STAFF PAPER

January 2018

IFRS® Interpretations Committee Meeting

Project	**IAS 28 *Investments in Associates and Joint Ventures*—Contributing PPE to an associate**
Paper topic	Agenda decision to finalise

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Introduction

1. The IFRS Interpretations Committee (Committee) received a request about how an entity accounts for a transaction in which it contributes property, plant and equipment (PPE) to a newly-formed associate in exchange for shares in the associate. The entities that set up the associate are under common control.

2. The request asked:

   (a) about the application of IFRS Standards to transactions involving entities under common control (common control transactions)—ie whether IFRS Standards provide a general exception or exemption from applying the requirements in a particular Standard to common control transactions (Question A);

   (b) whether an investor recognises any gain or loss on contributing PPE to the associate to the extent of other investors' interests in the associate (Question B); and

   (c) how an investor determines the gain or loss on contributing PPE to the associate and the cost of its investment in the associate. In particular, the request asked whether the cost of each investor's investment in the associate is based on the fair value of the PPE contributed or the fair value of the acquired interest in the associate (Question C).

3. The Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to account for the contribution of PPE to an associate in the fact pattern described in the request. Consequently, the Committee tentatively decided not to add this matter to its standard-setting agenda.

4. The purpose of this paper is to:

   (a) analyse the comments received on the tentative agenda decision; and

   (b) ask the Committee if it agrees with our recommendation to finalise the agenda decision.

Comment letter summary

5. We received six comment letters, included in Appendix B to this paper.

6. Five respondents agree with the Committee's decision not to add the matter to its standard-setting agenda for the reasons outlined in the tentative agenda decision.

7. The OIC also agrees with the Committee's analysis and conclusions on this matter. However, the OIC asks the Committee:

   (a) to explain, in its analysis of Question C, why an entity determines the gain or loss on contributing PPE based on the fair value of PPE contributed; and

   (b) to consider how this agenda decision interacts with the Committee's September 2017 discussion of the acquisition of an associate or joint venture from an entity under common control (common control acquisition transaction).

8. Further details on these matters, together with our analysis, are presented in the following section.

Staff analysis

Determining gain or loss on contributing PPE based on the fair value of PPE contributed

Matter raised by respondent

9. In its analysis of Question C (see paragraph 2(c) of this paper), the Committee observed in the tentative agenda decision that:

> …applying the requirements in IFRS Standards, an entity recognises a gain or loss on contributing PPE, and a carrying amount for the investment in the associate, that reflects the determination of those amounts based on the fair value of the PPE contributed…

10. The OIC asks the Committee to clarify why an entity determines the gain or loss on contributing PPE based on the fair value of the PPE contributed.

Analysis

11. In analysing Question C, the Committee noted that the question has an effect only if the fair value of the PPE contributed differs from the fair value of the equity interest in the associate received in exchange for that PPE. The Committee observed that in the fact pattern described in the request, it would generally expect the fair value of PPE contributed to be the same as the fair value of the equity interest in the associate that an entity receives in exchange. If there is initially any indication that the fair value of the PPE contributed might differ from the fair value of the acquired equity interest, the investor first assesses the reasons for this difference and reviews the procedures and assumptions it has used to determine fair value.

12. As explained in our analysis in September 2017 (see Agenda Paper 4 of the Committee's September 2017 meeting), we think it is relatively rare that the fair value of the PPE contributed would differ from the fair value of the equity interest in the associate received in exchange for that PPE (especially after having reviewed the procedures and assumptions used to determine fair value). In discussing this matter,

Committee members agreed that an entity would determine the gain or loss based on the fair value of the PPE contributed. However, because of the complexity of the transaction, and the nature of the interaction between the requirements in IAS 16 for derecognising PPE and those in IAS 28 for recognising an investment in an associate, Committee members reached this conclusion applying different rationales. For example, some members agreed with the staff analysis on the interaction and application of the requirements in IAS 16 and IAS 28 (see Agenda Paper 4 of the Committee's September 2017 meeting); others said the requirements in IAS 28 apply, rather than the more general requirements for derecognising PPE in IAS 16.

13. We think the tentative agenda decision provides helpful information that explains how an entity applies the requirements in the Standards in the relatively rare situations in which this question has an effect—ie situations in which the fair value of the PPE contributed differs from the fair value of the acquired interest in the associate. In our view, attempting to provide further explanation as to why an entity determines the gain or loss on contributing PPE based on the fair value of the PPE contributed would add unnecessary complexity to the agenda decision without providing any significant additional benefit.

14. Based on our analysis, we recommend that the Committee make no change to the agenda decision in this respect.

The Committee's discussion of the acquisition of an associate or joint venture from an entity under common control

Matter raised by respondent

15. In its analysis of Question A (see paragraph 2(a) of this paper), the Committee observed in the tentative agenda decision that:

> …unless a Standard specifically excludes common control transactions from its scope, an entity applies the applicable requirements in the Standard to common control transactions.

16. The OIC says this conclusion may affect the accounting for common control acquisition transactions, which the Committee discussed at its meetings in June and September 2017. The IFRIC Update from September 2017 states:

> The Committee discussed a request about how to account for the acquisition of an interest in an associate or joint venture from an entity under common control. The Board will discuss the matter at a future Board meeting in the light of the comments on the tentative agenda decision published in June 2017.

17. The OIC suggests that because of the similarity between the common control acquisition transaction and the matter discussed in this paper, the Committee should either:

    (a) not include its conclusion on Question A in the agenda decision; or

    (b) wait for the Board to conclude on the accounting for common control acquisition transactions before finalising the agenda decision.

Analysis

18. Since the Committee's discussion of the common control acquisition transaction in September 2017, the Board continued its discussions of the scope of the Business Combinations under Common Control research project. The Board noted that common control acquisition transactions are not in the scope of this project. Nonetheless, the Board will consider the interaction between the accounting for transactions included in the scope of the project and the accounting for other transactions under common control (such as the common control acquisition transaction) as the project progresses.

19. We recommend no change to the Committee's observation in the tentative agenda decision that 'unless a Standard specifically excludes common control transactions from its scope, an entity applies the applicable requirements in the Standard to common control transactions'.

20. Question A of this request relates more generally to the application of the Standards to transactions involving entities under common control, rather than to any particular transaction—ie the question asked whether IFRS Standards provide a general exception or exemption from applying the requirements in a particular Standard to common control transactions. This context is provided in the agenda decision.

21. In its discussions of both this matter and the common control acquisition transaction, Committee members agreed that it is inappropriate to apply the scope exemption in IFRS 3 *Business Combinations* for business combinations under common control by analogy to other common control transactions. Committee members were of the view that an entity applies the applicable requirements in an IFRS Standard unless that Standard specifically excludes common control transactions from its scope. When discussing the common control acquisition transaction, Committee members however had differing views about how to read the requirements in IAS 28 in the context of that particular transaction. No such differing views existed with respect to this matter.

22. For the reasons noted above, we see no reason to change the wording of the agenda decision in this respect.

Staff recommendation

23. Based on our analysis, we recommend confirming the tentative agenda decision as published in the IFRIC Update in September 2017 with no changes. Appendix A to this paper outlines the draft wording for the final agenda decision.

Question for the Committee
Does the Committee agree with our recommendation to finalise the agenda decision outlined in Appendix A to this paper?

Appendix A—Proposed wording for agenda decision

A1. We propose the following wording for the agenda decision, which is unchanged from the tentative agenda decision except to remove the square brackets in the last sentence.

IAS 28 *Investment in Associates and Joint Ventures*—Contributing property, plant and equipment to an associate

The Committee received a request about how an entity accounts for a transaction in which it contributes property, plant and equipment (PPE) to a newly-formed associate in exchange for shares in the associate.

In the fact pattern described in the request:

a. three entities, collectively referred to as investors, set up a new entity. The investors are all controlled by the same government—ie they are under common control.

b. the investors each contribute items of PPE to the new entity in exchange for shares in that entity. The PPE contributed by the investors is not a business (as defined in IFRS 3 *Business Combinations*).

c. each investor has significant influence over the new entity. Accordingly, the new entity is an associate of each of the investors. The investors do not have control or joint control of the entity.

d. the transaction is carried out on terms equivalent to those that would prevail in an orderly transaction between market participants.

The request asked:

a. about the application of IFRS Standards to transactions involving entities under common control (common control transactions)—ie whether IFRS Standards provide a general exception or exemption from applying the requirements in a particular Standard to common control transactions (Question A);

b. whether an investor recognises any gain or loss on contributing PPE to the associate to the extent of other investors' interests in the associate (Question B); and

c. how an investor determines the gain or loss on contributing PPE to the associate and the cost of its investment in the associate. In particular, the request asked whether the cost of each investor's investment in the associate is based on the fair value of the PPE contributed or the fair value of the acquired interest in the associate (Question C).

In analysing the request, the Committee assumed the contribution of PPE to the associate has commercial substance as described in paragraph 25 of IAS 16 *Property, Plant and Equipment*.

Question A

Paragraph 7 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires an entity to apply an IFRS Standard to a transaction when that Standard applies specifically to the transaction. The Committee observed, therefore, that unless a Standard specifically excludes common control transactions from its scope, an entity applies the applicable requirements in the Standard to common control transactions.

Question B

Paragraph 28 of IAS 28 requires an entity to recognise gains and losses resulting from upstream and downstream transactions with an associate only to the extent of unrelated investors' interests in the associate. Paragraph 28 includes as an example of a downstream transaction the contribution of assets from an entity to its associate.

The Committee observed that the term 'unrelated investors' in paragraph 28 of IAS 28 refers to investors other than the entity (including its consolidated subsidiaries)—ie the word 'unrelated' does not mean the opposite of 'related' as it is used in the definition of a related party in IAS 24 *Related Party Disclosures*. This is consistent with the premise that financial statements are prepared from the perspective of the reporting entity, which in the fact pattern described in the request is each of the investors.

Accordingly, the Committee concluded that an entity recognises any gain or loss on contributing PPE to an associate to the extent of other investors' interests in the associate.

Question C

This question has an effect only if the fair value of the PPE contributed differs from the fair value of the equity interest in the associate received in exchange for that PPE. The Committee observed that in the fact pattern described in the request, it would generally expect the fair value of PPE contributed to be the same as the fair value of the equity interest in the associate that an entity receives in exchange. If there is initially any indication that the fair value of the PPE contributed might differ from the fair value of the acquired equity interest, the investor first assesses the reasons for this difference and reviews the procedures and assumptions it has used to determine fair value.

The Committee observed that applying the requirements in IFRS Standards, an entity recognises a gain or loss on contributing PPE, and a carrying amount for the investment in the associate, that reflects the determination of those amounts based on the fair value of the PPE contributed—unless the transaction provides objective evidence that the entity's interest in the associate might be impaired. If this is the case, the investor also considers the impairment requirements in IAS 36 *Impairment of Assets*.

If, having reviewed the procedures and assumptions used to determine fair value, the fair value of the PPE is more than the fair value of the acquired interest in the associate, this would provide objective evidence that the entity's interest in the associate might be impaired.

For all three questions, the Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to account for the contribution of

PPE to an associate in the fact pattern described in the request. Consequently, the Committee ~~[~~decided~~]~~ not to add this matter to its standard-setting agenda.

Appendix B—Comment letters

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20 November 2017

Sue Lloyd
Chair
IFRS Interpretations Committee
30 Cannon Street
London
United Kingdom
EC4M 6XH

Dear Ms Lloyd

Tentative agenda decision – IAS 28 *Investments in Associates and Joint Ventures*: Contributing property, plant and equipment to an associate

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the September IFRIC Update of the tentative decision not to take onto the Committee's agenda the request for clarification on the accounting for a contribution of property, plant and equipment to a newly formed associate in return for shares in that associate.

We agree with the IFRS Interpretations Committee's decision not to add this item onto its agenda for the reasons set out in the tentative agenda decision.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely

Veronica Poole
Global IFRS Leader

Grant Thornton LLP China

Feedback to Contributing PPE to an Associate

Dear IFRIC members,

Grant Thornton LLP China appreciates the opportunity to comment on the IFRIC tentative agenda decision included in the September 2017 IFRIC update, contributing PPE to an associate. This letter represents the views of Grant Thornton LLP China.

We agree with the accounting analysis and conclusion reached in the IFRIC tentative decision.

Grant Thornton LLP China

20th Oct 2017

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18 October 2017

Sue Lloyd
Chair

IFRS Interpretations Committee
30 Cannon Street
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United Kingdom
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Dear Ms Lloyd

Tentative agenda decision – Contributing property, plant and equipment to an associate

SHU LUN PAN Certified Public Accountants LLP is pleased to respond to the IFRS Interpretations Committee's publication in the September IFRIC Update of the tentative agenda decision not to take onto the Committee's agenda the request for clarification of the accounting for a transaction in which an entity contributes property, plant and equipment (PPE) to a newly-formed associate in exchange for shares in the associate.

We agree with the IFRS Interpretations Committee's analysis of the three questions and the conclusion that principles and requirements in IFRS Standards provide an adequate basis for an entity to account for the contribution of PPE to an associate in the fact pattern described in the request. We agree with Committee's tentative agenda decisions.

Yours sincerely

SHU LUN PAN Certified Public Accountants LLP

Tentative agenda and comments: contributions on property, plant and equipment in an associate

Comments to be submitted by November 20, 2017

The Committee received a request about how an entity records a transaction in which it contributes property, plant and equipment (PPE) to a newly-formed associate in exchange for shares.

Analysis by the Committee

In reference to those three questions, the Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to record the contribution of PPE to an associate in the fact pattern described in the request. Therefore, the Committee decided not to add this matter to its regulatory agenda.

Answer:

We would like to thank the Committee for giving us the opportunity to make comments on this project.

We agree with both the analysis made by the IFRS Interpretations Committee on those three questions and the conclusion that principles and requirements in IFRS Standards provide an adequate basis for an entity to record the contribution of PPE to an associate, as described in the request. We agree with the Committee's tentative agenda decisions.

Should you require further information on this answer, please do not hesitate to contact us.

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28 November 2017

Re: IFRS Interpretations Committee tentative agenda decisions published in the September 2017 IFRIC Update

Dear Ms Lloyd,

We are pleased to have the opportunity to provide our comments on the IFRS Interpretations Committee ('the Committee') tentative agenda decisions included in the September 2017 IFRIC Update.

IFRS 15 Revenue from Contracts with Customers—Revenue recognition in a real estate contract

We note that this tentative agenda decisions is divided in two parts:

- In the first part, the Committee considered the requirements in IFRS 15 and concluded that the principles and requirements in IFRS 15 provide an adequate basis for an entity to determine whether to recognise revenue over time or at a point in time for a contract for the sale of a real estate unit.
- In the second part, the Committee discussed the application of those requirements to the fact pattern described in the request and concluded that, in the fact pattern described, the entity should recognise revenue at a point in time applying paragraph 38 of IFRS 15.

We think that the Committee should not discuss the application of IFRS Standards to specific fact patterns, because this may have unintended consequences (ie an entity might apply the Committee's conclusion to a similar fact pattern that should be accounted for in a different way).
In our view, the Committee should only assess whether the requirements in IFRS Standards are clear or need some clarifications or improvements.
Consequently, we think that the Committee should delete the second part of this tentative agenda decision.

IAS 28 Investments in Associates and Joint Ventures—Contributing property, plant and equipment to an associate

We agree with the Committee's conclusion that the entity recognises any gain or loss on contributing property, plant and equipment (PPE) to an associate to the extent of other investors' interests in the associate. However, we note that the tentative agenda decision includes this sentence:
"*Paragraph 7 of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors requires an entity to apply an IFRS Standard to a transaction when that Standard applies specifically to the transaction. The Committee observed, therefore, that unless a Standard specifically excludes common control transactions from its scope, an entity applies the applicable requirements in the Standard to common control transactions*."

We think that this conclusion may have an impact on the similar issue discussed in the June 2017 Committee's meeting, ie IAS 28—*Acquisition of an associate or joint venture from an entity under common control* ('the June issue'). Reading the September 2017 IFRIC Update, we understand that the June issue will be discussed by the IASB in a future meeting. We think that Committee should:

- wait for the IASB decision on the June issue before finalising this tentative agenda decision or
- not include the conclusion that "*unless a Standard specifically excludes common control transactions from its scope, an entity applies the applicable requirements in the Standard to common control transactions"* in its final agenda decision, because this conclusion is also relevant for the June issue. The June issue is very similar to this issue, because in June the Committee discussed whether it is appropriate to apply by analogy the scope exception for business combinations under common control in paragraph 2(c) of IFRS 3 to the acquisition of an associate or a joint venture from an entity under common control.

We also note that the tentative agenda decision states that: "*The Committee observed that applying the requirements in IFRS Standards, an entity recognises a gain or loss on contributing PPE, and a carrying amount for the investment in the associate, that reflects the determination of those amounts based on the fair value of the PPE contributed*". We think the Committee should explain in its final agenda decision why the gain or loss should be determined on the basis of the fair value of the PPE contributed.

Should you need any further information, please do not hesitate to contact us.

Yours sincerely,
Angelo Casò
(Chairman)

Feedback to Contributing PPE to an Associate

Dear IFRIC members,

I appreciates the opportunity to comment on the IFRIC tentative agenda decision. This letter represents the views of mine.

I agree with the accounting analysis of the three questions and the conclusion reached in the fact pattern described in the request.

Regards,

Fan Zhang

ACCA Member