

STAFF PAPER

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IFRS[®] Interpretations Committee meeting

Project	IAS 27 <i>Separate Financial Statements</i>—Investment in a subsidiary accounted for at cost: Step acquisition		
Paper topic	Initial consideration		
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Introduction

1. The IFRS Interpretations Committee (Committee) received a submission about the application of IAS 27 *Separate Financial Statements* when an entity obtains control of another entity in which it previously held an interest.
2. The objective of this paper is to:
 - (a) provide the Committee with a summary of the matter and our research and analysis; and
 - (b) ask the Committee whether it agrees with our recommendation not to add the matter to its standard-setting agenda.

Structure of the paper

3. This paper includes:
 - (a) background information;
 - (b) summary of outreach;
 - (c) staff analysis;
 - (d) staff recommendation; and

- (e) questions for the Committee.
4. There are two appendices to this paper:
- (a) Appendix A—proposed wording of the tentative agenda decision; and
 - (b) Appendix B—submission.

Background information

5. Paragraph 10 of IAS 27 requires an entity that prepares separate financial statements to account for investments in subsidiaries, joint ventures and associates either:
- (a) at cost;
 - (b) in accordance with IFRS 9 *Financial Instruments*; or
 - (c) using the equity method as described in IAS 28 *Investments in Associates and Joint Ventures*.
6. In the fact pattern described in the submission, Entity X:
- (a) prepares separate financial statements applying IAS 27;
 - (b) holds an equity interest in Entity Y (initial interest). This initial interest does not give Entity X control or joint control of, or significant influence over, Entity Y. The initial interest is an equity instrument as defined in paragraph 11 of IAS 32 *Financial Instruments: Presentation*. Entity X applies IFRS 9 in accounting for its initial interest and measures it at fair value¹.
 - (c) subsequently acquires an additional equity interest in Entity Y (additional interest). The acquisition of this additional interest results in Entity X obtaining control of Entity Y—ie Entity Y becomes a subsidiary of Entity X (step acquisition transaction). Applying paragraph 10 of IAS 27, Entity X elects to measure its investment in Entity Y at cost.

¹ See paragraphs 18–19 of Agenda Paper 6A for this meeting for a discussion about the requirements in IFRS 9 on accounting for investments in equity instruments.

7. The submitter asks how Entity X determines the cost of its investment in Entity Y on the date it obtains control of Entity Y (Question A). In particular, the submitter asks whether the cost of the investment in Entity Y is the sum of:
- (a) the fair value of the initial interest on the date Entity X obtains control of Entity Y, plus the consideration paid for the additional interest (FV as deemed cost approach).
 - (b) the consideration paid for the initial interest when Entity X acquired the initial interest (original consideration), plus the consideration paid for the additional interest (accumulated cost approach).
8. To illustrate this fact pattern, the submitter provided the following numerical example:
- (a) Entity X holds a 10 per cent equity interest in Entity Y, which it originally acquired for CU²100.
 - (b) Entity X subsequently acquires an additional 45 per cent interest in Entity Y and obtains control of Entity Y. Entity X pays CU540 for this additional interest.
 - (c) on the date Entity X obtains control of Entity Y, the fair value of the initial 10 per cent interest in Entity Y is CU120.
9. Applying the two approaches set out in paragraph 7 of this paper, Entity X would determine the cost of its investment in Entity Y on the date it obtains control of Entity Y as follows:

<i>(amounts in CU)</i>	FV as deemed cost	Accumulated cost
Consideration paid for the 10% initial interest		100
Fair value of the 10% initial interest	120	
Consideration paid for the 45% additional interest	540	540
Cost of the investment in Entity Y (55% interest)	660	640

² In this paper, monetary amounts are denominated in ‘currency units’ (CU).

10. If an entity applies the accumulated cost approach, the submitter asks how Entity X accounts for any difference between (i) the fair value of its 10% initial interest on the date it obtains control of Entity Y (ie CU120) and (ii) the original consideration (CU100) (Question B). The submitter also asks whether the conclusion would differ depending on whether Entity X, before obtaining control of Entity Y, measures its initial interest:
- (a) at fair value through profit or loss (FVPL); or
 - (b) at fair value and applies the presentation election in paragraph 4.1.4 of IFRS 9 to present in OCI subsequent changes in fair value of the initial interest.
11. The submitter's questions relate only to separate financial statements and not to consolidated financial statements. Appendix B to this paper reproduces the submission and provides further details about the accounting approaches identified by the submitter.

Summary of outreach

12. We sent information requests to members of the International Forum of Accounting Standard-Setters, securities regulators and the large accounting firms.
13. In our request we asked whether, in the participants' experience, the step acquisition transaction is common.
14. In addition, if the step acquisition transaction were common we asked:
- (a) whether entities that, applying paragraph 10 of IAS 27, elect to account for investments in subsidiaries at cost, apply the FV as deemed cost approach or the accumulated cost approach (see paragraphs 7–9 of this paper) to determine the cost of their investment in the subsidiary;
 - (b) whether entities, before obtaining control, elect to present in OCI subsequent changes in fair value of the initial interest; and
 - (c) if applying the accumulated cost approach, how entities recognise any difference between (i) the fair value of the initial interest on the date of

obtaining control of the investee and (ii) the consideration paid for this initial interest.

15. We received thirteen responses—five from the large accounting firms, four from national standard-setters, two from regulators, one from an organisation representing groups of regulators and one from a Committee member. The views received represent informal opinions and do not represent the official views of those respondents.

Findings

Prevalence of transactions

16. Respondents indicated that the prevalence of the step acquisition transaction depends on whether entities:
- (a) are required or permitted to prepare separate financial statements;
 - (b) apply IFRS Standards in preparing those separate financial statements; and
 - (c) elect or are required (because of jurisdictional regulations) to measure investments in subsidiaries at cost in those separate financial statements.
17. Four respondents said they had no experience of this transaction and two respondents said their experience is limited. This is because entities in their jurisdictions are either not required to prepare separate financial statements or do not apply IFRS Standards to separate financial statements.
18. Seven respondents said the step acquisition transaction occurred more than infrequently in some jurisdictions.

Determining the 'cost' of the investment in the subsidiary

19. Five respondents said both the FV as deemed cost approach and the accumulated cost approach are applied in practice. One respondent said the FV as deemed cost approach is predominant in its jurisdiction while another said the accumulated cost approach is predominant. In addition, one respondent with limited experience of those transactions said the accumulated cost approach is more common.

Presenting subsequent changes in fair value of the initial interest

20. Because IFRS 9 is effective for annual reporting periods beginning on or after 1 January 2018, respondents had not observed whether entities, before obtaining control, elect to present in OCI subsequent changes in fair value of the initial interest. However, respondents said entities applying IAS 39 *Financial Instruments: Recognition and Measurement* generally classified the initial interest as an available-for-sale equity instrument (AFS)³.

Accounting for any difference between the fair value and consideration paid for the initial interest

21. Two respondents said entities predominantly present any difference directly in equity:
- (a) One respondent said entities present the difference directly in equity but did not specify which component of equity.
 - (b) The other respondent said an entity presents the difference in retained earnings if the entity had measured the initial interest at FVPL, or in accumulated OCI if the entity had presented in OCI any subsequent changes in fair value.
22. Two respondents said entities recognise any difference in profit or loss if the entity had measured the initial interest at FVPL. If the entity had presented subsequent changes in fair value in OCI, the entity recognises any difference in OCI.

Staff analysis

Question A: How does an entity determine the cost of an investment acquired in stages?

What is cost?

23. IAS 27 does not define ‘cost’. It also does not explicitly specify how to determine the cost of an investment acquired in stages.

³ The requirements in IAS 39 for accounting for equity instruments classified as AFS differ from the requirements in IFRS 9 for equity instruments for which an entity elects to present in OCI subsequent changes in fair value.

24. Nonetheless, paragraph 6 of IAS 16 *Property Plant and Equipment*, paragraph 8 of IAS 38 *Intangible Assets* and paragraph 5 of IAS 40 *Investment Property* include a definition of the cost of an asset (emphasis added):

Cost is the amount of *cash or cash equivalents paid or the fair value of the other consideration given* to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other IFRSs, eg IFRS 2 *Share-based Payment*.

25. Similarly, the 2018 *Conceptual Framework for Financial Reporting (Conceptual Framework)* discusses different measurement bases. Paragraph 6.5 of the *Conceptual Framework* states:

The historical cost of an asset when it is acquired or created is the value of the costs incurred in acquiring or creating the asset, comprising the consideration paid to acquire or create the asset plus transaction costs...

26. Paragraph 10 of IAS 28 *Investments in Associates and Joint Ventures* requires an entity to initially recognise its investment in an associate or joint venture at cost. Similar to IAS 27, IAS 28 does not define cost. In May 2009, the Committee discussed how an entity determines the cost of its investment in an associate. The [agenda decision](#) issued in July 2009 states (emphasis added):

...Generally stated, cost includes *the purchase price* and other costs directly attributable to the acquisition or issuance of the asset such as professional fees for legal services, transfer taxes and other transaction costs. Therefore, the cost of an investment in an associate at initial recognition determined in accordance with paragraph 10 of IAS 28 comprises *its purchase price* and any directly attributable expenditures necessary to obtain it...

27. We think that even though IAS 27 does not define cost, an entity can apply the principles and requirements outlined in paragraphs 24–26 of this paper to determine the cost of an investment in a subsidiary when applying IAS 27.

Cost in a step acquisition transaction

28. From the date it obtains control, Entity X stops applying IFRS 9 in accounting for its investment in Entity Y and instead elects to account for it at cost applying paragraph 10 of IAS 27. As mentioned above, IAS 27 does not explicitly specify how to determine the cost of an investment acquired in stages.
29. We think the different approaches outlined in paragraph 7 of this paper arise from different views about whether the step acquisition transaction involves:
- (a) Entity X exchanging its initial interest (plus consideration paid for the additional interest) for a controlling interest in Entity Y (exchange view); or
 - (b) Entity X purchasing the additional interest while retaining the initial interest (non-exchange view).
30. If Entity X applies the exchange view, then in applying the principles and requirements discussed in paragraphs 24–26 of this paper, it would include the fair value of the initial interest on the date Entity X obtains control of Entity Y as part of the purchase price or consideration given to acquire the controlling interest. Using this view, Entity X would apply the FV as deemed cost approach to measure its investment in Entity Y at the date of the step acquisition transaction, and the cost of its investment in Entity Y (55% interest) would be CU660.
31. Instead if Entity X applies the non-exchange view, then it would not include the fair value of the initial interest in the purchase price or consideration given to acquire the controlling interest. Accordingly, using this view, Entity X would apply the accumulated cost approach to measure its investment in the subsidiary and the cost of the investment in Entity Y (55% interest) would be CU640.
32. In determining which of these two views Entity X applies, we considered the requirements in paragraphs 10–11 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (which apply when IFRS Standards do not specifically apply to a transaction). We first considered if there are requirements in IFRS Standards dealing with similar and related issues. We identified two transactions or events for which an entity (i) stops applying IFRS 9 to an investment in another entity and (ii) starts applying another measurement basis. In both these

cases, an entity is required to determine the consideration paid at the date of the transaction or event.

33. Paragraph 42 of IFRS 3 *Business Combinations* contains requirements for a business combination achieved in stages. It states:

In a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss or other comprehensive income, as appropriate...

34. Paragraph BC384 of IFRS 3 explains that the Board views a business combination achieved in stages as a transaction in which an acquirer exchanges its status as an owner of a non-controlling interest in a business for a controlling interest in all of the underlying assets and liabilities of that business. The Board concluded that such a transaction is a significant change in the nature of, and economic circumstances surrounding, that investment. That change warrants a change in the classification and measurement of that investment.

35. Paragraph 11B(a) of IAS 27 contains requirements on how an entity accounts for an investment in a subsidiary when it ceases to be an investment entity. In this situation, the entity ceases to measure its investment in the subsidiary at fair value applying IFRS 9 and, instead, applies IAS 27 to the investment from the date it ceases to be an investment entity. The paragraph states:

...when an entity ceases to be an investment entity, the entity shall account for an investment in a subsidiary in accordance with paragraph 10. The date of the change of status shall be the deemed acquisition date. The fair value of the subsidiary at the deemed acquisition date shall represent the transferred deemed consideration when accounting for the investment in accordance with paragraph 10.

36. While the Basis for Conclusions to IAS 27 does not explain the basis for these requirements, IFRS 10 contains similar requirements for an entity that ceases to be an investment entity. Paragraph BC271 of IFRS 10 explains the rationale for the

requirements and states that ‘...This treats the change in business purpose of the investor as a significant economic event...’.

37. In both these situations, the Board concluded that there is a significant economic event. Similarly, we think the step acquisition transaction is a significant economic event—this is because Entity X obtains control of Entity Y. In addition, IAS 27 contains different measurement requirements for controlling interests in an entity than for non-controlling interests that do not give rise to joint control or significant influence.
38. In both these situations, the fair value—and not the original cost—of the investment in the other entity is deemed to be the consideration paid at the date of the transaction or event.
39. Similarly, paragraph 60 of IAS 40 requires that when an entity transfers an investment property carried at fair value to owner-occupied property or inventories, the property’s deemed cost for subsequent accounting applying IAS 16, IFRS 16 *Leases* or IAS 2 *Inventories* is its fair value at the date of change in use.
40. Based on these requirements, we think in the step acquisition transaction, the cost of Entity X’s investment in Entity Y includes the fair value of the initial interest at the date Entity X obtains control, and not its original cost (ie FV as deemed cost approach).
41. Applying this approach, the consideration given is (a) the purchase price of the additional interest and (b) the fair value of the initial interest at the date Entity X obtains control. In other words, when Entity X obtains control of Entity Y, it exchanges its status as an owner of a non-controlling interest (plus consideration paid for the additional interest) for an investment that gives Entity X control of Entity Y.
42. For illustrative purposes, we consider the numerical example set out in paragraph 8 of this paper. Applying the FV as deemed cost approach, Entity X would derecognise the initial interest and instead recognise the total investment in Entity Y at the date of the step acquisition transaction.

43. When Entity X acquires the initial interest, it recognises the initial interest as follows:

(Dr) Investment in Entity Y	100	
		(Cr) Cash or Payable
		100

44. The entity recognises changes in fair value of its initial interest as follows:

(Dr) Investment in Entity Y	20	
		(Cr) Fair value increase ⁴
		20

45. At the date Entity X obtains control of Entity Y, it records the following to recognise the step acquisition transaction:

(Dr) Investment in Entity Y (subsidiary)	660	
		(Cr) Investment in Entity Y
		120
		(Cr) Cash or Payable
		540

46. This journal entry results in the cost of Entity X's investment in Entity Y being CU660 (ie CU120 fair value of the initial interest + CU540 consideration paid for the additional interest).

Is there an alternative way to read the requirements?

47. Notwithstanding our view that Entity X applies the FV as deemed cost approach in accounting for the step acquisition transaction, we considered whether the requirements could be read to support applying the accumulated cost approach. As mentioned in paragraph 29 of this paper, Entity X might consider that the step acquisition transaction simply involves acquiring an additional interest in Entity Y while retaining the initial interest.

48. In July 2010, the Committee considered a similar transaction. As discussed in paragraph 26 of this paper, paragraph 10 of IAS 28 requires an entity to initially recognise its investment in an associate or joint venture at cost. The Committee considered a transaction in which an entity acquires an investment in an associate in

⁴ Entity X would present this increase in profit or loss unless, applying paragraph 4.1.4 of IFRS 9, it elects to present in OCI subsequent changes in fair value of its initial interest.

stages and had classified its initial interest as AFS⁵ until the investment became an associate. The Committee discussed the amount at which the entity measures its investment in the associate at the date it obtains significant influence. Because of the acknowledged diversity in practice, the Committee recommended that the matter be referred to the Board for consideration (see [July 2010 IFRIC Update—IAS 28 — Purchases in stages—fair value as deemed cost](#)). In September 2011, the Board decided not to include this matter in its *Annual Improvements* process ([September 2011 IASB Update](#)). The Board has not further discussed the matter.

49. Although July 2010 *IFRIC Update* does not discuss the different approaches applied in practice, we understand from the relevant staff paper that the two methods applied in practice to account for this transaction were similar to the two approaches described in paragraph 7 of this paper.

50. In addition, the requirements for similar and related transactions that make reference to the cost of, or consideration for, the related transaction (see paragraphs 35 and 39 of this paper) specially refer to the fair value being used as the ‘deemed’ cost of, or the ‘deemed’ consideration for, the related transaction. The concept of ‘deemed cost’ is also used in IFRS 1 *First-time Adoption of International Financial Reporting Standards*. Appendix A of IFRS 1 defines deemed cost as (emphasis added) ‘an amount used as a *surrogate* for cost or depreciated cost at a given date...’.

51. We also note that the definition of ‘historical cost’ in the *Conceptual Framework* (reproduced in paragraph 25 of this paper) and the May 2009 Committee’s agenda decision (reproduced in paragraph 26 of this paper) both focus on the ‘purchase price’ or ‘consideration paid’. Some might say the purchase price or consideration paid can refer only to the consideration that was originally paid for the initial interest.

52. Applying this view, Entity X determines the cost of its investment in Entity Y as the consideration paid for the initial interest when Entity X acquired that initial interest, plus the consideration paid for the additional interest. In effect, this approach accumulates the costs of earlier purchases of interests in the investee. This approach

⁵ The entity applied IAS 39 in accounting for its initial interest before obtaining significant influence.

(accumulated cost approach) considers each acquisition of an interest in Entity Y to be a separate transaction.

53. For illustrative purposes, we consider the numerical example set out in paragraph 8 of this paper. Applying the accumulated cost approach, Entity X would record the following at the date of the step acquisition transaction⁶:

(a) Entity X recognises the purchase of the additional interest as follows:

(Dr) Investment in equity instrument	540
(Cr) Cash or Payable	540

(b) Because the cost of Entity X's investment in Entity Y is determined on the basis of the cost of each interest purchased, the entity must reverse any difference between (i) the fair value of the initial interest on the date the entity obtains control of the investee (ie CU120) and (ii) the consideration paid for this interest (ie CU100). Entity X recognises this adjustment as follows:

(Dr) Adjustment to the cost of equity instrument ⁷	20
(Cr) Investment in equity instrument	20

These journal entries result in the total cost of the investment being CU640 (ie CU100 consideration paid for the initial interest + CU540 consideration paid for the additional interest).

54. The accumulated cost approach results in Entity X adjusting the measurement basis of the initial interest—ie the entity 'resets' the value of the initial interest from fair value to its original cost and in effect unwinds previously recognised fair value changes. No similar adjustment is needed when applying the FV as deemed cost approach because the fair value of the initial interest, on the date the entity obtains control of Entity Y, is included as part of the cost of the total investment in Entity Y.

⁶ Before the step acquisition transaction, Entity X would record the acquisition of the initial interest and changes in fair value of the initial interest in same manner as described in paragraphs 43–44 of this paper.

⁷ We discuss later in this paper (see Question B) how Entity X accounts for this adjustment.

55. Based on the existing requirements in IFRS Standards and our consideration of similar and related matters, we think Entity X could interpret the requirements to support the application of the accumulated cost approach.

Summary

56. Based on our analysis of the applicable requirements, we think Entity X applies the FV value as deemed cost approach to account for the step acquisition transaction. Nonetheless, based on existing requirements in IFRS Standards and our consideration of similar and related matters, we think Entity X could interpret the requirements to support applying the accumulated cost approach.

Question 1 for the Committee

Does the Committee agree with our analysis set out in paragraphs 23–56 of this paper that, based on existing requirements in IFRS Standards, an entity could apply either the FV as deemed cost approach or the accumulated cost approach in accounting for the step acquisition transaction?

Question B: accounting for any difference between the fair value of the initial interest and its original cost (accumulated cost approach)

57. Before the step acquisition transaction, Entity X applies IFRS 9 in accounting for the initial interest. Applying paragraph 4.1.4 of IFRS 9, Entity X presents subsequent changes in fair value of that initial interest in either profit or loss or OCI.
58. If, at initial recognition, the entity elects to present subsequent changes in fair value in OCI, applying the requirements in paragraph B5.7.1 of IFRS 9 the entity:
- (a) does not subsequently transfer to profit or loss the amounts presented in OCI (ie recycling is prohibited).
 - (b) may transfer the cumulative gain or loss within equity. As explained in paragraph BC5.26 of IFRS 9, the Board did not provide specific requirements related to that transfer because of the existence of jurisdiction-specific restrictions on components of equity. Accordingly, an entity may transfer the cumulative gain or loss within equity at any time but is not required to do so.

59. As discussed in paragraph 54 of this paper, if Entity X applies the accumulated cost approach to account for the step acquisition transaction, it must recognise any difference between the fair value of the initial interest at the date of obtaining control (CU120 in paragraph 53(b) of this paper) and the original consideration paid for that initial interest (CU100 in paragraph 53(b) of this paper). In this section, we consider how Entity X accounts for this difference.
60. Any difference results from a change in the measurement basis of Entity X's initial interest in Entity Y because it obtains control of Entity Y. Because of this change in measurement basis, the measurement of Entity X's initial interest (an asset) would either decrease (if the fair value at the date of the step acquisition transaction is higher than the original consideration paid for the initial interest) or increase (if the fair value at the date of the step acquisition transaction is less than the original consideration paid for the initial interest)⁸.
61. Paragraph 35 of IAS 8 states that a change in measurement basis is a change in accounting policy. However, this change results from an event (ie obtaining control) and does not result from the entity changing the measurement basis of its investment in the absence of a transaction, other event or condition. Paragraph 16(a) of IAS 8 states that the application of an accounting policy for transactions, other events or conditions that differ in substance from those previously occurring is not a change in accounting policy. Accordingly, an entity does not apply the requirements in IAS 8 for changes in accounting policies in accounting for this difference.
62. We did not find requirements for similar or related transactions in which an entity uses the accumulated cost approach. Accordingly, we considered whether this difference meets the definition of income or expenses in the *Conceptual Framework*.

Definitions in the Conceptual Framework

63. Paragraphs 4.68 and 4.69 of the 2018 *Conceptual Framework* set out the following definitions for income and expenses:

⁸ If the measurement of Entity X's initial interest increases because the fair value of the initial interest on the date of obtaining control is lower than its original cost, then we think the entity also would need to consider whether its investment in the subsidiary is impaired applying IAS 36 *Impairment of Assets*.

Income is increases in assets, or decreases in liabilities, that result in increases in equity, other than those relating to contributions from holders of equity claims.

Expenses are decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims.

64. In the light of the definitions above, we think the difference as described in paragraphs 59–60 of this paper meets the definition of income or expenses. This is because:
- (a) the difference represents an increase or decrease in an asset (initial interest); and
 - (b) does not result from a contribution from, or distribution to, holders of equity claims.⁹

How does an entity present this difference?

65. Paragraph 88 of IAS 1 states:

An entity shall recognise all items of income and expense in a period in profit or loss unless an IFRS requires or permits otherwise.

66. No IFRS Standard requires or permits the presentation of any difference between the cost of an investment retained and its fair value other than in profit or loss. Accordingly, applying paragraph 88 of IAS 1, we think the entity recognises this difference as income or expense in profit or loss.

⁹ We think the difference also meets the definition of income or expenses in the 2010 *Conceptual Framework*. This is because paragraph BC4.95 of the 2018 *Conceptual Framework* explains that the Board noted that no major problems had been identified with the definitions of income and expenses. Hence, the only changes made were those necessary to make the definitions of income and expenses consistent with the revised definitions of an asset and a liability. In addition, other IFRS Standards require an entity to present differences resulting from a change in measurement basis in profit or loss. For example, see transactions discussed in paragraphs 26–27 of agenda paper 6A prepared for this meeting. In both those transactions, any difference resulting from a change in the measurement basis of the asset is recognised as income or expense. There is no indication that these requirements result in a departure from the definitions in the 2010 *Conceptual Framework*.

67. We do not see a basis for recognising the difference directly in equity. Paragraph 109 of IAS 1 states (emphasis added):

Changes in an entity's equity between the beginning and the end of the reporting period reflect the increase or decrease in its net assets during the period. Except for changes resulting from transactions with owners in their capacity as owners (such as equity contributions, reacquisitions of the entity's own equity instruments and dividends) and transaction costs directly related to such transactions, the overall change in equity during a period represents the total amount of income and expense, including gains and losses, generated by the entity's activities during that period.

Because the difference does not result from a transaction with owners in their capacity as owners, we do not see a basis to present the difference directly in equity.

68. In our view, the entity recognises any difference between the fair value of the initial interest and its original cost as income or expense in profit or loss, regardless of whether, before the step acquisition transaction, the entity had presented subsequent changes in fair value of its initial interest in profit or loss or OCI. The election in paragraph 4.1.4 of IFRS 9 to present changes in OCI applies only to 'subsequent changes in fair value'. This difference does not arise from a change in the fair value of the instrument—the entity ceases to apply IFRS 9 and immediately applies IAS 28 so no fair value change has occurred. Accordingly, the entity presents the difference in profit or loss.

Question 2 for the Committee

Does the Committee agree with our analysis in paragraphs 57–68 of this paper that, applying the accumulated cost approach, Entity X recognises as income or expense, and presents in profit or loss, any difference between the fair value of the initial interest at the date of obtaining control of the investee and its original cost?

Should the Committee add this matter to its standard-setting agenda?

*Is the matter widespread and expected to have a material effect on those affected?*¹⁰

69. As stated in paragraphs 16–18 of this paper, the step acquisition transaction is not common in several jurisdictions, particularly jurisdictions in which entities are either not required to prepare separate financial statements or do not apply IFRS Standards to separate financial statements. However, the transaction does occur more than infrequently in some jurisdictions.
70. Our outreach findings (paragraph 19 of this paper) indicate that entities apply different approaches in determining the cost of an investment in a subsidiary acquired in stages (Question A). Because the transaction does not occur frequently, we do not have evidence to assess whether the different approaches have a material effect on those affected.
71. IAS 27 does not have particular disclosure requirements in respect of this transaction. However, paragraph 15 of IAS 27 requires an entity to apply all applicable IFRS Standards when providing disclosures in its separate financial statements. Accordingly, when the application of either the FV as deemed cost approach or the accumulated cost approach would have a material effect on the separate financial statements, we would expect an entity to apply paragraph 122 of IAS 1 and disclose the judgement it has made in applying its accounting policy. Paragraph 122 of IAS 1 states:

An entity shall disclose, along with its significant accounting policies or other notes, the judgements, apart from those involving estimations (see paragraph 125), that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

¹⁰ Paragraph 5.16(a) of the *Due Process Handbook*.

Is it necessary to add to or change IFRS Standards to improve financial reporting?

72. We think for Question A (ie how an entity determines the cost of its investment in a subsidiary acquired in stages), without additional requirements or explanation beyond those in IAS 27 we cannot conclude that our view of determining the cost of an investment in a subsidiary (ie FV as deemed cost approach) is the only way that stakeholders might reasonably read the requirements. Accordingly, we would conclude that it is necessary to change IFRS Standards if the Board or Committee decides to address this matter.
73. Question B applies only if an entity uses the accumulated cost approach in determining the cost of its investment in a step acquisition transaction. In this situation, we think IFRS Standards provide an adequate basis for an entity to determine its accounting for any difference between the fair value of the initial interest at the date of obtaining control and its original cost. Accordingly, we think it is not necessary to change IFRS Standards to address this matter.

Would any solution developed be effective for a reasonable period of time?¹¹

74. The Board does not have a project on separate financial statements on its work plan or in its research pipeline. Therefore, we think any solution developed by the Committee to address Question A would be effective for a reasonable period of time.

Can the matter be resolved efficiently (is it sufficiently narrow in scope)?¹²

75. The Board could undertake standard-setting to specify whether an entity applies the FV as deemed cost approach or the accumulated cost approach when determining the cost of an investment in a subsidiary acquired in stages (Question A). However, as discussed in paragraphs 48–49 of this paper, a similar question arises when determining the cost of an investment in an associate or joint venture acquired in stages.

¹¹ Paragraph 5.21 of the *Due Process Handbook*.

¹² Paragraphs 5.16(c) and 5.17 of the *Due Process Handbook*.

76. Accordingly, we think it would be difficult to limit the scope of any possible standard-setting only to IAS 27. In particular, we think there would be cross-cutting implications for IAS 28 that the Committee would also need to consider.
77. There is also a question of whether the benefits would be sufficient to justify the cost of adding a standard-setting project in this respect. Because the step acquisition transaction occurs more than infrequently only in some jurisdictions (see paragraphs 16–18 of this paper), we think the benefits of any possible standard-setting in IAS 27 are limited. Step acquisition transactions are generally one-off transactions and, applying the requirements in IFRS Standards we would expect an entity to provide sufficient disclosures when the effect of any such transaction on an entity’s separate financial statements is material. Further, as outlined in paragraph 70 of this paper, we do not have evidence to assess whether the different approaches to determining cost have a material effect on those affected.
78. We consider that there could be additional benefits if the scope of any standard-setting project were also to consider the requirements in IAS 28. Those requirements apply in both consolidated and separate financial statements. Accordingly, any standard-setting would affect a broader population of transactions.
79. Nonetheless, the Board has a project on the equity method (Equity Method project) in the research pipeline. As noted in the [February 2018 IASB® Update](#), the Board expects to start work on this project in 2019 or early 2020.
80. The submission asked particularly about the application of cost in the context of separate financial statements and not in the context of IAS 28. In the absence of any new information suggesting that work on this aspect of IAS 28 is more urgent than other aspects of the equity method, we do not see a particular reason to reconsider this aspect of IAS 28 in isolation at this stage. The Board could consider adding this matter to the topics to be considered as part of the Equity Method project, including considering any effect on separate financial statements.

Staff conclusion, having considered the Committee’s agenda criteria

81. We think the benefits of developing a narrow-scope amendment to IAS 27 to address how to determine the cost of an investment in a subsidiary acquired in stages would not outweigh the cost of doing so. We also think this could not be addressed without

also considering the requirements in IAS 28. Although we think it is possible to develop a narrow-scope amendment to both IAS 27 and IAS 28 to address how an entity determines cost for an investment acquired in stages, we have not obtained information to suggest that the Board should reconsider this aspect of IAS 28 at this stage, in isolation of its wider consideration of IAS 28 as part of the Equity Method project. On balance, we think the Committee should not undertake standard-setting to address this matter.

82. In situations in which an entity applies the accumulated cost approach to determine its investment in a subsidiary, we think IFRS Standards provide an adequate basis for an entity to determine its accounting for any difference between the fair value of the initial interest on the date of obtaining control and its original cost (ie Question B of this paper).

Staff recommendation

83. On the basis of our assessment of the Committee’s agenda criteria in paragraphs 5.16-5.17 of the *Due Process Handbook*, on balance we recommend that the Committee not add the matter to its standard-setting agenda. Instead, we recommend publishing an agenda decision that explains the requirements that an entity applies when accounting for the step acquisition transaction.
84. Appendix A to this paper outlines the proposed wording of the tentative agenda decision.

Questions 3 and 4 for the Committee

3. Does the Committee agree with our recommendation not to add this matter to its standard-setting agenda?
4. Does the Committee have any comments on the proposed wording of the tentative agenda decision set out in Appendix A to this paper?

Appendix A—Proposed wording of the tentative agenda decision

The Committee received a request about how an entity applies the requirements in IAS 27 *Separate Financial Statements* 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:

(i) 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

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

Based on its analysis, the Committee concluded that a reasonable reading of 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 all 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

IFRS Standards do not explicitly specify how an entity applying the accumulated cost approach 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. In these circumstances, the entity applies the requirements in paragraphs 10-11 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. The Committee observed that such a difference meets the definitions of either income or expenses in the *Conceptual Framework for Financial Reporting*. Applying paragraph 88 of IAS 1, the Committee concluded that the entity recognises this difference as income or expense in profit or loss—this is regardless of whether, before obtaining control, the entity had presented subsequent changes in fair value of the initial interest in profit or loss or OCI.

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:

(i) it did not have evidence to assess whether the application of the two acceptable approaches to determining cost, outlined in this [tentative] agenda decision, would have a material effect on those affected; and

(ii) 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 has not obtained information to suggest that the Board should reconsider this aspect of IAS 28 at this stage, in isolation of its wider consideration of IAS 28 as part of its research project on the equity method.

On balance, the Committee [decided] not to undertake standard-setting to address this matter.

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 the matter to its standard-setting agenda.

Appendix B—Submission

We have reproduced the submission below, and in doing so deleted details that would identify the submitter of this request.

Accounting treatments for step disposal or step acquisition of interests in a subsidiary in the separate financial statements of a parent

For ease of reference, we provide simplified illustrative examples as follows.

...

[...] Accounting treatment for obtaining control of S Co. by step acquisition of interests in a subsidiary in the separate financial statements

Background information

- P Co. accounts for its investments in subsidiaries at cost in its separate financial statements (Paragraph 10 in IAS 27)
- (Dec. 31. 20X0) P Co. acquires a shareholding of 10% in S Co. at 100 and P Co. presents subsequent changes in fair value amounting to 20 in OCI (FV-OCI election, Paragraph 5.7.5 in IFRS 9)

Statement of Financial Position (Dec. 31. 20X0)

FV-OCI equity instrument 120
	OCI 20

- (Jan. 31, 20X1) P Co. acquires additional interests of 45% in S Co. at 540 and obtains control of S Co.
- Assume that no impairment has occurred

Issues

7. If P Co. has been accounting for its investments in subsidiaries at cost in its separate financial statements (Paragraph 10 in IAS 27), how should its investments in S Co. be accounted for at the acquisition date (the date of obtaining control)?

Views

View 1-1: the carrying amount at the acquisition date is 660 (120 + 540) which is the sum of the carrying amount of retained interests and consideration transferred to acquire additional interests at the acquisition date. The gain recognised in OCI before obtaining control (20) can be immediately transferred within equity at the acquisition date.

8. Referring to paragraph 42 of IFRS 3, the interests in the subsidiary could be considered to be acquired in one lump at the acquisition date, the carrying amount should be the fair value at the acquisition date including the previously held 10% interests.

9. According to paragraph BCE.38¹³ in IFRS 9; P Co. can transfer the cumulative gain or loss within equity at the acquisition date.

View 1-2: The carrying amount at the acquisition date is 660 (120 + 540) which is the sum of the carrying amount of retained interests and consideration transferred to acquire additional interests at the acquisition date. The gain previously recognised in OCI before obtaining control (20) cannot be immediately transferred within equity at the acquisition date.

View 2: Irrespective of the accounting treatment under IFRS 9 after the initial acquisition of the existing interests (10%), P Co. shall go back to the historical cost¹⁴ (100) and cancel the gain previously recognized in OCI (20). Hence, the carrying amount at the acquisition date is 640 (100+540).

10. P Co. acquired interests in S Co. in two steps. As IAS 28 does not explicitly require or allow to apply deemed cost, the cost (640) of the interests in the subsidiary (S Co.) is the sum of the historical cost of the existing interests in S Co.

¹³ BCE.38 Although IFRS 9 prohibits recycling of gains and losses into profit or loss when an equity investment is derecognised, entities are able to transfer the cumulative gain or loss within equity at any time; for example, to provide information on realisation. (the rest omitted)

¹⁴ Historical cost: Assets are recorded at the amount of cash or cash equivalents paid or the fair value of the **consideration given** to acquire them at the time of their acquisition.

(100, 10%) and the additional interests in S Co. (540, 45%). Accordingly, the gain previously recognised in OCI (20) shall be cancelled¹⁵.

11. Also, according to the notion of historical cost in the Conceptual Framework for Financial Reporting, the carrying amount at the acquisition date under cost method is the sum of the initial historical cost of the existing interests in S Co. and the additionally acquired interests in S Co. at the acquisition date.

Additional issues

12. If accounting policy for the previously held investment (10%) was to measure it at FVPL, what will be the appropriate treatment for the previously held interest at the acquisition date? Historical cost (100) or fair value at the acquisition date (as deemed cost)? If historical cost is applied to the original investment (10%), in which will the changes in fair value relating to the previously held investment (20) be reflected? Retained earnings or profit or loss in 20X1?

Reasons for the IFRS IC to address the issue

(a) Is the issue widespread and has, or is expected to have, a material effect on those affected?

Yes. As there is no specific guidance on the issue addressed in this paper under IAS 27 and IFRS 9, different views exist on the accounting treatments for step disposal or step acquisition of interests in a subsidiary. Major accounting firms also seem to hold different views on this issue – please refer to the below details pertaining to the Big 4 global manual, in the alphabetical order.

- i. Deloitte, iGAAP 2017 [...].
- ii. EY, International GAAP 2016 [...].
- iii. KPMG, 13th Edition 2016/17, Insights into IFRS, [...].

(b) Would financial reporting be improved through the elimination, or reduction, of diverse reporting methods?

¹⁵ (DR) OCI 20

(CR) FV-OCI equity instrument 20

Yes. Consistent application of IFRS Standards on the issue would enhance comparability of financial statements across entities.

(c) Can the issue be resolved efficiently within the confines of IFRSs and the Conceptual Framework for Financial Reporting?

Yes. It can be resolved efficiently as the issue is related to the interpretation of paragraph 10 of IAS 27 when applying IFRS 9.

(d) Is the issue sufficiently narrow in scope that the Interpretations Committee can address this issue in an efficient manner, but not so narrow that it is not cost-effective for the Interpretations Committee to undertake the due process?

Yes. We specified the issue to be the accounting treatments for partial disposal or partial acquisition of interests in a subsidiary.

(e) Will the solution developed by the Interpretations Committee be effective for a reasonable time period?

Yes. The issue does not relate to any of current or planned IASB projects.

For these reasons, we believe that this issue meets the criteria for acceptance onto the Committee's agenda.