EFRAG
European Financial Reporting Advisory Group

15 April 2013

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir/Madam,

Re: Exposure Draft *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Proposed amendments to IFRS 10 and IAS 28)*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Exposure Draft 2012/6 *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture – Proposed amendments to IFRS 10 and IAS 28*, issued by the IASB on 13 December 2012 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS in the European Union and European Economic Area.

EFRAG agrees with the IASB that there is perceived inconsistency between the guidance in IAS 27 *Consolidated and Separate Financial Statements* (as issued in 2008) dealing with the accounting for loss of control of a subsidiary and the requirements in SIC-13 *Jointly Controlled Entities – Non-Monetary Contributions by Venturers* which restricts a gain or loss arising from contributions of non-monetary assets to an associate or a joint venture. This inconsistency remained when IFRS 10 *Consolidated Financial Statements* replaced IAS 27 (as issued in 2008) and SIC-13 was withdrawn and incorporated into IAS 28 *Investments in Associates and Joint Ventures* (as revised in 2011). Therefore, EFRAG supports the IASB's efforts to address the issue.

EFRAG considers that the proposed amendments have the merit of being a short-term pragmatic solution to address diversity in practice. However, the proposed amendments will require an entity to determine whether the assets being sold or contributed meet the definition of a business under IFRS 3 *Business Combinations.* In our view, applying the definition of a business in IFRS 3 is not always straightforward and often requires considerable judgement. The amendments propose a different accounting treatment depending on whether the subsidiary includes a business, thereby putting considerable stress on the definition of a business, and risk leading to new diversity in practice.

Furthermore, we have a number of concerns with the way the proposed amendments will interact with the existing principles in IFRS 10 and IAS 28. Our concerns are explained in the Appendix to this letter.

In addition, EFRAG believes that the IASB should address in the proposed amendments the accounting treatment in the separate financial statements, sales or contributions to joint operations and the reclassification of gains or losses previously recognised in other comprehensive income.

If you would like to discuss our comments further, please do not hesitate to contact Filipe Alves or me.

Yours faithfully,

Françoise Flores
EFRAG Chairman

APPENDIX

EFRAG's responses to the questions raised in the proposed amendments to IFRS 10 and IAS 28

Question 1: proposed amendment to IFRS 10

The IASB proposes to amend IFRS 10 so that the gain or loss resulting from the sale or contribution of a subsidiary that does not constitute a business, as defined in IFRS 3, between an investor and its associate or joint venture is recognised only to the extent of the unrelated investors' interests in the associate or joint venture. The consequence is that a full gain or loss is recognised on the loss of control of a subsidiary that constitutes a business, as defined in IFRS 3, including cases in which the investor retains joint control of, or significant influence over, the investee.

Do you agree with the amendment proposed? Why or why not? If not, what alternative do you propose?

EFRAG's response

EFRAG agrees that there is an inconsistency between IAS 28 and IFRS 10 and supports the IASB's efforts to provide a short-term solution to remove diversity in practice. However, EFRAG has a number of concerns about the proposed amendments.

1 EFRAG agrees that there is an inconsistency between IAS 28 and IFRS 10 and supports the IASB's efforts to provide a short-term solution to remove diversity in practice and to avoid the accounting for a transaction being driven by its form rather than by its substance, as noted in paragraph BC4 of the ED.

2 However, EFRAG is concerned that the proposed amendments will change on a piecemeal basis the guidance in IFRS 10 on loss of control. This will introduce an inconsistency in IFRS 10 as accounting for the loss of control of a subsidiary will depend on whether it is sold or contributed to an associate or joint venture and on whether that subsidiary is a business or not. EFRAG's concerns in this respect are explained below.

Assessing whether a subsidiary is a business or not

3 EFRAG is concerned that the accounting proposed depends on whether the subsidiary that is being sold or contributed constitutes a business or not. Applying the definition of a business in IFRS 3 is not always straightforward and often requires considerable judgement.

4 This approach, which also underlies the Exposure Draft *Acquisition of an Interest in a Joint Operation (proposed amendments to IFRS 11)*, puts considerable stress on the definition of a business. We further note that the IASB recently had to consider that definition in the context of IAS 40 *Investment Property*. The increasing importance of the definition of a business calls for further guidance, otherwise further diversity in practice will arise. We believe the IASB should specifically consider whether or not that definition is sufficiently robust to ensure that it is consistently applied, as part of the post implementation review of IFRS 3.

Post-implementation review of IFRS 3

5 Paragraph BC7 of the ED explains that the IASB and the IFRS Interpretations Committee considered whether all sales and contributions between an investor

and an associate should give rise to 'full' gain or loss recognition. However, they expressed concern that such an approach would require addressing multiple cross-cutting issues. These issues might include clarifying both the principles underlying the application of the equity method (i.e. whether it is considered a 'one-line consolidation' or a valuation approach) and the definition of a group.

6 EFRAG considers that the cross-cutting issues raised in the Basis for Conclusions of the ED are also linked with the loss of control thinking developed by the IASB when discussing the project on Business Combinations, which included the development of the revised IAS 27 (2008). EFRAG believes that the issues raised in the development of the revised IAS 27 (2008) still need to be addressed and should be included in the post-implementation review of the Business Combinations projects. For example, the requirement in IFRS 10 to recognise a full gain or loss on the loss of control of a subsidiary, even when an entity retains an interest in the former subsidiary.

Accounting for the loss of control of a subsidiary that does not constitute a business

7 In the proposed amendments the IASB proposes that a full gain or loss should be recognised on the loss of control of a subsidiary that constitutes a business, as defined in IFRS 3, including cases in which the investor retains joint control of, or significant influence over, the investee. Paragraph BC5 of the ED explains that '…the accounting for the loss of control of a business, as defined in IFRS 3, should be consistent with the latest thinking developed in the Business Combinations project'.

8 However, paragraphs 25 and BCZ180-BCZ184 of IFRS 10 specifically refer to 'subsidiary' rather than business and paragraph BCZ183 explains that 'the Board decided that the loss of control of a subsidiary is, from the group's perspective, the loss of control over some of the group's individual assets and liabilities'. Therefore, we believe that the rationale in paragraph BC5 of the ED should be amended as it does not correspond with the wording of paragraphs 25 and BCZ180-BCZ184 of IFRS 10.

9 In our view, paragraph BC5 should just explain why the IASB believes it is appropriate that only sales and contributions of businesses to an associate or joint venture should result in full recognition of a gain or loss, even if this creates an exception from the requirements of paragraph 25 of IFRS 10 to account for loss of control over a subsidiary. More specifically, the IASB should clarify why the notion of a business in IFRS 3 should prevail over the principles in IFRS 10, which focus on accounting for subsidiaries. EFRAG notes in this context that the proposed amendments are consistent with current guidance in IFRS that already require different accounting for acquisitions of assets and business combinations under IFRS 3.

10 EFRAG does not believe that, to deal with this inconsistency, paragraph 25 of IFRS 10 should be amended to refer to 'business' as this would significantly broaden the scope of this project and have important other consequences that would need to be considered.

Elimination of gains and losses related to remeasurement of retained interest

11 EFRAG believes that paragraph B99A of the ED is not sufficiently explicit on how an entity should account for the sale or contribution of a part (e.g. 80% out of 100%) of a subsidiary – that is not a business – to an associate or joint venture. One reading of the proposed requirement is that paragraph B99A only applies to the gain or loss on the 80% that is sold or contributed. Alternatively, it is possible to read paragraph B99A as requiring partial or full elimination of the gain or loss on

the remeasurement of the retained interest (i.e. 20%). EFRAG considers that it is necessary to clarify this issue.

Question 2: proposed amendment to IAS 28 (2011)

The IASB proposes to amend IAS 28 (2011) so that:

(a) the current requirements for the partial gain or loss recognition for transactions between an investor and its associate or joint venture only apply to the gain or loss resulting from the sale or contribution of assets that do not constitute a business, as defined in IFRS 3; and

(b) the gain or loss resulting from the sale or contribution of assets that constitute a business, as defined in IFRS 3, between an investor and its associate or joint venture is recognised in full.

Do you agree with the amendment proposed? Why or why not? If not, what alternative do you propose?

EFRAG's response

EFRAG believes that the IASB has insufficiently articulated why it believes that the current requirement in paragraph 28 of IAS 28 to recognise partial gains or losses should only apply to transactions involving assets that do not constitute a business.

12 EFRAG believes that the proposed amendments to IAS 28 are consistent with the proposed amendments to IFRS 10, and that the amendments remove the inconsistency between IAS 28 and IFRS 10 regarding sales and contributions of assets (see paragraphs 1 and 2 above).

13 As noted in paragraphs 3 and 4 above, the ED puts considerable stress on the definition of a business, which is something the IASB should specifically consider in finalising the ED.

14 Current IAS 28 requires that gains and losses resulting from 'upstream' and 'downstream' transactions should be recognised only to the extent of the unrelated investors' interests in the associate or joint venture, regardless of whether they involve assets or businesses. EFRAG understands that to ensure consistency with the amendments to IFRS 10 regarding sales and contributions to an associate or joint venture (which are a form of 'downstream' transaction), it is necessary to make corresponding amendments to IAS 28.

15 We also understand that an investor that acquires a business from an associate or joint venture (i.e. an upstream transaction) would need to apply IFRS 3 to that business combination, which reflects the latest thinking developed in the Business Combination project. If an investor had to partially eliminate gains or losses on such transactions, it would need to adjust the carrying amount of the associate or joint venture, in which case the realisation of the eliminated gain or loss would depend on the disposal of that associate or joint venture rather than the disposal of the business. Not requiring elimination of the investor's share of the gain or loss in the associate or joint venture ensures a consistent treatment of 'upstream' and 'downstream' transactions involving businesses.

16 Nevertheless, EFRAG believes that the IASB has insufficiently articulated why it believes that the elimination procedures required by paragraph 28 of IAS 28 should only apply to transactions involving assets but not businesses. In particular,

these amendments would change the equity method on a piecemeal basis. We believe that amendments to the fundamental concepts underlying the equity method would be better addressed in the context of the IASB's research project.

Question 3: Transition requirements

The IASB proposes to apply the proposed amendments to IFRS 10 and IAS 28 (2011) prospectively to sales or contributions occurring in annual periods beginning on or after the date that the proposed amendments would become effective.

Do you agree with the proposed transition requirements? Why or why not? If not, what alternative do you propose?

EFRAG's response

EFRAG agrees that the proposed amendments should be applied prospectively

17 EFRAG generally supports retrospective application of IFRSs because it improves comparability.

18 However, EFRAG acknowledges that the proposed amendments might involve the use of hindsight and some entities might face difficulty in obtaining the information required for retrospective application. We therefore support the transition requirements.

EFRAG's additional comments on the proposed amendments

Separate financial statements

19 The IASB has not addressed the issue of sales and contributions of assets between an investor and its associate or joint venture, from the separate financial statements' point of view.

20 It is our understanding that a full gain or loss would be recognised in all transactions between an investor and its investee when the investor is preparing its separate financial statements. In order to avoid any diversity in practice, EFRAG recommends the IASB to address this issue from the separate financial statements perspective and make clear that a full gain or loss would be always recognised in the separate financial statements.

Sales or contributions of assets to a joint operation

21 The proposed amendments exclude transactions where an entity enters into a transaction with a joint operation in which it is a joint operator. However, in practice such transactions do occur and would be reflected both in separate and consolidated financial statements.

22 Paragraph B34 of IFRS 11 states that when an entity enters into a transaction with a joint operation in which it is a joint operator, the joint operator shall recognise gains and losses resulting from such transactions only to the extent of the other parties' interest in the joint operation. Therefore, an inconsistency also exists with IFRS 10.

Reclassification from OCI reserves relating to former subsidiary

23 The proposed amendments do not specifically state how an investor should treat any amounts that are recorded in other comprehensive income that relate to the subsidiary being sold or contributed to an associate or joint venture. Paragraph B99 of IFRS 10 requires a parent to account for amounts previously recognised in OCI in relation to that subsidiary, to be reclassified and recognised in profit or loss when control of the subsidiary is lost.

24 We believe the IASB should make clear that paragraph B99 of IFRS 10 would apply to the 'full' gain or loss resulting from the sale or contribution of assets that constitute a business as defined in IFRS 3. Furthermore, it should provide explicit guidance on accounting for amounts previously recognised in other comprehensive income.