposed wording for the tentative agenda decision in Appendix A?

Appendix A—Proposed wording for tentative agenda decision

A1 The proposed wording for the tentative agenda decision is presented below.

IAS 27 *Consolidated and Separate Financial Statements*—Non-cash acquisition of non-controlling interest

The Interpretations Committee received a request for guidance for guidance on the accounting for the purchase of a non-controlling interest (NCI) when the consideration includes non-cash items. More specifically, the submitter asked the Committee to clarify whether the difference between the fair value of the consideration given and the carrying amount of the assets transferred should be recognised in equity or in profit or loss.

The Committee noted that paragraph 31 of IAS 27 solely deals with the difference between the carrying amount of NCI and the fair value of the consideration given; this difference is required to be recognised in equity. This paragraph does not deal with the difference between the fair value of the consideration given and the carrying amount of the assets transferred. The difference between the fair value of the assets transferred and their carrying amount arises from the derecognition of those assets and IFRSs require an entity to recognise in profit or loss any gain or loss arising from the derecognition of an asset.

The Committee observed that this issue is not widespread and so did not expect there to be diversity in practice. The Committee noted that IFRSs provide sufficient guidance to address the issue submitted.

Consequently, the Committee [decided] not to add this issue to its agenda.

Appendix B—Request

B1 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.

IFRIC POTENTIAL AGENDA ITEM REQUEST

<u>The issue:</u>

How should an entity account for the purchase of non-controlling interest when the consideration includes non-cash items?

Background

Two shareholders established an entity some years ago. Shareholder X has 51 percent and control whilst shareholder Y has 49 percent.

This year X will buy all the shares from Y. The book value of the non-controlling interest is CU 25 million.

In consideration for the 49% X is required to pay 30 million cash and to transfer some property, plant and equipment items to Y.

The book value of the property, plant and equipment is CU 10 million. The fair value of the property, plant and equipment is CU 20 million.

Literature and technical support

It is clear that the transaction should be recorded in equity as a transaction between shareholders (IAS 27.30). Any difference between the fair value of the consideration given and the book value of the non-controlling interest is attributed to the parent equity (IAS 27.31).

Considering the guidance in IAS 27, the total fair value of the consideration is CU 50 million. The book value of the non-controlling interest is CU 25 million with a resulting impact in equity of CU 25 million.

However, the book value of the assets transferred is CU 40 million (property, plant and equipment CU 10 million and cash CU 30 million). Does that mean that there should be an income statement impact?

Views

There are two potential scenarios for the accounting entries:

Scenario A– no income statement impact

Debits

Non controlling interest CU 25 million

Shareholders' equity CU 25 million

Credits

Cash CU 30 million

Property, plant and equipment   CU 10 million

Shareholders' equity CU 10 million (to balance and avoid income statement impact)

Scenario B - with income statement impact

Debits

Non controlling interest CU 25 million

Shareholders' equity CU 25 million

Credits

Cash CU 30 million

Property, plant and equipment CU 10 million

Income statement gain CU 10 million

We consider that scenario A is supported by IAS 27 although it effectively presents a net position.
Scenario B could be supported by analogy to IFRIC 17 and represents a gross position.
We believe that the guidance on exchange of assets in IAS 16 cannot be applied as own shares cannot be an asset.

Current practice:

We currently see both positions presented and so there is diversity in practice.

Reasons for the IFRIC to address the issue:

(a) Is the issue widespread and practical?
We have seen this issue arise in several transactions in Central America and in Asia.

(b) Does the issue involve significantly divergent interpretations (either emerging or already existing in practice)?
Yes, we see both transactions showing an income statement impact and transactions which do not.

c) Would financial reporting be improved through elimination of the diversity?
In our opinion, financial reporting would be improved by eliminating diversity in practice.

(d) 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 that the issue is sufficiently narrow in scope for an interpretation as it addresses an apparent conflict in the literature. When non-cash assets are distributed to shareholders in a transaction which is within the scope of IFRIC 17 the accounting treatment is clear and an income statement impact will often occur. However if a transaction amongst shareholders occurs under IAS 27, then an income statement impact is prohibited.

(e) If the issue relates to a current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project?
We are not aware that this issue relates to either a current or a planned IASB project.