Investment in a subsidiary accounted for at cost: Step acquisition (IAS 27 *Separate Financial Statements*)—January 2019

The Committee received a request about how an entity applies the requirements in IAS 27 to a fact pattern involving an investment in a subsidiary.

In the fact pattern described in the request, the entity preparing separate financial statements:

- elects to account for its investments in subsidiaries at cost applying paragraph 10 of IAS 27.
- holds an initial investment in another entity (investee). The investment is an investment in an equity instrument as defined in paragraph 11 of IAS 32 *Financial Instruments: Presentation*. The investee is not an associate, joint venture or subsidiary of the entity and, accordingly, the entity applies IFRS 9 *Financial Instruments* in accounting for its initial investment (initial interest).
- subsequently acquires an additional interest in the investee (additional interest), which results in the entity obtaining control of the investee—ie the investee becomes a subsidiary of the entity.

The request asked:

a. whether the entity determines the cost of its investment in the subsidiary as the sum of:
    a. the fair value of the initial interest at the date of obtaining control of the subsidiary, plus any consideration paid for the additional interest (fair value as deemed cost approach); or
    b. the consideration paid for the initial interest (original consideration), plus any consideration paid for the additional interest (accumulated cost approach) (Question A).
b. how the entity accounts for any difference between the fair value of the initial interest at the date of obtaining control of the subsidiary and its original consideration when applying the accumulated cost approach (Question B).

Question A

IAS 27 does not define ‘cost’, nor does it specify how an entity determines the cost of an investment acquired in stages. The Committee noted that cost is defined in other IFRS Standards (for example, paragraph 6 of IAS 16 *Property Plant and Equipment*, paragraph 8 of IAS 38 *Intangible Assets* and paragraph 5 of IAS 40 *Investment Property*). The Committee observed that the two approaches outlined in the request arise from different views of whether the step acquisition transaction involves:

a. the entity exchanging its initial interest (plus consideration paid for the additional interest) for a controlling interest in the investee, or
b. purchasing the additional interest while retaining the initial interest.

Based on its analysis, the Committee concluded that a reasonable reading of the requirements in IFRS Standards could result in the application of either one of the two approaches outlined in this agenda decision (ie fair value as deemed cost approach or accumulated cost approach).

The Committee observed that an entity would apply its reading of the requirements consistently to step acquisition transactions. An entity would also disclose the selected approach applying paragraphs 117–124 of IAS 1 *Presentation of Financial Statements* if that disclosure would assist users of financial statements in understanding how step acquisition transactions are reflected in reporting financial performance and financial position.

Question B

In applying the accumulated cost approach, any difference between the fair value of the initial interest at the date of obtaining control of the subsidiary and its original consideration meets the definitions of income or expenses in the *Conceptual Framework for Financial Reporting*. Accordingly, the Committee concluded that, applying paragraph 88 of IAS 1, the entity recognises this difference in profit or loss, regardless of whether, before obtaining control, the entity had presented subsequent changes in fair value of the initial interest in profit or loss or other comprehensive income.

For Question A, the Committee considered whether to develop a narrow-scope amendment to address how an entity determines the cost of an investment acquired in stages. The Committee observed that:

a. it did not have evidence to assess whether the application of the two acceptable approaches to determining cost, outlined in this agenda decision, would have a material effect on those affected.
b. the matter could not be resolved without also considering the requirements in paragraph 10 of IAS 28 to initially measure an investment in an associate or joint venture at cost. The Committee did not obtain information to suggest that the Board should reconsider this aspect of IAS 28 at this stage, rather than as part of its wider consideration of IAS 28 within its research project on the Equity Method.

On balance, the Committee decided not to undertake standard-setting to address Question A.

For Question B, the Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to determine its accounting.

Consequently, the Committee decided not to add these matters to its standard-setting agenda.