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Transfer of a subsidiary to an associate or JV

Proposal seeks to resolve conflict

December 2012, Issue 2012/21

IN THE HEADLINES

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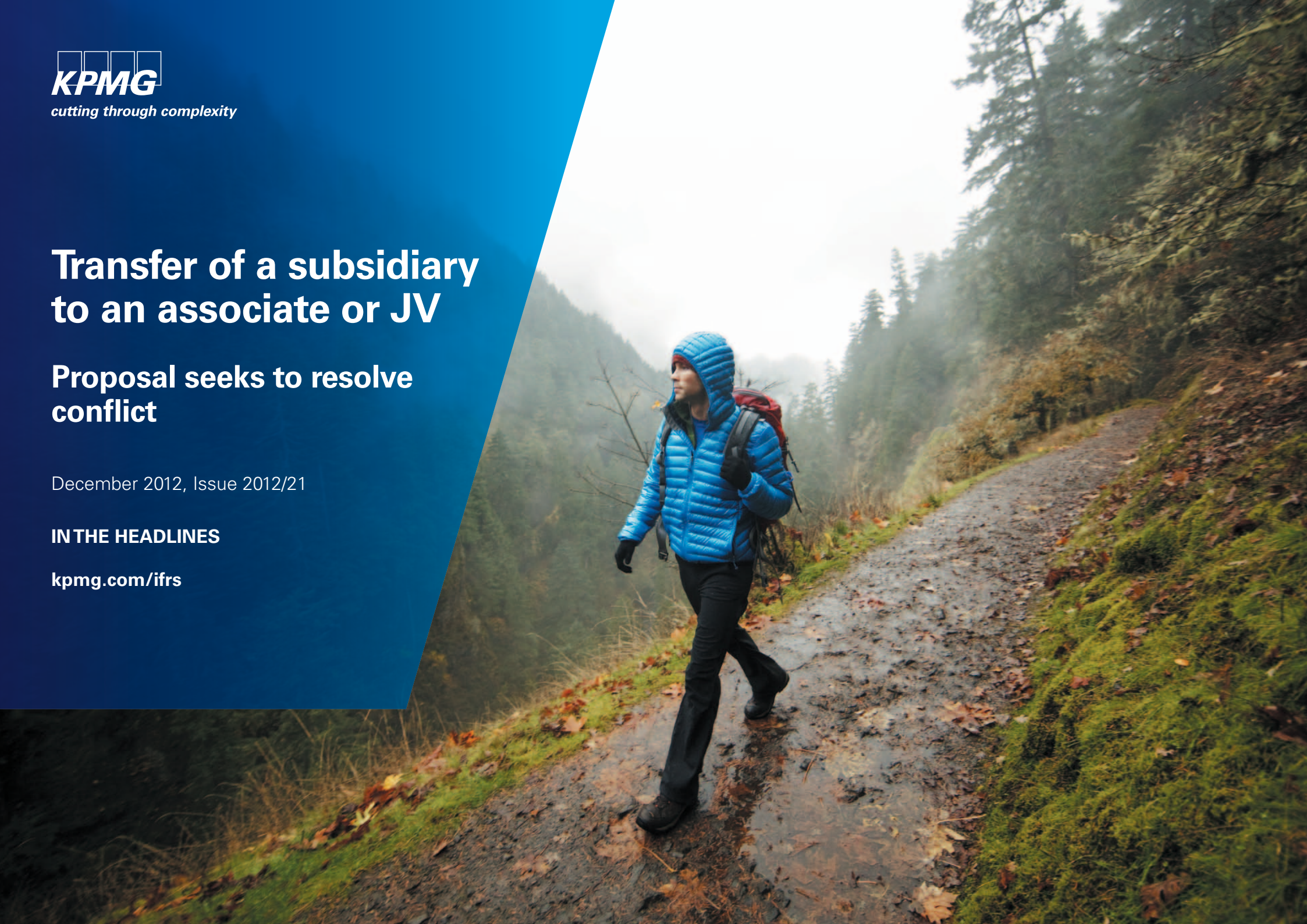


> "The distinction between a business and a collection of assets becomes more important, because the definition of a business would drive disposal accounting as well as acquisition accounting."

– Paul Munter
KPMG's global IFRS business combinations and consolidation leader

A long-standing conflict between consolidation and equity accounting

A conflict arises when a parent loses control of a subsidiary in a transaction with an associate or joint venture (JV); this could occur on formation of a JV, for example.

Consolidation standard	Standard on associates and JVs
Requires the parent to recognise the full gain on the loss of control.	Requires the parent to eliminate that portion of the gain that corresponds to its interest in the associate or JV.
Note: The proposal deals equally with a loss. However, in the case of a loss, it is recognised in full if the underlying assets are impaired.	

In response to this conflict and the resulting diversity in practice, on 13 December 2012 the IASB issued Exposure Draft *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (the ED).

Drawing a line based on the definition of a business

As shown in the diagram, the ED proposes that the full gain would be recognised only when the assets sold or contributed meet the definition of a business in accordance with IFRS 3 *Business Combinations*. The accounting is illustrated in the following example.

Fact pattern

- Company P sells its wholly owned subsidiary S to its 30% associate A for cash of 9,000.
- The carrying amount of S's net assets (including goodwill) in P's consolidated financial statements is 5,500.

How the proposal applies

S is a business

- P would recognise a gain in profit or loss of 3,500 on the loss of control (9,000 - 5,500).

S is a collection of assets

- Because P has a 30% interest in A, it would eliminate 30% of the gain – i.e. a gain of only 2,450 (3,500 x 70%) would be recognised.

Upstream transactions also in scope

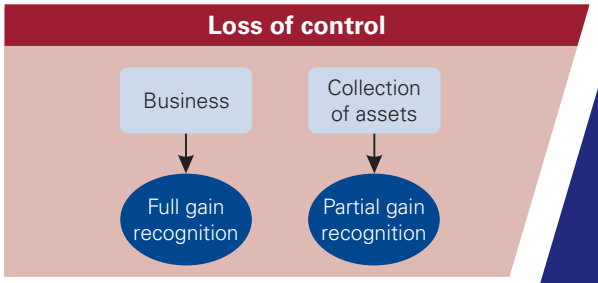
The above example illustrates a downstream transaction. However, the proposals would apply equally to upstream transactions.

Modifying the above facts, assume that A sells its wholly owned subsidiary S to P. If S meets the definition of a business, P would recognise its share (30%) of the gain of 3,500 recognised by A in full – i.e. 1,050.

Is it a business?

While the original conflict arose from transactions involving subsidiaries, the proposal is broader in scope. It applies to the loss of control over any business – regardless of whether it is housed in a subsidiary.

As a result, this places pressure on the judgement of whether the assets sold or transferred constitute a business. This would also expand the definition of a business to be a key driver in disposal accounting rather than just in acquisition accounting.



Adoption and comments

The ED does not propose an effective date, and is silent on whether early adoption would be allowed. Prospective application is proposed. Comments are due to the IASB by 23 April 2013.

Find out more

For more information on the ED, please go to the IASB press release or speak to your usual KPMG contact.

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