IFRS

STAFF PAPER

January 2015

IASB Meeting

Project	**Sale or contribution of assets between an Investor and its Associate or Joint Venture: Narrow-scope Amendment to IFRS 10 and IAS 28**
Paper topic	Interaction with existing paragraph 32 of IAS 28

CONTACT(S) April Pitman apitman@ifrs.org +44 (0)20 7246 6492

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

1. The staff have become aware of an unintended consequence that has arisen from the interaction of the narrow-scope amendment “Sale or Contribution of Assets between an Investor and its Associate or Joint Venture: Amendments to IFRS 10 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures”*, issued in September 2014, (the ‘September 2014 amendment’) and the existing requirements of IAS 28.

2. The September 2014 amendment deals with transactions in which an entity:

   (a) sells part of its interest in a subsidiary to an entity that is an associate or joint venture of the entity; and

   (b) retains an investment in the former subsidiary that is now accounted for using the equity method.

3. The September 2014 amendment requires that gains or losses on the loss of control of a former subsidiary, which does not contain a business and is now accounted for using the equity method, are restricted to an amount that reflects the unrelated investors’ interests in the new associate or joint venture. These requirements would appear to conflict with the requirements of paragraph 32(b) in IAS 28 with respect to accounting for a difference between the cost of the associate and the investor’s share of the fair value of the net assets acquired.

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

4. In this paper we propose amendments to IFRS 10 and IAS 28 that will resolve this conflict. We also ask for these proposed amendments to be bundled with the proposed amendments to IAS 28, relating to the elimination of gains or losses arising from transactions between an entity and its associate or joint venture, that were balloted for exposure in November 2014. That existing proposed amendment is described in more detail on the following project page:

http://www.ifrs.org/Current-Projects/IASB-Projects/IAS-28-Elimination-of-intercompany-profits/Pages/IAS-28-elimination-of-intercompany-profits.aspx

Structure of the paper

5. The paper is organised as follows:

(a) background;

(b) the issue;

(c) summary of the proposed amendments;

(d) combining the proposed amendments with ones already balloted; and

(e) Appendix 1–proposed drafting.

Background

6. The objective of the September 2014 amendments to IFRS 10 and IAS 28 was to address a conflict between the requirements of IFRS 10 and IAS 28. The conflict identified was that IFRS 10 requires that the gain or loss that arises on the loss of control of a subsidiary is recognised *in full*, even if the parent retains joint control of, or significant influence over, the investee. Paragraph 28 of IAS 28, on the other hand, requires a *partial* gain or loss recognition, limited to the unrelated investors' interests in the investee, for all transactions between an investor and its associate or joint venture. The original submitter had asked whether transactions that have both these characteristics should be accounted for in accordance with IFRS 10 or IAS 28. The IASB decided to resolve this conflict by basing the

accounting treatment on whether the assets transferred constituted a business or not.

7. In order to address this conflict the IASB 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 while 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, ie accounted for in accordance with IAS 28 before amendment; 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 while retaining joint control or significant influence, the gain or loss recognised by the entity is recognised in full, ie accounted for in accordance with IFRS 10 before amendment.

8. Any transaction of this type gives rise to two potential gains or losses:

   (a) the gain or loss arising from the sale of the part-interest in the subsidiary; and

   (b) any gain or loss that arises when accounting for the acquisition of the associate or joint venture, ie the gain or loss that arises when any residual interest in the subsidiary is remeasured to fair value at the date that control was lost.

9. At an early stage in its deliberations, the IASB decided that the gain or loss arising from the sale of the part interest in the subsidiary (paragraph 8(a) above) would be recognised in full if the assets constituted a business, but only in part if those assets did not constitute a business.

10. The requirements with respect to the gain or loss on remeasurement of the residual interest (paragraph 8(b) above) was a sweep issue considered in January

2014. At that meeting the IASB decided that this gain or loss would also be limited to the unrelated investors' interests if the assets did not constitute a business. This requirement was added to the amendments by the addition of paragraph B99A:

> B99A … In addition, if the parent retains an investment in the former subsidiary and the former subsidiary is now an associate or a joint venture that is accounted for using the equity method, the parent recognises 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. The remaining part of that gain is eliminated against the carrying amount of the investment retained in the former subsidiary. 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.

11. The paper in which this decision was discussed is available at:

http://www.ifrs.org/Meetings/MeetingDocs/IASB/2014/January/AP12A-IFRS%2010%20-%20IAS%2027%20-%20SIC%2013.pdf

The issue

12. The cost on first recognition of the investment in the associate that arises from the loss of control of a subsidiary is recognised at fair value in accordance with paragraph B98 (b)(iii) of IFRS 10. Recognising this investment at fair value gives rise to a gain or loss on remeasurement as noted in paragraph 8(b) of this paper.

13. When this type of transaction does not constitute a business, however, part of the gain or loss on the sale of the part interest (paragraph 8(a) of this paper) or on the remeasurement of the residual interest (paragraph 8(b) of this paper) in the former subsidiary is now eliminated against the carrying amount of the investment in

accordance with the requirements of new paragraph B99A of IFRS 10, introduced by the September 2014 amendment. Consequently, the carrying amount of the residual interest in the former subsidiary, which is now an equity-accounted investment, is fair value at the date that control was lost, adjusted for the elimination of the entity's share of the gain or loss on the transaction, as described in paragraphs 8(a) and 8(b) of this paper.

14. However, paragraph 32 of IAS 28 already contains guidance on accounting for the difference between cost and the investor's share of the net assets of an equity-accounted associate or joint venture:

> 32… On acquisition of the investment, any difference between the cost of the investment and the entity's share of the net fair value of the investee's identifiable assets and liabilities is accounted for as follows:
>
> (a) goodwill relating to an associate or joint venture is included in the carrying amount of the investment. Amortisation of that goodwill, is not permitted.
>
> (b) Any excess of the entity's share of the net fair value of the investee's identifiable assets and liabilities over the cost of the investment is included as income in the determination of the entity's share of the associates or joint venture's profit or loss in the period in which the investment is acquired.

15. In accordance with paragraph 32(b) of IAS 28, the excess of the entity's share of the fair value of the assets acquired, compared with cost, is recognised as income. There is a concern, therefore, that the gain attributable to the entity's own interest in the equity-accounted investment, eliminated against the carrying amount of the investment in accordance with the new requirements of paragraph B99A of IFRS 10, would be re-recognised as income by the requirements of existing paragraph 32(b) of IAS 28.

Summary of the proposed amendments

16. We propose amending IFRS 10 to specify that cost on initial recognition of the remaining investment in the former subsidiary is fair value at the date that control was lost in accordance with IFRS 10 paragraph 25(b). Consequently this 'cost' will be used in the calculation required by paragraph 32 if IAS 28. The elimination of the gain(s) that is required when the former subsidiary does not include a business will be described as a 'subsequent adjustment' to the carrying amount in order that the elimination does not affect the calculation required by paragraph 32 of IAS 28.

17. In order to achieve this, we propose:

    (a) amending paragraph 25(b) to explain that when loss of control of a subsidiary gives rise to an investment, that is equity-accounted and that does not contain a business, the investment should be measured initially in accordance with original paragraph B98(b)(iii) and then subsequently adjusted in accordance with the new paragraph B99A; and

    (b) amending paragraph B99A, inserted by the September 2014 amendments, to include a sentence to reiterate that the elimination of part of the gains at the date control is lost is an adjustment subsequent to the initial recognition of the retained interest and consequently does not affect the calculation required by paragraph 32 of IAS 28. This is proposed in order to prevent the requirements of paragraph 32 of IAS 28 from reversing the elimination required by paragraph B99A of IFRS 10.

18. We also propose amending IAS 28 so that it is clear, for the purposes of acquisition accounting in paragraph 32 of the Standard, that when the equity-accounted entity results from the loss of control of a subsidiary and does not include a business, cost on initial recognition is the fair value of the investment at the date that control is lost and is before any elimination of the gains or losses described above.

19. The proposed amendment is included as Appendix A to this paper.

Question 1 for the IASB
Do you have any comments on the proposed amendment to IAS 28 and IFRS 10?

Combining the proposed amendments with ones already balloted

20. In November 2014, the balloting process was completed on the Exposure Draft *Elimination of Gains or Losses arising from Transactions between an Entity and its Associate or Joint Venture:* Proposed amendments to IAS 28, (the 'balloted Exposure Draft'). These proposals are related to the September 2014 amendments.

21. The September 2014 amendments changed the requirements for accounting for gains and losses arising on transactions with equity-accounted investments. The balloted Exposure Draft proposes clarifying how gains eliminated against the carrying amount of those investments should be presented.

22. In the balloted Exposure Draft, the IASB proposes that:

    (a) an entity should eliminate its share of the gain from a 'downstream' transaction with its associate or joint venture, even if the gain that is eliminated exceeds the carrying amount of the entity's investment in the associate or joint venture;

    (b) the amount of the gain that is eliminated that exceeds the carrying amount of the entity's investment in the associate or joint venture is presented as a deferred gain; and

    (c) when an entity contributes an asset to its associate or joint venture in exchange for both equity and other assets, the portion of the gain or loss relating to the assets received should be recognised only to the extent of unrelated investors' interests in the associate or joint venture.

23. We recommend bundling the amendments proposed in this paper with those proposals already balloted because:

(a) both the balloted Exposure Draft and the amendments proposed in this paper arise as a consequence of the September 2014 amendment; and

(b) it will be more efficient for constituents who must manage changes in their financial reporting processes if both sets of proposals are issued together.

Question 2 for the IASB
Do you agree with the staff proposal to combine these amendments with the amendments to IAS 28 that have already been balloted?

Appendix A–Proposed drafting

Amendments made to IFRS in September 2014 are underlined or struck through in black. Amendments proposed in this paper are in red.

IFRS 10

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~~ retained interest is remeasured, as described in paragraph~~s~~ B98(b)(iii) ~~and B99A.~~ The remeasured value at the date that control is lost shall be regarded as the fair value on initial recognition of a financial asset in accordance with IFRS 9 or the cost on initial recognition of an investment in an associate or joint venture, if applicable. If the retained interest in the former subsidiary is now an associate or joint venture that is accounted for using the equity method and that investment does not contain a business, the cost on initial recognition of the investment, measured at fair value in accordance with paragraph B98(b)(iii), may need to be adjusted subsequently in accordance with paragraph B99A.

(c) recognises the gain or loss associated with the loss of control attributable to the former controlling interest.

B99A (a) 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. The remaining part of the gain is eliminated against the carrying amount of the investment in that associate or joint venture.

(b) In addition, if the parent retains an investment in the former subsidiary and the former subsidiary is now an associate or a joint venture that is accounted for using the equity method, the parent recognises 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. The remaining part of that gain is eliminated against the carrying amount of the investment retained in the former subsidiary.

(c) The eliminations required by (a) and (b) are adjustments subsequent to the initial recognition of the retained interest at the date control is lost. Consequently these adjustments do not affect the calculations required by paragraph 32 of IAS 28 on initial recognition of the retained interest.

(d) 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.

IAS 28

32 An investment is accounted for using the equity method from the date on which it becomes an associate or a joint venture. On acquisition of the investment, any difference between the cost of the investment

and the entity's share of the net fair value of the investee's identifiable assets and liabilities is accounted for as follows:

(a) goodwill relating to an associate or joint venture is included in the carrying amount of the investment. Amortisation of that goodwill is not permitted.

(b) Any excess of the entity's share of the net fair value of the investee's identifiable assets and liabilities over the cost of the investment is included as income in the determination of the entity's share of the associates or joint venture's profit or loss in the period in which the investment is acquired.

If the investment results from the loss of control of a subsidiary and the investment does not contain a business, cost on initial recognition of the investment is the fair value of the investment at the date when control is lost in accordance with B98(b)(iii) of IFRS 10. That definition of cost excludes any adjustment that may be required by B99A of IFRS 10.