STAFF PAPER

February 2014

IASB Meeting

Project	**Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28)**
Paper topic	Inconsistency with paragraph 31 of IAS 28

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Introduction

1. This paper describes a new issue that was identified by the IFRS Interpretations Committee (the 'Interpretations Committee') during its work on the Exposure Draft *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (proposed amendments to IFRS 10 and IAS 28), which had been published for comment in December 2012.

2. In July 2013, the Interpretations Committee:

   (a) recommended that the IASB should proceed with the amendments to IFRS 10 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures* (issued in 2011); and

   (b) decided that further analysis and discussion are needed before proposing whether or not the IASB should amend or delete paragraph 31 of IAS 28, which is perceived as conflicting with the proposed amendments to IFRS 10 and IAS 28 (2011). This additional issue was raised by some respondents to the proposed amendments.

3. In October 2013, the IASB tentatively decided to finalise the proposed amendments to IFRS 10 and IAS 28 (2011). In January 2014, the IASB considered a sweep issue related to these amendments and tentatively decided to clarify the wording of the amendments to IFRS 10.

4. In January 2014, the Interpretations Committee noted that paragraph 31 of IAS 28 is not consistent with the forthcoming amendments to (and the existing requirements of) IAS 28. It also noted that the deletion of paragraph 31 of IAS 28 would not have significant unintended consequences. Consequently, the Interpretations Committee recommended that the IASB should amend IAS 28.

Objective

5. The objective of this paper is to ask the IASB:

   (a) whether it agrees with the Interpretations Committee's recommendation to delete paragraph 31 of IAS 28: and

   (b) whether this proposal should be included in the forthcoming final amendments to IFRS 10 and IAS 28.

Background information

6. Paragraph 31 of IAS 28 (2011) states that:

   > 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 or loss the portion of the gain or loss on the non-monetary contribution relating to the monetary or non-monetary assets received.

7. Paragraph BCZ36 explains that:

   > BCZ36 To the extent that the entity also receives monetary or non-monetary assets dissimilar to the assets contributed in addition to equity interests in the investee, the realisation of which is not dependent on the future cash flows of the investee, the earnings process is complete. Accordingly, an entity should recognise in full in profit or loss the portion of the gain or loss on the non-monetary contribution relating to the monetary or non-monetary assets received.

8. In October 2013, the IASB tentatively decided to amend IAS 28 (2011) so that:

   (a) when an entity sells or contributes assets that constitute a business to a joint venture or associate, the gain or loss recognised by the entity is recognised in full; whereas

(b) when an entity sells or contributes assets that do not constitute a business to a joint venture or associate, the gain or loss recognised by the entity is limited to the unrelated investors' interests in the associate or joint venture.

9. The draft wording of the forthcoming amendments to IAS 28 will not change the requirements of paragraph 31 of IAS 28.

Staff analysis

The issue

10. Some respondents to the Exposure Draft *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* think that paragraph 31 of IAS 28 is not consistent with the proposed amendments to IAS 28. They think that the IASB should amend paragraph 31 of IAS 28 and should require partial gain or loss recognition for all sales and contributions of assets that do not constitute a business (whether those assets are monetary or non-monetary assets and whether the contribution is made in exchange for an equity interest in the investee or in exchange for other assets). In particular, they do not think that the nature of the assets received from the associate or joint venture should warrant a different accounting.

Staff view

11. We think that paragraph 31 is not consistent with the forthcoming amendments to IFRS 10 and IAS 28 nor with the existing requirements of IAS 28. It is inconsistent with the forthcoming amendments, because:

(a) the outcome of paragraph 31 of IAS 28 is that the accounting for the gain or loss resulting from the contribution of non-monetary assets depends on whether an equity interest or other assets are received in exchange (ie a full gain is recognised on the contribution relating to the other assets received and a partial gain is recognised on the contribution relating to the equity interest received); whereas

(b) in October 2013, the IASB tentatively decided that:

(i) all sales and contributions of assets (that do not constitute a business) between an investor and its associate or joint venture should be accounted for consistently, ie a partial gain should be recognised in those cases (except when the contribution lacks commercial substance); and

(ii) when a parent loses control of a subsidiary (that does not contain a business) in a transaction with an associate or a joint venture a partial gain should be recognised, even if the parent retains an interest in the former subsidiary (in other words: even if the parent receives an equity interest and other assets).

12. In addition, according to paragraph 31, if there is no equity interest received, then only a partial gain is recognised in respect of the consideration received, whereas if there is even only a small equity consideration received, then a full gain is recognised in respect of the non-equity consideration received.

13. We also think that there is also a different rationale behind paragraph 31 of IAS 28 compared with the other requirements of IAS 28 regarding transactions with associates and joint ventures. Indeed, paragraph BCZ36 refers to the earnings process being complete. It interprets the completion of the earnings process as being complete when monetary or non-monetary assets are received from the associate and suggests that because the economic benefits associated with those monetary and non-monetary assets are not dependent on the future cash flows of the associate, then the earnings process is complete on receipt of those assets. However, in our view, this is contrary to the existing guidance in IAS 28, which requires full gain recognition only when the economic benefits of the asset transferred to the associate (or joint venture) is consumed/realised by the associate or joint venture[1].

14. In other words, the existing requirements of IAS 28 for all other transactions with the associate or joint venture are independent of the nature of the assets received. The forthcoming amendments that were tentatively agreed by the IASB in October 2013 are also independent of the nature of the assets received. They focus instead on the nature of the assets contributed.

15. In our view:

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[1] Paragraph 26 of IAS 28 states that: "Many of the procedures that are appropriate for the application of the equity method are similar to the consolidation procedures described in IFRS 10…".

(a) the accounting for a contribution should not depend on whether cash, other assets or an equity interest are received in exchange for that contribution;

(b) recognising a full gain as required by paragraph 31 creates structuring opportunities. For example:

(i) one investor would recognise a partial gain on the sale of assets (that do not constitute a business) to an associate or joint venture (in exchange for cash); whereas

(ii) another investor would recognise a full gain on the contribution of assets (that do not constitute a business) for the portion relating to cash received, if cash is received in addition to receiving an equity interest in the associate or joint venture.

Outreach results

16. We asked IOSCO, ESMA and national standard-setters the following two questions:

(a) How common are the transactions in scope of paragraph 31 of IAS 28?

(b) Do you envisage any unintended consequences that could arise from the deletion of paragraph 31 of IAS 28?

17. On the basis of the comments received[2], we understand that the transactions within the scope of paragraph 31 of IAS 28 are not common in practice and that the deletion of this paragraph would not have significant unintended consequences.

Interpretations Committee's recommendation

18. In January 2014, the Interpretations Committee noted that paragraph 31 of IAS 28 is not consistent with the forthcoming amendments to (and the existing requirements of) IAS 28. It also noted that the deletion of paragraph 31 of IAS 28 would not have significant unintended consequences. Consequently, it recommended that the IASB should delete paragraph 31 of IAS 28.

[2] For further details see Agenda Paper 19 for the January 2014 Interpretations Committee meeting http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2014/January/AP19-Inconsistency%20between%20Amendements%20to%20IFRS%2010%20and%20IAS%2028.pdf

Final amendments or ED?

19. The original staff recommendation for the Interpretations Committee was to include the deletion of paragraph 31 in the forthcoming Exposure Draft *Elimination of gains arising from 'downstream' transactions* ('the ED'). During the January Interpretations Committee meeting, an IASB member asked the staff whether the proposal to delete paragraph 31 of IAS 28 could be included in the forthcoming (final) amendments to IFRS 10 and IAS 28 (instead of including it in the ED).

20. We think that the forthcoming (final) amendments to IFRS 10 and IAS 28 is the best 'place' for including the deletion of paragraph 31, because paragraph 31 is not consistent with the forthcoming amendments to IFRS 10 and IAS 28 and the inconsistency was noted by some respondents to the ED *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*. In our view, the deletion of paragraph 31 is a consequential amendment to the decisions that had been taken by the IASB during this project.

21. On the other hand, we note that the amendments to IFRS 10 and IAS 28 are final amendments, and so the deletion of paragraph 31 would not be exposed for comments.

22. Consequently, if the IASB agrees that paragraph 31 of IAS 28 should be deleted, we think that there are two possible options:

    (a) Option 1: include the deletion of paragraph 31 in the ED; or

    (b) Option 2: include the deletion of paragraph 31 in the forthcoming (final) amendments to IFRS 10 and IAS 28 (without re-exposure).

Due process considerations

23. In its November 2013 meeting, the IASB reviewed the due process steps that it has taken since the publication of the Exposure Draft *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* and concluded that the applicable due process steps have been completed. The IASB tentatively decided that:

    (a) the effective date of the amendment should be 1 January 2015; and

(b) the amendments to IFRS 10 and IAS 28 do not need to be re-exposed before finalisation.

24. In January 2014, the IASB considered a sweep issue, decided to clarify the wording of the amendments to IFRS 10 and confirmed the finalisation of the amendments to IFRS 10 and IAS 28. In our view, the illustrative example agreed in the January IASB meeting emphasises the inconsistency with paragraph 31 of IAS 28, because, in the example[3], the part of the gain resulting from the sale of the 60 per cent interest in the subsidiary to the associate is partially recognised (because the subsidiary does not contain a business), whereas according to paragraph 31 that part of the gain should be recognised in full, because the consideration received (in the example) is not an equity interest.

25. We think that the changes decided in the January IASB meeting and the deletion of paragraph 31 of IAS 28 are not fundamental, are coherent and respond to the feedback received. Consequently, we think that, on the basis of the re-exposure criteria in paragraphs 6.25–6.29 of the *Due Process Handbook*, the deletion of paragraph 31 of IAS 28 can be included in the forthcoming final amendments to IFRS 10 and IAS 28 without re-exposure.

26. We also think that the effective date of the amendments to IFRS 10 and IAS 28 should be 1 July 2015 (instead of 1 January 2015), because of the delays in the finalisation of the amendments. We now plan to publish the final amendments in Q2 2014, the previous forecast was Q1 2014.

Staff recommendation

27. On the basis of the analysis above, we recommend that the IASB should:

(a) delete paragraph 31 of IAS 28;

(b) include the deletion of paragraph 31 in the forthcoming (final) amendments to IFRS 10 and IAS 28 (without re-exposure of those amendments); and

(c) amend the effective date of the amendments to IFRS 10 and IAS 28 to 1 July 2015 (instead of 1 January 2015)

[3] For further details, see Example 17 in Appendix A of this paper.

28. Our recommend wording for the amendments to IFRS 10 and IAS 28 is in Appendix A of this paper.

Questions for the IASB

1. Does the IASB agree with the Interpretations Committee's recommendation to delete paragraph 31 of IAS 28?
2. Does the IASB agree with the staff's recommendation to include the deletion of paragraph 31 in the forthcoming (final) amendments to IFRS 10 and IAS 28 (without re-exposure of those amendments)?
3. Does the IASB agree with the staff's recommendation to amend the effective date of the amendments to IFRS 10 and IAS 28 to 1 July 2015?

Appendix A—Proposed wording for the amendments to IFRS 10 and IAS 28

A1. In this appendix, we report our proposed wording for the amendments to IFRS 10 and IAS 28.

Amendments to IFRS 10 *Consolidated Financial Statements*

Paragraphs 25–26 are amended and paragraphs B99A and C1C are added. New text is underlined.

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<u>, except as specified in paragraph B99A</u>.

26 Paragraphs B97–B99<u>A</u> set out guidance for the accounting for the loss of control of a subsidiary.

…

In Appendix B, paragraph B99A is added.

Loss of control

...

B99A If a parent loses control of a subsidiary that does not contain a business, as defined in IFRS 3, as a result of a transaction involving an associate or a joint venture that is accounted for using the equity method, the parent determines the gain or loss in accordance with paragraphs B98–B99. The gain or loss resulting from the transaction (including the amounts previously recognised in other comprehensive income that would be reclassified to profit or loss in accordance with paragraph B99) is recognised in the parent's profit or loss only to the extent of the unrelated investors' interests in that associate or joint venture. If the parent retains an investment in the former subsidiary to the effect that the former subsidiary is now an associate or a joint venture that is accounted for using the equity method, the parent will recognise the part of the gain or loss resulting from the remeasurement at fair value of the investment retained in that former subsidiary in its profit or loss only to the extent of the unrelated investors' interests in the new associate or joint venture. If the parent retains an investment in the former subsidiary that is now accounted for in accordance with IFRS 9, the part of the gain or loss resulting from the remeasurement at fair value of the investment retained in the former subsidiary is recognised in full in the parent's profit or loss.

Application examples

Example 17

A parent has a 100 per cent interest in a subsidiary that does not contain a business. The parent sells 60 per cent of its interest in the subsidiary to an associate in which it has a 20 per cent interest. The carrying amount of the net assets of the subsidiary is CU100 and the carrying amount of the interest sold is CU60 (CU60 = CU100 × 60%). The fair value of the consideration received is CU180, which is also the fair value of the interest sold. The investment retained in the former subsidiary is an associate accounted for using the equity method and its fair value is CU120. The gain determined in accordance with paragraphs B98–B99 is CU200 (CU200 = CU180 + CU120 – CU100). This gain comprises two parts:

(a) One part is the gain (CU120) resulting from the sale of the 60 per cent interest in the subsidiary to the associate. This gain is the difference between the fair value of the consideration received (CU180) and the carrying amount of the interest sold (CU60). According to paragraph B99A the parent recognises in its profit or loss the amount of the gain attributable to the unrelated investors' interests in the existing associate. This is 80 per cent of this gain, that is CU96 (CU96 = CU120 × 80%). The remaining 20 per cent of the gain (CU24 = CU120 × 20%) is eliminated against the carrying amount of the investment in the existing associate.

(b) The other part is the gain (CU80) resulting from the remeasurement at fair value of the investment retained in the former subsidiary. This gain is the difference between the fair value of the investment retained in the former subsidiary (CU120) and 40 per cent of the carrying amount of the net assets of the subsidiary (CU40 = CU100 × 40%). According to paragraph B99A the parent recognises in its profit or loss the amount of the gain attributable to the unrelated investors' interests in the new associate. This is 48 per cent (60% × 80%) of the gain, that is CU38 (CU38 = CU80 × 48%). The remaining 52 per cent of the gain CU42 (CU42 = CU80 × 52%) is eliminated against the carrying amount of the investment retained in the former subsidiary.

…

In Appendix C, paragraph C1C is added.

Effective date

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C1C *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (Amendments to IFRS 10 and IAS 28), issued in [date], amended paragraphs 25–26 and added paragraph B99A. An entity shall apply that amendment prospectively to transactions occurring in annual periods beginning on or after [date]. Early application is permitted. If an entity applies those amendments earlier, it shall disclose that fact.

Amendments to IAS 28 *Investments in Associates and Joint Ventures*

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

Equity method procedures

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28 Gains and losses resulting from 'upstream' and 'downstream' transactions involving assets that do not constitute a business, as defined in IFRS 3, between an ~~entity~~ investor (including its consolidated subsidiaries) and its associate or joint venture are recognised in the ~~entity's~~ investor'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 from an associate or a joint venture to the investor. The investor's share in the associate's or joint venture's gains or losses resulting from these transactions is eliminated. 'Downstream' transactions are, for example, sales or contributions of assets 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 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 that ~~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 An entity might sell or contribute assets in two or more arrangements (transactions). 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.

Paragraph 45A is added.

Effective date and transition

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45A *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (Amendments to IFRS 10 and IAS 28), issued in [date], amended paragraphs 28 and 30, deleted paragraph 31 and added paragraphs 31A–31B. An entity shall apply those amendments prospectively to the sale or contribution of assets occurring in annual periods beginning on or after [date]. Early application is permitted. If an entity applies those amendments earlier, it shall disclose that fact.