IFRS Accounting

STAFF PAPER

September 2022

IASB® meeting

Project	Equity Method
Paper topic	Transactions between an investor and its associate–an acknowledged inconsistency between the requirements of IFRS 10 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*
CONTACT	Mostafa Mouit mmouit@ifrs.org

This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (IASB). This paper does not represent the views of the IASB or any individual IASB member. Any comments in the paper do not purport to set out what would be an acceptable or unacceptable application of IFRS® Accounting Standards. The IASB's technical decisions are made in public and reported in IASB® *Update*.

Introduction

1. This paper introduces, as part of the equity method project, application questions related to: *Transactions between an investor and its associate.* The following application questions, are in the scope of the project and relate to transactions between an investor and its associate:
    (a) how should an investor account for gains and losses that arise from the sale of a subsidiary to its associate, applying the requirements of IFRS 10 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*.
    (b) in a downstream transaction, whether an investor recognises its share of a gain that exceeds the carrying amount of its investment in the associate.
    (c) in an upstream transaction, whether an investor eliminates its share of gain or loss from the carrying amount of the investment in the associate or the acquired asset.
    (d) whether the provision of service and transactions, that are not transfer of assets, are subject to the requirements for upstream or downstream transactions.

The International Accounting Standards Board is an independent standard-setting body of the IFRS Foundation, a not-for-profit corporation promoting the adoption of IFRS Standards. For more information visit www.ifrs.org.

Objective of this paper

2. The objective of this paper is to introduce how the equity method might be applied to the application question set out in paragraph 1(a), which relates to an acknowledged inconsistency between the requirements in IFRS 10 and those in IAS 28.

3. The International Accounting Standards Board (IASB) is not asked to make decisions at this meeting. The staff will use the feedback from this IASB meeting to refine the analysis and develop recommendations for decision-making at a future meeting.

Structure of the paper

4. The paper is structured as follows:

   (a) scope of the analysis (paragraphs 6–9 of this paper);

   (b) summary of the application question (paragraphs 10–11 of this paper);

   (c) applying the principles that underlie IAS 28 (paragraphs 12–16 of this paper);

   (d) possible alternatives to address the inconsistency between IFRS 10 and IAS 28 (paragraphs 17–69 of this paper); and

   (e) questions to IASB members.

5. There are two appendices to this paper:

   (a) Appendix A sets out the background of the application question.

   (b) Appendix B sets out other conceptual matters relevant to the staff's analysis in this paper.

Scope of the analysis

6. The analysis in this paper have been developed for investments in associates. IFRS Accounting Standards also require the equity method for joint ventures and permit the equity method for investments in subsidiaries in the separate financial statements of a parent entity. At a later stage of the project, the staff will apply the IASB's tentative decisions to investments other than associates and discuss any implications with the IASB.

7. This paper analyses the inconsistency between IFRS 10 and IAS 28 by providing alternatives to address the accounting for the following transactions:

   (a) contributions (or sales) of a subsidiary to an associate in exchange for an equity interest in that associate (and/or cash consideration); and

   (b) contributions (or sales) of assets that are not housed in a subsidiary to an associate.[1]

8. Therefore, it should be noted that:

   (a) all the contributions/sales analysed in this paper result in the loss of control of the subsidiary or assets contributed/sold.

   (b) the subsidiary or the assets contributed/sold may or may not constitute a business.

   (c) the entity that makes the contribution/sale may retain significant influence over the interest in the former subsidiary or the assets contributed/sold.[2]

9. The equity method project approach focuses on resolving application questions on the equity method. When the IASB discussed the project's approach the staff recommended the IASB did not undertake a fundamental review of the equity method.[3] In this agenda paper the staff have considered the boundary of the reporting entity and the objective of the elimination entries to help answer the group of application questions on transactions between an investor and its associate.

[1] For the purpose of this paper, 'an asset that is not housed in a subsidiary' refers to the *direct* contribution/sale of that asset itself to an associate and not the controlling interest in a subsidiary that might hold that asset before the transaction.
[2] See paragraphs B11–B16 of Appendix B to this paper for illustrations on how an entity retains significant influence over the assets contributed/sold.
[3] See October 2020 IASB meeting; AP13: Project objective and approach.

Summary of the application question

10. As noted in paragraph 2 of this paper, there is an acknowledged inconsistency between the requirements of IFRS 10 and IAS 28 for the sale of a subsidiary to an investor's associate. The inconsistency arises because:

    (a) paragraphs 25 and B97–B99 of IFRS 10 require an investor to recognise in full the gain or loss on the loss of control of a subsidiary, remeasuring any retained interest, if any, at fair value; whereas

    (b) paragraphs 28 and 30 of IAS 28 require an investor to restrict the gain or loss recognised to the extent of the unrelated investors' interests in an associate, that is an investor reduces the gain for its related interest (elimination entries).

11. For further details of the history of this inconsistency, including the amendment issued in 2014 (2014 Amendment), whose effective date was deferred indefinitely, refer to Appendix A of this paper.

Applying the principles that underlie IAS 28

12. At its June 2021 meeting, the IASB discussed:

    (a) principles identified as underlying IAS 28 (these provide a toolbox to help the IASB answer application questions); and

    (b) the approach to answering application questions that cannot be resolved using the identified principles.[4]

13. Paragraph 11 of IAS 28 states that in applying the equity method, the investor accounts for its interest in an associate by extending the scope of its financial statements to include its share of the profit or loss of such an associate.

14. Principle C states that the reporting entity is extended to include the investor's share of the associate's net assets and is derived from paragraph 28 of IAS 28.

[4] See June 2021 IASB Meeting; AP13: Identifying the principles in IAS 28.

15. At its April 2022 meeting, the IASB reviewed the changes made to IFRS Accounting Standards arising from the *Conceptual Framework for Financial Reporting (Conceptual Framework)*, Business Combinations, Consolidations and Joint Arrangements projects.[5] The staff think that the following changes, introduced to IFRS Accounting Standards by those projects, are relevant to discussing the application questions in this paper:

    (a) the economic entity perspective under which financial statements are prepared from the perspective of the reporting entity as a whole and not a particular group of the entity's investors.

    (b) the IASB did not consider revisions to the Equity Method in any of these projects, including the requirement in paragraph 26 of IAS 28 which state that many procedures that are appropriate for the equity method are similar to consolidation procedures.[6] [7]

    (c) in determining the boundary of a reporting entity that is not a legal entity and does not comprise only legal entities linked by a parent-subsidiary relationship, the focus should be on the information needs of the primary users of the financial statements. Those users need relevant information that faithfully represents what it purports to represent, see paragraphs 30–31 of this paper for further analysis on the usefulness of the financial information.[8]

16. From paragraph 15, it can be noted that:[9]

    (a) control is the appropriate basis for determining the boundary of the reporting group and an associate is not part of the group; however

    (b) the *Conceptual Framework* permits a reporting entity to have a boundary outside the group (parent and subsidiaries) where an associate could sit (the

[5] See AP13B: Research findings for further details.

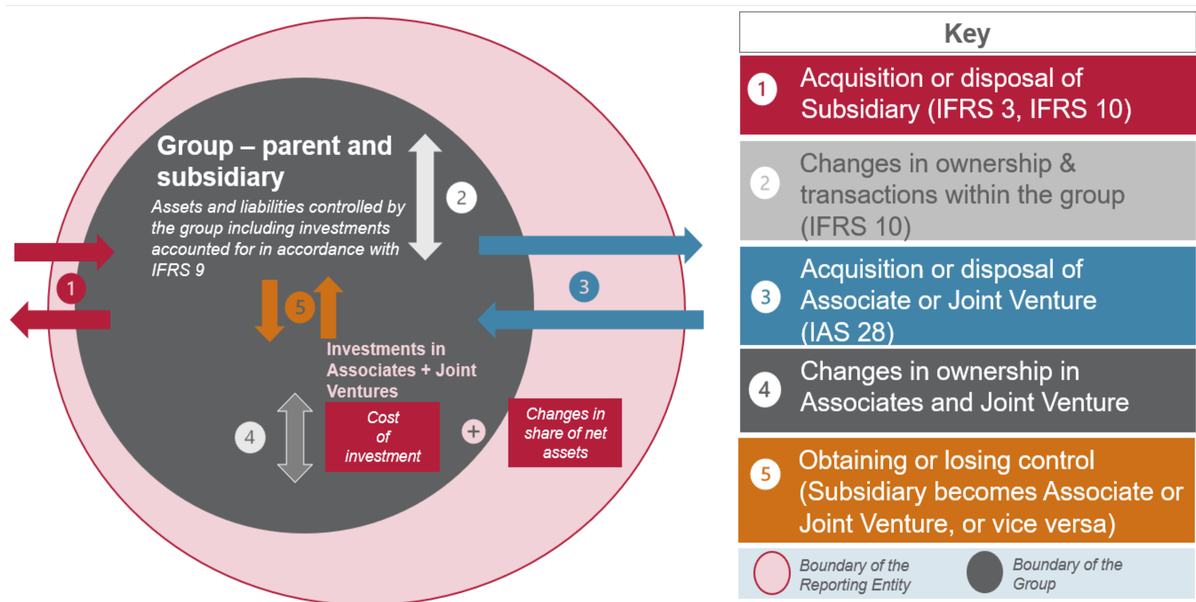
[6] The staff encountered difficulties in identifying underlying principles when the application problems involve the interaction of the requirements in IAS 28 with other IFRS Accounting Standards, such as IFRS 3 and IFRS 10. The staff's initial research has indicated that this may be because significant changes were made to accounting for the acquisition of a subsidiary by the Business Combinations project completed in 2008 and Consolidation project completed in 2011, and it is not clear how some of these changes affect, in particular, paragraph 26 of IAS 28.

[7] Paragraph BCZ2.42 of the Basis for Conclusions on IFRS 9 explains that the linkage between acquisition accounting and equity method is *only* in respect of accounting *'methodology'* and *not* in respect of *'principles'*.

[8] Paragraphs 3.13–3.14 of the *Conceptual Framework*.

[9] See paragraph 44 of this paper for the outcome of the *Post-implementation Review of IFRS 10, IFRS 11 and IFRS 12*. See also paragraph 3 of IAS 28.

extended boundary). The extended boundary would include the changes in the investor's share of the associate' net assets. The following diagram explains the structure of the extended boundary of the reporting entity:



Possible alternatives to address the inconsistency between IFRS 10 and IAS 28

Objective of elimination entries

17. Elimination entries' requirements in the preparation of consolidated financial statements ensure that the consolidated financial statements show the result of the parent entity and its subsidiaries as a single economic entity. In consolidated financial statements, elimination entries' requirements remove profits that have not been earned by the group (as a single economic entity) because the transaction has not taken place outside the group.

18. The objective of elimination entries is clear for the purposes of accounting for subsidiaries in consolidated financial statements. The same cannot be said when the equity method is applied, as an associate is not controlled by the parent and is therefore outside the group.

19. IFRS Accounting Standards do not identify whether the equity method is a one-line consolidation method or a measurement method. If the equity method was applied as a one-line consolidation method, it would follow that gains and losses on upstream and downstream transactions should be eliminated. Whereas, if the equity method is applied as a measurement method, it is more challenging to identify why gains and losses are eliminated.

20. By definition, transactions between a parent and its associate take place outside the group and the reasons that exist in consolidated financial statements to eliminate the gain or loss do not apply. That said, an investor has significant influence over the associate and recognises its share of the associate profits or losses rather than dividend income. IAS 28 acknowledges that for associate entities the recognition of income on the basis of distributions may not be an adequate measure of the income earned by an investor. The elimination entries' requirements may also be attempting to address the reporting of income and therefore there may be a special case of reporting transactions between the group and its associate entities.

Interaction with the Conceptual Framework

21. As the objective of elimination entries for associate entities is not clear, it is appropriate to look to the *Conceptual Framework*:

    (a) paragraph 1.2 of the *Conceptual Framework* provides that:

    > The objective of general-purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity…

    (b) paragraph 2.2 of the *Conceptual Framework* states that:

    > Financial reports provide information about the reporting entity's economic resources, claims against the reporting entity and the

effects of transactions and other events and conditions that change those resources and claims…

(c) paragraph 1.22 of the *Conceptual Framework* states that:

> Information about how efficiently and effectively the reporting entity's management has discharged its responsibilities to use the entity's economic resources helps users to assess management's stewardship of those resources. Such information is also useful for predicting how efficiently and effectively management will use the entity's economic resources in future periods. Hence, it can be useful for assessing the entity's prospects for future net cash inflows.

(d) paragraph 1.18 of the *Conceptual Framework* states that:

> …Information about a reporting entity's financial performance during a period can also help users to assess management's stewardship of the entity's economic resources.

(e) paragraph 7.16 of the *Conceptual Framework* states that:

> The statement of profit or loss is the primary source of information about an entity's financial performance... That statement contains a total for profit or loss that provides a highly summarised depiction of the entity's financial performance... Many users of financial statements incorporate that total in their analysis either as a starting point for that analysis or as the main indicator of the entity's financial performance for the period…

(f) paragraph 7.17 of the *Conceptual Framework* states that:

> Because the statement of profit or loss is the primary source of information about an entity's financial performance..., all income and expenses are, in principle, included in that statement…

22. The staff think that the objective of the elimination entries must be related to measuring the profit or loss that an investor would report. In the staff's view, there could be two alternatives. The objective of the elimination entries could be either:

    (a) to provide a measure of the profit or loss as if the investor had entered into the transaction with unrelated investors (in other words, as if the investor had control of its share of the underlying assets and liabilities), that is the investor restricts the gain or loss to the extent of the unrelated investors' proportion; or

    (b) to provide a measure of the profit or loss as if the associate is considered as a third party.

23. If the objective is as described in paragraph 22(b) of this paper, there is no good reason for the investor to restrict the gain or loss in a transaction with its associate. Accordingly, the investor's share of the associate's profit or loss will be as reported by the associate.

24. The staff note that the objective of elimination entries does not necessarily apply equally to all investments. For example:

    (a) applying the objective, as set out in paragraph 22(a) of this paper, could be useful where the business activities mean that operations of the associate are 'embedded' within the operations of the investor; while

    (b) applying the objective, as set out in paragraph 22(b) of this paper, could be useful where the holding of an asset transferred is temporary or not held for the principal purpose of the business activities.

25. The question that we need to answer is: which of the alternatives set out in paragraph 22 of this paper (elimination or non-elimination) provides useful financial information to primary users of financial statements for:

(a) predicting how efficiently and effectively management will use the entity's economic resources in future periods; and

(b) assessing the entity's prospects for future net cash inflows.

Usefulness of financial information

26. Some argue as the objective of elimination entries when applying the equity method is unclear and the associate is not part of the group there is no clear basis to require the elimination of gains or losses for the investor's related interest.

27. However, others argue that without the requirement to eliminate the investor's related interest, it is possible for an entity to manage its earnings—for example, the investor could sell products to an associate at a profit and, without the requirement to eliminate the investor's share of that profit, the profit and loss is overstated. Others do not agree and argue in the circumstance of significant influence prices between an investor and its associate are negotiated on an arm's length basis.

28. A possible solution to the concern about earnings management could be to require elimination entries when the transactions are not at fair value. However, the staff do not consider that this would be a viable option because it is an anti-avoidance measure. In addition, it may be challenging to identify whether the transaction is at fair value, and therefore this option may not meet the cost constraint, that is the benefits of reporting this information are unlikely to justify the cost of providing the information.

29. Another possible solution could be to provide additional related party disclosures on transactions between an investor and its associate.

30. In assessing the usefulness of the financial information as set out in paragraph 25 of this paper, the *Conceptual Framework* states that information must be relevant and faithfully represent what it purports to represent. That relevant financial information is capable of making a difference in the decisions made by users.[10]

[10] Paragraphs 2.4–2.6 of the *Conceptual Framework.*

31. Some argue that users of financial statement, when estimating future cash flow, disregard gains or losses on transactions that are not in the scope of IFRS 15 *Revenue from Contracts with Customers* (for example, not an output of an entity's ordinary activities)[11], regardless of how they are measured, because those transactions are often non-recurring and do not affect recurring earnings. If this is true more emphasis could be placed on simplifying the equity method and eliminating the difference between transactions involving assets and transactions involving businesses. So that:

    (a) when an investor loses control (or derecognises) an asset that is not an output of its ordinary activities (that is *out* of the scope of IFRS 15), the gains and losses recognised would not be restricted to the extent of the unrelated investors' interests in an associate:

        (i) whether the asset constitutes a business or not; and

        (ii) whether the asset is housed in a subsidiary or not; whilst

    (b) retaining the elimination entries' requirements for the transactions that are an output of an investor's ordinary activities (that are *in* the scope of IFRS 15), so that the gain or loss recognised would be restricted to the extent of the unrelated investors' interests in an associate.

32. Paragraphs 55–62 of this paper provide further details, including this proposal (referred to as alternative 3).

[11] Paragraphs BC52–BC53 of the Basis for Conclusions on IFRS 15 explains that the IASB decided to define the term 'customer' to enable an entity to distinguish contracts that should be accounted for under IFRS 15 (ie contracts with customers) from contracts that should be accounted for under other requirements. The definition of a 'customer' focuses on an entity's ordinary activities. However, 'ordinary activities' are not defined. In some cases, the assessment of whether a good is an output of the entity's ordinary activity may be straightforward. However, in other cases the assessment may require judgement.

Possible alternatives to address the inconsistency between IFRS 10 and IAS 28

33. The following table is a summary of alternatives identified by staff to address the inconsistency.

Recognition of **full** gain or loss *versus* **partial** gain or loss	Sale/contribution of a ***business*** that is		Sale/contribution of an ***asset*** that is		
	housed in a subsidiary	***not housed*** in a subsidiary	***housed*** in a subsidiary	***not housed*** in a subsidiary	
Alternative 1 *(Non-elimination)*	Full	Full	Full	Full	
Alternative 2 *(Elimination)*	Partial	Partial	Partial	Partial	
Alternative 3 *(Mixture)*	Full	Full	Full[12]	Ordinary activities[13]	*Not* ordinary activities
				Partial	Full
Alternative 4 *(Reviving 2014 Amendment)*	Full	Full	Partial	Partial	
Current practice approach(es)	Policy choice (full/partial)[14]	Unclear[15]	Many towards policy choice (full/partial)[16]	Partial[17]	

[12] It assumes that selling an asset that housed in a subsidiary as not an output of entities' ordinary activities.
[13] See footnote 11 of this paper.
[14] Because of the inconsistency in IFRS Accounting Standards, most audit practice manuals state that the entity has an accounting policy choice of applying consistently either IFRS 10 or IAS 28 (although IFRS Accounting Standards do not present it as an accounting policy choice). Some of audit practice manuals do not make distinction whether subsidiary constitutes a business or not.
[15] Many audit practice manuals do not have specific guidance, while some allowed full gain or loss (ie applying the 2014 Amendment).
[16] Many audit practice manuals provide an accounting policy choice, while some does not have specific guidance.
[17] IFRS 10 does not apply to sale/contribute asset that not housed in a subsidiary. As a result, IAS 28 applies in that case and there is no accounting policy choice.

34. Paragraphs 36 to 69 of this paper discuss each of the alternatives in paragraph 33 of this paper and provide:

    (a) the staff's preliminary analysis;

    (b) which IFRS Accounting Standards would need to be amended; and

    (c) advantages and disadvantages of the alternatives.

35. Alternatives that could lead to structuring opportunities have not been considered, see paragraphs A10 of Appendix A to this paper and B15–B16 of Appendix B to this paper. For example, if a contribution to an associate is an interest in a subsidiary (regardless of whether it is a business or not) an investor would be required to recognise the full gain applying IFRS 3 *Business Combinations* / IFRS 10. However, if a contribution is a single asset (regardless of whether it is a business or not), an investor would be required to recognise a partial gain applying IAS 28. The staff do not think the existence of a subsidiary should affect the financial reporting outcome.

Alternative 1—account for all contributions and sales applying IFRS 10

Staff's preliminary analysis

36. Alternative 1 would require an investor that loses control of a subsidiary (or assets) to measure the consideration received at fair value, including any investment retained in the former subsidiary (or at transaction price; see paragraphs B5–B8 of Appendix B to this paper for further discussion), and recognise a full gain or loss irrespective of:

    (a) whether the subsidiary or the assets constitute a business; or

    (b) whether the assets are housed in a subsidiary.

37. Alternative 1 is consistent with the IASB's thinking when it issued the 2014 Amendment—that is, the most robust alternative (from a conceptual point of view) is to follow the rationale that underlies IFRS 3 and IFRS 10 for all sales and contributions (including the sale or contribution of assets that do not constitute a business), see paragraphs:

(a) BC37G and BC190G of the Basis for Conclusions on the 2014 Amendment;[18] and

(b) B1–B16 and B25–B29 of Appendix B to this paper for further discussion on other conceptual matters relevant to the staff's analysis in this section.

38. The staff think that alternative 1 can be supported because:

(a) the rational in IAS 28 to restrict gains to the extent of the unrelated investors' interests in the associate is consistent with the parent-entity perspective; in contrast IFRS 3 and IFRS 10 are consistent with the reporting entity concept.

(b) a group is a parent and its subsidiaries. A group does not include associates.

39. Therefore, some argue that:

(a) having expanded the use of the acquisition method of accounting in IFRS 3, alongside articulating the reporting entity concept in the *Conceptual Framework*, the objective of the elimination entries in IAS 28 is questionable; and

(b) there is no basis to retain on the elimination entries' requirements in IAS 28 because this elimination is a consolidation procedure.[19]

Which IFRS Accounting Standards would need to be amended?

40. Alternative 1 would require the IASB to propose amendments to paragraphs 28–31 of IAS 28. A full gain would be recognised on all contributions/sales of assets or businesses, regardless of whether they are housed or not in a subsidiary.

Advantages and disadvantages of this alternative

41. The staff think that some would argue not requiring elimination entries is a move away from the traditional view that the equity method is a one-line consolidation method. Those holding this view could have concerns on the effect on profit or loss, see paragraph 19 of this paper.

[18] See 2014 Amendment for further details.
[19] Paragraph BCZ2.42 of the Basis for Conclusions on IFRS 9 explains that the linkage between acquisition accounting and equity method is *only* in respect of accounting *'methodology'* and *not* in respect of *'principles'*.

42. In contrast, those that do not agree that the equity method is a one-line consolidation method might argue that removing the elimination entries' requirements would remove the demonstrated diversity in practice, in particular:

    (a) in a sale or contribution of a business, irrespective of whether it is not housed in a subsidiary; and

    (b) in a sale or contribution of an asset that is housed in a subsidiary.

43. The supporters of Alternative 1 would argue that the preparers (that have significant influence, and not control) sometimes have difficulty in obtaining information required for the equity method of accounting, for example when gains and losses are restricted on downstream transactions tracking whether an asset remains/depreciates in an associate's books in subsequent periods can be difficult.

Other considerations

44. The IASB recently completed the *Post-implementation Review of IFRS 10, IFRS 11 and IFRS 12* and concluded that the requirements of IFRS 10 are working as intended. In particular, the IASB concluded that IFRS 10 is meeting its objectives, and using the control model as the single basis for consolidation enables entities to determine whether they control another entity. The definition of a 'group' in IFRS 10 and its implications on the measurement requirements of investments outside the group boundaries (such as associates) remains.

Alternative 2—apply IFRS 10 requirements and then overlay with IAS 28 requirements (overlay approach)

Staff's preliminary analysis

45. Those that support alternative 2 would argue that the requirements of IFRS 10 and IAS 28 could both be applied to the transaction—that is, they are not inconsistent. An investor would:

    (a) apply the loss of control requirements in IFRS 10 (by recognising a full gain or loss and measuring any investment retained in the former subsidiary at fair value); and

(b) overlay with the elimination entries' requirements in IAS 28 by restricting the gain or loss in paragraph 45(a) of this paper to the extent of the unrelated investor's interests in the associate.[20]

46. Alternative 2 would be consistent with application of paragraph 30 of IAS 28 whereby an entity first applies the derecognition requirements in IAS 16 *Property, Plant and Equipment* (using transfer of control requirements in IFRS 15) and then overlays with the elimination entries' requirements in IAS 28, see paragraphs B17–B24 of Appendix B to this paper for further discussion of other conceptual matters relevant to the staff's analysis in this section.

47. The staff could not establish why for the derecognition of an asset the overlay approach *is* used but *is not* used for the derecognition of a business, see paragraphs B25–B29 of Appendix B to this paper for further discussion of other conceptual matters relevant to the staff's analysis in this section.[21]

48. In the staff's view, alternative 2 does not result in an entity no longer complying with the loss of control requirements in IFRS 10 but that there is another aspect to the loss of control transaction—a new relationship between an investor and its associate. This new relationship results in restricting the gain or loss that would otherwise result from applying the loss of control requirements in isolation.

49. The staff have also considered the IFRS Interpretations Committee (Committee) discussion at its February 2021 meeting, in particular the analysis in paragraphs 26 and 32 of agenda paper 2 of that meeting explained the interaction:[22]

(a) of the requirements in IFRS 10 and IFRS 16 *Leases* in the same way that the derecognition requirements in IAS 16, IAS 38 *Intangible Assets* and IAS 40 *Investment Properties* interact with the requirements in IFRS 16 for sale and leaseback transactions that involve an item of PPE, an intangible asset or investment property—in these situations an entity applies the derecognition

[20] An overlay approach is about the general mechanics of how the Standards interact with each other.
[21] In other words, an overlay approach applies to all contributions/sales of assets or businesses, regardless of whether they are housed or not in a subsidiary.
[22] See AP2: Comment letters on tentative agenda decision and IFRIC Update February 2021 for further details.

requirements in IAS 16, IAS 38 or IAS 40 and then the sale and leaseback requirements in IFRS 16.

(b) between IFRS 10 and IAS 28 addressed in the 2014 Amendment is similar to the interaction between IFRS 10 and IFRS 16 with respect to the sale and leaseback transaction in the submission (also, in the same way between IAS 16 and IAS 28, and IFRS 9 *Financial Instruments* interaction with IAS 23 *Borrowing Costs*).

50. In the Committee agenda paper 2, the analysis in paragraph 31 also explained that IFRS 9 requires an entity to recognise interest expense calculated using the effective interest method in profit or loss over the relevant period. However, IAS 23 requires an entity to capitalise interest expense in specified circumstances[23]. These requirements were not viewed as inconsistent, even though the requirement in IFRS 9 to recognise interest expense in profit or loss does not include an explicit cross-reference to IAS 23. In applying these requirements, an entity first recognises interest expense calculated using the effective interest method applying IFRS 9 and then applies (or overlays) the requirements in IAS 23.

Which IFRS Accounting Standards would need to be amended?

51. This alternative would require amending:

(a) paragraph 30 of IAS 28—so that, it applies to all contributions/sales of assets or businesses, regardless of whether they are housed or not in a subsidiary.

(b) possibly, add a cross-reference in paragraphs 25 and B98 of IFRS 10 to the elimination entries' requirements in IAS 28.

(c) possibly, add a cross-reference in IAS 16, IAS 38 and IAS 40 to the elimination entries' requirements in IAS 28.

Advantages and disadvantages of this alternative

52. Some may argue that alternative 2 could be complex to apply in practice whereas others would argue that this alternative is less complex than Alternative 1.

[23] Paragraph 8 of IAS 23 states 'An entity shall capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. An entity shall recognise other borrowing costs as an expense in the period in which it incurs them'.

53. Furthermore, Alternative 2 has the disadvantage that the preparers may face further difficulties, in practice, in obtaining information required for the elimination entries, particularly in a contribution that constitutes a business in which it has assets and liabilities, see paragraph 43 of this paper.

54. Alternative 2 describes the mechanics between IFRS 10 and IAS 28 without compromising the IASB's rationale that underlies the Business Combination project and the Consolidations project—that is, the loss of control is a significant economic event for which it leads to full recognition of gains and losses.

Alternative 3—apply IFRS 10 to contributions and sales of businesses and of assets depending on whether they are ordinary activities (mixture)[24]

Staff's preliminary analysis

55. Alternative 3 is a mixture of Alternative 1 and Alternative 2; it leverages the possible simplification set out in paragraph 31 of this paper. Alternative 3 would require that:

    (a) when an investor loses control (or derecognises) an asset that is not an output of its ordinary activities[25], the gain or loss recognised would not be restricted to the extent of the unrelated investors' interests in an associate:

        (i) whether the asset constitutes a business or not; and

        (ii) whether the asset is housed in a subsidiary or not.

    (b) retaining the elimination entries' requirements for the transactions involving assets that are an output of an investor's ordinary activities (that are *in* the scope of IFRS 15), so that the gain or loss recognised would be restricted to the extent of the unrelated investors' interests in an associate.

56. The staff think this alternative is supported by:

    (a) part elimination of the gains and losses depends on:

[24] See footnote 11 of this paper.
[25] See footnote 11 of this paper.

(i) the derecognition requirements in IFRS 10 and IAS 16 (including IFRS 15); and

(ii) the nature of the relationship between the investor and its associate—that is, whether a counterparty is a 'customer' in accordance with IFRS 15.[26]

(b) placing more emphasis on simplifying the accounting and eliminating differences between transactions involving derecognition of assets and transactions involving derecognition of businesses rather than the amount of the gain or loss recognised.

(c) the view that financial statement users generally disregard, when estimating future cash flow, gains or losses on transactions that are not an output of an entity's ordinary activities, regardless of how they are measured, because those transactions generally are non-recurring and as such do not affect recurring earnings.

Which IFRS Accounting Standards would need to be amended?

57. This alternative would require amending the elimination entries' requirements in paragraphs 28 and 30 of IAS 28—so that:

(a) not applying the elimination entries' requirements (that is, gain and loss recognised would not be restricted in IAS 28) for a:

(i) transaction involving a business (whether it is housed in a subsidiary or not); and

(ii) transaction involving an asset that is not an output of an entity's ordinary activities (even if this asset is not housed in a subsidiary); whilst

(b) retaining the elimination entries' requirements for transactions involving assets that are an output of an entity's ordinary activities.

[26] Paragraph 6 of IFRS 15 states a 'customer' is a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.

Advantages and disadvantages of this alternative

58. Alternative 3 is the middle ground alternative—on the one hand, it limits the tensions that could be raised as set out in Alternative 1. Whilst on the other hand, it eliminates differences between transactions involving derecognition of assets and transactions involving derecognition of businesses.

US GAAP

59. The staff note that Alternative 3 is consistent with the requirements in Accounting Standards Codification 610-20 *Other Income–Gain and Losses from the Derecognition of Nonfinancial Assets.* [27]

60. In February 2017 the Financial Accounting Standards Board (FASB) clarified the scope of Subtopic 610-20 in response to comments from stakeholders that they:

    (a) were uncertain on how to account for partial sales of non-financial assets (in which the seller retains an equity interest in the entity that owns the assets or has an equity interest in the buyer); and

    (b) also noted that differences in accounting for transfers of assets and businesses to equity method investees create additional complexity.[28]

61. When an investor transfers a non-financial asset to counterparties that are not customers (eg sale of equipment that is not an output of an investor's ordinary activities), it recognises a gain or loss for the difference between the consideration received and the carrying amount of the asset. If the investor retains a non-controlling interest, it measures such interest at fair value similar to the guidance on the sale of business. This would result in full gain or loss recognition upon the partial sale of the non-financial asset and measuring any retained non-controlling interest at fair value, irrespective of whether the counterparty is an associate (in a downstream transaction).[29]

---

[27] See Clarifying the Scope of Subtopic 610-20 and Accounting for Partial Sales of Nonfinancial Assets for further details.
[28] See paragraphs BC2–BC10 of the Basis for Conclusions on the ASU 2017-05 for further details.
[29] Paragraph BC63 of the Basis for Conclusions on the ASU 2017-05 explains that a retained non-controlling interest should be accounted for as non-cash consideration and measured at fair value at contract inception, and this is consistent with the guidance in Topic 606 *Revenue from Contracts with Customers*.

62. FASB, amongst other things, also: [30] [31] [32]

(a) decided that accounting for derecognition of non-financial assets generally should be the same regardless of whether the assets are transferred as a group of assets or a legal entity, that is, the substance of partial sales transactions are the same;

(b) acknowledged that the requirement that no gain or loss should be eliminated when the counterparty is an associate is inconsistent with the accounting for revenue transactions with equity method investees. However, the FASB placed more emphasis on eliminating differences between the derecognition of assets and the derecognition of businesses; and

(c) considered an alternative view in which the gain (arises from a partial sale) would be limited to the extent of the ownership interest transferred because the investor retains an interest in the asset. However, the FASB concluded that recognising a full gain is justified because the nature of the asset has changed.

Alternative 4—account for all contributions and sales of businesses applying IFRS 10 and account for all other contributions and sales applying IAS 28 (Reviving 2014 Amendment)

Staff's preliminary analysis

63. As noted in paragraphs A9–A13 of Appendix A to this paper, the main consequence of the 2014 Amendment (which does not have an effective date) is to limit IAS 28 elimination entries' requirements to contributions of assets that do not constitute a business, so that:

(a) the full gain or loss is recognised when a transaction involves a business (whether it is housed in a subsidiary or not); and

[30] See paragraphs BC43–BC54 of the Basis for Conclusions on the ASU 2017-05 for the partial sales.
[31] See paragraphs BC62–BC67 of the Basis for Conclusions on the ASU 2017-05 for the measurement of a retained noncontrolling interest.
[32] See paragraphs BC68–BC71 of the Basis for Conclusions on the ASU 2017-05 for the comparison with IFRS Accounting Standards.

(b) the partial gain or loss is recognised when a transaction involves assets that do not constitute a business, even if these assets are housed in a subsidiary.

64. The basis of this alternative was that the requirements in IFRS 10 on the loss of control of a subsidiary arose from to the Business Combinations project and should therefore apply to all businesses, whether housed in a subsidiary or not. Because groups of assets that do not constitute a business were not part of that project, there is no reason to change the accounting for these contributions.

65. After issuing the 2014 Amendment the IASB received feedback that the recognition of a partial gain or loss (namely, resulting from the remeasurement of the investment retained in the former subsidiary) when a transaction involves assets that do not constitute a business, even if these assets are housed in a subsidiary, is inconsistent with a requirement in IAS 28. This is because paragraph 32 of IAS 28 requires any difference between the costs of the investment and the entity's share of the net fair value of the associate's identifiable assets and liabilities to be recognised as goodwill or a bargain purchase on commencement of the equity method. The 2014 Amendment would result, in certain circumstances, that the cost of the investment is not at fair value, because the gain or loss has been restricted to the unrelated investors' interests.[33] [34] [35]

66. The staff think that, if the IASB's members wish to pursue this alternative, the 2014 Amendment would itself need amending, in particular paragraph B99A of IFRS 10 (and bullet (b) in Example 17 of IFRS 10). In the staff's view, requiring the investor (parent) to restrict recognition of the gain or loss resulting from the remeasurement of the investment retained in the former subsidiary to the unrelated investors' interests is difficult to justify, because it recognises a gain on the strength of a third-party interests

[33] See Interaction with existing paragraph 32 of IAS 28 for further details.

[34] 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, that is the gain or loss that arises when any residual interest in the former subsidiary is remeasured to fair value at the date that control was lost.

[35] At its April 2022 meeting, the IASB tentatively decided to consult with stakeholders on measuring the cost of an investment, when an investor obtains significant influence, as the fair value of the consideration transferred, including the fair value of any previously held interest in the investee.

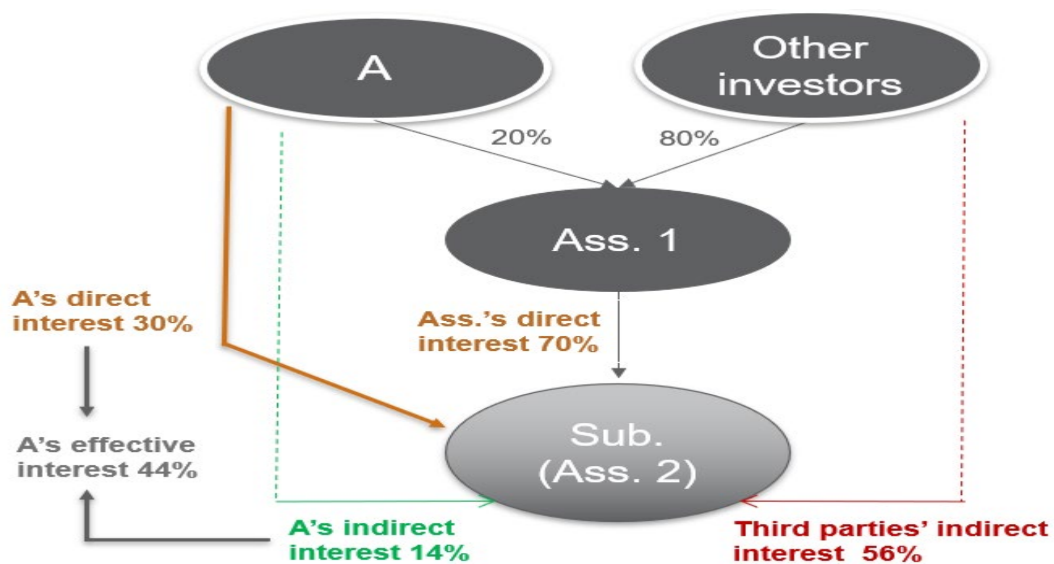
that does not exist. This part of the 2014 Amendment produces counter-intuitive results because:

(a) such a partial 'step-up' of retained interests does not relate to the portion of the investment transferred;

(b) the third-party (ie the other investors) have no interest at all in the parent's 30% direct interest retained in the former subsidiary; and

(c) the third-party (ie the other investors) will have only an indirect interest of the investment transferred which is 56%.

The following diagram explains further:



67. Therefore, the staff think that, if IASB members wish to pursue this alternative, this part of the 2014 Amendment would need to be omitted—ie no elimination entries' requirements being applied upon such 'step-up' of retained interests. By omitting this part:

(a) the tension between the 2014 Amendment and paragraph 32 of IAS 28 will no longer exist; and

(b) the additional amendment proposed at that time (the sweep issue that considered in January 2014) will no longer be needed.

Which IFRS Accounting Standards would need to be amended?

68. The IASB would need to set an effective date for the 2014 Amendment as issued and amend the amendment to omit the part of the amendment set out in paragraph 66 of this paper. Therefore, this alternative would require:

    (a) clarifying that the non-monetary assets in IAS 28 excludes businesses (as defined in IFRS 3) and it includes subsidiaries that do not constitute a business;

    (b) amending IFRS 10 to clarify that it applies to the loss of control of a business not housed in a subsidiary and that it does not apply to the loss of control of a subsidiary that does not constitute a business; and

    (c) clarifying that paragraph 28 of IAS 28 on the accounting for sales between an investor and an associate only applies to sales of assets that do not constitute a business.

Advantages and disadvantages of this alternative

69. Some may argue that this alternative is resource efficient for both the IASB and its stakeholders, as only the 2014 Amendment is amended. Others may not agree with this viewpoint and argue that drawing a line between what constitutes a business versus a collection of assets requires significant judgement. So, introducing another accounting difference, when it comes to derecognition and losing control, that is dependent on the interpretation and exercising judgement of the definition of a business could lead to unduly complexities.

Questions to IASB members
1. Do you have comments or questions on the analysis in this paper? Namely, is there anything IASB members would like the staff to research or analyse further before the IASB makes tentative decisions in a future meeting? 2. What are your views on the alternatives set out in paragraph 33 of this paper? 3. Do you agree the staff should refine its analysis and bring a decision-making paper to the IASB?

Appendix A—Background to the application question

'Upstream' and 'Downstream' transactions

A1. ‘Upstream’ transactions are, for example, sales of assets from an associate to the investor (or a subsidiary in the same group as the investor).

A2. ‘Downstream’ transactions are, for example, sales or contributions of assets from the investor (or a subsidiary in the same group as the investor) to its associate.

Elimination of gains or losses

A3. Gains and losses resulting from ‘upstream’ and ‘downstream’ transactions between an investor and its associate are recognised in the investor’s financial statements to the extent of the unrelated investors’ interests in the associate. Put simply:

(a) the investor’s share in the associate’s gains or losses resulting from upstream and downstream transactions are eliminated.[36]

(b) to the extent of ‘unrelated investors’ interests, that is investors other than the investor (including its consolidated subsidiaries).

A4. For example, a downstream transaction where:

(a) an investor owns 40% of an associate;

(b) the investor sells inventory to the associate at a transaction price that is arm’s length;

(c) the investor applies IFRS 15 and sells the inventory to the associate for CU850, recognising a CU250 gain; and

(d) as of the reporting date, all the inventory remains in the associate stocks (ie not sold yet to third-party).

[36] Even though it is not an explicit requirement; however, impliedly, the gains or losses being eliminated are the unrealised gains or losses (which are normally eliminated only on assets still remaining on the books of an investor or an associate).

The investor recognises only the gain to the extent of the unrelated investors' interests in the associate by eliminating its portion of the gain by CU100 (CU250 gain x 40%).

A5. IAS 28 requires such an elimination of the investor's share of gains or losses on transactions with its associate when applying the equity method. Balances such as receivables or payables and deposits or loans to or from the associate are not eliminated.

How to apply the elimination entries' requirements to different types of transactions?

A6. The table below summarises how the requirements of IFRS Accounting Standards are applied to downstream fact patterns, for example a sale of an asset (or a subsidiary) from an investor to its associate.

Derecognition requirements	Example of transaction	How the elimination entries' guidance in IAS 28 is applied
IAS 2 Inventories (IFRS 15)	Sale of an inventory that is *in* the scope of IFRS 15.	Eliminate proportionate share of gain if the inventory remains in the associate's inventories at the end of the reporting period.
IAS 16 (IFRS 15)	Sale of an equipment that is *not in* the scope of IFRS 15.	Eliminate proportionate share of gain if the equipment remains in the associate's books at the end of the reporting period.
IFRS 10	Sale of a subsidiary.[37]	See paragraph A7 of this Appendix.

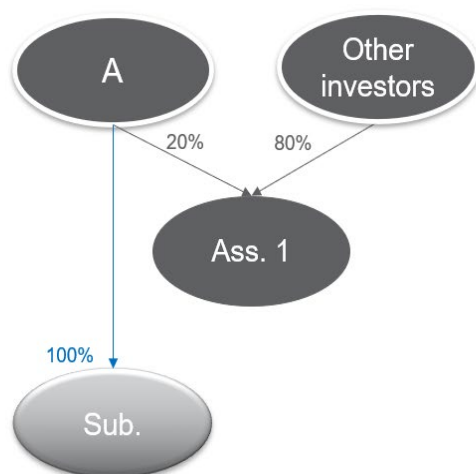
[37] A subsidiary may constitute a business or not. However, the derecognition of a subsidiary, regardless of whether it is an asset or a business, is accounted for in accordance with IFRS 10.

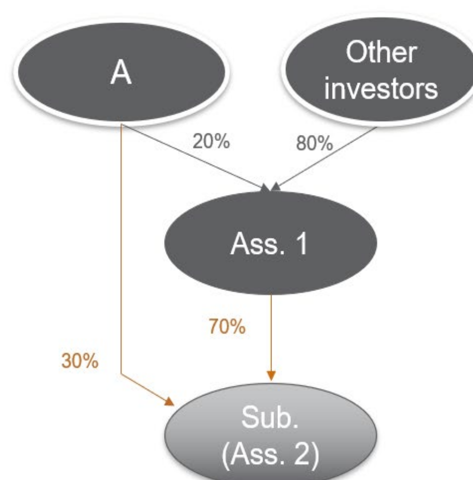
A7. The relevant requirements of IFRS Accounting Standards for the sale of a subsidiary to an investor's associate are:

(a) an investor recognises in full the gain or loss on loss of control of a subsidiary, remeasuring any retained interest, if any, at fair value (paragraph 25, alongside with the guidance set out in paragraphs B97–B99 of IFRS 10).

(b) an investor restricts the gain or loss recognised to the extent of the unrelated investors' interests in an associate, that is an investor reduces the gain for its related interest (paragraphs 28 and 30 of IAS 28).

A8. The following diagram illustrates the sale of a subsidiary from an investor to its associate before and after the transaction, retaining an interest in the former subsidiary.





Sale or contribution of assets between an investor and its associate[38]

A9. The inconsistency set out in paragraph A7 of this Appendix arose between IAS 27 *Consolidated Financial Statements and Accounting for Investments in Subsidiaries* (as revised in 2008) and SIC-13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers.* The requirements in IAS 27 on the accounting for the loss of control of a subsidiary were moved to IFRS 10. The requirements in SIC-13 are incorporated into

[38] See Effective Date of 2014 Amendment and 2014 Amendment for further details.

paragraphs 28 and 30 of IAS 28 (as amended in 2011) and apply to the sale or contribution of assets between an investor and its associate or joint venture.

A10. The IASB sought to address the inconsistency between the requirements in IFRS 10 and IAS 28, issuing the 2014 Amendment. The IASB was concerned that the existing requirements could result in the accounting for a transaction being driven by its form rather than by its substance. For example, different accounting might be applied to a transaction involving the same underlying assets depending on whether those assets were:

(a) transferred in a transaction that is structured as a sale of assets, or as a sale of the entity that holds the assets (a subsidiary); or

(b) sold in exchange for cash or contributed in exchange for an equity interest.

A11. The IASB discussed whether all sales and contributions (including the sale or contribution of assets that do not constitute a business) should be consistent with IFRS 3. Although the IASB considered this alternative to be the most robust (from a conceptual point of view), it concluded that:

(a) the accounting for the loss of control of a business, as defined in IFRS 3, should be consistent with the conclusions made in developing IFRS 3; and

(b) because assets that do not constitute a business were not part of the Business Combinations project, the IASB concluded that the current requirements in IAS 28 apply to the sale or contribution of assets that do not constitute a business.

A12. The 2014 Amendment requires:[39]

(a) a full gain or loss is recognised when a transaction involves a business (whether it is housed in a subsidiary or not).

[39] Three IASB members voted against the publication of the 2014 Amendment:

(a) one member disagreed with introducing another accounting difference that is dependent on the interpretation of the definition of a business.

(b) two members believed that 2014 Amendment does not fully address the concerns they were intended to address.

(b) a partial gain or loss is recognised when a transaction involves assets that do not constitute a business, even if these assets are housed in a subsidiary.

A13. After issuing the 2014 Amendment, the Committee and the IASB considered several other issues[40] related to the 2014 Amendment and in December 2015, the IASB decided:

(a) that these further issues should be addressed as part of its research project on equity accounting; and

(b) to defer indefinitely the effective date of the 2014 Amendment. However, the IASB continued to allow early application of that amendment as it did not wish to prohibit the application of better financial reporting.

The Committee's Agenda Decision

A14. In January 2018, the Committee issued an agenda decision on '*contributing property, plant and equipment to an associate*'. The request asked 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. Of the questions asked in the request, 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 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.[41]

[40] See AP13—Project plan and methodology for further discussions on the other issues.
[41] See IFRIC Update, January 2018 for further details.

Appendix B—Other conceptual matters relevant to the staff's analysis in this paper

Ways an investor may transition from consolidation to the equity method (or from having non-monetary asset to equity accounted investment)

Loss of control of a subsidiary, while retaining an equity accounted investment

B1 IFRS 10 requires that on loss of control of a subsidiary the parent derecognised the subsidiary, *regardless of whether it is an asset or a business*. If the investor retains an interest in the former subsidiary, it applies the requirements in paragraph 25, alongside with the guidance set out in paragraphs B97–B99, of IFRS 10.

B2 A parent deconsolidates the subsidiary by removing its net assets and recognising a gain or loss (*full gain or loss*) in profit or loss that is measured, at the date when control is lost, as the difference between:[42]

(a) the aggregate of:

(i) the fair value of the consideration received;

(ii) the *fair value of any investment retained* in the former subsidiary;

(iii) the carrying amount of any non-controlling interests in the former subsidiary; and

(b) the carrying amounts of the former subsidiary's assets (including any goodwill) and liabilities.

B3 The loss of control is a significant economic event—the parent-subsidiary relationship ceases to exist and an investor-investee relationship begins (that differs significantly from the former parent-subsidiary relationship). The consequence is that the partial disposal of an interest in a subsidiary resulting in a loss of control is accounted for as:

(a) a full disposal; followed by

(b) a reacquisition of the retained interest.

[42] For simplicity, it assumes that there is no distribution of shares of the subsidiary to owners in their capacity as owners, nor amounts recognised in other comprehensive income in relation to the subsidiary.

B4 As a result, the investor measures a retained investment in the investee at its fair value on deconsolidation when the equity method begins. This fair value measurement becomes the investor's cost on applying the equity method.

Transfer control of a non-monetary asset, while obtaining an equity accounted investment

B5 IFRS Accounting Standards require the derecognition and measurement requirements of IFRS 15 to be applied to the sale or transfer a non-monetary asset that is not an output of the entity's ordinary activities. This includes, for example, PPE in the scope of IAS 16.[43] [44] IAS 16 was amended for IFRS 15—so that, requiring an entity to apply the guidance in IFRS 15 on determining when an entity transfers control of a non-monetary asset and how to measure the gain or loss upon derecognition.

B6 Applying IAS 16 an investor derecognises the asset and recognising a gain or loss (*full gain or loss*) in profit or loss that is measured, at the date when control transfers to the recipient, as the difference between:

(a) the transaction price measured applying IFRS 15, including the *fair value of any investment obtained (that is, effectively retained);* and

(b) the asset's carrying amount.

B7 To determine the transaction price the guidance in IFRS 15 is applied; an investor considers the guidance on measuring variable consideration—including the non-cash consideration. So that, any investment retained in the asset is included in the transaction price—as non-cash consideration—and measured at fair value.[45] This fair value measurement becomes the investor's cost on applying the equity method.

B8 The staff note that transfer control of a non-monetary asset, while obtaining an equity accounted investment could be perceived as a significant event, because, effectively, the nature of the asset changes from a non-financial asset (PPE that is a non-monetary asset)

[43] Paragraph 81J of IAS 16 states that IFRS 15, issued in May 2014, amended paragraphs 68A, 69 and 72 of IAS 16. [Refer: paragraphs 87–90 and BC494–BC503 of the Basis for Conclusions on IFRS 15].
[44] It includes also intangible assets in the scope of IAS 38 and investment properties in the scope of IAS 40.
[45] Paragraph 66 of IFRS 15 requires that non-cash consideration is to be measured at fair value.

to a financial instrument (investment in an associate). In other words, the investment retained (or obtained) is substantially different from the initial investment.

How the measurement differs in those types of transactions

B9 On the sale of:

(a) a subsidiary, the investor applies the deconsolidation requirements in IFRS 10 and, as part of determining the gain or loss on the transaction, measures any investment retained at the fair value.

(b) an asset, the investor applies the derecognition requirements in IAS 16 and, as part of determining the gain or loss on the transaction, measures the consideration in accordance with IFRS 15 requirements (in which case, the non-cash consideration, that is any investment obtained, is being measured at fair value, see paragraph B7 of this Appendix).

B10 The staff note that, and regardless of whether transferring control of a subsidiary or a non-monetary asset, applying IFRS Accounting Standards require:

(a) recognising a gain or loss (*full gain or loss*) in profit or loss on:

(i) loss of control over a subsidiary; or

(ii) transferring control of an asset; and

(b) if an investor obtained an investment (that is effectively retained), such an investment is measured *at fair value*.

Illustrations of a partial sale of non-monetary asset(s)[46]

B11 When a partial sale of a non-monetary asset is structured in the form as the sale of a controlling interest in a subsidiary,[47] the question that we need to answer is: what is the unit of account—that is, it is unclear whether the unit of account is:

(a) the controlling interest transferred (in which case the investor applies the requirements of IFRS 10 as set out in paragraphs B1–B4 of this Appendix); or

(b) the underlying non-monetary asset (in which case the investor applies the requirements of IAS 16 as set out in paragraphs B5–B8 of this Appendix).

B12 The following examples illustrate variants of a partial sale of a non-monetary asset:

Underlying distinct non-monetary asset	**Controlling interest transferred**	**Differences**
Investor X owns a PPE and enters into a transaction with Counterparty Y, as follows: • Y establishes a new entity, Entity Z. • Y contributes CA 1,000 in cash to Z. • X transfers the PPE directly to Z in exchange for cash consideration of CA 1,000 and a 25% ownership interest in Z.	Investor X sells 75% of Subsidiary Z, a wholly owned subsidiary that holds an PPE to Counterparty Y. X receives cash consideration of CA 1,000.	In both transactions, X ends up with: • CA 1,000 cash consideration; and • 25% non-controlling interest in Z. In other words, X retains an ownership interest, *indirectly*, in the PPE transferred.

B13 The staff note that in dealing with the respondents' questions that are related to transactions that involve 'corporate wrappers' in the *Post-implementation Review of IFRS 10, IFRS 11 and IFRS 12*, the IASB was concerned that:

(a) it might not be able to successfully resolve this matter within the scope of IFRS 10, particularly as the matter extends beyond the scope of this Post-

[46] For the purpose of this appendix:
(a) the partial sale of a non-monetary asset may be structured in a way that, for example, an investor transfers effectively the control of a non-monetary asset to a counterparty and, at the same time, as part of the transaction price, receives a non-controlling interest in the legal entity to which the non-monetary asset was transferred.
(b) the non-monetary asset would exclusively refer to a group of assets that do not meet the definition of a business as defined in IFRS 3, such as items of PPE, intangible assets and investment properties.

[47] A parent may also transfer ownership interest in a consolidated subsidiary that includes such a non-monetary asset but retains a non-controlling interest in the former subsidiary.

implementation Review. For example, the matter might also affect IFRS 15 or IFRS 16.

(b) the structure of 'corporate wrappers' also depends on jurisdictional laws and/or regulations.

(c) therefore, identifying matters to be addressed by the IASB could require substantial resources for both the IASB and its stakeholders.[48]

B14 Consequently, the staff have not tried to assess further whether an entity should evaluate whether it transfers control of the controlling interest or the underlying non-monetary asset.

B15 The staff think that it is important to understand the economics of the underlying transaction and that judgement would, therefore, be needed to determine the appropriate accounting. The staff also think that the substance of the transactions, as set out in paragraph B12 of this Appendix, should be the same and, therefore, should be accounted for in a similar manner. In other words, the staff think that the accounting should not be driven by whether an entity exists or not.

B16 Accordingly, the staff viewed the substance of partial sales transactions of non-monetary assets as the transfer of a distinct non-monetary asset in exchange for a non-controlling interest in another entity. This is because, the form of the transaction generally should not dictate the accounting model. The consequence is that the partial disposal of an PPE, resulting in transferring control to the recipient, is accounted for as, as set out in paragraphs B5–B8 of Appendix B to this paper:

(a) a full disposal of a PPE; followed by

(b) a reacquisition of the non-controlling interest.

[48] See page 19 of *Project Report and Feedback Summary Post-implementation Review of IFRS 10, IFRS 11 and IFRS 12* for further details.

IFRS 10 and IAS 28 requirements[49]

Application of the requirements in IFRS 10 and IAS 28

B17 There are effectively two steps in applying the requirements in IFRS 10 and IAS 28:

(a) Step 1—the deconsolidation requirements of IFRS 10, and how to measure the gain or loss due to such a derecognition (on the loss of control of a subsidiary).

(b) Step 2—acquisition of the retained interest and, due to the nature of the transaction (ie transaction between an investor and its associate), to what extent the gain or loss in Step 1 should be restricted.

Step 1—The deconsolidation requirements

B18 As part of the transaction, a parent loses control of a subsidiary; it applies paragraph B98 of IFRS 10 that explains how the parent measures and recognises a gain or loss on the derecognition (full gain or loss).

Step 2—Acquisition of the retained interest—adjusting the gain or loss as transaction between an investor and its associate

B19 As part of the transaction, an investor is required:

(a) at initial recognition to measure the investment retained at fair value; and

(b) in accordance with paragraph 28 of IAS 28, to adjust the gain or loss from Step 1 to the extent of the unrelated investor's interests in the associate (ie subsequent accounting). In other words, to meet the elimination entries' requirements in IAS 28, the investor restricts the gain or loss in Step 1 (*partial gain or loss*).

B20 The staff observe that the requirements set out in paragraph 28 of IAS 28 are part of equity method procedures. In other words, it is about recognising investor-level adjustments (that is, as a subsequent measurement at day 2). Such requirements specify only how to restrict the gain or loss in Step 1 (arising from loss of control over a subsidiary)—they do not include:

[49] The other way around if it is a partial sale of a non-monetary asset should be read 'IAS 16 (IFRS 15) and IAS 28 requirements'.

(a) derecognition requirements;

(b) how to measure the gain or loss upon such a derecognition; or

(c) initial recognition and measurement of the investment retained.

Applying Step 1 and Step 2 on a partial sale of a non-monetary asset

B21 The staff note that the mechanics of applying the above steps should be the same in situations in which an entity contributes a PPE to an associate—in these situations an entity applies:

(a) the derecognition requirements (alongside the measurement requirements of the gain or loss as per IFRS 15) in IAS 16 first (*full gain or loss*); then

(b) the initial recognition and measurement of the investment obtained (that is effectively retained) at fair value, followed by the elimination entries' requirements of the gain or loss in IAS 28 to adjust the gain or loss in paragraph B21(a) of this Appendix (*partial gain or loss*).

B22 For example, paragraph 29 of agenda paper 2 to the Committee, at its February 2021 meeting, considered the discussion made in 2018 on *Contributing Property, Plant and Equipment to an Associate*, see paragraph A14 of Appendix A to this paper, in which it explained that:

(a) paragraph 68 of IAS 16 requires an entity to recognise the gain or loss arising from the derecognition of an item of PPE in profit or loss.

(b) paragraph 71 of IAS 16 specifies how to calculate the gain or loss (as the difference between the net disposal proceeds and the carrying amount of the item of PPE (*full gain or loss*).

(c) however, paragraph 28 of IAS 28, after applying the initial recognition and measurement of the investment obtained, requires an entity to recognise gains and losses resulting from transactions between an entity and its associate only to the extent of unrelated investors' interests in the associate (*partial gain or loss*).

B23 The Committee's conclusion in that agenda decision confirmed that on contributing an item of PPE to an associate (and consequently derecognising that item of PPE), an entity eliminates (or does not recognise) any gain or loss related to its own interest in the associate. The entity therefore recognises only the amount of any gain or loss that relates to unrelated investors' interests in the associate. In reaching its conclusion on that submission, the Committee did not view the requirements in IAS 16 and IAS 28 as being inconsistent, even though the gain or loss requirements in IAS 16 do not include a cross-reference to IAS 28.[50]

B24 The staff's view is that IAS 28 sets a specific requirement as an exclusion from the requirement in IAS 16 (or IFRS 10 for the subject matter of this paper). It appears also that, the specificity of the requirements in IAS 28 concerning a sale or contribution of an asset to an associate should be applied as a sub-set of Step 2, as set out in paragraph B19 of this Appendix, regardless of the fact that the origination of the transaction that is in Step 1 was:

(a) derecognising PPE applying IAS 16; or

(b) derecognising a subsidiary applying IFRS 10.

Would it differ if it is an asset or a business?

B25 In the light of the above analysis, it appears that the:

(a) loss of control over a subsidiary (regardless of whether it is an asset or a business); or

(b) transferring control of an asset (regardless of whether the asset is housed in a subsidiary),

both—should be considered as a significant event that triggers the measurement at fair value of any investment interest retained (or obtained) in an associate, see paragraphs B3 and B8 of this Appendix.

[50] See IFRIC Update, January 2018 for further details.

B26 In other words, the loss of control (or derecognition) of any asset would trigger the recognition of a full gain or loss and the recognition of any investment retained at fair value:

(a) whether the assets constitute a business or not; or

(b) whether the assets are housed in a subsidiary or not.

B27 The staff note that this represents the IASB's thinking when it issued the 2014 Amendment, see paragraph 37 of this paper.

B28 Consequently, the staff could not find a reason of not aligning the accounting between assets and businesses when it comes to derecognition and losing control—because:

(a) derecognising a business applying IFRS 10 requires removing the carrying amounts of the former subsidiary's assets (including any goodwill) and liabilities from the consolidated financial statement.

(b) derecognising an asset requires also, applying IAS 16, removing the asset's carrying amount from the financial statement.

B29 In the staff's view, drawing a line between what constitutes a business versus a collection of assets requires significant judgement applying IFRS 3. So, introducing another accounting difference, when it comes to derecognition and losing control, that is dependent on the interpretation and exercising judgement of the definition of a business could lead to unduly complexities.[51]

[51] Paragraph BC20 of the Basis for Conclusions on IFRS 3 explains that the FASB and the IASB considered whether to expand the scope of the revised standards to all acquisitions of groups of assets. *They noted that doing so would avoid the need to distinguish between those groups that are businesses and those that are not*. However, both boards noted that broadening the scope of the revised standards beyond acquisitions of businesses would require further research and deliberation of additional issues and delay the implementation of the revised standards' improvements to practice. The boards therefore did not extend the scope of the revised standards to acquisitions of all asset groups. Paragraph 2(b) of the revised IFRS 3 describes the typical accounting for an asset acquisition.