STAFF PAPER

Agenda ref **12B**

22 January – 24 January 2014

IASB Meeting

Project	**Elimination of gains from 'downstream' transactions**		
Paper topic	Due process consideration		
CONTACT(S)	Won-Hee Han	whan@ifrs.org	+44 (0)20 7246 6960

This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IASB and does not represent the views of the IASB or any individual member of the IASB. Comments on the application of IFRSs do not purport to set out acceptable or unacceptable application of IFRSs. Technical decisions are made in public and reported in IASB *Update*.

Purpose of this paper

1. The purpose of this paper is to explain the steps in the due process that the IASB has taken before the publication of the final Exposure Draft (Proposed Amendments to IAS 28 *Investments in Associates and Joint Ventures*) and to ask the IASB to confirm that it is satisfied that it has complied with the due process requirements to date.

Background

2. In January 2013, the Interpretations Committee received a request to clarify the accounting for a transaction between a joint venturer (an entity) and its joint venture. The entity accounts for its interest in the joint venture using the equity method in accordance with IAS 28 which requires partial elimination of the gain recognised on transactions between an entity and its associate or joint venture. The request describes a circumstance in which the amount of a gain in a 'downstream' transaction that is to be eliminated in the entity's financial statements exceeds the amount of the entity's investment in the joint venture. Specifically, the submitter requested that the Interpretations Committee should clarify whether:

   (a) the gain from the transaction should be eliminated only to the extent that it does not exceed the carrying amount of the entity's investment in the joint venture; or

The IASB is the independent standard-setting body of the IFRS Foundation, a not-for-profit corporation promoting the adoption of IFRSs. For more information visit www.ifrs.org

(b) the remaining gain in excess of the carrying amount of the entity's investment in the joint venture should also be eliminated and, if so, what it should be eliminated against.

3. At its March 2013 meeting, the Interpretations Committee observed that the entity should eliminate all of its share of the gain from the transaction even if the entity's share of the gain exceeds the carrying amount of the entity's investment in the associate or joint venture, referring paragraph 28 of IAS 28.

4. At its May 2013 meeting, the interpretations Committee also discussed how to present the corresponding entry for the amount of the eliminated gain that exceeds the carrying amount of the entity's investment in the associate or joint venture. The Interpretations Committee noted that presenting the eliminated gain in excess of the carrying amount of the entity's investment in the associate or joint venture as a deferred gain would be appropriate because other alternative accounting treatments are not consistent with the principle described in IAS 28. However, the Interpretations Committee observed that IAS 28 does not provide sufficient guidance on this issue.

5. Consequently, the Interpretations Committee decided to recommend to the IASB that it should make a narrow-scope amendment to add specific guidance on how to account for the corresponding entry for the eliminated gain in excess of the carrying amount of the entity's investment in the associate or joint venture in a 'downstream' transaction.

6. At its July 2013 meeting, The IASB discussed and tentatively agreed with the recommendation from the IFRS Interpretations Committee.

Effect of the proposed amendments

7. The proposed amendments (see Appendix A of this paper) set out the following:

    (a) an entity should eliminate the gains from 'downstream' transactions to the extent of its interest in the associate or joint venture even if the gains to be eliminated exceeds the carrying amount of the entity's investment in the associate or joint venture; and

(b) the remaining gains to be eliminated in excess of the carrying amount of the entity's investment in the associate or joint venture should be presented as a deferred gain.

8. The proposed amendments clarify the requirements in paragraph 28 of IAS 28. Paragraph 28 of IAS 28 states that gains and losses from 'downstream' transactions between an entity and its associate or joint venture are recognised in the entity's financial statements only to the extent of unrelated investors' interest in the associate or joint venture. It means that paragraph 28 of IAS 28 does not specify whether this requirement also applies to the specific case which the proposed amendments deal with. Consequently, the proposed amendments would clarify that paragraph 28 of IAS 28 applies to all circumstances involving 'downstream' transactions without exception.

9. The proposed amendments also clarify the accounting in the specific case which the proposed amendments deal with, by requiring that the remaining gains to be eliminated in excess of the carrying amount of the entity's investment in the associate or joint venture should be presented as a deferred gain. The IASB considered the possible alternative accounting alternatives[1] and decided that presenting it as a deferred gain would be the most appropriate method in the context of the current Standards. The IASB also noted that presenting it as a deferred gain would clearly show how much gain from a 'downstream' transaction is eliminated and therefore improve financial reporting.

10. The IASB noted that the proposed amendments would reduce diversity in practice because the feedback from outreach activity to the members of International Forum of Accounting Standards Setters (IFASS) and securities regulators shows that there is diversity in practice.

[1] Alternative accountings include: (1) reducing the related asset, but if the related asset is cash or cash equivalents, recognise the eliminated gain in profit or loss; and (2) reducing the related asset, but if the related asset is cash or cash equivalents, present the eliminated gain as a deferred gain. For more detail information, see Appendix A of the agenda paper (Agenda paper 15) presented to the July 2013 IASB meeting.

Intention to dissent

11. When the IASB discussed the proposed amendment at its meeting in July 2013, one member voted against it. In accordance with paragraph 6.23 of the Due Process Handbook, we also formally ask whether any members intend to dissent to the final amendment before we ballot.

Proposed timetable for balloting and publication

12. The balloting process of *Elimination of gains from 'downstream' transactions* (Amendments to IAS 28) will start in February 2014 and its publication is scheduled for March 2014.

Comment period

13. In accordance with paragraph 6.7 of the Due Process Handbook, we propose a minimum standard comment period of 120 days for the Exposure Draft *Elimination of gains from 'downstream' transactions* (Proposed amendments to IAS 28).

Confirmation of due process steps

14. In Appendix B we have summarised the due process steps we have taken in developing the proposed amendments to IAS 28.
15. We note that the required due process steps for the publication of the proposed amendments have been completed, as documented in Appendix B. However, because the proposed amendments to IAS 28 are narrow-scope in nature, the extent of the due process steps performed was more limited than the ones that are required for an Exposure Draft of a new Standard.

Questions to the IASB—Compliance with due process
1. Do any IASB members dissent to the publication of the proposed amendments? 2. Do the IASB members agree with the proposed timetable for balloting and

publication?

3. Do the IASB members agree with a comment period of 120 days for the proposed amendments?

4. Is the IASB satisfied that all required due process steps that pertain to the publication of proposed amendments have been complied with?

Appendix A—Proposed amendments to IAS 28 as discussed at the July 2013 IASB meeting

Paragraph 28A and paragraph 45A are added. New text is underlined.

Equity method procedures

28[2] Gains and losses resulting from 'upstream' and 'downstream' transactions 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 from an associate or a joint venture to the investor. '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.

28A In 'downstream' transactions, if the gain to be eliminated exceeds the carrying amount of the entity's interest in the associate or joint venture, the remaining gain in excess of the carrying amount of the entity's investment in the associate or joint venture is presented as a deferred gain.

Effective date and transition

45A[3] *Elimination of gains from 'downstream' transactions'* (Amendments to IAS 28), issued in xxx 20xx, added paragraph 28A. An entity shall apply this paragraph for annual periods beginning on or after 1 January 20xx. An entity shall apply this amendment retrospectively in

---

[2] Exposure Draft *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (Proposed amendments to IFRS 10 and IAS 28, 'ED/2012/6') proposed changes to paragraph 28 of IAS 28 as follows. ED/2012/6 is expected to be finalised in the first quarter of 2014.

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~~ 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 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.

[3] Exposure Draft *Equity Method: Share of Other Net Asset Changes* (Proposed amendments to IAS 28, 'ED/2013/3') and ED/2012/6 are in the process of finalisation. Consequently, the numbering of this proposed amendment would be subject to change depending on these two projects.

accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Earlier application is permitted. If an entity applies those amendments for an earlier period it shall disclose that fact.

Appendix B—Confirmation of Due Process Steps followed in the development of the amendments to IAS 28 *Investments in Associates and Joint Ventures*

The following table sets out the due process steps followed by the IASB that are required for publication of the Exposure Draft

Step	***Required/ Optional***	***Actions***
Board meetings held in public, with papers available for observers. All decisions are made in public session.	Required	This issue was discussed by the IFRS Interpretations Committee (the 'Interpretations Committee') during its March and May 2013 meetings and by the IASB at its July 2013 meeting. The IASB decided to propose a narrow-scope amendment to IAS 28 *Investments in Associates and joint Ventures.* An *IFRIC Update* and An *IASB Update* were posted after each of the Interpretations Committee meetings and the IASB meeting at which this issue was discussed. A project webpage was created after the Interpretations Committee March 2013 meeting.
Consultation with the Trustees and the Advisory Council.	Required	Because of the narrow-scope nature of the amendments this was considered to be unnecessary.
Analysis of the likely effects of the forthcoming Standard or major amendment, for example, initial costs or ongoing associated costs.	Required	This is a narrow-scope amendment and its objective is to clarify the guidance in IAS 28 when the gains to be eliminated in 'downstream' transactions exceed the carrying amount of the entity's investment in an associate or joint venture. The staff assessed the likely effects of the proposed amendment as limited because the scope of the proposed amendment is narrow. The staff provided the IASB with a description of the financial reporting effects of the proposed amendment at the July 2013 IASB meeting, which are included in the Basis for Conclusions of the Exposure Draft.
Finalisation		
Due process steps reviewed by the IASB.	Required	The IASB will review the due process steps in its January 2014 meeting.
The ED has an appropriate comment period.	Required	The IASB agreed at its January 2014 meeting that the ED will be published with a standard comment period of 120 days.
Drafting		
Drafting quality assurance steps are adequate.	Required	The translation team will be asked to review the pre-ballot draft.
Drafting quality	Required	The XBRL team will be asked to review the pre-ballot draft.

Step	*Required/ Optional*	*Actions*
assurance steps are adequate.		
Publication		
ED published.	Required	The DPOC will be informed as part of the routine reporting to them and also following the January 2014 IASB meeting.
Press release to announce publication of ED.	Required	A press release will be published announcing the ED.