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STAFF PAPER

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Project	**IAS 28 *Investments in Associates and Joint Ventures*—Contributing property, plant & equipment to an associate**
Paper topic	Initial consideration

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This paper has been prepared for discussion at a public meeting of the IFRS Interpretations Committee (Committee). Comments on the application of IFRS Standards do not purport to set out acceptable or unacceptable application of IFRS Standards—only the Committee or the International Accounting Standards Board (Board) can make such a determination. Decisions made by the Committee are reported in IFRIC® *Update*. The approval of a final Interpretation by the Board is reported in IASB® *Update*.

Introduction

1. The IFRS Interpretations Committee (Committee) received a request to clarify how an entity accounts for a transaction in which it contributes property, plant and equipment (PPE) to a newly-formed associate in exchange for shares in that associate. The entities that set-up the associate are under common control.

2. The objective of the paper is to:

   (a) provide the Committee with a summary of the matter and the staff's analysis; and

   (b) ask the Committee whether it agrees with the staff recommendation not to add the matter to its standard-setting agenda.

Structure of the paper

3. This paper includes the following:

   (a) background information;

   (b) summary of outreach;

   (c) staff analysis; and

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(d) staff recommendation.

4. There are two appendices to this paper:

(a) Appendix A—proposed wording of the tentative agenda decision; and

(b) Appendix B—submission.

Background information

5. In the fact pattern described in the submission:

(a) three entities, Entity A, Entity B and Entity C (collectively referred to as investors), set up a new entity (Associate). The investors are all controlled by the same government—ie they are under common control.

(b) the investors contribute items of PPE to Associate in exchange for shares in Associate. The PPE contributed by the investors is not a business (as defined in IFRS 3 *Business Combinations*).

(c) after the contribution, each investor owns approximately 33% of the shares in Associate and has significant influence over Associate.

(d) the investors enter into lease agreements with Associate to use specified portions of the PPE—these arrangements cover the PPE contributed by the investors as well as any PPE newly-constructed by Associate. The leases reflect market terms. Applying IAS 17 *Leases,* the leases are classified as operating leases.

(e) the transaction is carried out on terms equivalent to those that would prevail in an orderly transaction between market participants.

6. The submitter asks how each investor accounts for the transaction. In particular, the submitter asks:

(a) about the application of IFRS Standards to transactions involving entities under common control (common control transactions)—ie whether IFRS Standards provide a general exception or exemption from applying the requirements in a particular Standard to common control transactions *(Question A)*;

(b) whether an investor recognises any gain or loss on contributing PPE to Associate to the extent of the other investors' interests in Associate *(Question B)*; and

(c) how an investor determines any gain or loss on contributing PPE to Associate and the cost of its investment in Associate. In particular, the submitter asks whether the gain or loss on contributing PPE and the cost of each investor's investment in Associate is based on the fair value of the PPE contributed or the fair value of the investor's acquired interest in Associate *(Question C)*.

7. The submitter asked the Committee to consider the transaction applying existing requirements in IFRS Standards—ie IFRS Standards applicable on 1 January 2017 and not those with an effective date after 1 January 2017.

8. In analysing the question, we have assumed the contribution of PPE to Associate has commercial substance as described in paragraph 25 of IAS 16 *Property, Plant and Equipment*. In addition, for simplicity and illustrative purposes, we have assumed that after the transaction each investor has a 33% ownership interest in Associate.

Question A—applying IFRS Standards to common control transactions

9. The submitter asks whether IFRS Standards provide a general exception or exemption from applying the requirements in a particular Standard to common control transactions. The submitter has identified two views:

(a) View I—Apply the requirements in IFRS Standards unless a specific exception or exemption applies.

(b) View II—Apply the scope exception in paragraph 2(c) of IFRS 3 to all common control transactions so that an entity is not required to measure such transactions at fair value.

10. The appendix to the submission, reproduced in Appendix B to this paper, explains both views further.

Question B—eliminating the gain or loss on contributing PPE to Associate

11. Paragraph 28 of IAS 28 states (emphasis added):

> Gains and losses resulting from 'upstream' and 'downstream' transactions between an entity (including its consolidated subsidiaries) and its associate or joint venture are recognised in the entity's financial statements only to the extent of *unrelated investors'* interests in the associate or joint venture…

12. The submitter asks for clarity as to the meaning of 'unrelated investors' in paragraph 28 of IAS 28. The submitter has identified two views:

    (a) *View I—'Unrelated investors' refers to any investor other than the reporting entity*

    Applying this view, for example Entity A would recognise any gain or loss on contributing PPE to Associate only to the extent of Entity B and Entity C's interests in Associate—ie Entity A would eliminate 33% of any gain or loss, which represents its interest in Associate after the contribution.

    (b) *View II—'Unrelated investors' refers to investors that do not meet the definition of a 'related party' in IAS 24* Related Party Disclosures

    Applying this view, for example Entity A would not recognise any gain or loss on contributing PPE to Associate. This is because, applying IAS 24, Entity A is related to the other investors (Entity B and Entity C)[1].

13. The appendix to the submission, reproduced in Appendix B to this paper, explains both views further.

Question C—determining the gain or loss on contributing PPE to Associate (and the cost of the investment in Associate)

14. The submitter asks whether an investor determines the gain or loss on contributing PPE to Associate (and the cost of its investment in Associate) based on the fair value

[1] In the fact pattern described in the submission, all three investors (Entity A, Entity B and Entity C) are controlled by the same government. Paragraph 9(b) of IAS 24 states that each fellow subsidiary is a related party of the other.

of the PPE contributed (View I) or the fair value of its acquired interest in Associate (View II):

(a) *View I—fair value of PPE contributed*

Paragraph 10 of IAS 28 requires an entity to initially recognise an investment in an associate at cost. ‘Cost’ is not defined in IAS 28. However, proponents of this view say that paragraph 4.55 of the *Conceptual Framework* defines historical cost as ‘…the amount of cash or cash equivalents paid or the fair value of consideration given…’. The contributed PPE represents the consideration given and, accordingly, its fair value represents the cost of an investor’s acquired interest in Associate. The investor uses the fair value of the PPE contributed to determine any gain or loss on contributing PPE to Associate.

(b) *View II—fair value of acquired interest in Associate*

In determining the gain or loss on disposal of PPE, paragraph 72 of IAS 16 requires an entity to recognise the consideration receivable on disposal initially at its fair value. Proponents of this view say the acquired interest in Associate represents the consideration receivable for the PPE. Accordingly, the investor uses the fair value of Associate to determine any gain or loss on contributing PPE to Associate, which is then also considered to be the cost of its investment in Associate for purposes of applying the requirements in IAS 28.

15. The appendix to the submission, reproduced in Appendix B to this paper, explains both views further.

Summary of outreach

16. In order to gather information about the matter, we sent requests to members of the International Forum of Accounting Standard-Setters, securities regulators, and the large accounting firms.

17. The request asked those participating whether transactions in which entities contribute PPE in exchange for an interest in an associate are prevalent. Respondents were also

asked to provide information on the predominant and any other methods an entity uses to determine the gain or loss on contributing PPE to the associate (and the cost of its acquired interest in the associate).

18. We received ten responses—four from large accounting firms, four from national standard-setters, one from an organisation representing a group of regulators and one from an individual respondent. The views received represent informal opinions, rather than formal views of those responding.

Findings from outreach

Prevalence

19. Two respondents said the transaction is prevalent in their jurisdictions. One noted its prevalence in capital intensive industries; the other said entities in its jurisdiction contribute not only PPE but also businesses and, in some cases, intangible assets.

20. One respondent said the transaction had been observed in Canada and Germany; another said these transactions are more common in China because of the prevalence of state-owned enterprises. Four respondents said the transaction occurs but not frequently. The remaining respondents said the transaction is not prevalent in their jurisdictions.

Accounting treatment observed

21. Three respondents said entities predominantly determine the gain or loss on contributing PPE (and the cost of the investment in the associate) using either the fair value of PPE contributed or the fair value of the acquired interest, whichever is more readily and reliably determinable. One of these respondents said entities generally use the fair value of the acquired interest if it is listed and use the fair value of PPE contributed if the acquired interest is not listed. Another respondent said if both fair values are readily and reliably determinable, entities generally use the fair value of PPE contributed.

22. Two respondents said entities predominantly determine the cost of the investment in the associate using the fair value of PPE contributed while one respondent said entities use the fair value of the acquired interest. One respondent said the fair value

of PPE contributed would generally be the same as the fair value of the acquired interest in the associate. Another respondent said that if these fair values differ, an entity would need to understand the reason why.

23. One respondent said that according to local law, entities in its jurisdiction were required to submit a report by an expert stating, among other things, that the value assigned to PPE contributed is not lower than the value of the acquired interest.

Staff analysis

Question A—applying IFRS Standards to common control transactions

Analysis

24. Paragraph 7 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* states:

> When an IFRS specifically applies to a transaction, other event or condition, the accounting policy or policies applied to that item shall be determined by applying the IFRS.

25. Accordingly, we think an entity applies the applicable requirements of an IFRS Standard to a transaction, other event or condition, regardless of whether the transaction is a common control transaction.

26. Paragraph 2(c) of IFRS 3 provides a scope exception for business combinations under common control (BCUCC scope exception). In our view, it is inappropriate for an entity to apply an exception or exemption by analogy. Exceptions and exemptions in IFRS Standards provide entities with targeted relief from applying the general principles and requirements in particular situations—in our view, exceptions and exemptions do not establish principles or concepts that an entity can apply by analogy to other situations. Applying an exception or exemption by analogy would result in an entity not applying requirements that specifically apply to the particular transaction in question.

27. In addition, we note that IAS 8 specifies that an entity considers requirements in IFRS Standards dealing with similar and related issues *only* in the absence of a Standard that specifically applies to the transaction. Accordingly, if the requirements in an

IFRS Standard are applicable to a transaction, an entity cannot apply the BCUCC scope exception by analogy.

Conclusion

28. In our view, unless an IFRS Standard specifically excludes common control transactions from its scope, an entity applies the applicable requirements in the Standard to common control transactions—the entity cannot apply the BCUCC scope exception by analogy to other common control transactions.

Question 1 for the Committee
Does the Committee agree with our analysis of the requirements in IFRS Standards that unless an IFRS Standard specifically excludes common control transactions from its scope, an entity applies the applicable requirements in the Standard to common control transactions?

Question B—eliminating the gain or loss on contributing PPE to Associate

Analysis

29. Paragraph 28 of IAS 28 states (emphasis added):

> Gains and losses resulting from 'upstream' and 'downstream' transactions between an entity (including its consolidated subsidiaries) and its associate or joint venture are recognised in the entity's financial statements only to the extent of *unrelated investors'* interests in the associate or joint venture…

30. In the fact pattern described in the submission, Entity B and Entity C meet the definition of a 'related party' for Entity A for the purpose of applying IAS 24—similarly, Entities A and C are related parties of Entity B, and Entities A and B are related parties of Entity C. Nonetheless, we think each investor recognises a gain or loss on contributing PPE to Associate (a downstream transaction) to the extent of the other investors' interests in Associate. So, for example, Entity A recognises a gain or loss only to the extent of Entity B and Entity C's interests in Associate.

31. In our view, the term 'unrelated investors' in paragraph 28 of IAS 28 refers to investors other than the reporting entity—regardless of whether those other investors meet the definition of a related party for the purpose of applying IAS 24.

32. Although paragraph 28 of IAS 28 uses the word 'unrelated', it does not define that term. In addition, it does not refer to IAS 24, nor does it use the term 'related party' which IAS 24 defines.

33. The requirements in paragraph 28 of IAS 28 were derived from those in SIC-3 *Elimination of Unrealised Profits and Losses on Transactions with Associates.* The Board incorporated those requirements into IAS 28 as part of its 2003 improvements project. Paragraph 3 of SIC-3 stated (emphasis added):

> Where an associate is accounted for using the equity method, unrealised profits and losses resulting from 'upstream' and 'downstream' transactions between an investor (or its consolidated subsidiaries) and associates should be eliminated *to the extent of the investor's interest in the associate*.

34. The Board issued a revised IAS 28 in 2003, which incorporated the requirements of SIC-3. Paragraph 22 of that revised IAS 28 (now paragraph 28 of IAS 28) states:

> Profits and losses resulting from 'upstream' and 'downstream' transactions between an investor (including its consolidated subsidiaries) and an associate are recognised in the investor's financial statements only to the extent of unrelated investors' interests in the associate.

35. The Board drafted paragraph 22 of IAS 28 (as issued in 2003) differently from paragraph 3 of SIC-3—with a focus on how an entity determines the gain or loss it recognises on an upstream or downstream transaction rather than on how the entity determines the gain or loss it eliminates on such a transaction. However, the Board did not reconsider the requirements of SIC-3 at that time and, in our view, did not intend to change those requirements.

36. Two aspects of IAS 28 (as issued in 2003) indicate the Board's intentions in this respect:

    (a) Paragraph BC3 of the Basis for Conclusions on IAS 28 (as issued in 2003) said:

    > Because the Board's intention was not to reconsider the fundamental approach to the accounting for investments in associates established by IAS 28, this Basis for Conclusions does not discuss requirements in IAS 28 that the Board has not reconsidered.

    The Basis for Conclusions did not explicitly address the incorporation of the requirements in SIC 3 into IAS 28, thus indicating that the Board did not reconsider those requirements as part of the improvements project.

    (b) Paragraph IN11 of the Introduction to IAS 28 (as issued in 2003) said:

    > Profits and losses resulting from 'upstream' and 'downstream' transactions between an investor and an associate must be eliminated to the extent of the investor's interest in the associate. The consensus in SIC-3 has been incorporated into the Standard.

Consistency with other requirements

37. Recognising any gain or loss on upstream or downstream transactions with associates to the extent of other investors' interests in the associate is consistent with the requirements on recognising an associate's gains or losses resulting from upstream transaction. Paragraph 28 of IAS 28 states (emphasis added):

    > … The *entity's share* in the associate's or the joint venture's gains or losses resulting from these transactions is eliminated.

38. In addition, this approach is consistent with the premise that financial statements are prepared from the perspective of the reporting entity, and not, for example, from the perspective of the parent (if any) of the reporting entity. In the fact pattern described in the submission, each investor prepares its financial statements from its perspective—the other investors are not part of the reporting group ie, Entities B and C are not part of Entity A's reporting group; similarly, Entities A and C and not part

of Entity B's reporting group and Entities A and B are not part of Entity C's reporting group.

39. For recognition and measurement purposes, IFRS Standards do not generally distinguish between transactions with entities that meet the definition of a 'related party' in IAS 24 and those that do not. For example, if Entity A sold goods to Entity B or Entity C, Entity A would account for that transaction, including recognising any gain or loss on sale, as it would a similar transaction with a party that does not meet the definition of a 'related party' in IAS 24.

Conclusion

40. In our view, an investor recognises any gain or loss on contributing PPE to an associate (a downstream transaction) to the extent of other investors' interests in the associate—regardless of whether the other investors meet the definition of a 'related party' for the purpose of applying IAS 24. Other investors are parties, other than the investor (including its consolidated subsidiaries), that have an interest in the associate.

Question 2 for the Committee
Does the Committee agree with our analysis of the requirements in IFRS Standards that an investor recognises any gain or loss on contributing PPE to an associate (a downstream transaction) to the extent of other investors' interests in the associate—regardless of whether the other investors meet the definition of a 'related party' for the purpose of applying IAS 24?

Question C—determining the gain or loss on contributing PPE to Associate (and the cost of the investment in Associate)

Analysis[2]

41. Question C has an effect in practice only if the fair value of the PPE contributed differs from the fair value of the equity interest in Associate received in exchange for

[2] For simplicity and unless otherwise stated, the analysis in this section assumes that the investor contributes PPE in exchange for only an equity interest in Associate—ie the investor does not contribute or receive any other monetary or non-monetary assets or liabilities as part of this transaction.

that PPE. If the fair values of the PPE contributed and the equity interest received are the same, the gain or loss calculated on contributing PPE to Associate would be the same, regardless of whether the investor determines this gain or loss based on the fair value of the PPE contributed or the fair value of its acquired interest in Associate.

42. Assuming orderly transactions between market participants, we would expect it to be relatively rare for the fair value of PPE contributed by an investor to differ from the fair value of its acquired interest in the associate (assuming there is nothing else exchanged as part of the transaction).

43. If there is initially any indication or evidence that the fair value of the acquired interest might differ from the fair value of PPE contributed, we would expect the investor to first assess the reasons for this difference and to review the procedures it has used to determine fair value. We think this assessment could identify either:

    (a) the investor has received something else in addition to the equity interest in Associate in exchange for the PPE, or has contributed something else in addition to the PPE—if so, it accounts for that by applying relevant IFRS Standards. For example, if the investor receives cash in addition to the equity interest in Associate, the value of PPE contributed in exchange for the equity interest in Associate would be the relevant portion of the total value of the PPE contributed. Paragraph 31 of IAS 28 specifies how an investor recognises the portion of the gain or loss on PPE contributed relating to monetary or non-monetary assets received in addition to the equity interest in Associate; or

    (b) the investor's initial estimate of fair value is not correct. The investor would also consider whether the PPE contributed might be impaired. Paragraph 29 of IAS 28 states:

    > When downstream transactions provide evidence of a reduction in the net realisable value of the assets to be sold or contributed, or of an impairment loss of those assets, those losses shall be recognised in full by the investor…

    For example, in the fact pattern described in the submission, the investors lease back portions of the PPE contributed at market terms. If, instead, the

investors were to lease back some or all of the contributed PPE at below-market terms, the investor might need to revisit assumptions used in determining the contributed PPE's fair value.

44. Although expected to be relatively rare, we have nonetheless considered when the fair value of PPE contributed by an investor might differ from the fair value of its acquired interest in Associate and, if that is the case, how an investor would apply the requirements in IFRS Standards to account for the transaction.

Fair value of acquired interest in Associate is more than the fair value of PPE

Could the fair value of the acquired interest be more than the fair value of PPE contributed?

45. In the fact pattern described in the submission, all investors contribute PPE to Associate. It is possible that the combination of PPE from each of the investors in Associate generates synergies, thus creating additional value. We think this additional value would not necessarily result in the fair value of an investor's acquired interest in Associate being more than the fair value of its contributed PPE, unless that additional value would not have been available to market participants.

46. This is because IFRS 13 *Fair Value Measurement* requires an entity to consider the highest and best use of a non-financial asset when determining its fair value. In doing so, an entity considers whether the highest and best use of a non-financial asset is to use it in combination with other assets. Paragraph 31(a)(i) of IFRS 13 states:

> If the highest and best use of the asset is to use the asset in combination with other assets or with other assets and liabilities, the fair value of the asset is the price that would be received in a current transaction to sell the asset assuming that the asset would be used with other assets or with other assets and liabilities and that those assets and liabilities (ie its complementary assets and the associated liabilities) would be available to market participants.

47. In the light of the requirements in IFRS 13, we think it would be relatively rare that the combination of PPE from each of the investors in Associate would create additional value that would not be assumed to be available to market participants

when determining the fair value of the PPE contributed. However, such a case is possible. In the following paragraphs, we analyse how an investor applies the requirements in IFRS Standards in this situation. We have analysed the transaction from Entity A's perspective.

Applying the requirements in IFRS Standards in this situation

48. For illustrative purposes, assume each of the investors—Entity A, Entity B and Entity C—contribute PPE with a fair value of CU3,000 to Associate. In exchange, each of the investors receive a 33% equity interest in Associate[3]. The additional value generated from combining the PPE of all investors (additional value that would not have been available to market participants) is CU300. The carrying amount of PPE contributed by Entity A is CU2,700. The following table summarises Associate's fair value after the contribution:

Fair value of PPE contributed by Investors: Entity A—CU3,000 Entity B—CU3,000 Entity C—CU3,000	CU9,000
Fair value of Associate's identifiable assets and liabilities	**CU9,000**
Goodwill (additional value from combining PPE from all investors)	CU300
Fair value of Associate (X)	**CU9,300**
Fair value of Entity A's acquired interest in Associate (33% of X)	**CU3,100**

49. Paragraph 30 of IAS 28 specifies how an entity accounts for a transaction in which it contributes a non-monetary asset in exchange for an equity interest in an associate. It states:

> The contribution of a non-monetary asset to an associate or a joint venture in exchange for an equity interest in the associate

[3] For simplicity, we have assumed that Associate does not have any assets or liabilities other than the contributed PPE.

> or joint venture shall be accounted for in accordance with paragraph 28, except when the contribution lacks commercial substance, as that term is described in IAS 16…

50. Paragraph 28 of IAS 28 states:

> Gains and losses resulting from 'upstream' and 'downstream' transactions involving assets that do not constitute a business, as defined in IFRS 3, between an entity (including its consolidated subsidiaries) and its associate or joint venture are recognised in the entity's financial statements only to the extent of unrelated investors' interests in the associate or joint venture… 'Downstream' transactions are, for example, sales or contributions of assets from the investor to its associate or its joint venture.

Step I—calculating the gain or loss on contributing PPE

51. Applying paragraphs 28 and 30 of IAS 28, Entity A first determines the gain or loss on contributing PPE to Associate. IAS 28 does not specify how to determine that gain or loss. However, paragraphs 71 and 72 of IAS 16 include requirements in this respect on derecognition of PPE. These paragraphs state:

> 71. The gain or loss arising from the derecognition of an item of property, plant and equipment shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.
>
> 72. The consideration receivable on disposal of an item of property, plant and equipment is recognised initially at its fair value…

52. The carrying amount of the PPE that Entity A contributes is CU2,700. Entity A acquires a 33% interest in Associate as consideration for its contribution—the fair value of the consideration (ie fair value of its acquired interest) is CU3,100.

Accordingly, the gain on contributing PPE to Associate is CU400 (CU3,100 – CU2,700). Entity A recognises the following:

Dr. Investment in Associate CU3, 100

Cr. PPE CU2,700

Cr. Gain on disposal of PPE CU400

53. Because Entity A leases back portions of its contributed PPE from Associate, we considered whether the requirements in IAS 17 for sale and leaseback transactions affect the determination or recognition of the gain. As outlined in the submission, the transaction is established at fair value and the sale and leaseback transaction results in an operating lease. Accordingly, we think those requirements do not affect the determination or recognition of the gain. This is because paragraph 61 of IAS 17 states:

> If a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, any profit or loss shall be recognised immediately….

Step II—eliminating the gain or loss to the extent of the investor's interest

54. Applying paragraph 28 of IAS 28, Entity A then eliminates the gain related to its interest in Associate. Accordingly, it eliminates CU133 of the gain (gain of CU400 X 33% interest in Associate) against its interest in Associate.

Dr. Gain on disposal of PPE CU133

Cr. Investment in Associate CU133

Step III—measuring the investment in Associate

55. We then considered whether the investment in Associate is recognised at an amount consistent with the measurement requirements in IAS 28. Paragraph 10 of IAS 28 states '…on initial recognition the investment in an associate or a joint venture is recognised at cost…'. Paragraph 32 of IAS 28 states:

> An investment is accounted for using the equity method from the date on which it becomes an associate or a joint venture. On acquisition of the investment, any difference between the cost of the investment and the entity's share of the net fair value of

> the investee's identifiable assets and liabilities is accounted for as follows:
>
> (a) Goodwill relating to an associate or a joint venture is included in the carrying amount of the investment. Amortisation of that goodwill is not permitted.
>
> (b) Any excess of the entity's share of the net fair value of the investee's identifiable assets and liabilities over the cost of the investment is included as income in the determination of the entity's share of the associate or joint venture's profit or loss in the period in which the investment is acquired.

56. In effect, IAS 28 requires an entity to recognise an investment at the higher of (a) cost or (b) its share of the net fair value of the investee's identifiable assets and liabilities. IAS 28 does not define cost. In 2009, the Committee discussed how an entity determines the cost of its investment in an associate. The agenda decision issued in July 2009 states:

> …Generally stated, cost includes the purchase price and other costs directly attributable to the acquisition or issuance of the asset such as professional fees for legal services, transfer taxes and other transaction costs. Therefore, the cost of an investment in an associate at initial recognition determined in accordance with paragraph [10] of IAS 28 comprises its purchase price and any directly attributable expenditures necessary to obtain it…

57. The fair value of the PPE contributed by Entity A in exchange for the equity interest in Associate is CU3,000. Ignoring any transaction costs, this fair value of CU3,000 would represent the 'cost' or purchase price of Entity A's acquired interest. The fair value of Associate's identifiable assets and liabilities is CU9,000. Accordingly, Entity A's share of the net fair value of these assets would be CU3,000 (33% of CU9,000).

58. However, Entity A retains a 33% interest in Associate, and thus indirectly retains a 33% interest in its contributed PPE. The effect of the gain or loss elimination required by paragraph 28 of IAS 28 (see paragraph 49 of this paper) is that Entity A

continues to recognise—indirectly through its interest in Associate—its share of contributed PPE at the pre-contribution carrying amount of that PPE.

59. Accordingly, Entity A determines its share of identifiable assets and liabilities of Associate as the sum of (a) its share (33%) of the carrying amount of its contributed PPE—CU900[4]; and (b) its share (33%) of the fair value of PPE contributed by Entity B and Entity C—CU2,000[5]. Consequently, Entity A's share of the net identifiable assets and liabilities of Associate is CU2,900.

60. Similarly, Entity A determines the cost of its acquired interest in Associate as CU2,900. This is determined as the sum of (a) 67% of the fair value of the PPE contributed—CU2,000[6]; and (b) 33% of the carrying amount of the PPE it contributes—CU900[7]. This is because in contributing PPE to Associate, Entity A in effect disposes of 67% of that PPE to the other investors—it measures this portion at fair value—and indirectly retains a 33% interest in that PPE through its interest in Associate—it measures this portion at the pre-contribution carrying amount of that PPE.

61. Applying IAS 28, Entity A recognises its acquired interest in Associate at CU2,900 (higher of the cost of its investment in Associate of CU2,900 and its share of the net fair value of identifiable assets and liabilities in Associate, which is also CU2,900).

62. Because Entity A's investment in Associate is initially determined as CU2,967 (CU3,100 per paragraph 52 less CU133 per paragraph 54), Entity A recognises a further adjustment of CU67 as follows:

Dr. Gain on disposal of PPE	CU67	
Cr. Investment in Associate		CU67

[4] 33% of the carrying amount of the contributed PPE of CU2,700

[5] 33% of the fair value of PPE contributed by Entity B (CU3,000) and Entity C (CU3,000)

[6] 67% of the fair value of the contributed PPE of CU3,000

[7] 33% of the carrying amount of the contributed PPE of CU2,700

63. Accordingly, after the contribution Entity A recognises the following:

Dr. Investment in Associate	CU2,900	
Cr. PPE		CU2,700
Cr. Gain on disposal of PPE		CU200

Fair value of acquired interest in Associate is less than the fair value of PPE

Could the fair value of the acquired interest be less than the fair value of PPE contributed?

64. In the fact pattern described in the submission, all investors contribute PPE to Associate, a new entity. If the fair value of Associate is lower than the fair value of PPE contributed by the investors, this implies that the combination of PPE of the investors results in a loss of value for Associate—perhaps, for example, because of redundancies of some of the PPE.

65. Assuming orderly transactions between market participants, we would not expect investors to enter into such an arrangement. An entity would not generally contribute an asset in exchange for acquiring something with a lower fair value. As noted in paragraph 42, in this situation we would expect an investor to consider whether it might need to revisit its initial estimate of the fair value of the PPE contributed. Nonetheless—although extremely rare in our view—it is possible that the investors might enter into such a transaction, for example to protect their competitive position.

Applying the requirements in IFRS Standards in this situation

66. Similar to the illustrative example in paragraph 47 above, we have assumed that each of the investors contribute PPE with a fair value of CU3,000 to Associate. In exchange, each of the investors receive a 33% equity interest in Associate. However, in this situation, the combination of PPE of all investors results in a loss of value of CU90. The carrying amount of PPE contributed by Entity A is CU2,700. The following table summarises Associate's fair value after the contribution:

Fair value of PPE contributed by Investors: Entity A—CU3,000 Entity B—CU3,000 Entity C—CU3,000	CU9,000
Fair value of Associate's identifiable assets and liabilities	**CU9,000**
Loss of value	CU90
Fair value of Associate (X)	**CU8,910**
Fair value of Entity A's acquired interest in Associate (33% of X)	**CU2,970**

Step I—calculating the gain or loss on contributing PPE

67. Similar to the analysis in paragraphs 48-63, applying IAS 16 Entity A initially determines the gain on contributing PPE based on the fair value of its acquired interest in Associate (ie consideration received). Accordingly, it determines the gain to be CU270[8], initially recognised as follows:

Dr. Investment in Associate	CU2,970	
Cr. Gain on contributing PPE		CU270
Cr. PPE		CU2,700

68. As in the example in paragraph 48, the requirements in IAS 17 on sale and leaseback transactions have no effect on this transaction.

Step II—eliminating the gain or loss to the extent of the investor's interest

69. Entity A then applies the requirements in paragraph 28 of IAS 28 and eliminates its share of the gain, ie CU90 (CU270 X 33%), against its interest in Associate as follows:

Dr. Gain on contributing PPE	CU90	
Cr. Investment in Associate		CU90

[8] Calculated as fair value of acquired interest in Associate (CU2,970) less carrying amount of PPE (CU2,700).

Step III—measuring the investment in Associate

70. As outlined in paragraph 56, IAS 28 requires an entity to recognise an investment at the higher of (a) cost or (b) its share of the net fair value of the investee's identifiable assets and liabilities. Similar to our analysis in paragraphs 57- 60, the cost of Entity A's investment in Associate is CU2,900 and its share of the net fair value of identifiable assets and liabilities in Associate is also CU2,900.

71. Because Entity A's investment in Associate is initially determined at CU2,880[9], Entity A recognises a further adjustment as follows:

Dr. Investment in Associate	CU20	
Cr. Gain on disposal of PPE		CU20

72. Accordingly, after the contribution Entity A recognises the following:

Dr. Investment in Associate	CU2,900	
Cr. PPE		CU2,700
Cr. Gain on disposal of PPE		CU200

73. In this situation, we think the transaction would provide objective evidence that Entity A's investment in Associate might be impaired. Accordingly, the entity considers the impairment requirements in IAS 36 *Impairment of Assets* and recognises any resulting impairment loss.

Summary

74. In a situation in which the fair value of an investor's acquired interest in an associate differs from the fair value of PPE contributed, the investor:

    (a) recognises any gain or loss on contributing PPE only to the extent of other investors' interests in the associate (as required by paragraphs 28 and 30 of IAS 28)—the entity applies the derecognition requirements in paragraphs 67-72 of IAS 16 to measure the gain or loss. Applying these requirements, the investor determines the gain or loss based on the fair value of the equity interest acquired; and

[9] CU2,970 per paragraph 69 less CU90 per paragraph 71.

(b) applies the requirements in paragraphs 10 and 32 of IAS 28 to recognise and measure its acquired interest in the associate—in doing so, it adjusts the gain or loss on contributing PPE if needed.

75. In this situation, applying the relevant requirements in IFRS Standards results in the investor recognising the same gain on contributing PPE, and the same carrying amount for the investment in the associate, as that which would result if the investor determined those amounts based on the fair value of the PPE contributed[10].

76. However, in a situation in which the fair value of the acquired interest in an associate is less than the fair value of PPE contribute, the transaction would provide objective evidence that the investment in the associate might be impaired. Accordingly, the entity considers the impairment requirements in IAS 36 and recognises any resulting impairment loss.

Other considerations

Consistency with concepts in IFRS 3 *Business Combinations*

77. Paragraph 26 of IAS 28 states '…the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for the acquisition of an investment in an associate or a joint venture.' Accordingly, we considered whether the outcome is consistent with the concepts underlying the procedures used in accounting for the acquisition of a subsidiary.

78. In our view, the outcomes in both situations analysed above are consistent. This is because:

(a) in a business combination, an entity measures any consideration payable at fair value. Paragraph 38 of IFRS 3 specifies that an entity remeasures any transferred assets or liabilities to their fair values as of the acquisition date and recognises any resulting gains or losses in profit or loss. However, the entity does not recognise any gain or loss if the transferred assets or

[10] In the example in paragraph 47 of this paper, if determined using the fair value of PPE contributed, the gain on contributing PPE would be CU300 [fair value of CU3,000 less carrying amount of CU2,700]. Entity A would eliminate CU100 of the gain [representing its 33% interest in Associate] resulting in a gain of CU200. Similarly, Entity A would recognise its investment in Associate at CU2,900 [fair value of PPE contributed of CU3,000 less eliminated gain of CU100 relating to its interest in Associate].

liabilities remain within the combined entity after the business combination and the acquirer retains control of those assets or liabilities. Applying those requirements to the situations analysed in this paper would result in an investor not recognising any gain or loss on its share of PPE contributed.

(b) applying IFRS 3, an entity generally determines its share of goodwill as the excess of consideration transferred over its share of the net identifiable assets and liabilities assumed (paragraph 32 of IFRS 3). Accordingly, an entity does not recognise goodwill relating to its acquired interest in a subsidiary unless it transfers consideration to acquire that goodwill. In applying those requirements to the situations analysed in this paper, an investor would not recognise goodwill (as part of its investment in Associate) for which it has not transferred consideration.

An entity does not apply paragraphs 24 and 26 of IAS 16

79. The submitter says in the fact pattern described in the submission, the fair value of PPE is reliably measurable and is more clearly evident than the fair value of the acquired interest. Proponents of view I (ie determining gain or loss on contributing PPE based on the fair value of the contributed PPE) analogise to the requirements in paragraphs 24 and 26 of IAS 16 on exchanges of one non-monetary asset for another. Paragraph 26 of IAS 16 states:

> … If an entity is able to measure reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure the cost of the asset received unless the fair value of the asset received is more clearly evident.

80. Similarly, some respondents to our outreach request said that entities determine the cost of the acquired interest using the fair value of PPE contributed or the fair value of the acquired interest, whichever is more readily and reliably determinable.

81. We think an entity applies the requirements as outlined in our analysis above, and does not apply paragraphs 24 and 26 of IAS 16. Those paragraphs specify how an entity determines the cost of an item of PPE when it acquires that item in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary

assets. IAS 8 specifies that an entity considers requirements in IFRS Standards dealing with similar and related issues only in the absence of a Standard that specifically applies to the transaction. Because IAS 28 specifies how an entity accounts for the contribution of a non-monetary asset in exchange for an equity interest in an associate and IAS 16 specifies how an entity determines the gain or loss on derecognition of PPE—in our view, an entity cannot apply the requirements in paragraphs 24 and 26 of IAS 16 by analogy to the transaction.

Conclusion

Application of the requirements

82. When an entity contributes PPE in exchange for an equity interest in an associate, it:

    (a) recognises any gain or loss on contributing PPE only to the extent of the other investors' interests in the associate (as required by paragraphs 28 and 30 of IAS 28)—the entity applies the derecognition requirements in paragraphs 67-72 of IAS 16 to measure the gain or loss. Applying these requirements, the entity determines the gain or loss based on the fair value of the equity interest acquired; and

    (b) applies the requirements in paragraphs 10 and 32 of IAS 28 to recognise and measure its acquired interest in the associate—in doing so, if the entity adjusts the carrying amount of its investment in the associate, then it also makes the same adjustment to the gain or loss on contributing PPE.

Outcome of applying the requirements

83. In the fact pattern described in the submission, we would generally expect the fair value of PPE contributed to be the same as the fair value of the equity interest in the associate that an entity receives in exchange. However, in some relatively rare situations, this might not be the case. Applying the requirements outlined in paragraph 82 above, an entity would recognise the same gain or loss on contributing PPE, and the same carrying amount for the investment in the associate, as that which would result if the entity determined those amounts based on the fair value of the PPE contributed—unless the transaction provides objective evidence that the entity's

interest in the associate might be impaired. If this is the case, the entity also considers the impairment requirements in IAS 36 and recognises any resulting impairment loss.

84. We think if there is any indication or evidence that the fair value of its contributed PPE is more than the fair value of its acquired interest in the associate, the entity first reviews the procedures it has used to determine fair value. If, having done so, the fair value of the PPE (used in applying the requirements outlined in paragraph 82) is more than the fair value of the acquired interest in the associate, then we think this would provide objective evidence that the entity's interest in the associate might be impaired.

Question 3 for the Committee
Does the Committee agree with our conclusion about the application of the requirements in IFRS Standards in paragraphs 82-84 of this paper?

Should the Committee add this matter to its standard setting agenda?

Is the matter widespread and expected to have a material effect on those affected?[11]

85. The outreach responses indicate that, although not common in all jurisdictions, transactions similar to the one in the submission occur in several jurisdictions around the world.

86. As discussed earlier, question C raised by the submitter would have a material effect on those affected only when the fair value of the PPE an investor contributes to an associate differs from the fair value of its acquired interest in the associate—as outlined in our analysis, we think this would be relatively rare.

[11] Paragraph 5.16(a) of the *Due Process Handbook*.

Is it necessary to add to or change IFRS Standards to improve financial reporting?[12]

87. Based on our analysis, we think the requirements in IFRS Standards provide an adequate basis for an investor to account for the contribution of PPE to an associate in exchange for an equity interest in the associate.

Staff recommendation

88. Based on our assessment of the Committee's agenda criteria in paragraphs 5.16-5.17 of the *Due Process Handbook* (discussed in paragraphs 87- 89 above), we recommend that the Committee does not add this matter to its standard-setting agenda. Instead, we recommend publishing an agenda decision that outlines how an entity applies the applicable requirements in accounting for the transaction.

89. Appendix A to this paper outlines the proposed wording of the tentative agenda decision.

Questions 4 and 5 for the Committee
4. Does the Committee agree with our recommendation not to add this matter to its standard-setting agenda? 5. Does the Committee have any comments on the proposed wording of the tentative agenda decision outlined in Appendix A to this paper?

[12] Paragraph 5.16(b) of the *Due Process Handbook*.

Appendix A - Proposed wording for tentative agenda decision

IAS 28 *Investments in Associates and Joint Ventures*— Contributing property, plant & equipment in exchange for an equity interest in an associate

The Committee received a request to clarify how an entity accounts for a transaction in which it contributes property, plant and equipment (PPE) to a newly-formed associate in exchange for shares in the associate.

In the fact pattern described in the submission:

a. three entities, Entity A, Entity B and Entity C (collectively referred to as investors), set up a new entity. The investors are all controlled by the same government—ie they are under common control.

b. the investors contribute items of PPE to the new entity in exchange for shares in that entity. The PPE contributed by the investors is not a business (as defined in IFRS 3 *Business Combinations*).

c. each investor has significant influence over the new entity. Accordingly, the new entity is an associate of each of the investors.

d. the transaction is carried out on terms equivalent to those that would prevail in an orderly transaction between market participants.

The submitter asked:

a. about the application of IFRS Standards to transactions involving entities under common control (common control transactions)—ie whether IFRS Standards provide a general exception or exemption from applying the requirements in a particular Standard to common control transactions *(Question A*);

b. whether an investor recognises any gain or loss on contributing PPE to the associate to the extent of the other investors' interests in the associate (*Question B*); and

c. how an investor determines the gain or loss on contributing PPE to the associate (and the cost of its investment in the associate). In particular, the submitter asks whether the cost of each investor's investment in the associate is based on the fair

value of the PPE contributed or the fair value of the acquired interest in the associate (*Question C*).

In analysing the questions, the Committee has assumed the contribution of PPE to the associate has commercial substance as described in paragraph 25 of IAS 16 *Property, Plant and Equipment.*

Question A

Paragraph 7 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires an entity to apply an IFRS Standard to a transaction when that Standard specifically applies to the transaction. The Committee observed, therefore, that unless a Standard specifically excludes common control transactions from its scope, an entity applies the applicable requirements in the Standard to common control transactions.

Question B

Paragraph 28 of IAS 28 requires an entity to recognise gains and losses resulting from upstream and downstream transactions with an associate only to the extent of unrelated investors' interests in the associate. Paragraph 28 includes as an example of a downstream transaction the contribution of assets from an entity to its associate.

The Committee observed that the term 'unrelated investors' in paragraph 28 of IAS 28 refers to investors other than the entity (including its consolidated subsidiaries). This is consistent with the premise that financial statements are prepared from the perspective of the reporting entity.

Accordingly, the Committee concluded that an entity recognises any gain or loss on contributing PPE to an associate to the extent of other investors' interests in the associate.

Question C

The Committee observed that when an entity contributes PPE in exchange for an equity interest in an associate, it:

a. recognises any gain or loss on contributing PPE only to the extent of other investors' interests in the associate (as required by paragraphs 28 and 30 of IAS 28)—the entity applies the derecognition requirements in paragraphs 67-72 of IAS 16 to measure the gain or loss. Applying these requirements, the entity determines the gain or loss based on the fair value of the equity interest acquired; and

b. applies the requirements in paragraphs 10 and 32 of IAS 28 to recognise and measure its acquired interest in the associate—in doing so, if the entity adjusts the carrying amount of its investment in the associate, then it also makes the same adjustment to the gain or loss on contributing PPE.

The Committee observed that, in the fact pattern described in the submission, it would generally expect the fair value of PPE contributed to be the same as the fair value of the equity interest in the associate that an entity receives in exchange. However, in some situations, this might not be the case.

Applying the requirements outlined in a. and b. above, an entity would recognise the same gain or loss on contributing PPE, and the same carrying amount for the investment in the associate, as that which would result if the investor determined those amounts based on the fair value of the PPE contributed—unless the transaction provides objective evidence that the entity's interest in the associate might be impaired. If this is the case, the investor also considers the impairment requirements in IAS 36 *Impairment of Assets* and recognises any resulting impairment loss.

The Committee observed that if there is any indication or evidence that the fair value of its contributed PPE is more than the fair value of its acquired interest in the associate, the entity first reviews the procedures it has used to determine fair value. If, having done so, the fair value of the PPE (used in applying the requirements outlined in a. and b. above) is more than the fair value of the acquired interest in the associate, this would provide objective evidence that the entity's interest in the associate might be impaired.

For all three questions, the Committee concluded that the principles and requirements in IFRS Standards provide an adequate basis for an entity to account for the contribution of PPE to an associate in the fact pattern described in the submission. Consequently, the Committee [decided] not to add this matter to its standard-setting agenda.

Appendix B
Submission

B1. We received the following request. We have deleted details that would identify the submitter of this request.

Potential Agenda Item Request

Dear Sir/Madam,

We would like to respectfully suggest an agenda item for your consideration to be included in your next meeting. The issue and current practice are described as below:

Three companies contributed items of their property, plant and equipment ("PPE") to a newly set-up associate ("Associate"), in exchange for cash and/or the shares in the Associate. Each of these companies has approximately 1/3 of the shares and votes, with none of these companies having control or joint control over the Associate.

The three companies are competitors in the same line of business. This line of business involves providing services to customers using certain infrastructure assets. The purpose of the transaction was to create a single pool of these infrastructure assets, to facilitate shared usage of the assets, as each of the infrastructure assets is capable of simultaneously supporting each of the companies' provision of services to their own customers. Therefore, after the transfer of control of the infrastructure assets to the Associate, each of the companies lost the exclusive right to use the whole of each item of infrastructure asset and instead continued to use only a portion of the asset under a lease agreement, with the Associate being in control of granting the right to the other companies to use other portions of the asset simultaneously.

The terms of the lease agreements over the portions of the infrastructure assets covered the leasing of both portions of the infrastructure assets contributed by the three companies as well as portions of assets newly constructed by the Associate. It may be assumed by IFRIC that none of these leases would meet the definition of a finance lease under IAS 17 Leases. There was a transition arrangement between the parties for the period from the date of asset disposal until signing of the lease agreements, under which each of the companies continued to have access to the specified portions of each of these assets. It may be assumed by IFRIC that the

terms of the leases reflected market terms and that there was no differentiation in terms between sharing an infrastructure asset contributed by the company and sharing an infrastructure asset contributed by another company or constructed by the Associate.

The gain on disposal of each of the three companies was determined as the difference between the fair value of the PPE given up and the carrying amount of the PPE. The Companies accounted for the contribution as a downstream transaction with an associate, and recognized a gain on disposal to the extent of the other investors' interests in the associate.

Each of the parties in the transaction is controlled by the same government as the ultimate majority shareholder. Each of them is also a listed entity and it may be assumed by IFRIC that the boards of each of these companies followed appropriate due process and high standards of corporate governance in deciding whether it was in their own shareholders' interests to enter into the transaction and when agreeing on the terms of the transaction.

Regarding to whether gain can be recognized and how it should be recognized in such transaction, we raised three questions in the **appendix** about how specific IFRS principles should be applied. We would be very grateful if the IFRIC members can share your views about interpretations of these principles considering the significance of the issue in the following aspects:

Is the issue widespread and practical? Yes. The transactions between entities controlled by a government are prevalent in many countries and it is of great significance to use a unified accounting approach to such transactions. Contributions of assets by investors in conjunction with the formation of an investee are also common.

Does the issue involve significantly divergent interpretations? Yes. As each of the three companies is listed in different jurisdictions, the interpretation of IFRS of different regulators may be different. The views of IFRIC will help promoting consistent application of IFRS across different jurisdictions.

Would financial reporting be improved through elimination of the diversity? Yes. The comparability of financial statements would be improved.

Is the issue sufficiently narrow? Yes. It is concerned with the application of specific paragraphs in IAS 16 and IAS 28.

If the issue relates to a current or planned IASB project, is there a pressing need for guidance sooner than would be expected from the IASB project? Some of the issues might be thought to be related to the research project around business combinations involving entities under common control. This is not due to be completed soon. We believe that the issues highlighted have pervasive implications and are far more pressing than that, and should therefore be addressed with a higher priority.

[cont…]

Appendix [to the submission]

Question 1. Recognition and measurement of transactions between entities under common control

Does IFRS contain a general principle that when there is a transaction between entities under common control, any requirement in IFRS to recognise the transaction at fair value with the resultant gain or loss recognized in profit or loss should be over-ridden?

We are of the view that there is nothing in any of the IFRSs or in the Conceptual Framework that prohibits the recognition of a gain on transactions between entities under common control. The only standard which allows a different accounting for common control transaction is IFRS 3.2(c) which contains a specific exception from the requirements of IFRS 3 in the case of business combinations between entities under common control. This exception is specific to IFRS 3 and does not prohibit accounting for the transaction based on IFRS3. It is a principle of IFRSs that exceptions or exemptions shall not be analogized to. If another IFRS requires a transaction (which is not a business combination between entities under common control) to be measured at fair value, then those requirements should be followed.

Alternatively, we are aware of an alternative interpretation that the exemption in IFRS 3.2(c) for business combinations under common control should be understood to represent a principle in IFRS that transactions under common control should not be measured at fair value. This over-riding principle applies even if an IFRS is silent on the question of common control and states that a transaction should be measured at fair value.

Question 2. The meaning of "unrelated investors" in IAS 28.28

IAS 28.28 states that when recognising a gain on a upstream or downstream transaction the gain is recognised in the investor's financial statements "only to the extent of unrelated investors' interests in the associate". In this context what does "unrelated investors" mean?

In our opinion, IAS 28.28 is from SIC-3 *Elimination of Unrealised Profits or Losses on Transactions with Associates*, i.e. profits and losses resulting from 'upstream' and 'downstream' transactions between an investor and an associate must be eliminated to the extent of the investor's interest in the associate. Therefore, **"unrelated investors" in this context means parties other than the reporting entity.** For example, assume the reporting entity together with its own subsidiaries own 30% of an associate, and the reporting entity's

fellow subsidiaries hold the remaining 70%. In accordance with IAS 28.28, in a downstream transaction the reporting entity should eliminate 30% of the gain and therefore should recognise 70% (equal to the interests of the other shareholders). The portion to be eliminated by the reporting entity is not further reduced simply because the other investors are fellow subsidiaries. Instead, such adjustments would be made further up the group by any immediate or ultimate parent preparing its own consolidated financial statements for the larger group which contain all these parties.

Alternatively, we are aware of an alternative interpretation under which "unrelated investors" in this context has the same meaning as in IAS 24. For example, if a reporting entity together with its own subsidiaries own 30% of the associate and in addition the reporting entity's fellow subsidiaries held a direct interest in the associate (say 10%), then the reporting entity would be precluded from recognising 40% of the gain in any downstream transaction. It then follows that if all the other investors in the associate are fellow subsidiaries of the reporting entity (or related to the reporting entity in any other way as defined in IAS 24), then the reporting entity is precluded from recognising any gain at all.

Question 3. Measurement of the gain in an exchange of non-monetary assets

In a transaction where an entity contributes fixed assets in exchange for an equity interest in an associate, how should the cost of investment in associate and the gain on disposal of fixed assets be measured? Is it acceptable to measure the cost of the interest in the associate at the fair value of the assets given up if that is more clearly evident and should that same value also be used to measure the gain on disposal?

i. **When fixed assets are contributed in exchange for equity interests in an associate, IAS 28 sets out the accounting treatment as described in the following paragraphs:**
   - The recognition of the equity accounted associate at cost is based on the guidance in paragraph 10 of IAS 28 which states that "on initial recognition the investment in an associate or a joint venture is recognised at cost".
   - IAS 28 does not define what cost is. However the conceptual framework defines cost in paragraph 4.55 (a) as "the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire an asset at the time of their acquisition". This is also consistent with IFRS 3.38 which requires the use of fair value when

measuring the consideration transferred in the form of non-monetary assets of the acquirer.

- IAS 28.26 states that the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for the acquisition of an investment in an associate. Consistent with this guidance and IFRS 3.38, the cost of the investment in the associate should be measured at the fair value of the consideration given, even if the consideration takes the form of assets previously controlled by the reporting entity.
- IAS 28.30 requires the recognition of a gain or loss in a transaction where a non-monetary asset is contributed to an equity accounted associate, subject to the constraint set out in IAS 28.28 discussed in question 2 above. This paragraph does not indicate how the gain or loss is calculated, however the requirement to recognise the equity interest acquired at cost (i.e., the fair value of the assets contributed) in paragraph 10 of IAS 28 provides the measurement basis for the gain or loss (i.e., the difference between (a) the amount recognised as the cost of the interest in the associate at cost and (b) the carrying amount of the non-monetary asset in the books of the contributing entity). This is also consistent with IFRS 3.38 which requires the assets to be re-measured to their fair value at the date of acquisition and the resulting gains or losses to be recognised in profit or loss when the consideration is in the form of non-monetary assets of the acquirer.

ii. With respect to an exchange of non-monetary assets with commercial substance, IAS 16.26 states that *"If an entity is able to measure reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure the cost of the asset received unless the fair value of the asset received is more clearly evident.*" This paragraph illustrates the following IFRS principles:

a. in an exchange of non-monetary assets, it is necessary to consider whether the exchange should be measured based on the fair value of the assets given up or the fair value of the assets received. The judgement made in this regard will determine both the measurement of the "cost" of the asset received and the "proceeds" for the asset disposed of, when the exchange is simultaneous;

b. the fair value of the assets given up is the more relevant measure when measuring the exchange value, if fair values of equal reliability are available for both the assets given up and the assets received. This indicates that the net disposal proceeds for

the PPE would be measured using the fair value of the PPE given up if that is more clearly evident; and

c. measuring fair values reliably involves maximising the use of relevant observable inputs and minimising the use of unobservable inputs as stated in IFRS 13.61.

The guidance in IAS 16.26 is therefore relevant when computing the gain or loss on disposal of an item of PPE under IAS 16.71 if the disposal is part of an exchange of non-monetary assets that has commercial substance.

Alternatively, we are aware of an alternative interpretation under which 'cost' for the purposes of IAS 28.10 should be the fair value of the associate on the basis of the reference to 'consideration receivable on disposal of an item of property, plant and equipment is recognised initially at fair value' notwithstanding the guidance in IAS 16.26.