STAFF PAPER

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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	Sweep issue

CONTACT Leonardo Piombino lpiombino@ifrs.org +44 (0)20 7246 0571

Purpose of this paper

1. The objective of this paper is to address a sweep issue identified by interested parties during the editorial review of the *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (Amendments to IFRS 10 and IAS 28).

2. Some reviewers asked the IASB to clarify how the amendments to IFRS 10 *Consolidated Financial Statements* should be applied when a parent loses control of a subsidiary (that does not contain a business) but retains an interest in that former subsidiary that is accounted for using the equity method. The issue is whether the gain or loss related to the remeasurement at fair value of the retained interest in the former subsidiary should be recognised:

   (a) in full;

   (b) only to the extent of the unrelated investors' interests in the former subsidiary; or

   (c) should not be recognised.

Staff analysis

The amendments to IFRS 10 and IAS 28

3. The objective of the amendments to IFRS 10 and IAS 28 is to address the conflict between the requirements of IFRS 10 and IAS 28 *Investments in Associates and Joint Ventures* (issued in May 2011). The conflict identified is that IFRS 10 requires a full gain or loss recognition on the loss of control of a subsidiary (even though the parent retains joint control of, or significant influence over, the investee), whereas IAS 28 requires a partial gain or loss recognition in transactions between an investor and its associate or joint venture.

4. In order to address this conflict the IASB tentatively decided to amend IFRS 10 and IAS 28 so that:

   (a) when an entity sells or contributes assets that do not constitute a business to a joint venture or associate, or when an entity loses control of a subsidiary that does not contain a business whilst retaining joint control or significant influence, the gain or loss recognised by the entity is limited to the unrelated investors' interests in the associate or joint venture; and

   (b) when an entity sells or contributes assets that constitute a business to a joint venture or associate, or when an entity loses control of a subsidiary that contains a business whilst retaining joint control or significant influence, the gain or loss recognised by the entity is recognised in full.

5. At its meeting in October 2013, the IASB tentatively decided to finalise the amendments to IFRS 10 and IAS 28.

6. These amendments are expected to be published in Q1 of 2014.

The issue

7. We distributed to a selected group of reviewers the editorial review drafts of the Amendments to IFRS 10 and IAS 28. In this draft paragraphs 25–26 of IFRS 10 are amended and paragraph B99A is added to the Appendix B of IFRS 10.

8. The draft wording of paragraph B99A is the following:

B99A If a parent loses control of a subsidiary that does not contain a business, as defined in IFRS 3, the parent's interest in the gain or loss (determined in accordance with paragraphs B98–99) resulting from that transaction is eliminated when:

(a) the parent retains an investment in the former subsidiary that is accounted for using the equity method: or

(b) the parent sells or contributes an interest in the former subsidiary to an associate or joint venture that is accounted for using the equity method.

9. Some reviewers think that the wording of paragraph B99A is not sufficiently clear. They asked the IASB to clarify how paragraph B99A should be applied when a parent loses control of a subsidiary (that does not contain a business) but retains an interest in that former subsidiary that is accounted for using the equity method. They think that there are two components to the gain:

(a) the gain arising from the difference between the carrying amount of the portion of the investment disposed and the proceeds received in exchange; and

(b) the (potential) gain arising from the remeasurement of the retained interest to fair value at the date of the transaction. The issue is whether this part of the gain should be recognised:

(i) in full;

(ii) only to the extent of the unrelated investors' interests in the former subsidiary; or

(iii) should not be recognised.

10. In the following paragraphs we provide an example that illustrates this issue.

Illustrative example

11. Assumptions:

(a) Parent (P) owns 100 per cent of Subsidiary (S);

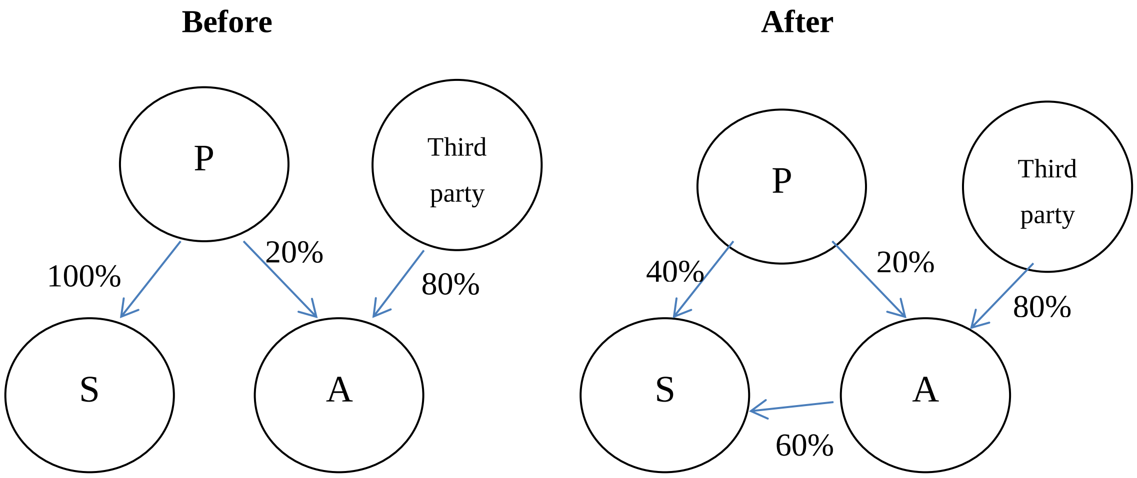
(b) S does not contain a business;

(c) P sells 60 per cent of its interest in S to Associate (A) in which it has a 20 per cent interest;

(d) the carrying amount of the net assets of S is CU100 and the carrying amount of the interest sold is CU60 (CU60 = CU100 × 60%);

(e) the fair value of the consideration received is CU180, which is also the fair value of the interest sold; and

(f) after the transaction, the investment retained in S is an associate accounted for using the equity method and its fair value is CU120 (ie P loses control of S).



12. The full gain determined in accordance with paragraphs B98–B99 of IFRS 10 is CU200 (CU200 = consideration received CU180 + fair value of the retained investment CU120 – carrying amount of S 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's interest in the gain or loss is eliminated. In other words, 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. The journal entries are the following:

	Debit	Credit
Net assets of S (60%)		60
Cash	180	
Gain on the sale (100%, before elimination)		120
Gain on the sale (20% of the gain is eliminated)	24	
Investment in A		24

(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%). The issue relates to the accounting for of this gain (CU80).

13. We understand that three different views exist on the accounting for the gain resulting from the remeasurement at fair value of the investment retained in the former subsidiary:

(a) View 1: the gain should be accounted for in full;

(b) View 2: the gain should be eliminated in full;

(c) View 3: the gain should be recognised to the extent of unrelated investors' interests in the former subsidiary.

14. Supporters of View 1 think that paragraph B99A only applies to the gain resulting from the sale of the 60 per cent interest in S to A. In their view, paragraph B99A does not apply to the gain related to the remeasurement of the retained investment. Consequently, the latter gain should be recognised in full in the parent's profit or loss, because measuring the retained investment at fair value reflects the IASB's view that the loss of control of a subsidiary is a significant economic event, even though the subsidiary does not contain a business.

15. Using View 1 the journal entries are the following:

	Debit	Credit
Net assets of S (40%)		40
Investment in S	120	
Gain on the investment retained in S		80

16. Supporters of View 2 think that paragraph B99A applies also to the part of the gain related to the remeasurement of the retained investment, because it refers to paragraph B98.[1] They think that this gain should be eliminated in full, because:

(a) the gain has not been realised, P's interest in this gain is 100 per cent (ie the gain relates to the stake of S that has not been sold to A); and

(b) S is not a business.

In their view, this gain should be recognised in P's profit or loss when P will sell the retained investment in S. The consequence of this view is that the investment retained in S would not be remeasured.

17. Using View 2 the journal entries are the following:

	Debit	Credit
Net assets of S (40%)		40
Investment in S	120	
Investment in S		80

18. Similarly to View 2, supporters of View 3 think that paragraph B99A applies also to the part of the gain related to the remeasurement of the retained investment. However, they think that this part of the gain (as the part of the gain resulting from the sale of the 60 per cent interest in S to A) should be recognised in P's profit or loss to the extent of the unrelated investors' interests. In their view, the only difference is that:

[1] Paragraph B98(b)(iii) requires any investment retained in the former subsidiary to be recognised at its fair value.

(a) the former part of the gain is recognised to the extent of the unrelated investors' interests in A; whereas

(b) the latter part of the gain is recognised to the extent of the unrelated investors' interests in the former S.

19. In this example, the amount of the gain attributable to the unrelated investors' interests in S is 48 per cent (60% × 80%) of the gain, that is CU38 (CU38 = CU80 × 48%). The remaining 52[2] per cent of the gain CU42 (CU42=CU80*52%) is eliminated against the carrying amount of the investment retained in the former subsidiary S.

20. Using View 3 the journal entries are the following:

	Debit	Credit
Net assets of S (40%)		40
Investment in S	120	
Gain on investment retained in S (100%, before elimination)		80
Gain on investment retained in S (52% eliminated)	42	
Investment in S		42

Staff view

21. We support View 3, because we think that it reflects the IASB's decision that a partial gain or loss should be recognised in accounting for the loss of control of a subsidiary that does not constitute a business between an investor and its associate or joint venture accounted for using the equity method.

22. We think that if a parent loses control of a subsidiary that does not contain a business, as a result of a transaction involving an associate or a joint venture that is accounted for using the equity method, the parent should:

(a) first determine the gain or loss in accordance with paragraphs B98–B99 of IFRS 10; and then

[2] The retained interest of P in S is 52 per cent, that is 40 per cent (direct interest) plus 12 per cent (indirect interest = 60% × 20%).

(b) recognise the gain or loss resulting from the transaction in the parent's profit or loss only to the extent of the unrelated investors' interests in that associate or joint venture if:

(i) the parent does not retain any investment in the subsidiary; or

(ii) the investment in the former subsidiary is now accounted for in accordance with IFRS 9 *Financial Instruments*.

However, if the parent retains an investment in the former subsidiary such that the former subsidiary is now an associate or a joint venture that is accounted for using the equity method, the parent should 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.

Staff recommendation

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

(a) clarify that the part of the gain or loss resulting from the remeasurement at fair value of the investment retained in the former subsidiary should be recognised to the extent of unrelated investors' interests in that former subsidiary; and

(b) confirm the finalisation of the amendments to IFRS 10 and IAS 28.

24. Our recommend wording for the amendments to Appendix B of IFRS 10 is in Appendix A of this paper.

Questions for the IASB

1. Does the IASB agree with the staff's recommendation to clarify that the part of the gain or loss resulting from the remeasurement at fair value of the investment retained in the former subsidiary should be recognised to the extent of unrelated investors' interests in that former subsidiary?
2. Does the IASB agree with the staff's recommendation to confirm the finalisation of the amendments to IFRS 10 and IAS 28?

Appendix A—Proposed wording for the amendments to Appendix B of IFRS 10

A1. In this appendix, we report our proposed wording for the amendments to the Appendix B of IFRS 10.

In Appendix B, paragraph B99A and Example 17 are 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 such 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.