STAFF PAPER

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IASB Meeting

Project	IFRS 11 *Joint Arrangements*		
Paper topic	Remeasurement of previously held interests—loss of control		
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Introduction

1. The IFRS Interpretations Committee ('the Interpretations Committee') discussed whether the retained interest in the assets and liabilities of a joint operation should be remeasured when an entity loses control over an asset or group of assets. The asset or group of assets may or may not constitute a business. In the transaction discussed, the entity either retains joint control over a joint operation or is a party to a joint operation (with rights to the assets and obligations for the liabilities) subsequent to the transaction.

2. A number of members of the Interpretations Committee expressed a preference for remeasurement of the retained interest in transactions in which the asset, or group of assets, constitute a business (as defined by IFRS 3 *Business Combinations*). However, the Interpretations Committee also noted that this transaction has similarities with a sale or contribution of assets to a joint venture or an associate, which has been the subject of recent discussions by the IASB.

3. Consequently, the Interpretations Committee decided to consult the IASB to assess whether it should postpone further discussion on this transaction (both for transactions in which the asset, or group of assets, constitutes a business and those in which it does not) until the research project on the equity method of accounting is completed.

Purpose of this paper

4. The purpose of this paper is to:

(a) present background information on the issue;

(b) provide a summary of the staff's analysis and the Interpretations Committee's discussions;

(c) provide a recommendation; and

(d) ask the IASB for input on whether the Interpretations Committee should continue its discussions on this transaction or postpone them.

5. While we have provided a brief summary of our technical analysis and the Interpretations Committee's discussions, the purpose of this paper is to ask the IASB for direction on the way forward.

Background

6. An entity may enter into a transaction as a result of which it loses control of a business. The transaction results in the entity having joint control of, or being a party to, a joint operation subsequent to this transaction. The question arises as to how the retained interest should be accounted for as a result of this transaction.

7. We understand from our outreach that in situations in which the asset, or group of assets, meets the definition of a business, the transaction is widespread. We also observed that there are three divergent views that have developed in practice:

(a) View 1—the entity's retained interest is remeasured to fair value.

Proponents of this view note that paragraph 25 of IFRS 10 *Consolidated Financial Statements* provides guidance for accounting for a loss of control transaction and requires retained interests to be remeasured.

They also note that paragraph BCZ182 of IFRS 10 states that in the IASB's view loss of control is a significant economic event, which results in a change in the nature of the investment. This same rationale is also applicable to the transaction being discussed.

(b) View 2—the entity's retained interest is not remeasured.

Proponents of this view think that paragraph 25 of IFRS 10 was only intended to address the scenario in which the retained interest will be subsequently accounted for as a financial asset or an investment in an associate or a joint venture and is not applicable to a loss of control transaction that results in the entity having joint control in, or being a party to, a joint operation subsequent to the transaction. They think that an entity should not derecognise or remeasure the share of assets and liabilities of the joint operation in which it retains an interest.

They also note that paragraphs B34–B35 of IFRS 11 *Joint Arrangements* contain specific guidance on accounting for sales or contributions of assets to a joint operation. In accordance with these requirements, gains and losses can only be recognised to the extent of the other parties' interests in the joint operation.

(c) View 3—the entity's retained interest is remeasured only if the joint operation is structured through a separate legal entity.

Proponents of this view note that the guidance in paragraph 25 of IFRS 10 applies only to the loss of control of a subsidiary. Appendix A of IFRS 10 defines a subsidiary as an entity that is controlled by another entity. Accordingly, proponents of this view distinguish the accounting for loss of control depending on whether the business is housed in a separate legal entity or not. If a business is housed in a separate legal entity the requirements in paragraph 25 of IFRS 10 would be applicable and any retained interests would be remeasured.

Summary of the staff's analysis and the Interpretations Committee's discussions

8. The following section presents a summary of the staff's analysis and the discussions of the Interpretations Committee. Our full analysis of the issue can be found in Agenda Paper 5B of the Interpretations Committee meeting in September 2015.

9. As discussed in Agenda Paper 12B, the Interpretations Committee noted that the key factors that should be used in assessing whether previously held interests should be remeasured are:

(a) the significance of the underlying economic event; and

(b) the measurement model applicable to the recognition of the previously held/retained interests.

Several members of the Interpretations Committee also noted that the structure of the investment and whether or not it is structured through a separate legal entity may have a bearing on the analysis and should be a relevant consideration.

10. For transactions involving a business, our analysis noted that:

(a) *the transaction represents a significant economic event.*

This is because the entity has surrendered its controlling interests in exchange for being either a passive investor (ie a party to the joint operation) or a joint controller in the joint operation. In effect, it has surrendered its right to unilaterally *direct* how the acquiree and its management use those assets in its operation. It no longer has *unilateral decision-making power* over the wealth generating abilities of the business. We think that the loss of control transaction changes the nature of the investment and the relationship between the parties.

(b) *the fair value model used by IFRS 10 in accounting for the loss of control is the appropriate measurement model to apply to this transaction.*

IFRS 11 requires a joint operator to account for the assets, liabilities, revenues and expenses relating to its interests in a joint operation in accordance with the applicable Standards. Some of those Standards, such as IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*, provide a cost-based model for initial recognition.

IFRS 10 requires an entity to remeasure its retained interest at fair value when it loses control of a subsidiary (in situations in which the subsidiary meets the definition of a business). We note that IAS 28 *Investments in Associates and Joint Ventures* uses a cost-based model, because it specifies that an investment in an associate or a joint venture is recognised at cost on initial recognition (see paragraph 10 of IAS 28). Paragraph 25(b) of IFRS 10 notes that the remeasured value shall be regarded as the cost on initial recognition of an investment in an associate or a joint venture.

We think that the fair value model used by IFRS 10 in accounting for the loss of control in a subsidiary would also be applicable in the transaction.

11. Our conclusion is that the retained interest should be remeasured. We also did not think that the structure of the joint operation (ie whether there is a legal entity in place or not) should affect the analysis.

12. At the Interpretations Committee meeting in September 2015, a number of its members agreed with our analysis and expressed a preference for remeasurement of the retained interests in transactions in which the asset, or group of assets, constitutes a business.

13. We did not think that transactions not involving a business were common in practice. This was based on past experience and previous outreach. However, a few Interpretations Committee members noted that they have had some experience with these transactions and suggested addressing transactions involving a business and those not involving a business together.

14. However, there have been recent IASB discussions on a related issue of sale or contribution of assets to an associate or a joint venture. We think that the outcome of those discussions could have a direct impact on the Interpretations Committee's analysis. Details of the interrelationship are presented in the next section.

Similarities with a recent amendment made by the IASB

15. The IASB noted a conflict between the requirement to eliminate gains and losses resulting from downstream transactions with associates and joint ventures in IAS 28 compared with the requirement to recognise in full all gains and losses resulting from the loss of control of a subsidiary in instances in which the retained interest may be classified as an associate or a joint venture.

16. In order to address this conflict, the IASB recently made some amendments to IFRS 10 and IAS 28. The IASB noted that when the asset, or group of assets contributed to an associate or a joint venture meets the definition of a business, full gain or loss recognition is required and the retained interest should be measured at fair value. When the asset, or group of assets, contributed to an associate or a joint venture does not meet the definition of a business, only partial gain or loss recognition is permitted (to the extent of the unrelated investors' interests).

17. Consequently, the amendment to IFRS 10 specifies that when an investment is retained in the former subsidiary (either an associate or a joint venture) that is not a business, the retained interest is remeasured to fair value; however, the part of the gain or loss resulting from the remeasurement that does not relate to the unrelated investors' interests should be eliminated against the carrying amount of the retained investment. In situations in which the retained interest is a financial asset, the retained interest would be measured at fair value and the gain or loss resulting from the remeasurement would be recognised in full in profit or loss.

18. This results in the retained investment being measured at a different amount post-transaction depending on whether or not the transaction involved a business, and on the nature of the retained investment (ie whether it is a financial asset or an equity-method accounted-for investee).

19. Subsequent to this amendment, the IASB intended to propose a further narrow-scope amendment to clarify some matters linked to this amendment. However, the IASB decided that those issues should instead be addressed as part of the limited-scope research project on the equity method of accounting. Accordingly, the IASB has decided to postpone these amendments until this project is completed, in order to avoid making multiple changes to the Standard within a short period of time.

20. A similar conflict exists for joint operations. Paragraphs B34–B35 of IFRS 11 specifies that gains and losses can only be recognised to the extent of the other parties' interests in the joint operation. The wording in these paragraphs could be seen as conflicting with the requirements in IFRS 10 to remeasure any retained interest.

21. Our recommendation to the Interpretations Committee was that it should postpone further discussions on this transaction until the research project on the equity method of accounting progresses and a decision is made on accounting for sale or contribution of assets to an associate or a joint venture. We made this recommendation because:

    (a) the conflict that exists between the requirements in IFRS 10 and IFRS 11 are similar to those that the IASB is trying to address through its amendment; and

(b) any decision reached by the Interpretations Committee in respect of a joint operation may need to be revisited within a short time period if the IASB reaches a different conclusion for associates and joint ventures.

22. The Interpretations Committee noted that it may be able to reach a consensus on the appropriate accounting treatment for the transaction (for example, a number of members expressed a preference for remeasurement to fair value in cases in which the transaction involved a business). It has requested us to consult the IASB to assess whether it should continue its deliberations or whether it should postpone further discussion on this transaction (both for transactions in which the asset, or group of assets, meets the definition of a business and for those in which it does not).

Questions for the IASB

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1. Does the IASB think that the Interpretations Committee should continue its deliberations on the transaction or should it postpone further discussion on the transaction?
2. Does the IASB have any other comments or advice for the Interpretations Committee in respect of this matter?