

IFRS Developments

Step acquisition of a subsidiary in separate financial statements (IAS 27)

What you need to know

- ▶ The Committee finalised its agenda decision on how an entity applies the requirement in IAS 27 to an investment in a subsidiary accounted for at cost when the subsidiary is acquired in stages.
- ▶ The Committee concluded that an entity would account for the cost of the investment in the subsidiary by applying either the fair value as deemed cost approach or accumulated cost approach consistently.
- ▶ The Committee concluded that the entity recognises the difference between the fair value of the initial interest and its original consideration in profit or loss, regardless of the measurement of the initial investment.

Highlights

In January 2019, the IFRS Interpretations Committee (the Committee) finalised its agenda decision on how an entity applies the requirement in IAS 27 *Separate Financial Statements* to an investment in a subsidiary accounted for at cost when a subsidiary is acquired in stages (step acquisition). The initial investment was not an associate, joint venture or subsidiary of the entity and, hence, was accounted for in accordance with IFRS 9 at fair value.

The Committee concluded that an entity would account for the cost of the investment in the subsidiary as either the sum of 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 the sum of the consideration paid for the initial interest, plus any consideration paid for the additional interest (accumulated cost approach). An entity is required to apply the selected approach consistently to all step acquisition transactions and to disclose the approach, if that disclosure would assist users of financial statements in understanding how step acquisition transactions are reflected in its separate financial statements.

The Committee also concluded that an entity, when applying the accumulated cost approach, recognises the difference between the fair value of the initial interest at the date of obtaining control of the subsidiary and its original consideration in profit or loss, regardless of whether, before obtaining control, the initial investment had been measured at fair value through profit and loss or fair value through other comprehensive income (OCI).

Background

The Committee discussed two questions about how an entity applies the requirements in IAS 27 to a fact pattern involving an investment in a subsidiary which was acquired in stages.

In the fact pattern, the entity elects to account for its investment in subsidiaries at cost in its separate financial statements, in accordance with paragraph 10 of IAS 27. The entity holds an initial investment which is not an associate, joint venture or subsidiary of the entity and, accordingly, is accounted for in accordance with IFRS 9 at fair value. The entity subsequently acquires an additional interest in the investee, giving it control of the investee and the investee becomes a subsidiary of the entity.

The Committee was asked the following questions:

- ▶ 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).
- ▶ 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.

The cost of an investment in the subsidiary acquired in stages

IAS 27 does not define 'cost', nor does it specify how an entity determines the cost of an investment acquired in stages. However, cost is defined in other IFRS standards (e.g., 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 (the fair value as deemed cost approach and the accumulated cost approach) arise from the different views of the step acquisition. The fair value as deemed cost approach arises from the view that the entity exchanges its initial interest (plus consideration paid for the additional interest) for a controlling interest in the investee. On the other hand, the accumulated cost approach arises from the view that the entity purchases the additional interest while retaining the initial interest.

Based on its analysis, the Committee concluded that a reasonable reading of the IFRS requirements could result in the application of either one of the two approaches. An entity would apply the selected approach consistently to all step acquisition transactions. An entity would also disclose the approach in accordance with 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 its separate financial statements.

The Committee considered whether to develop a narrow-scope amendment to address this issue. However, the Committee observed that it did not have evidence to assess whether the application of the two acceptable approaches to determining cost would have a material impact on those affected. The Committee also observed that this matter could not be resolved without considering the requirements in paragraph 10 of IAS 28 to initially measure an investment in an associate or joint venture at cost. However, the Committee did not obtain information to suggest that this aspect of IAS 28 should be reconsidered at this stage, rather than as part of research project on the Equity Method. Hence, the Committee decided not to undertake standard-setting to address this matter.

Accounting for any difference between the fair value of the initial interest and its original cost (accumulated cost approach)

In applying the accumulated cost approach, an entity needs to adjust the difference between the fair value of the initial interest at the date of obtaining control of the subsidiary and its original consideration. The Committee concluded that the difference meets the definitions of income or expenses in the *Conceptual Framework for Financial Reporting* since the difference represents an increase or decrease in an asset (initial interest) and it does not result from a contribution from, or distribution to, holders of equity claims. In addition, paragraph 88 of IAS 1 states that an entity shall recognise all items of income and expense in a period in profit or loss unless an IFRS requires or permits otherwise. 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, the Committee concluded that, the entity recognises this difference in profit or loss, regardless of whether, before obtaining control, the investment had been measured at fair value through profit and loss or fair value through OCI, in accordance with paragraph 88 of IAS 1.

The Committee concluded that the principles and requirements in IFRS 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. On the first question, the Committee, based on a reasonable reading of the requirements in IFRS, does not express a preference for either approach in its agenda decision. However, the Committee decided to report to the Board in a public meeting and to include in the January 2019 *IFRIC Update* that its members concluded that, in their view, the fair value as deemed cost approach would provide more useful information to users of financial statements than the accumulated cost approach.

How we see it

This agenda decision is helpful in clarifying how to apply the requirement in IAS 27 to the investment in a subsidiary accounted for at cost when a subsidiary is acquired in stages. If an entity decides to change its accounting policy as a result of the agenda decision, the change in accounting policy shall be applied retrospectively, according to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

Although the agenda decision does not deal with IAS 28 *Investments in Associates and Joint Ventures*, we think that it could also be applied by analogy to step acquisition transactions where an existing investment accounted for under IFRS 9 subsequently becomes an associate or a joint venture, to which the equity method is applied. IAS 28 is unclear on how an investor should account for such a step acquisition, and as a result, there is diversity in practice here too.

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