STAFF PAPER

February 2022

IASB® meeting

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| **Project** | **Second Comprehensive Review of the *IFRS for SMEs*® Standard** |
| **Paper topic** | **Towards an Exposure Draft—Other Issues (due to the alignment with IFRS 3, IFRS 10 and IFRS 11)** |


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## Introduction

1. At its December 2021 meeting, the International Accounting Standards Board (IASB) tentatively decided to propose amendments:[1]

   (a) to Section 19 *Business Combinations and Goodwill* of the *IFRS for SMEs* Standard to align with parts of IFRS 3 *Business Combinations*, including the 2018 definition of a business;

   (b) to Section 9 *Consolidated and Separate Financial Statements* of the *IFRS for SMEs* Standard to align with IFRS 10 *Consolidated Financial Statements*—aligning the definition of control; and

   (c) to Section 15 *Investments in Joint Ventures* of the *IFRS for SMEs* Standard to align with IFRS 11 *Joint Arrangements*—aligning the definition of joint control whilst retaining the classification and measurement requirements of Section 15.

[1] For more detail of the IASB's tentative decisions see IASB Update December 2021. A summary of the IASB's tentative decisions to date is included in Agenda Paper 30 *Cover paper* of this meeting.

2. Following the IASB's tentative decisions in paragraph 1 of this paper, the staff have identified other issues that may require amendments to the *IFRS for SMEs* Standard due to the alignment with IFRS 3, IFRS 10 and IFRS 11, particularly:

   (a) step-disposals that result in loss of control (paragraph 25(b) of IFRS 10);

   (b) changes in a parent's ownership interests in a subsidiary without losing control (paragraph 23 of IFRS 10); and

   (c) a party that participates in, but does not have joint control of, a joint arrangement (paragraphs 23 and 25 of IFRS 11).

3. In this paper, the term SMEs refers to small and medium-sized entities that are eligible to apply the *IFRS for SMEs* Standard.

## Purpose of the paper

4. The purpose of this paper is to ask the IASB to decide whether to propose amendments to the *IFRS for SMEs* Standard to align the Standard with:

   (a) requirements of IFRS 10 for:

      (i) step-disposals that result in loss of control as set out in paragraph 25(b) of IFRS 10; and

      (ii) changes in a parent's ownership interests in a subsidiary without losing control as set out in paragraph 23 of IFRS 10; and

   (b) requirements of IFRS 11 for a party that participates in, but does not have joint control of, a joint arrangement (paragraphs 23 and 25 of IFRS 11).

## Summary of staff recommendations

5. The staff recommend the IASB:

   (a) propose amendments to Section 9 of the *IFRS for SMEs* Standard to align with the requirements:

      (i) for step-disposals that result in loss of control as set out in paragraph 25(b) of IFRS 10—an SME would measure any retained interest at fair value when control is lost; and

      (ii) for changes in a parent's ownership interests in a subsidiary without losing control as set out in paragraph 23 of IFRS 10—such changes are equity transactions (ie transactions with owners in their capacity as owners).

   (b) propose amendments to Section 15 of the *IFRS for SMEs* Standard to align with the requirements set out in paragraphs 23 and 25 of IFRS 11—so that paragraph 15.18 of the *IFRS for SMEs* Standard would require a party to a joint arrangement, that does not have joint control, to account for its interest in the joint arrangement in accordance with the classification of the joint arrangement—and ask for further views in the *Invitation to Comment* of the Exposure Draft proposing amendments to the *IFRS for SMEs* Standard.

## Step-disposals that result in loss of control[2]

6. Applying paragraph 9.19 of the *IFRS for SMEs* Standard, when a parent ceases to control a subsidiary but retains an investment in the former subsidiary, the carrying amount of the investment at the date that the entity ceases to be a subsidiary is regarded as the cost on initial measurement of financial asset (the retained investment), which is accounted for either:

[2] A small number of stakeholders (through the feedback from comment letters) who supported introducing the requirements for the accounting for step acquisitions as set out in the IFRS 3, also suggested the IASB consider including the requirements of step disposals.

(a) as a financial asset in aclcordance with Section 11 *Basic Financial Instruments* or Section 12 *Other Financial Instrument Issues* of the *IFRS for SMEs* Standard; or

(b) as investments in an associate or joint venture, in which case Section 14 *Investments in Associates* or Section 15 of the *IFRS for SMEs* Standard applies.[3]

7. In contrast applying IFRS 10, the retained investment is measured at fair value. That measurement will be regarded as the fair value on initial recognition of a financial asset in accordance with IFRS 9 *Financial Instruments*, or the cost on initial recognition of an investment in an associate or a joint venture, if applicable.[4]

8. Paragraph BCZ182 of the Basis for Conclusions on IFRS 10 explains the IASB's decision 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. The IASB reasoned that:

(a) measuring the investment at fair value reflected the IASB's view that the loss of control of a subsidiary is a significant economic event;

(b) the parent-subsidiary relationship ceases to exist and an investor-investee relationship begins that differs significantly from the former parent-subsidiary relationship; and

(c) therefore, the new investor-investee relationship is recognised and measured initially at the date when control is lost.[5]

9. Paragraph 14.8(i)(ii) of the *IFRS for SMEs* Standard states that in discontinuing the equity method:

> …An investor shall cease using the equity method from the date that significant influence ceases:
>
> (ii) if an investor loses significant influence over an associate as a result of a full or partial disposal, it shall derecognise that associate and recognise in profit or loss the difference

[3] Paragraph 9.19 of the *IFRS for SMEs* Standard.
[4] Paragraph 25(b) of IFRS 10.
[5] Paragraph BCZ182 of the Basis for Conclusions on IFRS 10.

between, on the one hand, the sum of the proceeds received plus *the fair value of any retained interest* and, on the other hand, the carrying amount of the investment in the associate at the date significant influence is lost. Thereafter, the investor shall account for any *retained interest* using Section 11 and Section 12 , as appropriate.[6]

10. The staff think that consistent with the reporting entity concept (the reporting entity notion) and considering that the IASB tentatively decided to propose aligning Section 2 of the *IFRS for SMEs* Standard with the 2018 *Conceptual Framework*, an SME should measure any retained investment the parent has in the former subsidiary after control is lost at fair value at the date that control is lost (as reasoned by the IASB—it is a significant economic event). The staff note that measuring the retained investment at fair value at the date that control is lost creates accounting symmetry with the measurement requirements set out in paragraph 14.8(i)(ii) of the *IFRS for SMEs* Standard (when an investor loses significant influence over an associate as a result of partial disposal).

11. The staff also think that not aligning Section 9 with the requirements for step-disposals that result in loss of control as set out in paragraph 25(b) of IFRS 10 could be perceived as inconsistent with:

    (a) paragraph 14.8(i)(i) of the *IFRS for SMEs* Standard—an SME is required to measure previously held equity interests at fair value and recognise the resulting gain or loss, if any, in profit or loss (ie if an investor ceases using the equity method from the date that significant influence has been lost, and the associate becomes a subsidiary); and

    (b) the IASB tentative decision, at its December 2021 meeting, to propose amendments to Section 19 to introduce requirements for an acquisition achieved in stages (step acquisitions) as set out in IFRS 3—such that an SME would be required to:

[6] Paragraph 14.8 of the *IFRS for SMEs* Standard.

(i) measure the fair value of assets and liabilities acquired at the acquisition date, thereby determining the amount of goodwill at the acquisition date; and

(ii) remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss in profit or loss.

## Changes in a parent's ownership interests in a subsidiary without losing control

12. Section 9 of the *IFRS for SMEs* Standard does not provide requirements for changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary.

13. Paragraph 23 of the IFRS 10 states that changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (ie transactions with owners in their capacity as owners).

14. The IASB reasoned that: [7] [8]

    (a) after control of an entity is obtained, changes in a parent's ownership interest that do not result in a loss of control are equity transactions (ie transactions with owners in their capacity as owners).

    (b) no change in the carrying amounts of the subsidiary's assets (including goodwill) or liabilities should be recognised as a result of such transactions. Otherwise, it could be viewed as inconsistent with the IASB's decision in IFRS 3 that obtaining control in a business combination is a significant economic event. In other words, subsequent transactions with owners should not affect the measurement of those assets and liabilities.

15. The IASB reached this conclusion because it believed that the approach adopted was consistent with its previous decision that non-controlling interests being presented in

[7] Paragraph BCZ168 of the Basis for Conclusions on IFRS 10.
[8] Paragraph BCZ173 of the Basis for Conclusions on IFRS 10.

the consolidated statement of financial position within equity, and as a separate component of equity (noting that the accounting for such changes, as equity transactions, was a consequence of classifying non-controlling interests as equity).[9] The IASB also reasoned that the parent already controls the assets of the business, although it must share the income from those assets with the non-controlling interests. For example, 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.[10]

16. The staff believe that aligning Section 9 with the requirements for changes in a parent's ownership interests in a subsidiary without losing control as set out in paragraph 23 of the IFRS 10 is consistent with the IASB tentative decision to align the *IFRS for SMEs* Standard with IFRS 3 and IFRS 10.

17. The staff also think that aligning Section 9 with such requirements may not add incremental costs for SMEs (for example, as it would require no remeasurement to the carrying amounts of the subsidiary's assets (including goodwill) or liabilities as a result of such transactions). In contrast, it is expected to provide users of SMEs' financial statements with an improved understanding of the subsequent transactions with owners after control of an entity is obtained. The staff, therefore, conclude that the benefits of aligning the *IFRS for SMEs* Standard with such requirements, as recommended in this paper, will outweigh any related costs.

## A party to a joint arrangement that does not have joint control

18. Section 15 of the *IFRS for SMEs* Standard includes requirements on how a party in a joint arrangement that does not have joint control accounts for that interest. Particularly, paragraph 15.18 of the *IFRS for SMEs* Standard states:

[9] Paragraphs BCZ156–BCZ159 and BCZ169–BCZ170 of the Basis for Conclusions on IFRS 10.
[10] Paragraph BCZ174 of the Basis for Conclusions on IFRS 10.

An investor in a joint venture[11] that does not have joint control shall account for that investment in accordance with Section 11 *Basic Financial Instruments*, Section 12 *Other Financial Instrument Issues* or, if it has significant influence in the joint venture, Section 14 *Investments in Associates*.

19. Paragraph 15.18 of the *IFRS for SMEs* Standard was aligned with paragraph 51 of IAS 31 *Interests in Joint Ventures* which has been superseded by IFRS 11.

20. Paragraph 51 of IAS 31 was replaced by paragraphs 23 and 25 of IFRS 11:

(a) paragraph 23 of IFRS 11 states:

A party that participates in, but does not have joint control of, *a joint operation shall also account for its interest in the arrangement in accordance with paragraphs 20–22 if that party has rights to the assets, and obligations for the liabilities, relating to the joint operation*. If a party that participates in, but does not have joint control of, a joint operation does not have rights to the assets, and obligations for the liabilities, relating to that joint operation, it shall account for its interest in the joint operation in accordance with the IFRSs applicable to that interest.

(b) paragraph 25 of IFRS 11 states:

A party that participates in, but does not have joint control of, a joint venture shall account for its interest in the arrangement in accordance with IFRS 9 *Financial Instruments*, unless it has significant influence over the joint venture, in which case it shall account for it in accordance with IAS 28 (as amended in 2011).

21. The effect of paragraphs 23 and 25 of IFRS 11 is to require a party to a joint arrangement that does not have joint control to account for its interest in the joint

[11] Glossary of terms of the *IFRS for SMEs* Standard defines a joint venture as a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. In contrast, IFRS 11 *Joint Arrangements* defines an arrangement of which two or more parties that have joint control as a joint arrangement. Joint venture is also used in IFRS 11 as one of the two classifications of joint arrangements. To avoid confusion, this section of this paper "a party to a joint arrangement that does not have joint control" uses joint arrangement, as a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control, unless otherwise indicated.

arrangement in accordance with the classification of the joint arrangement, ie joint operation or joint venture.

22. Paragraph BC49 of the Basis for Conclusions on IFRS 11 explains that the IASB concluded that, even though those parties are not joint operators, they do have rights and obligations for the assets, liabilities, revenues and expenses relating to the joint operation, which they should recognise in accordance with the terms of the contractual arrangement. IFRS 11 carried forward the requirements for a party to a joint venture that does not have joint control from paragraph 51 of IAS 31—which was aligned with paragraph 15.18 of the *IFRS for SMEs* Standard.

23. At its December 2021 meeting, the IASB tentatively decided to retain the classification requirements of joint arrangements in Section 15 of the *IFRS for SMEs* Standard. An SME classifies joint arrangements as 'jointly controlled operations', 'jointly controlled assets' or 'jointly controlled entities'.

24. In considering whether to align the *IFRS for SMEs* Standard with IFRS Accounting Standards the staff think the IASB could consider two alternative approaches:

    (a) propose amending paragraph 15.18 of the *IFRS for SMEs* Standard to align with the requirements set out in paragraphs 23 and 25 of IFRS 11 (Approach 1); or

    (b) retain unchanged paragraph 15.18 of the *IFRS for SMEs* Standard (Approach 2).

### *Approach 1*

25. A party (an SME) that does not have joint control but is a party to a jointly controlled operation or a jointly controlled asset (applying the classification requirements of Section 15 of the *IFRS for SMEs* Standard) might have the rights to the assets and obligations for the liabilities. However, if paragraph 15.18 of the *IFRS for SMEs* Standard is retained unchanged an SME would recognise a financial asset or an investment in an associate. The staff do not think, consistent with paragraph BC49 of the Basis for Conclusions on IFRS 11, this outcome is a faithful representation of the party's interest in the joint arrangement if the party has the rights to the assets and

obligations for the liabilities relating to the jointly controlled operation or the jointly controlled asset.

26. Therefore, the staff think it would be an improvement to the financial information provided applying Section 15 if the IASB proposed to align with IFRS 11 the accounting of an interest in a joint arrangement, for a party to a joint arrangement that does not have joint control. In particular:

    (a) a party (an SME) that participates in, but does not have joint control of, a jointly controlled operation which involves the use of assets and other resources instead of establishment of a separate vehicle or a jointly controlled asset in which the party involves in joint ownership of one or more assets contributed to, or acquired for the purpose of, the joint arrangement and dedicated to the purpose of the joint arrangement would also account for its interest in the arrangement in the same way that a party that jointly controls the arrangement accounts for its interest applying paragraphs 15.5 or 15.7 of the *IFRS for SMEs* Standard; and

    (b) a party (an SME) that participates in, but does not have joint control of, a jointly controlled entity would account for its interest in the arrangement in accordance with Section 11 or Section 12 of the *IFRS for SMEs* Standard, unless it has significant influence over the jointly controlled entity, in which case it shall account for it in accordance with Section 14 of the *IFRS for SMEs* Standard.

27. On the one hand, the staff think that applying Approach 1 would add complexity to the *IFRS for SMEs* Standard because a party to a joint arrangement that does not have joint control would need to classify the joint arrangement before deciding how it accounts for its interests in that joint arrangement. However, on the other hand, the requirements of classifying joint arrangements applying Section 15 are relatively straightforward compared to the classification requirements in IFRS 11. This is why the IASB tentatively decided to retain the classification requirements in Section 15.

28. Under Approach 1, the IASB's proposed amendments to paragraph 15.18 (if the IASB agrees with the staff' recommendation as set out in paragraph 31 of this paper) would be included in the Exposure Draft, which enable the respondents to comment on these

amendments and the relevance of the requirements. If the IASB applies Approach 2 in the Exposure Draft, it may not be able to change to Approach 1 without re-exposure.

### *Approach 2*

29. Retaining unchanged paragraph 15.18 of the *IFRS for SMEs* Standard would avoid adding complexity to the Standard as set out in paragraph 27 of this paper. However, retaining paragraph 15.18 would result in an accounting outcome that a party to a jointly controlled asset or a jointly controlled operation without having joint control accounts for its interests in the joint arrangement as a financial asset if the party does not exercise significant influence over the arrangement.

30. The staff note that given the IASB did not seek views on this matter in the Request for Information, respondents did not address this matter in their feedback, and then it is unclear whether this matter is relevant for SMEs.

### *Staff recommendation*

31. Given the analysis in paragraphs 25 to 30 of this paper, the staff recommend Approach 1 that the IASB would propose:

    (a) amending paragraph 15.18 of the *IFRS for SMEs* Standard to align with the requirements set out in paragraphs 23 and 25 of IFRS 11; and

    (b) asking for further views in the *Invitation to Comment* of the Exposure Draft proposing amendments to the *IFRS for SMEs* Standard.

## Staff recommendations and question for the IASB

32. In the light of the staff analysis, the staff recommend the IASB:

    (a) propose amendments to Section 9 of the *IFRS for SMEs* Standard to align with the requirements:

(i) for step-disposals that result in loss of control as set out in paragraph 25(b) of IFRS 10—an SME would measure any retained interest at fair value when control is lost; and

(ii) for changes in a parent's ownership interests in a subsidiary without losing control as set out in paragraph 23 of IFRS 10—such changes are equity transactions (ie transactions with owners in their capacity as owners).

(b) propose amendments to Section 15 of the *IFRS for SMEs* Standard to align with the requirements set out in paragraphs 23 and 25 of IFRS 11—so that paragraph 15.18 of the *IFRS for SMEs* Standard would require a party to a joint arrangement, that does not have joint control, to account for its interest in the joint arrangement in accordance with the classification of the joint arrangement—and ask for further views in the *Invitation to Comment* of the Exposure Draft proposing amendments to the *IFRS for SMEs* Standard.

**Questions for the IASB**

1. Does the IASB agree with the staff recommendation to propose amendments to Section 9 of the *IFRS for SMEs* Standard to align with the requirements for step-disposals that result in loss of control as set out in paragraph 25(b) of IFRS 10—an SME would measure any retained interest at fair value when control is lost?
2. Does the IASB agree with the staff recommendation to propose amendments to Section 9 of the *IFRS for SMEs* Standard to align with the requirements for changes in a parent's ownership interests in a subsidiary without losing control as set out in paragraph 23 of IFRS 10—such changes are equity transactions (ie transactions with owners in their capacity as owners)?
3. Does the IASB agree with the staff recommendation to propose amendments to Section 15 of the *IFRS for SMEs* Standard to align with the requirements set out in paragraphs 23 and 25 of IFRS 11—so that paragraph 15.18 of the *IFRS for SMEs* Standard would require a party to a joint arrangement, that does not have joint control, to account for its interest in the joint arrangement in accordance with the classification of the joint arrangement—and ask for further views in the *Invitation to Comment* of the Exposure Draft proposing amendments to the *IFRS for SMEs* Standard?