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IAS 27

Approval by the Board of IAS 27 issued in December 2003

International Accounting Standard 27 *Consolidated and Separate Financial Statements* (as revised in 2003) was approved for issue by thirteen of the fourteen members of the International Accounting Standards Board. Mr Yamada dissented. His dissenting opinion is set out after the Basis for Conclusions.

Sir David Tweedie

Chairman

Thomas E Jones

Vice-Chairman

Mary E Barth

Hans-Georg Bruns

Anthony T Cope

Robert P Garnett

Gilbert G  lard

James J Leisenring

Warren J McGregor

Patricia L O'Malley

Harry K Schmid

John T Smith

Geoffrey Whittington

Tatsumi Yamada

Approval by the Board of amendments to IAS 27 issued in January 2008

The amendments to International Accounting Standard 27 *Consolidated and Separate Financial Statements* in 2008 were approved for issue by nine of the fourteen members of the International Accounting Standards Board. Messrs Danjou, Engström, Garnett, Gélard and Yamada dissented. Their dissenting opinions are set out after the Basis for Conclusions.

Sir David Tweedie

Chairman

Thomas E Jones

Vice-Chairman

Mary E Barth

Hans-Georg Bruns

Anthony T Cope

Philippe Danjou

Jan Engström

Robert P Garnett

Gilbert Gélard

James J Leisenring

Warren J McGregor

Patricia L O'Malley

John T Smith

Tatsumi Yamada

Approval by the Board of *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* (Amendments to IFRS 1 and IAS 27) issued in May 2008

Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate (Amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* and IAS 27) was approved for issue by eleven of the thirteen members of the International Accounting Standards Board. Professor Barth and Mr Danjou dissented. Their dissenting opinions are set out after the Basis for Conclusions.

Sir David Tweedie

Chairman

Thomas E Jones

Vice-Chairman

Mary E Barth

Hans-Georg Bruns

Anthony T Cope

Philippe Danjou

Jan Engström

Robert P Garnett

Gilbert Gélard

James J Leisenring

Warren J McGregor

Patricia L O'Malley

John T Smith

Tatsumi Yamada

Basis for Conclusions on IAS 27 Consolidated and Separate Financial Statements

This Basis for Conclusions accompanies, but is not part of, IAS 27.

Introduction

- BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching its conclusions on revising IAS 27 *Consolidated Financial Statements and Accounting for Investments in Subsidiaries* in 2003 and on amending IAS 27 *Consolidated and Separate Financial Statements* in 2008. Individual Board members gave greater weight to some factors than to others.
- BC2 In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of standards, including IAS 27 (as revised in 2000). The project was undertaken in the light of queries and criticisms raised in relation to the standards by securities regulators, professional accountants and other interested parties. The objectives of the Improvements project were to reduce or eliminate alternatives, redundancies and conflicts within standards, to deal with some convergence issues and to make other improvements. In May 2002 the Board published its proposals in an exposure draft of *Improvements to International Accounting Standards*, with a comment deadline of 16 September 2002. The Board received over 160 comment letters on the exposure draft. After redeliberating the issues in the light of the comments received, the Board issued a revised IAS 27 in December 2003.
- BC3 In July 2001 the Board added a project on business combinations to its agenda. Phase I of the project resulted in the Board issuing in March 2004 IFRS 3 *Business Combinations* and revised versions of IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets*. The second phase of the project was conducted jointly with the US Financial Accounting Standards Board (FASB), and focused primarily on the application of the acquisition method.
- BC4 Part of the second phase of the business combinations project was the reconsideration of business combinations in which an acquirer obtains control of a subsidiary through the acquisition of some, but not all, of the equity interests in that subsidiary. In those business combinations, non-controlling interests in the subsidiary exist at the date of the business combination.
- BC5 When the Board revised IAS 27 in 2003, it acknowledged that additional guidance was needed on the recognition and measurement of non-controlling interests and the treatment of transactions with non-controlling interests. The Board was aware of diversity in practice in the absence of guidance in IFRSs, with as many as five methods being used to account for acquisitions of non-controlling interests after control is obtained.

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- BC6 In June 2005 the Board published an exposure draft of proposed amendments to IAS 27 in conjunction with an exposure draft of proposed amendments to IFRS 3 as part of the second phase of the business combinations project. The Board received 95 comment letters on the exposure draft of amendments to IAS 27.
- BC7 After redeliberating the issues in the light of the comments received, in 2008 the Board issued a revised IFRS 3 together with an amended version of IAS 27. Close to the same time, the FASB issued Statement No. 141 (revised 2007) *Business Combinations* and Statement No. 160 *Noncontrolling Interests in Consolidated Financial Statements*, which amended Accounting Research Bulletin No. 51, *Consolidated Financial Statements* (ARB 51). In developing the amendments, the Board did not reconsider all of the requirements in IAS 27, and the FASB did not discuss all of the requirements of ARB 51. The changes primarily relate to accounting for non-controlling interests and the loss of control of subsidiaries. The boards reached the same conclusions on all of the issues considered jointly.
- BC8 Because the Board's intention was not to reconsider the fundamental approach to consolidation established in IAS 27, this Basis for Conclusions does not discuss requirements in IAS 27 that the Board has not reconsidered. The Board is considering the other requirements of IAS 27 as part of its project on consolidation.

Presentation of consolidated financial statements (2003 revision)

Exemption from preparing consolidated financial statements

- BC9 Paragraph 7 of IAS 27 (as revised in 2000) required consolidated financial statements to be presented. However, paragraph 8 permitted a parent that is a wholly-owned or virtually wholly-owned subsidiary not to prepare consolidated financial statements. The Board considered whether to withdraw or amend this exemption from the general requirement.
- BC10 The Board decided to retain an exemption, so that entities in a group that are required by law to produce financial statements available for public use in accordance with International Financial Reporting Standards, in addition to consolidated financial statements, would not be unduly burdened.
- BC11 The Board noted that in some circumstances users can find sufficient information for their purposes regarding a subsidiary from either its separate financial statements or consolidated financial statements. In addition, the users of financial statements of a subsidiary often have, or can get access to, more information.

- BC12 Having agreed to retain an exemption, the Board decided to modify the circumstances in which an entity would be exempt and considered the following criteria.

Unanimous agreement of the owners of the minority interests*

- BC13 The 2002 exposure draft proposed to extend the exemption to a parent that is not wholly-owned if the owners of the minority interest, including those not otherwise entitled to vote, unanimously agree.
- BC14 Some respondents disagreed with the proposal for unanimous agreement of minority shareholders to be a condition for exemption, in particular because of the practical difficulties in obtaining responses from all of those shareholders. The Board decided that the exemption should be available to a parent that is not wholly-owned when the owners of the minority interests have been informed about, and do not object to, consolidated financial statements not being presented.

Exemption available only to non-public entities

- BC15 The Board believes that the information needs of users of financial statements of entities whose debt or equity instruments are traded in a public market are best served when investments in subsidiaries, jointly controlled entities and associates are accounted for in accordance with IAS 27, IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures*. The Board therefore decided that the exemption from preparing such consolidated financial statements should not be available to such entities or to entities in the process of issuing instruments in a public market.
- BC16 The Board decided that a parent that meets the criteria for exemption from the requirement to prepare consolidated financial statements should, in its separate financial statements, account for those subsidiaries in the same way as other parents, venturers with interests in jointly controlled entities or investors in associates account for investments in their separate financial statements. The Board draws a distinction between accounting for such investments as equity investments and accounting for the economic entity that the parent controls. In relation to the former, the Board decided that each category of investment should be accounted for consistently.
- BC17 The Board decided that the same approach to accounting for investments in separate financial statements should apply irrespective of the circumstances for which they are prepared. Thus, parents that present consolidated financial

* IAS 27 (as amended in 2008) changed the term 'minority interest' to 'non-controlling interest'. For further discussion see paragraph BC28.

statements, and those that do not because they are exempted, should present the same form of separate financial statements.

Scope of consolidated financial statements (2003 revision)

Scope exclusions

- BC18 Paragraph 13 of IAS 27 (as revised in 2000) required a subsidiary to be excluded from consolidation when control is intended to be temporary or when the subsidiary operates under severe long-term restrictions.

Temporary control

- BC19 The Board considered whether to remove this scope exclusion and thereby converge with other standard-setters that had recently eliminated a similar exclusion. The Board decided to consider this issue as part of a comprehensive standard dealing with asset disposals. It decided to retain an exemption from consolidating a subsidiary when there is evidence that the subsidiary is acquired with the intention to dispose of it within twelve months and that management is actively seeking a buyer. The Board's exposure draft ED 4 *Disposal of Non-current Assets and Presentation of Discontinued Operations* proposed to measure and present assets held for sale in a consistent manner irrespective of whether they are held by an investor or in a subsidiary. Therefore, ED 4 proposed to eliminate the exemption from consolidation when control is intended to be temporary and it contained a draft consequential amendment to IAS 27 to achieve this.*

Severe long-term restrictions impairing ability to transfer funds to the parent

- BC20 The Board decided to remove the exclusion of a subsidiary from consolidation when there are severe long-term restrictions that impair a subsidiary's ability to transfer funds to the parent. It did so because such circumstances may not preclude control. The Board decided that a parent, when assessing its ability to control a subsidiary, should consider restrictions on the transfer of funds from the subsidiary to the parent. In themselves, such restrictions do not preclude control.

* In March 2004, the Board issued IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. IFRS 5 removed this scope exclusion and eliminated the exemption from consolidation when control is intended to be temporary. See the Basis for Conclusions on IFRS 5.

Venture capital organisations, private equity entities and similar organisations

- BC21 The 2002 exposure draft of IAS 27 proposed to clarify that a subsidiary should not be excluded from consolidation simply because the entity is a venture capital organisation, mutual fund, unit trust or similar entity. Some respondents from the private equity industry disagreed with this proposed clarification. They argued that private equity entities should not be required to consolidate the investments they control in accordance with the requirements in IAS 27. They argued that they should measure those investments at fair value. Those respondents raised varying arguments—some based on whether control is exercised, some on the length of time that should be provided before consolidation is required, and some on whether consolidation was an appropriate basis for private equity entities or the type of investments they make.
- BC22 Some respondents also noted that the Board decided to exclude venture capital organisations and similar entities from the scope of IASs 28 and 31 when investments in associates or jointly controlled entities are measured at fair value in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*. In the view of those respondents, the Board was proposing that similar assets should be accounted for in dissimilar ways.
- BC23 The Board did not accept these arguments. The Board noted that those issues are not specific to the private equity industry. It confirmed that a subsidiary should not be excluded from consolidation on the basis of the nature of the controlling entity. Consolidation is based on the parent's ability to control the investee, which captures both the power to control (ie the ability exists but it is not exercised) and actual control (ie the ability is exercised). Consolidation is triggered by control and should not be affected by whether management intends to hold an investment in an entity that it controls for the short term.
- BC24 The Board noted that the exception from the consolidation principle in IAS 27 (as revised in 2000), when control of a subsidiary is intended to be temporary, might have been misread or interpreted loosely. Some respondents to the exposure draft had interpreted 'near future' as covering a period of up to five years. The Board decided to remove these words and to restrict the exception to subsidiaries acquired and held exclusively for disposal within twelve months, providing that management is actively seeking a buyer.
- BC25 The Board did not agree that it should differentiate between types of entity, or types of investment, when applying a control model of consolidation. It also did not agree that management intention should be a determinant of control. Even if it had wished to make such differentiations, the Board did not see how or why it would be meaningful to distinguish private equity investors from other types of entities.
- BC26 The Board believes that the diversity of the investment portfolios of entities operating in the private equity sector is not different from the diversification of portfolios held by a conglomerate, which is an industrial group made up of entities that often have diverse and unrelated interests. The Board acknowledged

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that financial information about an entity's different types of products and services and its operations in different geographical areas—segment information—is relevant to assessing the risks and returns of a diversified or multinational entity and may not be determinable from the aggregated data presented in the consolidated balance sheet.* The Board noted that IAS 14 *Segment Reporting* establishes principles for reporting segment information by entities whose equity or debt instruments are publicly traded, or any entity that discloses segment information voluntarily.†

- BC27 The Board concluded that for investments under the control of private equity entities, users' information needs are best served by financial statements in which those investments are consolidated, thus revealing the extent of the operations of the entities they control. The Board noted that a parent can either present information about the fair value of those investments in the notes to the consolidated financial statements or prepare separate financial statements in addition to its consolidated financial statements, presenting those investments at cost or at fair value. By contrast, the Board decided that information needs of users of financial statements would not be well served if those controlling investments were measured only at fair value. This would leave unreported the assets and liabilities of a controlled entity. It is conceivable that an investment in a large, highly geared subsidiary would have only a small fair value. Reporting that value alone would preclude a user from being able to assess the financial position, results and cash flows of the group.

Non-controlling interests (2003 revision and 2008 amendments)

- BC28 The 2008 amendments to IAS 27 changed the term 'minority interest' to 'non-controlling interest'. The change in terminology reflects the fact that the owner of a minority interest in an entity might control that entity and, conversely, that the owners of a majority interest might not control the entity. 'Non-controlling interest' is a more accurate description than 'minority interest' of the interests of those owners who do not have a controlling interest in an entity.
- BC29 Non-controlling interest is defined in IAS 27 as the equity in a subsidiary not attributable, directly or indirectly, to a parent. Paragraph 26 of IAS 27 (as revised in 2000) required minority (non-controlling) interests to be presented in the consolidated balance sheet separately from liabilities and the equity of the shareholders of the parent.
- BC30 As part of the 2003 revision of IAS 27, the Board decided to amend this requirement to require minority (non-controlling) interests to be presented in the

* AS 1 *Presentation of Financial Statements* (as revised in 2007) replaced the term 'balance sheet' with 'statement of financial position'.

† In 2006 IAS 14 *Segment Reporting* was replaced by IFRS 8 *Operating Segments*.

consolidated balance sheet within equity, separately from the equity of the shareholders of the parent. The Board concluded that a minority (non-controlling) interest is not a liability of a group because it does not meet the definition of a liability in the *Framework for the Preparation and Presentation of Financial Statements**.

- BC31 Paragraph 49(b) of the *Framework*[†] states that a liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits. Paragraph 60 of the *Framework*[‡] further indicates that an essential characteristic of a liability is that the entity has a present obligation and that an obligation is a duty or responsibility to act or perform in a particular way. The Board noted that the existence of a minority (non-controlling) interest in the net assets of a subsidiary does not give rise to a present obligation of the group, the settlement of which is expected to result in an outflow of economic benefits from the group.
- BC32 Rather, the Board noted that minority (non-controlling) interests represent the residual interest in the net assets of those subsidiaries held by some of the shareholders of the subsidiaries within the group, and therefore meet the *Framework*'s definition of equity. Paragraph 49(c) of the *Framework* states that equity is the residual interest in the assets of the entity after deducting all of its liabilities.

Attribution of losses (2008 amendments)

- BC33 IAS 27 (as revised in 2003) stated that when losses attributed to the minority (non-controlling) interests exceed the minority's interests in the subsidiary's equity the excess, and any further losses applicable to the minority, is allocated against the majority interest except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.
- BC34 The Board decided that this treatment was inconsistent with its conclusion that non-controlling interests are part of the equity of the group and proposed that an entity should attribute total comprehensive income applicable to non-controlling interests to them, even if this results in the non-controlling interests having a deficit balance.
- BC35 If the parent enters into an arrangement that places it under an obligation to the subsidiary or to the non-controlling interests, the Board believes that the entity should account for that arrangement separately and the arrangement should not

* IASC's *Framework for the Preparation and Presentation of Financial Statements* was adopted by the IASB in 2001. In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*.

[†] now paragraph 4.4(b) of the *Conceptual Framework*

[‡] now paragraph 4.15 of the *Conceptual Framework*

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affect the way the entity attributes comprehensive income to the controlling and non-controlling interests.

- BC36 Some respondents to the 2005 exposure draft agreed with the proposal, noting that non-controlling interests share proportionately in the risks and rewards of the investment in the subsidiary and that the proposal is consistent with the classification of non-controlling interests as equity.
- BC37 Other respondents disagreed with the proposal, often on the grounds that controlling and non-controlling interests have different characteristics and should not be treated the same way. Those respondents argued that there was no need to change the guidance in IAS 27 (as revised in 2003) (ie that an entity should allocate excess losses to the controlling interest unless the non-controlling interests have a binding obligation and are able to make an additional investment to cover the losses). The reasons offered by those respondents were:
- (a) The non-controlling interests are not compelled to cover the deficit (unless they have otherwise specifically agreed to do so) and it is reasonable to assume that, should the subsidiary require additional capital in order to continue operations, the non-controlling interests would abandon their investments. In contrast, respondents asserted that in practice the controlling interest often has an implicit obligation to maintain the subsidiary as a going concern.
 - (b) Often guarantees or other support arrangements by the parent, without any effect on the way losses are attributed to the controlling and non-controlling interests, protect the non-controlling interests from losses of the subsidiary in excess of equity. Respondents believe that allocating those losses to the parent and non-controlling interests and recognising separately a guarantee would not reflect the underlying economics, which are that only the parent absorbs the losses of the subsidiary. In their view, it is misleading for financial statements to imply that the non-controlling interests have an obligation to make additional investments.
 - (c) Recognising guarantees separately is contrary to the principle of the non-recognition of transactions between owners.
 - (d) Loss allocation should take into account legal, regulatory or contractual constraints, some of which may prevent entities from recognising negative non-controlling interests, especially for regulated businesses (eg banks and insurers).
- BC38 The Board considered these arguments but observed that, although it is true that non-controlling interests have no further obligation to contribute assets to the subsidiary, neither does the parent. Non-controlling interests participate proportionally in the risks and rewards of an investment in the subsidiary.
- BC39 Some respondents asked the Board to provide guidance on the accounting for guarantees and similar arrangements between the parent and the subsidiary or the non-controlling interests. They also suggested that the Board should require additional disclosures about inter-company guarantees and the extent of deficits, if any, of non-controlling interests.

- BC40 The Board considered these requests but observed that this is an issue that is wider than negative non-controlling interests. Similarly, the parent is not necessarily responsible for the liabilities of a subsidiary, and often there are factors that restrict the ability of a parent entity to move assets around in a group, which means that the assets of the group are not necessarily freely available to that entity. The Board decided that it would be more appropriate to address comprehensively disclosures about non-controlling interests.

Changes in ownership interests in subsidiaries (2008 amendments)

- BC41 The Board decided that after control of an entity is obtained, changes in a parent's ownership interest that do not result in a loss of control are accounted for as equity transactions (ie transactions with owners in their capacity as owners). This means that no gain or loss from these changes should be recognised in profit or loss. It also means that no change in the carrying amounts of the subsidiary's assets (including goodwill) or liabilities should be recognised as a result of such transactions.
- BC42 The Board reached this conclusion because it believes that the approach adopted in these amendments is consistent with its previous decision that non-controlling interests are a separate component of equity (see paragraphs BC29–BC32).
- BC43 Some respondents agreed that non-controlling interests are equity but stated that they should be treated as a special class of equity. Other respondents disagreed with the requirement because they believe that recognising transactions with non-controlling interests as equity transactions means that the Board has adopted an entity approach whereas the respondents prefer a proprietary approach. The Board disagreed with this characterisation of the accounting treatment, noting that the accounting proposed is a consequence of classifying non-controlling interests as equity. The Board did not consider comprehensively the entity and proprietary approaches as part of the amendments to IAS 27 in 2008.
- BC44 Many respondents to the 2005 exposure draft suggested alternative approaches for the accounting for changes in controlling ownership interests. The most commonly suggested alternative would result in increases in controlling ownership interests giving rise to the recognition of additional goodwill, measured as the excess of the purchase consideration over the carrying amount of the separately identified assets in the subsidiary attributable to the additional interest acquired.
- BC45 Some respondents suggested that when an entity reduces its ownership interest in a subsidiary, without losing control, it should recognise a gain or loss attributable to the controlling interest. They would measure that gain or loss as the difference between the consideration received and the proportion of the carrying amount of the subsidiary's assets (including recognised goodwill) attributable to the ownership interest being disposed of. Respondents supporting this alternative believed that it would provide relevant information about the gains and losses

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attributable to the controlling interest arising on the partial disposal of ownership interests in subsidiaries.

- BC46 The Board rejected this alternative. Recognising a change in any of the assets of the business, including goodwill, is inconsistent with the Board's decision in IFRS 3 (as revised in 2008) that obtaining control in a business combination is a significant economic event. That event causes the initial recognition and measurement of all the assets acquired and liabilities assumed in the business combination. Subsequent transactions with owners should not affect the measurement of those assets and liabilities.
- BC47 The parent already controls the assets of the business, although it must share the income from those assets with the non-controlling interests. By acquiring the non-controlling interests the parent is obtaining the rights to some, or all, of the income to which the non-controlling interests previously had rights. Generally, the wealth-generating ability of those assets is unaffected by the acquisition of the non-controlling interests. That is to say, the parent is not investing in more or new assets. It is acquiring more rights to the income from the assets it already controls.
- BC48 By acquiring some, or all, of the non-controlling interests the parent will be allocated a greater proportion of the profits or losses of the subsidiary in periods after the additional interests are acquired. The adjustment to the controlling interest will be equal to the unrecognised share of the value changes that the parent will be allocated when those value changes are recognised by the subsidiary. Failure to make that adjustment will cause the controlling interest to be overstated.
- BC49 The Board noted that accounting for changes in controlling ownership interests as equity transactions, as well as ensuring that the income of the group and the reported controlling interests are faithfully represented, is less complex than the other alternatives considered.
- BC50 Some respondents disagreed with the proposal because they were concerned about the effect on reported equity of the subsequent acquisition of non-controlling interests by the parent. Those respondents seemed to be particularly concerned about the effect on the reported leverage of an entity that acquires non-controlling interests and whether this might, for example, cause those entities to have to renegotiate loan agreements.
- BC51 The Board observed that all acquisitions of an entity's equity reduce the entity's equity, regardless of whether it is an acquisition of the parent's ordinary or preference shares or non-controlling interests. Hence, the treatment of a subsequent acquisition of non-controlling interests is consistent with the general accounting for the acquisition by an entity of instruments classified as equity.
- BC52 The Board understands the importance of providing owners of the parent with information about the total changes in their reported equity. Therefore, the Board decided to require entities to present in a separate schedule the effects of any changes in a parent's ownership interest in a subsidiary that do not result in a loss of control on the equity attributable to owners of the parent.

Loss of control (2008 amendments)

- BC53 A parent loses control of a subsidiary when it loses the power to govern the financial and operating policies of an investee so as to obtain benefit from its activities. Loss of control can result from the sale of an ownership interest or by other means, such as when a subsidiary issues new ownership interests to third parties. Loss of control can also occur in the absence of a transaction. It may, for example, occur on the expiry of an agreement that previously allowed an entity to control a subsidiary.
- BC54 On loss of control, the parent-subsidiary relationship ceases to exist. The parent no longer controls the subsidiary's individual assets and liabilities. Therefore, the parent derecognises the individual assets, liabilities and equity related to that subsidiary. Equity includes any non-controlling interests as well as amounts previously recognised in other comprehensive income in relation to, for example, available-for-sale financial instruments and foreign currency translation.
- BC55 The Board decided that any investment the parent has in the former subsidiary after control is lost should be measured at fair value at the date that control is lost and that any resulting gain or loss should be recognised in profit or loss. Some respondents disagreed with that decision. Those respondents asserted that the principles for revenue and gain recognition in the *Framework* would not be satisfied for the retained interest. The Board disagreed with those respondents. Measuring the investment at fair value reflects the Board's view that the loss of control of a subsidiary is a significant economic event. The parent-subsidiary relationship ceases to exist and an investor-investee relationship begins that differs significantly from the former parent-subsidiary relationship. Therefore, the new investor-investee relationship is recognised and measured initially at the date when control is lost.
- BC56 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. Accordingly, the general requirements in IFRSs should be applied in accounting for the derecognition from the group's financial statements of the subsidiary's assets and liabilities. If a gain or loss previously recognised in other comprehensive income would be reclassified to profit or loss on the separate disposal of those assets and liabilities, the parent reclassifies the gain or loss from equity to profit or loss on the indirect disposal of those assets and liabilities through loss of control of a subsidiary. For example, if a subsidiary sells one of its available-for-sale financial assets in a separate transaction, a gain or loss previously recognised in other comprehensive income would be reclassified to profit or loss. Similarly, on the loss of control of a subsidiary, the entire gain or loss attributed to the parent on that former subsidiary's available-for-sale financial assets previously recognised in other comprehensive income would be reclassified to profit or loss.
- BC57 The Board also discussed the accounting when an entity transfers its shares in a subsidiary to its own shareholders with the result that the entity loses control of the subsidiary (commonly referred to as a spin-off). The International Financial

Reporting Interpretations Committee had previously discussed this matter, but decided not to take it on to its agenda while the business combinations project was in progress. The Board observed that the issue is outside the scope of the business combinations project. Therefore, the Board decided not to address the measurement basis of distributions to owners in the amendments to IAS 27.

Multiple arrangements

- BC58 The Board considered whether its decision that a gain or loss on the disposal of a subsidiary should be recognised only when that disposal results in a loss of control could give rise to opportunities to structure transactions to achieve a particular accounting outcome. For example, would an entity be motivated to structure a transaction or arrangement as multiple steps to maximise gains or minimise losses if an entity was planning to dispose of its controlling interest in a subsidiary? Consider the following example. Entity P controls 70 per cent of entity S. P intends to sell all of its 70 per cent controlling interest in S. P could initially sell 19 per cent of its ownership interest in S without loss of control and then, soon afterwards, sell the remaining 51 per cent and lose control. Alternatively, P could sell all of its 70 per cent interest in S in one transaction. In the first case, any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration received on the sale of the 19 per cent interest would be recognised directly in equity, whereas the gain or loss from the sale of the remaining 51 per cent interest would be recognised in profit or loss. In the second case, a gain or loss on the sale of the whole 70 per cent interest would be recognised in profit or loss.
- BC59 The Board noted that the opportunity to conceal losses through structuring would be reduced by the requirements of IAS 36 and IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. Paragraph 12 of IAS 36 includes significant changes in how an entity uses or expects to use an asset as one of the indicators that the asset might be impaired.
- BC60 Once an asset meets the criteria to be classified as held for sale (or is included in a disposal group that is classified as held for sale), it is excluded from the scope of IAS 36 and is accounted for in accordance with IFRS 5. In accordance with paragraph 20 of IFRS 5 ‘an entity shall recognise an impairment loss for any initial or subsequent write-down of the asset (or disposal group) to fair value less costs to sell ...’. Therefore, if appropriate, an impairment loss would be recognised for the goodwill and non-current assets of a subsidiary that will be sold or otherwise disposed of before control of the subsidiary is lost. Accordingly, the Board concluded that the principal risk is the minimising of gains, which entities are unlikely to strive to do.
- BC61 The Board decided that the possibility of such structuring could be overcome by requiring entities to consider whether multiple arrangements should be accounted for as a single transaction to ensure that the principle of faithful representation is adhered to. The Board believes that all of the terms and conditions of the arrangements and their economic effects should be considered in determining

whether multiple arrangements should be accounted for as a single arrangement. Accordingly, the Board included indicators in paragraph 33 to assist in identifying when multiple arrangements that result in the loss of control of a subsidiary should be treated as a single arrangement.

- BC62 Some respondents disagreed with the indicators that were provided in the exposure draft. Some respondents stated that the need for guidance on when multiple arrangements should be accounted for as a single arrangement indicates a conceptual weakness in the accounting model developed in the exposure draft. They also stated that such guidance would be unnecessary under other alternatives for accounting for decreases in ownership interests. The Board acknowledges that guidance on multiple arrangements would be unnecessary under some of the other accounting alternatives. However, the Board believes that this does not mean that those models are conceptually superior.
- BC63 Some respondents suggested that IAS 27 should include examples rather than indicators for when multiple transactions should be treated as a single transaction or arrangement, but that those examples should not be considered a complete list. The Board considered that suggestion, but decided to affirm the indicators that were in the exposure draft. The Board believed that the indicators could be applied to a variety of situations and are preferable to providing what could be an endless list of examples to try to capture every possible arrangement.

Loss of significant influence or joint control

- BC64 The Board observed that the loss of control of a subsidiary, the loss of significant influence over an associate and the loss of joint control over a jointly controlled entity are economically similar events; thus they should be accounted for similarly. The loss of control as well as the loss of significant influence or joint control represents a significant economic event that changes the nature of an investment. Therefore, the Board concluded that the accounting guidance on the loss of control of a subsidiary should be extended to events or transactions in which an investor loses significant influence over an associate or joint control over a jointly controlled entity. Thus, the investor's investment after significant influence or joint control is lost should be recognised and measured initially at fair value and the amount of any resulting gain or loss should be recognised in profit or loss. Therefore, the Board decided to amend IAS 21 *The Effects of Changes in Foreign Exchange Rates*, IAS 28 and IAS 31, accordingly. The FASB considered whether to address that same issue as part of this project. The FASB concluded that the accounting for investments that no longer qualify for equity method accounting was outside the scope of the project.

Measurement of investments in subsidiaries, jointly controlled entities and associates in separate financial statements (2003 revision and 2008 amendments)

- BC65 Paragraph 29 of IAS 27 (as revised in 2000) permitted investments in subsidiaries to be measured in any one of three ways in a parent's separate financial statements. These were cost, the equity method, or as available-for-sale financial assets in accordance with IAS 39. Paragraph 12 of IAS 28 (as revised in 2000) permitted the same choices for investments in associates in separate financial statements, and paragraph 38 of IAS 31 (as revised in 2000) mentioned that IAS 31 did not indicate a preference for any particular treatment for accounting for interests in jointly controlled entities in a venturer's separate financial statements. The Board decided to require use of cost or IAS 39 for all investments included in separate financial statements.
- BC66 Although the equity method would provide users with some profit and loss information similar to that obtained from consolidation, the Board noted that such information is reflected in the investor's economic entity financial statements and does not need to be provided to the users of its separate financial statements. For separate statements, the focus is upon the performance of the assets as investments. The Board concluded that separate financial statements prepared using either the fair value method in accordance with IAS 39 or the cost method would be relevant. Using the fair value method in accordance with IAS 39 would provide a measure of the economic value of the investments. Using the cost method can result in relevant information, depending on the purpose of preparing the separate financial statements. For example, they may be needed only by particular parties to determine the dividend income from subsidiaries.
- BC66A As part of its annual improvements project begun in 2007, the Board identified an apparent inconsistency with IFRS 5. The inconsistency relates to the accounting by a parent in its separate financial statements when investments it accounts for in accordance with IAS 39 are classified as held for sale in accordance with IFRS 5. Paragraph 38 requires an entity that prepares separate financial statements to account for such investments that are classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5. However, financial assets that an entity accounts for in accordance with IAS 39 are excluded from IFRS 5's measurement requirements.
- BC66B Paragraph BC13 of the Basis for Conclusions on IFRS 5 explains that the Board decided that non-current assets should be excluded from the measurement scope of IFRS 5 only 'if (i) they are already carried at fair value with changes in fair value recognised in profit or loss or (ii) there would be difficulties in determining their fair value less costs to sell.' The Board acknowledged in the Basis for Conclusions on IFRS 5 that not all financial assets within the scope of IAS 39 are recognised at fair value with changes in fair value recognised in profit or loss, but it did not want to make any further changes to the accounting for financial assets at that time.

BC66C Therefore, the Board amended paragraph 38 by *Improvements to IFRSs* issued in May 2008 to align the accounting in separate financial statements for those investments that are accounted for in accordance with IAS 39 with the measurement exclusion that IFRS 5 provides for other assets that are accounted for in accordance with IAS 39 before classification as held for sale. Thus, an entity should continue to account for such investments in accordance with IAS 39 when they meet the held for sale criteria in IFRS 5.

Dividend received from a subsidiary, jointly controlled entity or associate

BC66D Before *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* was issued in May 2008, IAS 27 described a ‘cost method’. This required an entity to recognise distributions as income only if they came from post-acquisition retained earnings. Distributions received in excess of such profits were regarded as a recovery of investment and were recognised as a reduction in the cost of the investment. To apply that method retrospectively upon first-time adoption of IFRSs in its separate financial statements, an investor would need to know the subsidiary’s pre-acquisition retained earnings in accordance with IFRSs.

BC66E Restating pre-acquisition retained earnings would be a task tantamount to restating the business combination (for which IFRS 1 *First-time Adoption of International Financial Reporting Standards* provides an exemption in Appendix B^{*}). It might involve subjective use of hindsight, which would diminish the relevance and reliability of the information. In some cases, the restatement would be time-consuming and difficult. In other cases, it would be impossible (because it would involve making judgements about the fair values of the assets and liabilities of a subsidiary at the acquisition date).

BC66F Therefore, in *Cost of an Investment in a Subsidiary*, an exposure draft of proposed amendments to IFRS 1 (published in January 2007), the Board proposed to give first-time adopters an exemption from restating the retained earnings of the subsidiary at the date of acquisition for the purpose of applying the cost method.

BC66G In considering the responses to that exposure draft, the Board observed that the principle underpinning the cost method is that a return of an investment should be deducted from the carrying amount of the investment. However, the wording in the previous version of IAS 27 created a problem in some jurisdictions because it made specific reference to retained earnings as the means of making that assessment. The Board determined that the best way to resolve this issue was to delete the definition of the cost method.

* As a result of the revision of IFRS 1 *First-time Adoption of International Financial Reporting Standards* in November 2008, Appendix B became Appendix C.

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- BC66H In removing the definition of the cost method, the Board concluded that an investor should recognise a dividend from a subsidiary, jointly controlled entity or associate as income in its separate financial statements. Consequently, the requirement to separate the retained earnings of an entity into pre-acquisition and post-acquisition components as a method for assessing whether a dividend is a recovery of its associated investment has been removed from IFRSs.
- BC66I To reduce the risk that removing the definition of the cost method would lead to investments in subsidiaries, jointly controlled entities and associates being overstated in the separate financial statements of the investor, the Board proposed that the related investment should be tested for impairment in accordance with IAS 36.
- BC66J The Board published its revised proposals in *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate*, an exposure draft of proposed amendments to IFRS 1 and IAS 27, in December 2007. Respondents generally supported the proposed amendments to IAS 27, except for the proposal to require impairment testing of the related investment when an investor recognises a dividend. In the light of the comments received, the Board revised its proposal and identified specific indicators of impairment. This was done to narrow the circumstances under which impairment testing of the related investment would be required when an investor recognises a dividend (see paragraph 12(h) of IAS 36). The Board included the amendments in *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* issued in May 2008.

Measurement of cost in the separate financial statements of a new parent

- BC66K In 2007 the Board received enquiries about the application of paragraph 38(a) when a parent reorganises the structure of its group by establishing a new entity as its parent. The new parent obtains control of the original parent by issuing equity instruments in exchange for existing equity instruments of the original parent.
- BC66L In this type of reorganisation, the assets and liabilities of the new group and the original group are the same immediately before and after the reorganisation. In addition, the owners of the original parent have the same relative and absolute interests in the net assets of the new group immediately after the reorganisation as they had in the net assets of the original group before the reorganisation. Finally, this type of reorganisation involves an existing entity and its shareholders agreeing to create a new parent between them. In contrast, many transactions or events that result in a parent–subsidiary relationship are initiated by a parent over an entity that will be positioned below it in the structure of the group.
- BC66M Therefore, the Board decided that in applying paragraph 38(a) *in the limited circumstances in which a parent establishes a new parent in this particular manner*, the new parent should measure the cost of its investment in the original parent at the carrying amount of its share of the equity items shown in the

separate financial statements of the original parent at the date of the reorganisation. In December 2007 the Board published an exposure draft proposing to amend IAS 27 to add a paragraph with that requirement.

BC66N In response to comments received from respondents to that exposure draft, the Board modified the drafting of the amendment (paragraphs 38B and 38C of the Standard) to clarify that it applies to the following types of reorganisations when they satisfy the criteria specified in the amendment:

- (a) reorganisations in which the new parent does not acquire all of the equity instruments of the original parent. For example, a new parent might issue equity instruments in exchange for ordinary shares of the original parent, but not acquire the preference shares of the original parent. In addition, a new parent might obtain control of the original parent, but not acquire all of the ordinary shares of the original parent.
- (b) the establishment of an intermediate parent within a group, as well as the establishment of a new ultimate parent of a group.
- (c) reorganisations in which an entity that is not a parent establishes a new entity as its parent.

BC66O In addition, the Board clarified that the amendment focuses on the measurement of one asset—the new parent's investment in the original parent in the new parent's separate financial statements. The amendment does not apply to the measurement of any other assets or liabilities in the separate financial statements of either the original parent or the new parent or in the consolidated financial statements.

BC66P The Board included the amendment in *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* issued in May 2008.

BC66Q The Board did not consider the accounting for other types of reorganisations or for common control transactions more broadly. Accordingly, paragraphs 38B and 38C apply only when the criteria in those paragraphs are satisfied. Therefore, the Board expects that entities would continue to account for transactions that do not satisfy the criteria in paragraphs 38B and 38C in accordance with their accounting policies for such transactions. The Board plans to consider the definition of common control and the accounting for business combinations under common control in its project on common control transactions.

Disclosure (2008 amendments)

BC67 In considering the 2008 amendments to IAS 27 the Board discussed whether any additional disclosures were necessary. The Board decided that the amount of any gain or loss arising on the loss of control of a subsidiary, including the portion of the gain or loss attributable to recognising any investment retained in the former subsidiary at its fair value at the date when control is lost, and the line item in the statement of comprehensive income in which the gains or losses are recognised should be disclosed. This disclosure will provide information about the effect of

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the loss of control of a subsidiary on the financial position at the end of, and performance for, the reporting period.

- BC68 In its deliberations in the second phase of the business combinations project, the FASB decided to require entities with one or more partially-owned subsidiaries to disclose in the notes to the consolidated financial statements a schedule showing the effects on the controlling interest's equity of changes in a parent's ownership interest in a subsidiary that do not result in a loss of control.
- BC69 In the 2005 exposure draft, the Board did not propose to require this disclosure. The Board noted that IFRSs require this information to be provided in the statement of changes in equity or in the notes to the financial statements. This is because IAS 1 *Presentation of Financial Statements* requires an entity to present, within the statement of changes in equity, a reconciliation between the carrying amount of each component of equity at the beginning and end of the period, disclosing separately each change.
- BC70 Many respondents to the 2005 exposure draft requested more prominent disclosure of the effects of transactions with non-controlling interests on the equity of the owners of the parent. Therefore, the Board decided to converge with the FASB's disclosure requirement and to require that if a parent has equity transactions with non-controlling interests, it should disclose in a separate schedule the effects of those transactions on the equity of the owners of the parent.
- BC71 The Board understands that some users will be interested in information pertaining only to the owners of the parent. The Board expects that the presentation and disclosure requirements of IAS 27, as revised, will meet their information needs.

Transitional provisions (2008 amendments)

- BC72 To improve the comparability of financial information across entities, amendments to IFRSs are usually applied retrospectively. Therefore, the Board proposed in its 2005 exposure draft to require retrospective application of the amendments to IAS 27, on the basis that the benefits of retrospective application outweigh the costs. However, in the 2005 exposure draft the Board identified two circumstances in which it concluded that retrospective application would be impracticable:
- (a) accounting for increases in a parent's ownership interest in a subsidiary that occurred before the effective date of the amendments. Therefore, the accounting for any previous increase in a parent's ownership interest in a subsidiary before the effective date of the amendments should not be adjusted.
 - (b) accounting for a parent's investment in a former subsidiary over which control was lost before the effective date of the amendments. Therefore, the carrying amount of any investment in a former subsidiary should not

be adjusted to its fair value on the date when control was lost. In addition, an entity should not recalculate any gain or loss on loss of control of a subsidiary if the loss of control occurred before the effective date of the amendments.

- BC73 The Board concluded that the implementation difficulties and costs associated with applying the amendments retrospectively in these circumstances outweigh the benefit of improved comparability of financial information. Therefore, the Board decided to require prospective application. In addition, the Board concluded that identifying those provisions for which retrospective application of the amendments would be impracticable, and thus prospective application would be required, would reduce implementation costs and result in greater comparability between entities.
- BC74 Some respondents were concerned that the transitional provisions were different for increases and decreases in ownership interests. They argued that accounting for decreases in non-controlling interests retrospectively imposes compliance costs that are not justifiable, mainly because the requirement to account for increases prospectively reduces comparability anyway. The Board accepted those arguments and decided that prospective application would be required for all changes in ownership interests. The revised transitional provisions mean that increases and decreases in ownership interests will be treated symmetrically and that recasting of financial statements is limited to disclosure and presentation. The recognition and measurement of previous transactions will not be changed upon transition.
- BC75 In response to practical concerns raised by respondents, the Board also decided to require prospective application of the requirement to allocate losses in excess of the non-controlling interests in the equity of a subsidiary to the non-controlling interests, even if that would result in the non-controlling interests being reported as a deficit.

Appendix Amendments to the Basis for Conclusions on other IFRSs

This appendix contains amendments to the Basis for Conclusions on other IFRSs that are necessary in order to ensure consistency with the amendments to IAS 27 and the related amendments to other IFRSs.

The amendments contained in this appendix when IAS 27, as amended in 2008, was issued have been incorporated into the Basis for Conclusions on IASs 21, 28 and 31 and on SIC-7 as issued at 10 January 2008.

Dissenting opinions

Dissent of Tatsumi Yamada from IAS 27 (as revised in 2003)

- DO1 Mr Yamada dissents from this Standard because he believes that the change in classification of minority interests in the consolidated balance sheet, that is to say, the requirement that it be shown as equity, should not be made as part of the Improvements project. He agrees that minority interests do not meet the definition of a liability under the *Framework for the Preparation and Presentation of Financial Statements*^{*}, as stated in paragraph BC31 of the Basis for Conclusions, and that the current requirement, for minority interests to be presented separately from liabilities and the parent shareholders' equity, is not desirable. However, he does not believe that this requirement should be altered at this stage. He believes that before making the change in classification, which will have a wide variety of impacts on current consolidation practices, various issues related to this change need to be considered comprehensively by the Board. These include consideration of the objectives of consolidated financial statements and the accounting procedures that should flow from those objectives. Even though the Board concluded as noted in paragraph BC27, he believes that the decision related to the classification of minority interests should not be made until such a comprehensive consideration of recognition and measurement is completed.[†]
- DO2 Traditionally, there are two views of the objectives of consolidated financial statements; they are implicit in the parent company view and the economic entity view. Mr Yamada believes that the objectives, that is to say, what information should be provided and to whom, should be considered by the Board before it makes its decision on the classification of minority interests in IAS 27. He is of the view that the Board is taking the economic entity view without giving enough consideration to this fundamental issue.
- DO3 Step acquisitions are being discussed in the second phase of the Business Combinations project, which is not yet finalised at the time of finalising IAS 27 under the Improvements project. When the ownership interest of the parent

* IASC's *Framework for the Preparation and Presentation of Financial Statements* was adopted by the IASB in 2001. In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*.

† Paragraph BC27 of IAS 27 (as revised in 2003) was deleted as part of the 2008 amendments to IAS 27. That paragraph stated:

The Board acknowledged that this decision gives rise to questions about the recognition and measurement of minority interests but it concluded that the proposed presentation is consistent with current standards and the *Framework* and would provide better comparability than presentation in the consolidated balance sheet with either liabilities or parent shareholders' equity. It decided that the recognition and measurement questions should be addressed as part of its project on business combinations.

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increases, the Board has tentatively decided that the difference between the consideration paid by the parent to minority interests and the carrying value of the ownership interests acquired by the parent is recognised as part of equity, which is different from the current practice of recognising a change in the amount of goodwill. If the parent retains control of a subsidiary but its ownership interest decreases, the difference between the consideration received by the parent and the carrying value of the ownership interests transferred is also recognised as part of equity, which is different from the current practice of recognising a gain or a loss. Mr Yamada believes that the results of this discussion are predetermined by the decision related to the classification of minority interests as equity. The changes in accounting treatments are fundamental and he believes that the decision on which of the two views should govern the consolidated financial statements should be taken only after careful consideration of the ramifications. He believes that the amendment of IAS 27 relating to the classification of minority interests should not be made before completion of the second phase of the Business Combinations project.

Dissent of Philippe Danjou, Jan Engström, Robert P Garnett, Gilbert Gélard and Tatsumi Yamada from the 2008 amendments to IAS 27 on the accounting for non-controlling interests and the loss of control of a subsidiary

DO1 Messrs Danjou, Engström, Garnett, Gélard and Yamada dissent from the 2008 amendments to IAS 27.

Accounting for changes in ownership interests in a subsidiary

DO2 Messrs Danjou, Engström, Gélard and Yamada do not agree that acquisitions of non-controlling interests in a subsidiary by the parent should be accounted for in full as equity transactions.

DO3 Those Board members observe that the consideration paid for an additional interest in a subsidiary will reflect the additional interest's share in:

- (a) the carrying amount of the subsidiary's net assets at that date;
- (b) additionally acquired goodwill; and
- (c) unrecognised increases in the fair value of the subsidiary's net assets (including goodwill) since the date when control was obtained.

DO4 Paragraphs 30 and 31 of the Standard require such a transaction to be accounted for as an equity transaction, by adjusting the relative interests of the parent and the non-controlling interests. As a consequence, the additionally acquired goodwill and any unrecognised increases in the fair value of the subsidiary's net assets would be deducted from equity. Those Board members disagree that such accounting faithfully represents the economics of such a transaction.

DO5 Those Board members believe that an increase in ownership interests in a subsidiary is likely to provide additional benefits to the parent. Although control has already been obtained, a higher ownership interest might increase synergies accruing to the parent, for example, by meeting legal thresholds provided in company law, which would give the parent an additional level of discretion over the subsidiary. If the additional ownership interest has been acquired in an arm's length exchange transaction in which knowledgeable, willing parties exchange equal values, these additional benefits are reflected in the purchase price of the additional ownership interest. Those Board members believe that the acquisition of non-controlling interests by the parent should give rise to the recognition of goodwill, measured as the excess of the consideration transferred over the carrying amount of the subsidiary's net assets attributable to the additional interest acquired. Those Board members acknowledge that this amount also includes unrecognised increases in the fair value of the subsidiary's net assets since the date when control was obtained. However, on the basis of cost-benefit

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considerations, they believe that it is a reasonable approximation of the additionally acquired goodwill.

- DO6 Messrs Danjou, Gélard and Yamada agree that, in conformity with the *Framework for the Preparation and Presentation of Financial Statements*^{*}, non-controlling interests should be presented within the group's equity, because they are not liabilities. However, they believe that until the debates over the objectives of consolidated financial statements (ie what information should be provided and to whom) and the definition of the reporting entity have been settled at the conceptual level, transactions between the parent and non-controlling interests should not be accounted for in the same manner as transactions in which the parent entity acquires its own shares and reduces its equity. In their view, non-controlling interests cannot be considered equivalent to the ordinary ownership interests of the owners of the parent. The owners of the parent and the holders of non-controlling interests in a subsidiary do not share the same risks and rewards in relation to the group's operations and net assets because ownership interests in a subsidiary share only the risks and rewards associated with that subsidiary.
- DO7 In addition, Messrs Danjou and Gélard observe that IFRS 3 *Business Combinations* (as revised in 2008) provides an option to measure non-controlling interests in a business combination as their proportionate share of the acquiree's net identifiable assets rather than at their fair value. However, paragraph BC207 of the Basis for Conclusions on IFRS 3 (as revised in 2008) states that accounting for the non-controlling interests at fair value is conceptually superior to this alternative measurement. This view implies that the subsidiary's portion of goodwill attributable to the non-controlling interests at the date when control was obtained is an asset at that date and there is no conceptual reason for it no longer to be an asset at the time of any subsequent acquisitions of non-controlling interests.
- DO8 Mr Garnett disagrees with the treatment of changes in controlling interests in subsidiaries after control is established (paragraphs BC41–BC52 of the Basis for Conclusions). He believes that it is important that the consequences of such changes for the owners of the parent entity are reported clearly in the financial statements.
- DO9 Mr Garnett believes that the amendments to IAS 27 adopt the economic entity approach that treats all equity interests in the group as being homogeneous. Transactions between controlling and non-controlling interests are regarded as mere transfers within the total equity interest and no gain or loss is recognised on such transactions. Mr Garnett observes that the non-controlling interests represent equity claims that are restricted to particular subsidiaries, whereas the controlling interests are affected by the performance of the entire group. The consolidated financial statements should therefore report performance from the perspective of the controlling interest (a parent entity perspective) in addition to the wider

* IASC's *Framework for the Preparation and Presentation of Financial Statements* was adopted by the IASB in 2001. In September 2010 the IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting*.

perspective provided by the economic entity approach. This implies the recognition of additional goodwill on purchases, and gains or losses on disposals of the parent entity's interest in a subsidiary.

- DO10 If, as Mr Garnett would prefer, the full goodwill method were not used (see paragraphs DO7–DO10 of the dissenting views on IFRS 3), the acquisition of an additional interest in a subsidiary would give rise to the recognition of additional purchased goodwill, measured as the excess of the consideration transferred over the carrying amount of the subsidiary's net assets attributable to the additional interest acquired.
- DO11 Mr Garnett does not agree with the requirement in paragraph 31 of the Standard that, in respect of a partial disposal of the parent's ownership interest in a subsidiary that does not result in a loss of control, the carrying amount of the non-controlling interests should be adjusted to reflect the change in the parent's interest in the subsidiary's net assets. On the contrary, he believes that the carrying amount of the non-controlling interests should be adjusted by the fair value of the consideration paid by the non-controlling interests to acquire that additional interest.
- DO12 Mr Garnett also believes that it is important to provide the owners of the parent entity with information about the effects of a partial disposal of holdings in subsidiaries, including the difference between the fair value of the consideration received and the proportion of the carrying amount of the subsidiary's assets (including purchased goodwill) attributable to the disposal.

Loss of control

- DO13 Mr Garnett disagrees with the requirement in paragraph 34 of the Standard that if a parent loses control of a subsidiary, it measures any retained investment in the former subsidiary at fair value and any difference between the carrying amount of the retained investment and its fair value is recognised in profit or loss, because the retained investment was not part of the exchange. The loss of control of a subsidiary is a significant economic event that warrants deconsolidation. However, the retained investment has not been sold. Under current IFRSs, gains and losses on cost method, available-for-sale and equity method investments are recognised in profit or loss only when the investment is sold (other than impairment). Mr Garnett would have recognised the effect of measuring the retained investment at fair value as a separate component of other comprehensive income instead of profit or loss.

Accounting for losses attributable to non-controlling interests

- DO14 Mr Danjou disagrees with paragraph 28 of the Standard according to which losses can be attributed without limitation to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

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- DO15 In many circumstances, in the absence of any commitment or binding obligation of the non-controlling interests to make an additional investment to cover the excess losses of the subsidiary, the continuation of the operations of a subsidiary will be funded through the contribution of additional capital by the parent and with the non-controlling interests being diluted. In those circumstances, the deficit balance attributable to the non-controlling interests that would result from the amendment in paragraph 28 does not present faithfully the equity of the consolidating entity.
- DO16 Mr Danjou believes that the Standard should therefore not preclude the allocation against the parent equity of losses that exceed the non-controlling interests in a consolidated subsidiary when the facts and circumstances are as outlined in paragraph DO15.

**Dissent of Mary E Barth and Philippe Danjou from
Cost of an Investment in a Subsidiary, Jointly
Controlled Entity or Associate (amendments to
IFRS 1 and IAS 27) issued in May 2008**

- DO1 Professor Barth and Mr Danjou voted against the publication of the amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* and IAS 27 *Consolidated and Separate Financial Statements—Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate*. The reasons for their dissent are set out below.
- DO2 These Board members disagree with the requirement in paragraphs 38B and 38C of IAS 27 that when a reorganisation satisfies the criteria specified in those paragraphs and the resulting new parent accounts for its investment in the original parent at cost in accordance with paragraph 38(a) of IAS 27, the new parent must measure the cost at the carrying amount of its share of the equity items shown in the separate financial statements of the original parent at the date of the reorganisation.
- DO3 These Board members acknowledge that a new parent could choose to apply paragraph 38(b) of IAS 27 and account for its investment in the original parent in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*. However, the new parent then would be required to account for the investment in accordance with IAS 39 in subsequent periods and to account for all other investments in the same category in accordance with IAS 39.
- DO4 These Board members also acknowledge, as outlined in paragraph BC66L of the Basis for Conclusions on IAS 27, that this type of reorganisation is different from other types of reorganisations in that the assets and liabilities of the new group and the original group are the same immediately before and after the reorganisation, as are the interests of the owners of the original parent in the net assets of those groups. Therefore, using the previous carrying amount to measure the cost of the new parent's investment in the original parent might be appropriate on the basis that the separate financial statements of the new parent would reflect its position as part of a pre-existing group.
- DO5 However, these Board members believe that it is inappropriate to preclude a new parent from measuring the cost of its investment in the original parent at the fair value of the shares that it issues as part of the reorganisation. Separate financial statements are prepared to reflect the parent as a separate legal entity (ie not considering that the entity might be part of a group). Although such a reorganisation does not change the assets and liabilities of the group and therefore should have no accounting effect at the consolidated level, from the perspective of the new parent as a separate legal entity, its position has changed—it has issued shares and acquired an investment that it did not have previously. Also, in many jurisdictions, commercial law or corporate governance regulations require entities to measure new shares that they issue at the fair value of the consideration received for the shares.

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- DO6 These Board members believe that the appropriate measurement basis for the new parent's cost of its investment in the original parent depends on the Board's view of separate financial statements. The Board is or will be discussing related issues in the reporting entity phase of its Conceptual Framework project and in its project on common control transactions. Accordingly, these Board members believe that the Board should have permitted a new parent to measure the cost of its investment in the original parent either at the carrying amount of its share of the equity items shown in the separate financial statements of the original parent or at the fair value of the equity instruments that it issues until the Board discusses the related issues in its projects on reporting entity and common control transactions.

**Guidance on implementing
IAS 27 Consolidated and Separate Financial
Statements,
IAS 28 Investments in Associates
IAS 31 Interests in Joint Ventures**

This guidance accompanies IAS 27, IAS 28 and IAS 31, but is not part of them.

Consideration of potential voting rights

Introduction

- IG1 Paragraphs 14, 15 and 19 of IAS 27 *Consolidated and Separate Financial Statements* (as amended in 2008) and paragraphs 8 and 9 of IAS 28 *Investments in Associates* require an entity to consider the existence and effect of all potential voting rights that are currently exercisable or convertible. They also require all facts and circumstances that affect potential voting rights to be examined, except the intention of management and the financial ability to exercise or convert potential voting rights. Because the definition of joint control in paragraph 3 of IAS 31 *Interests in Joint Ventures* depends upon the definition of control, and because that Standard is linked to IAS 28 for application of the equity method, this guidance is also relevant to IAS 31.

Guidance

- IG2 Paragraph 4 of IAS 27 defines control as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Paragraph 2 of IAS 28 defines significant influence as the power to participate in the financial and operating policy decisions of the investee but not to control those policies. Paragraph 3 of IAS 31 defines joint control as the contractually agreed sharing of control over an economic activity. In these contexts, power refers to the ability to do or effect something. Consequently, an entity has control, joint control or significant influence when it currently has the ability to exercise that power, regardless of whether control, joint control or significant influence is actively demonstrated or is passive in nature. Potential voting rights held by an entity that are currently exercisable or convertible provide this ability. The ability to exercise power does not exist when potential voting rights lack economic substance (eg the exercise price is set in a manner that precludes exercise or conversion in any feasible scenario). Consequently, potential voting rights are considered when, in substance, they provide the ability to exercise power.

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- IG3 Control and significant influence also arise in the circumstances described in paragraph 13 of IAS 27 and paragraphs 6 and 7 of IAS 28 respectively, which include consideration of the relative ownership of voting rights. IAS 31 depends on IAS 27 and IAS 28 and references to IAS 27 and IAS 28 from this point onwards should be read as being relevant to IAS 31. Nevertheless it should be borne in mind that joint control involves contractual sharing of control and this contractual aspect is likely to be the critical determinant. Potential voting rights such as share call options and convertible debt are capable of changing an entity's voting power over another entity—if the potential voting rights are exercised or converted, then the relative ownership of the ordinary shares carrying voting rights changes. Consequently, the existence of control (the definition of which permits only one entity to have control of another entity) and significant influence are determined only after assessing all the factors described in paragraph 13 of IAS 27 and paragraphs 6 and 7 of IAS 28 respectively, and considering the existence and effect of potential voting rights. In addition, the entity examines all facts and circumstances that affect potential voting rights except the intention of management and the financial ability to exercise or convert such rights. The intention of management does not affect the existence of power and the financial ability of an entity to exercise or convert potential voting rights is difficult to assess.
- IG4 An entity may initially conclude that it controls or significantly influences another entity after considering the potential voting rights that it can currently exercise or convert. However, the entity may not control or significantly influence the other entity when potential voting rights held by other parties are also currently exercisable or convertible. Consequently, an entity considers all potential voting rights held by it and by other parties that are currently exercisable or convertible when determining whether it controls or significantly influences another entity. For example, all share call options are considered, whether held by the entity or another party. Furthermore, the definition of control in paragraph 4 of IAS 27 permits only one entity to have control of another entity. Therefore, when two or more entities each hold significant voting rights, both actual and potential, the factors in paragraph 13 of IAS 27 are reassessed to determine which entity has control.
- IG5 The proportion allocated to the parent and non-controlling interests in preparing consolidated financial statements in accordance with IAS 27, and the proportion allocated to an investor that accounts for its investment using the equity method in accordance with IAS 28, are determined solely on the basis of present ownership interests. The proportion allocated is determined taking into account the eventual exercise of potential voting rights and other derivatives that, in substance, give access at present to the economic benefits associated with an ownership interest.
- IG6 In some circumstances an entity has, in substance, a present ownership as a result of a transaction that gives it access to the economic benefits associated with an ownership interest. In such circumstances, the proportion allocated is determined taking into account the eventual exercise of those potential voting rights and other derivatives that give the entity access to the economic benefits at present.

- IG7 IAS 39 *Financial Instruments: Recognition and Measurement* does not apply to interests in subsidiaries, associates and jointly controlled entities that are consolidated, accounted for using the equity method or proportionately consolidated in accordance with IAS 27, IAS 28 and IAS 31 respectively. When instruments containing potential voting rights in substance currently give access to the economic benefits associated with an ownership interest, and the investment is accounted for in one of the above ways, the instruments are not subject to the requirements of IAS 39. In all other cases, instruments containing potential voting rights are accounted for in accordance with IAS 39.

Illustrative examples

- IG8 The five examples below each illustrate one aspect of a potential voting right. In applying IAS 27, IAS 28 or IAS 31, an entity considers all aspects. The existence of control, significant influence and joint control can be determined only after assessing the other factors described in IAS 27, IAS 28 and IAS 31. For the purpose of these examples, however, those other factors are presumed not to affect the determination, even though they may affect it when assessed.

Example 1: Options are out of the money

Entities A and B own 80 per cent and 20 per cent respectively of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity C. Entity A sells one-half of its interest to Entity D and buys call options from Entity D that are exercisable at any time at a premium to the market price when issued, and if exercised would give Entity A its original 80 per cent ownership interest and voting rights.

Though the options are out of the money, they are currently exercisable and give Entity A the power to continue to set the operating and financial policies of Entity C, because Entity A could exercise its options now. The existence of the potential voting rights, as well as the other factors described in paragraph 13 of IAS 27, are considered and it is determined that Entity A controls Entity C.

Example 2: Possibility of exercise or conversion

Entities A, B and C own 40 per cent, 30 per cent and 30 per cent respectively of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity D. Entity A also owns call options that are exercisable at any time at the fair value of the underlying shares and if exercised would give it an additional 20 per cent of the voting rights in Entity D and reduce Entity B's and Entity C's interests to 20 per cent each. If the options are exercised, Entity A will have control over more than one-half of the voting power. The existence of the potential voting rights, as well as the other factors described in paragraph 13 of IAS 27 and paragraphs 6 and 7 of IAS 28, are considered and it is determined that Entity A controls Entity D.

Example 3: Other rights that have the potential to increase an entity's voting power or reduce another entity's voting power

Entities A, B and C own 25 per cent, 35 per cent and 40 per cent respectively of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity D. Entities B and C also have share warrants that are exercisable at any time at a fixed price and provide potential voting rights. Entity A has a call option to purchase these share warrants at any time for a nominal amount. If the call option is exercised, Entity A would have the potential to increase its ownership interest, and thereby its voting rights, in Entity D to 51 per cent (and dilute Entity B's interest to 23 per cent and Entity C's interest to 26 per cent).

Although the share warrants are not owned by Entity A, they are considered in assessing control because they are currently exercisable by Entities B and C. Normally, if an action (eg purchase or exercise of another right) is required before an entity has ownership of a potential voting right, the potential voting right is not regarded as held by the entity. However, the share warrants are, in substance, held by Entity A, because the terms of the call option are designed to ensure Entity A's position. The combination of the call option and share warrants gives Entity A the power to set the operating and financial policies of Entity D, because Entity A could currently exercise the option and share warrants. The other factors described in paragraph 13 of IAS 27 and paragraphs 6 and 7 of IAS 28 are also considered, and it is determined that Entity A, not Entity B or C, controls Entity D.

Example 4: Management intention

Entities A, B and C each own 33⅓ per cent of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity D. Entities A, B and C each have the right to appoint two directors to the board of Entity D. Entity A also owns call options that are exercisable at a fixed price at any time and if exercised would give it all the voting rights in Entity D. The management of Entity A does not intend to exercise the call options, even if Entities B and C do not vote in the same manner as Entity A. The existence of the potential voting rights, as well as the other factors described in paragraph 13 of IAS 27 and paragraphs 6 and 7 of IAS 28, are considered and it is determined that Entity A controls Entity D. The intention of Entity A's management does not influence the assessment.

Example 5: Financial ability

Entities A and B own 55 per cent and 45 per cent respectively of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity C. Entity B also holds debt instruments that are convertible into ordinary shares of Entity C. The debt can be converted at a substantial price, in comparison with Entity B's net assets, at any time and if converted would require Entity B to borrow additional funds to make the payment. If the debt were to be converted, Entity B would hold 70 per cent of the voting rights and Entity A's interest would reduce to 30 per cent.

Although the debt instruments are convertible at a substantial price, they are currently convertible and the conversion feature gives Entity B the power to set the operating and financial policies of Entity C. The existence of the potential voting rights, as well as the other factors described in paragraph 13 of IAS 27, are considered and it is determined that Entity B, not Entity A, controls Entity C. The financial ability of Entity B to pay the conversion price does not influence the assessment.

Appendix Amendments to guidance on other IFRSs

The following amendments to guidance on other IFRSs are necessary in order to ensure consistency with the amendments to IAS 27 and the related amendments to other IFRSs. In the amended paragraphs, new text is underlined and deleted text is struck through.

*The amendments contained in this appendix when IAS 27, as amended in 2008, was issued have been incorporated into the *Guidance on Implementing IFRSs 1 and 5 and IAS 1*, and the appendix (now renamed *illustrative examples*) accompanying IAS 7, as published at 10 January 2008.*

Table of Concordance

This table shows how the contents of the superseded version of IAS 27 and the amended version of IAS 27 correspond. Paragraphs are treated as corresponding if they broadly address the same matter even though the guidance may differ.

Superseded IAS 27 paragraph	Amended IAS 27 paragraph	Superseded IAS 27 paragraph	Amended IAS 27 paragraph	Superseded IAS 27 paragraph	Amended IAS 27 paragraph
1	1	17	None	33	27
2	2	18	None	34	28
3	3	19	16	35	28
4	4	20	17	36	29
5	5	21	32	37	38
6	6	22	18	38	39
7	7	23	19	39	40
8	8	24	20	40	41
9	9	25	21	41	42
10	10	26	22	42	43
11	11	27	23	43	44
12	12	28	24	44	46
13	13	29	25	45	None
14	14	30	26	None	30, 31, 33–35, 45
15	15	31	36		
16	None	32	37		

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The main amendments made in 2008 were:

- The term *minority interest* was replaced by the term *non-controlling interest*, with a new definition.
- An entity must attribute total comprehensive income to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance. The previous version required excess losses to be allocated to the owners of the parent, except to the extent that the non-controlling interests had a binding obligation and were able to make an additional investment to cover the losses.
- Requirements were added to specify that changes in a parent's ownership interest in a subsidiary that do not result in the loss of control must be accounted for as equity transactions. The previous version did not have requirements for such transactions.
- Requirements were added to specify how an entity measures any gain or loss arising on the loss of control of a subsidiary. Any such gain or loss is recognised in profit or loss. Any investment retained in the former subsidiary is measured at its fair value at the date when control is lost. The previous version required the carrying amount of an investment retained in the former subsidiary to be regarded as its cost on initial measurement of the financial asset in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*.

The amendments also changed the structure of IAS 27, by moving some paragraphs within the standard. The paragraphs were renumbered for ease of reading.