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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	Inconsistency with paragraph 31 of IAS 28

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Introduction

1. This paper retraces the history of paragraph 31 of IAS 28 *Investments in Associates and Joint Ventures* (issued in 2011). This paragraph is perceived as conflicting with the existing requirements of IAS 28 and with the forthcoming amendment *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (Amendments to IFRS 10 and IAS 28).
2. This issue 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.
3. The Interpretations Committee:

   (a) in July 2013, recommended that the IASB should proceed with the amendments to IFRS 10 and IAS 28 (issued in 2011); and

   (b) in January 2014, recommended that the IASB should amend IAS 28, because paragraph 31 of IAS 28 is not consistent with the forthcoming amendments to (and the existing requirements of) IAS 28.

4. The IASB:

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(a) in October 2013, tentatively decided to finalise the proposed amendments to IFRS 10 and IAS 28 (2011); and

(b) in February 2014, asked the staff to investigate further the background and the rationale behind paragraph 31 of IAS 28, before deciding whether IAS 28 should be amended.

Objective

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

   (a) whether it agrees that paragraph 31 of IAS 28 should be amended: and

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

Staff analysis

The requirements of SIC–13

6. Paragraph 31 of IAS 28 comes from SIC–13 *Jointly Controlled Entities—Non-Monetary Contributions by Venturers*, which was withdrawn in 2011. In 2011, the requirements in SIC–13 were incorporated into IAS 28 (2011).

7. SIC–13 was issued because there was no explicit guidance on the recognition of gains and losses resulting from contributions of non-monetary assets to jointly controlled entities (JCE) (see SIC–13 paragraph 1).

8. SIC–13 addressed the following issues:

   (a) when the *appropriate portion* of gains or losses resulting from a contribution of a non-monetary asset to a JCE in exchange for an equity interest in the JCE should be recognised by the venturer in profit or loss;

   (b) how *additional consideration* (ie cash or other consideration that does not depend on future cash flows of the JCE) should be accounted for by the venturer; and

(c) how any unrealised gain or loss should be presented in the consolidated financial statements of the venturer (see SIC–13 paragraph 3).

9. Paragraphs 5-7 of SIC–13 stated that (emphasis added):

> 5 In applying IAS 31.48[1] to non-monetary contributions to a JCE in exchange for an equity interest in the JCE, a venturer shall recognise in profit or loss for the period the portion of a gain or loss attributable to the equity interests of the other venturers except when:
>
> (a) the significant risks and rewards of ownership of the contributed non-monetary asset(s) have not been transferred to the JCE; or
>
> (b) the gain or loss on the non-monetary contribution cannot be measured reliably; or
>
> (c) the contribution transaction lacks commercial substance, as that term is described in IAS 16.
>
> **If exception (a), (b) or (c) applies, the gain or loss is regarded as unrealised and therefore is not recognised in profit or loss unless paragraph 6 also applies.**
>
> 6 If, in addition to receiving an equity interest in the JCE, a venturer receives monetary or non-monetary assets, **an appropriate portion of gain or loss on the transaction shall be recognised by the venturer in profit or loss.**
>
> 7 Unrealised gains or losses on non-monetary assets contributed to JCEs shall be eliminated against the underlying assets under the proportionate consolidation method or against the investment under the equity method. Such unrealised gains or losses shall not be presented as deferred gains or losses in the venturer's consolidated statement of financial position.

The incorporation of SIC–13 into IAS 28

10. Paragraphs 5-7 of SIC–13 have been incorporated in paragraphs 30 and 31 of IAS 28 (2011), as explained in the following paragraphs of this paper.

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[1] Paragraph 48 of IAS 31 *Interests in Joint Ventures* stated that (emphasis added): *When a venturer contributes or sells assets to a joint venture, recognition of any portion of a gain or loss from the transaction shall reflect the substance of the transaction. While the assets are retained by the joint venture, and provided the venturer has transferred the significant risks and rewards of ownership,* ***the venturer shall recognise only that portion of the gain or loss that is attributable to the interests of the other venturers.***

The incorporation of paragraphs 5 and 7 of SIC–13

11. Paragraphs 5 and 7 of SIC–13 were incorporated into paragraph 30 of IAS 28. However, in December 2009[2] the IASB decided:

    (a) not to incorporate the requirements in (a) and (b) of paragraph 5 of SIC-13 (ie “the significant risks and rewards of ownership of the contributed non-monetary asset(s) have not been transferred to the JCE” and “the gain or loss on the non-monetary contribution cannot be measured reliably”); and

    (b) to incorporate the requirements in paragraph 5(c) of SIC-13. Consequently, the only circumstance in which the portion of a gain or loss attributable to the equity interests of the other venturers is not recognised is if the contribution transaction lacks commercial substance. This means that, in all the other cases the general guidance (which was in paragraph 48 of IAS 31 and that is now in paragraph 28 of IAS 28) applies. In other words, in all the other cases the gain or loss is partially recognised:

        (i) only to the extent of unrelated investors’ interests in the associate or joint venture (to use the current wording of IAS 28 paragraph 28); or

        (ii) only that portion of the gain or loss that is attributable to the interests of the other venturers (to use the ‘old’ wording of IAS 31 paragraph 48).

    Indeed, paragraph 30 of IAS 28 now states that (emphasis added):

    30 The contribution of a non-monetary asset 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[3], 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

[2] Please see the December 2009 IASB Update: http://media.iasb.org/UpdateDecember2009.html#jointventures

[3] Paragraph 28 states that: *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…*

> 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.

The incorporation of paragraph 6 of SIC–13

12. Paragraphs 6 of SIC–13 stated that (emphasis added):

> 6 If, in addition to receiving an equity interest in the JCE, a venturer receives monetary or non-monetary assets, **an appropriate portion of gain or loss on the transaction shall be recognised by the venturer in profit or loss.**

13. Paragraphs 6 of SIC–13 has been incorporated in paragraph 31 of IAS 28 as follows (emphasis added):

> 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.**

14. The wording of paragraph 6 of SIC–13 was modified during the balloting process of IAS 28 (2011) with the aim of clarifying the meaning of "appropriate portion". The meaning of "appropriate portion" used in the balloting documentation in 2011 was **the full portion** of the gain or loss relating to the cash or other consideration received that does not depend on future cash flows of the investee, because for this part of the consideration the earnings process is complete.

15. Paragraph 12 of the Basis for Conclusions of SIC–13 referred to the completion of the earnings process and stated that (emphasis added):

> 12 To the extent that the venturer also receives cash or non-monetary assets dissimilar to the assets contributed in addition to equity interests in the JCE, the realisation of which is not dependent on the future cash flows of the JCE, **the earnings process is complete. Accordingly, the appropriate portion of the gain on the non-monetary contribution is recognised in profit or loss for the period.**

16. The paragraph above has been incorporated into paragraph BCZ 36 of IAS 28 (2011), which states that (emphasis added):

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.**

17. We note that the meaning of the prefix BCZ is explained in paragraph BC 6 of IAS 28, which states (emphasis added):

BC6 The Board has incorporated into its Basis for Conclusions on IAS 28 (as amended in 2011) material from the previous Basis for Conclusions because **it discusses matters that the Board has not reconsidered**. That material is contained in paragraphs denoted by numbers with the prefix BCZ. In those paragraphs cross-references have been updated accordingly and **minor necessary editorial changes have been made**.

18. On the basis of the above analysis, we think that:

(a) In 2011, the term "appropriate portion" was replaced with "full portion"; and that

(b) the intention was to clarify (and not to change) the original meaning of "appropriate portion" as used in SIC–13.

The original meaning of "appropriate portion"

19. We think that the original meaning of "appropriate portion" was 'that portion of the gain or loss relating to the cash or other assets received (that do not depend on future cash flows of the joint venture) **that is attributable to the interests of the other venturers**', for the reasons provided in the following paragraphs of this paper.

20. SIC–13 was an interpretation of paragraph 48 of IAS 31. This paragraph required that when a venturer contributes or sells assets to a joint venture, the venturer shall recognise only the portion of the gain or loss that is attributable to the interests of the other venturers, if the assets are retained by the joint venture. The paragraph stated that:

48 When a venturer contributes or sells assets to a joint venture, recognition of any portion of a gain or loss from the transaction shall reflect the substance of the transaction. While the assets

> are retained by the joint venture, and provided the venturer has transferred the significant risks and rewards of ownership, the venturer shall recognise only that portion of the gain or loss that is attributable to the interests of the other venturers.

21. Consequently, according to paragraph 48 of IAS 31, the gain or loss was recognised in full, only when the assets transferred to the joint venture are consumed/realised by the joint venture. This principle still exists, because paragraph 26 of IAS 28 states that:

> 26 Many of the procedures that are appropriate for the application of the equity method are similar to the consolidation procedures described in IFRS 10.

22. In our view, it is important to note that according with paragraph 48, a partial gain was recognised even when the venturer sells assets to a joint venture (ie even when the entire consideration received does not depend on future cash flows of the joint venture). Consequently, SIC–13 could not require a full gain recognition of the gain, relating to the part of the consideration received that does not depend on future cash flows of the joint venture, because this would have been inconsistent with the partial gain recognition required by paragraph 48 of IAS 31, which applied both to sales and contributions.

23. In summary, SIC–13 required:

    (a) a partial gain recognition as general requirement[4];

    (b) that the gain is not recognised if the exceptions in (a), (b) or (c) of paragraph 5 apply; and

    (c) a partial gain recognition when the exceptions in (a), (b) or (c) of paragraph 5 apply and a part of the consideration received does not depend on future cash flows of the joint venture. Indeed paragraph 5 stated that (emphasis added): "*If exception (a), (b) or (c) applies, the gain or loss is regarded as unrealised and therefore is not recognised in profit or loss **unless paragraph 6 also applies***".

24. In our view, according to paragraph 6 of SIC–13 the part of the gain that relates to the equity received was not recognised (because of one of the three exceptions) and the part of the gain that relates to the cash or other assets received (that do not depend on

[4] The first sentence of paragraph 5 of SIC–13 stated: "*In applying IAS 31.48 to non-monetary contributions to a JCE in exchange for an equity interest in the JCE, a venturer shall recognise in profit or loss for the period the portion of a gain or loss attributable to the equity interests of the other venturers except when…*".

future cash flows of the joint venture) was partially recognised (ie to the extent of the interests of the other venturers).

The proposed amendment to paragraph 31 of IAS 28

25. On the basis of the above analysis, we think that paragraph 31 of IAS 28 should be amended as follows:

> 31 If, in addition to receiving an equity interest in an associate or a joint venture, an entity receives ~~monetary or non-monetary~~ other 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 only to the extent of unrelated investors' interests in the associate or joint venture.

26. We think that this amendment to paragraph 31 should be included in the forthcoming amendments to IFRS 10 and IAS 28, because these amendments highlight the inconsistency between paragraph 31 (which requires a full gain recognition) and the other current requirements of IAS 28 (that require a partial gain recognition).

27. For further details on the inconsistency between paragraph 31 of IAS 28 and the forthcoming amendments to (and the existing requirements of) IAS 28, see Agenda Paper 12H (February IASB meeting).

Due process considerations

28. 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.

29. We think that the proposed changes to paragraph 31 of IAS 28 are not fundamental and are coherent with the existing principles of IAS 28 and with the forthcoming

amendments to IFRS 10 and IAS 28. Consequently, we think that, on the basis of the re-exposure criteria in paragraphs 6.25–6.29 of the *Due Process Handbook*, the amendments to paragraph 31 of IAS 28 can be included in the forthcoming final amendments to IFRS 10 and IAS 28 without re-exposure.

30. 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

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

    (a) amend paragraph 31 of IAS 28;

    (b) include the amendments to 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)

32. 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 staff's recommendation to amend paragraph 31 of IAS 28? 2. Does the IASB agree with the staff's recommendation to include the amendments to 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

...

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

...

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~~ other 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 only to the extent of unrelated investors' interests in the associate or joint venture.

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

...

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.