IASB 13A

Staff Paper Date Week commencing 17 May 2010

Project **Joint Ventures**

Topic **Application of IFRS 5 to the loss of joint control**

1. This paper discusses the interaction between IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and situations of loss of joint control. It also addresses two issues relating to IFRS 5 described in paragraphs 15-24 below, for which we seek Board decisions.

Application of IFRS 5 to the loss of joint control

2. The application of IFRS 5 to loss of significant influence over an associate or loss of joint control over a jointly controlled entity (JCE) was included in the August 2009 *Annual Improvements* project.

3. In this Agenda Paper we have:

   (a) summarised the proposals of the *Annual Improvements* project [paragraphs 4-5];

   (b) summarised the Board's tentative decisions relating to loss of joint control made in the Joint Ventures project [paragraph 6]; and

   (c) analysed the interaction between (a) and (b) and set out our recommendation [paragraphs 7-14].

Summary of the proposals included in the Annual Improvements project

4. The *Annual Improvements* project proposed to amend IFRS 5 to require an entity to classify as held for sale its interest in an associate, or in a jointly controlled entity, when it is committed to a sale plan involving loss of significant influence or loss of joint control.

5. The proposals were backed up as follows:

> BC 2. The Board concluded in the second phase of its project on business combinations that the loss of control of an entity and the loss of significant influence/joint control over an entity are economically similar events and thus they should be accounted for similarly (see paragraph BC21 of the Basis for Conclusions on IAS 28 *Investments in Associates*). The Board therefore clarified that all the interest an entity has in an associate or jointly controlled entity is classified as held for sale if the entity is committed to a sale plan involving loss of significant influence or joint control.

Summary of the decisions tentatively made by the Board in the Joint Ventures project

6. We discussed the loss of joint control in Agenda Paper 17B, which was presented at the February 2010 Board meeting. In that meeting, the Board tentatively decided to remove all descriptions that associate *loss of joint control* and *loss of significant influence* in existing IFRSs with the term 'significant economic event'. The Board tentatively decided to retain this term for the event of *loss of control*. These decisions were supported by the following rationale:

   (a) This approach would be aligned to the Group definition (ie losing joint control, and losing significant influence, do not represent a change in the Group boundaries). In the case of loss of control, ceasing to have a parent-subsidiary relationship causes the *derecognition* of the assets and the liabilities of the investee, contrasting with the case of loss of joint control or significant influence;

   (b) If significant influence is maintained, loss of joint control does not trigger any change in the measurement of the new investment if significant influence is maintained. Even though the nature of the investment changes, it does not, by itself, warrant the remeasurement of the retained interest.

   (c) Losing joint control or significant influence with the result that the investment becomes a financial asset requires no special treatment because the measurement requirement for the retained investment is addressed in IAS 39 / IFRS 9.

Analysis of the interaction between the proposed amendments to IFRS 5 and the decisions tentatively made by the Board in the Joint Ventures project

7. The proposal in the *Annual Improvements to IFRSs* for an entity to classify as held for sale its interest in an associate or in a JCE when it is committed to a sale plan involving loss of significant influence or loss of joint control was based on the Board's conclusions that the loss of control of an entity, and the loss of significant influence or the loss of joint control over an entity, are economically similar events and should be accounted for in the same manner. The proposal implies that the whole investment (ie the entire investment in a joint venture or the entire investment in an associate) would be classified as held for sale when the joint venturer or investor is committed to a sale plan, even if only a partial disposal takes place.

8. We question the treatment proposed above, particularly in the following circumstances:

   (a) a sale plan triggers the loss of joint control over a joint venture, but significant influence is maintained;

   (b) a sale plan does not trigger the loss of joint control over a joint venture or the loss of significant influence over an associate (eg an investor having 50 per cent ownership interest in an associate is committed to a sale plan that will represent a decrease of 30 percentage points in its ownership interest maintaining, however, 20 per cent ownership interest and significant influence in the investment); and

   (c) a sale plan triggers the loss of joint control or significant influence and the interest retained is a financial asset.

9. In the first two circumstances in paragraphs 8(a) and 8(b), the sale plan (independently of whether the disposal does or does not trigger the loss of joint control or the loss of significant influence over the investment) does not cause a change in the measurement method of the retained interest (ie equity method is the method applied to account for the investment before and after the disposal). In this case (ie when the disposal does not cause the measurement method of the

retained investment to change), we question the appropriateness of classifying the whole investment as held for sale, because of the following reasons:

(a) the whole investment would need to be measured at the lower of its carrying amount and fair value less costs to sell. However, subsequent to the sale, the retained interest would need to be measured again under equity method; in that situation,

(b) should an entity that has partially disposed of an interest in a joint venture or associate, but maintains joint control / significant influence over the retained investment, interpret paragraph 43 of IAS 31[1] or paragraph 15 of IAS 28 as applying to their specific circumstance? If so, once the partial disposal has taken place, the entity will have to resume to accounting for the retained investment under the equity method as from the date of its classification as held for sale. We question whether the retained interest should have been reclassified as held for sale in the first place.

10. In the third circumstance (paragraph 8(c)), the entity retains an interest in a financial asset after the sale plan. In this case the entity would need to reclassify the entire interest as held for sale, measure it at the lower of the carrying amount and fair value less costs to sell, and subsequent to the sale, remeasure the retained interest (ie a financial asset) at fair value in accordance with IAS 39 / IFRS 9. In this circumstance as well, we question, whether the remaining interest should have been reclassified as held for sale in the first place.

11. We note that the words in the ED 9 *Joint Arrangements* would also lead to the classification as held for sale of the entire investment in a joint venture, even in the case of partial disposals:

[1] Paragraph 43 of IAS 31 states: 'When an interest in a jointly controlled entity previously classified as held for sale no longer meets the criteria to be so classified, it shall be accounted for using proportionate consolidation or the equity method as from the date of its classification as held for sale. Financial statements for the periods since classification as held for sale shall be amended accordingly'.

> ED 9.33 – A venturer shall account for an interest in a joint venture that is classified as held for sale in accordance with IFRS 5.

12. Based on the arguments provided in paragraphs 8, 9 and 10 above, we recommend drafting the requirements in the final standard to state that, if the disposal fulfils the criteria for classification as held for sale in accordance with IFRS 5, and this disposal is a partial disposal, only the interest disposed shall be classified as held for sale, with any retained interest measured in accordance with the type of investment of the retained interest (ie an associate, in the case significant influence is maintained, or a financial asset). We recommend to extending these requirements to IAS 28 as well.

13. The recommendation above would mean that if a partial disposal of an interest in a joint venture no longer meets the criteria to be classified as held for sale, not only the portion classified as held for sale would need to be accounted for using the equity method as from the date of its classification as held for sale but, so will any previously-retained interest that was a financial asset and that was accounted for using fair value. Paragraph 28 of IFRS 5 states:

> The entity shall include any required adjustment to the carrying amount of a non-current asset that ceases to be classified as held for sale in profit or loss from continuing operations in the period in which the criteria in paragraphs 7-9 are no longer met. The entity shall present that adjustment in the same caption in the statement of comprehensive income used to present a gain or loss, if any, recognised in accordance with paragraph 37.

14. The requirements of this paragraph in the case of partial disposals shall apply not only to the portion classified as held for sale but also to the retained interest (when the latter was measured in accordance with IAS 39/IFRS 9 and, because of changes to the plan of sale, it would be accounted for using the equity method).

Question 1 – Classification of partial disposals of interests in joint ventures and associates as held for sale
Does the Board agree with the staff's recommendation of allowing that an entity classifies a partial interest in a joint venture or in an associate as held for sale, if such partial disposal fulfils the criteria for the classification as held for sale set out in IFRS 5, while accounting for the retained interest in accordance with its corresponding type of investment (ie an associate or a financial asset)?

Question 2 – Classification of partial disposals of interests in joint ventures and associates as held for sale when there are changes to a plan of sale
Does the Board agree with the staff's recommendation that in the case a plan of sale changes, a previously-retained interest in a joint venture or an associate that had been accounted for as a financial asset (in accordance with our recommendation for the accounting of partial disposals) should be incorporated back to the initial interest in the joint venture or associate and should resume equity method accounting?

Other issues relating to IFRS 5

15. The following paragraphs describe two matters for which we seek Board decisions.

16. ED 9 addresses the classification and accounting of a *joint venture* as held for sale, but it is silent on the classification and accounting of a *joint operation* as held for sale.

17. We note that circumstances in which a disposal might trigger classification of the assets and liabilities of a joint operation as held for sale will not often arise. We think that this may, however, happen when joint operations are structured in an entity. We note that, in these circumstances, the assets and liabilities of a joint operation may potentially fulfil the definition of a 'disposal group' in accordance with IFRS 5 and, consequently, they may be subject to the classification as held for sale.

18. IFRS 5 defines a disposal group as follows:

> A group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction. […].

19. In this case, the group of assets and liabilities would need to be measured at the lower of its carrying amount and fair value less cost to sell. Our recommendation in this case is to classify as held for sale the entire group of assets and liabilities arising from the joint operator's share in the joint operation.

Question 3 – Joint Operations held for sale
Does the Board agree with the staff's recommendation for extending the requirement, in the case of joint operations, for the classification as held for sale of all the assets and liabilities in which the joint operator has an interest, in the case in which a disposal meets the criteria of classification as held for sale as defined in IFRS 5?

20. The second of the matters relating to IFRS 5 is as follows. IAS 31, IAS 28 and ED 9 state the following similar requirements/proposals:

> IAS 31.43/IAS 28.15. When an interest in a jointly controlled entity/associate previously classified as held for sale no longer meets the criteria to be so classified, it shall be accounted for using proportionate consolidation or the equity method/the equity method as from the date of its classification as held for sale. **Financial statements for the periods since classification as held for sale shall be amended accordingly.**
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> ED 9.34. When an interest in a joint venture no longer meets the criteria to be classified as held for sale, a venturer recognises its interest in the joint venture using the equity method from the date of its classification as held for sale. A venturer **amends its financial statements for the periods since classification as held for sale accordingly, so that it presents those financial statements as if the venture had not been classified as held for sale.**

21. IFRS 5, however, requires the following:

> 26. If an entity has classified an asset (or disposal group) as held for sale, but the criteria in paragraphs 7–9 are no longer met, the entity shall cease to classify the asset (or disposal group) as held for sale.
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> 27. The entity shall measure a non-current asset that ceases to be classified as held for sale (or ceases to be included in a disposal group classified as held for sale) at the lower of:

> (a) its carrying amount before the asset (or disposal group) was classified as held for sale, adjusted for any depreciation, amortisation or revaluations that would have been recognised had the asset (or disposal group) not been classified as held for sale, and
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> (b) its recoverable amount at the date of the subsequent decision not to sell.
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> 28 The entity shall include any required adjustment to the carrying amount of a non-current asset that ceases to be classified as held for sale in profit or loss from continuing operations **in the period in which the criteria in paragraphs 7–9 are no longer met.** The entity shall present that adjustment in the same caption in the statement of comprehensive income used to present a gain or loss, if any, recognised in accordance with paragraph 37.

22. Even though the underlying principle in IFRS 5, as stated in BC 50, is *‘to restore the carrying value of the asset to what it would have been had it never been classified as held for sale, taking into account any impairments that may have occurred’*, the requirement in IAS 31 and in ED 9 to amend prior year comparatives appears to be in conflict with paragraph 28 in IFRS 5, which require that any required adjustment to the carrying amount of a non-current asset that ceases to be classified as held for sale is included in income from continuing operations in the period in which the criteria for being held are no longer met.

23. We recommend amending the requirements in paragraph 28 of IFRS 5 to state that if the disposal group or non-current asset relate to a subsidiary, joint arrangement or associate, any required adjustment to their carrying value shall be carried out retrospectively.

24. We also recommend that the proposals in paragraph 34 of ED 9 are reworded to include the corresponding requirements for joint operations that not longer meet the criteria to be classified as held for sale.

Question 4– Changes to a plan of sale
Does the Board agree with the staff's recommendation of amending paragraph 28 of IFRS 5 to clarify that the financial statements for the periods since classification as held for sale shall be amended retrospectively when the disposal group or non-current asset that ceases to be classified as held for sale is a subsidiary, a joint arrangement or an associate?

Question 5 – Changes to a plan of sale
Does the Board agree to reword the requirements in paragraph 34 of ED 9 to include the corresponding requirements for joint operations that not longer meet the criteria to be classified as held for sale?