IFRS

STAFF PAPER

10 July 2012

IFRS Interpretations Committee Meeting

Project	IFRS Interpretations Committee Work In Progress		
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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in IFRIC *Update*. The approval of a final Interpretation by the Board is reported in IASB *Update*.

Objective of this paper

1. The objective of this paper is to update the IFRS Interpretations Committee (the Committee) on the current status of issues that are in progress but not to be discussed by the Committee in the **July 2012** meeting.

2. We have split the analysis of the work in progress into three broad categories

   (a) **Ongoing issues:** submissions that the Committee is actively working on but the issue was not presented in this meeting;

   (b) **New issues:** submissions that have been received but have not yet been presented to the Committee. Where this is the case, the submission has been attached as an appendix to this paper for information purposes only; and

   (c) **Issues on hold:** submissions that the Committee will discuss again at a future meeting but for some reason has decided to temporarily suspend work on the issue, for example, because there is a Board project that might have a knock-on impact to the Committee's discussions.

3. The following table summarises the work in progress that will be discussed at a future meeting:

Ongoing Issues			
Ref.	**Topic**	**Brief description**	**Progress**
IFRS 3-10	*Business Combinations:* Definition of a business	Request for clarification on whether an asset with relatively simple associated processes meets the definition of a business in accordance with IFRS 3. More specifically, the question was whether the acquisition of a single investment property, with lease agreements with multiple tenants over varying periods and associated processes, such as cleaning, maintenance and administrative services such as rent collection, constitutes a business as defined in IFRS 3.	At the September 2011 meeting, the Interpretations Committee observed that the difficulty in determining whether an acquisition meets the definition of a business in Appendix A of IFRS 3 is not limited to the acquisition of investment property. The Committee noted that this broader issue goes beyond the scope of its activities and should be addressed by the Board as part of its post-implementation review of IFRS 3. However, the Committee considered it to be useful for the Board's post-implementation review if it contributes to that review its experience and the results from the discussions on this issue. Consequently, the Committee directed the staff to continue their discussions with the staff of the US accounting standard-setter, the Financial Accounting Standards Board, and to continue their outreach to interested parties from other industry sectors with the aim of providing the IASB with relevant information for its post-implementation review.

Ongoing Issues			
Ref.	**Topic**	**Brief description**	**Progress**
IFRS 3-10	*Business Combinations:* Definition of a business (cont.)		Currently, we are asking preparers, industry sector groups and the large audit firms what practical difficulties they have encountered when applying/auditing the application of the definition of a business in Appendix A of IFRS 3 (revised 2008) and the related application guidance in paragraphs B7-B12 of IFRS 3 (revised 2008). In the outreach to preparers and industry sector groups we also ask for observations on specific fact patterns. Afterwards we want to discuss the results from our outreach with the staff of the FASB and the Post Implementation Review Team of the Financial Accounting Foundation. We plan to present an analysis of the outreach results and an update on our discussions with the staff of the FASB and the Post Implementation Review Team of the Financial Accounting Review Team of the Financial Accounting Foundation at the Committee's September 2012 meeting.

Ongoing Issues			
Ref.	**Topic**	**Brief description**	**Progress**
IAS 12-11	*Income Taxes:* Recognition of deferred tax for a single asset in a corporate wrapper	Request for clarification of the calculation of deferred tax in circumstances in which the entity holds a subsidiary which has a single asset within it. Specifically, the question asked was whether the tax base described in paragraph 11 of IAS 12 and used to calculate the deferred tax should be the tax base of the (single) asset within the entity which holds it, or the tax base of the shares of the entity holding the asset.	At the May 2012 meeting, the Committee noted significant diversity in practice in accounting for deferred tax when tax law attributes separate tax bases to the asset inside and the parent's investment in the shares and each tax base is separately deductible for tax purposes. The Committee also noted that current IAS 12 requires the parent to recognise both the deferred tax related to the asset inside and the deferred tax related to the shares, if tax law considers the asset inside and the shares to be two separate assets and if no specific exceptions in IAS 12 apply. Considering however the concerns raised by commentators in respect of these requirements in current IAS 12, the Committee decided in the May 2012 meeting not to recommend to the IASB that it should address this issue through an Annual Improvement, but instead to explore further options to address this issue that would result in a different accounting for this specific type of transaction. Consequently, the Committee directed the staff to analyse whether the requirements of IAS 12 should be amended in response to the concerns raised by commentators. We plan to present this analysis at the September 2012 meeting.

Ongoing Issues			
IAS 41-6	*Agriculture:* Valuation of biological assets using a residual method	Paragraph 25 of IAS 41 permits the use of a residual method to arrive at the fair value of biological assets that are physically attached to land, if the biological assets have no separate market but an active market exists for the combined assets. The submitter's concern is that, when using the residual method, the use of the fair value of land (ie based on its highest and best use as required by IFRS 13) when its highest and best use is different from its current use, might result in a minimal or nil fair value for the biological assets.	At the May 2012 meeting, the Committee observed that it is unlikely that the residual method will be appropriate if it returns a nil or minimal value for the biological assets. The Committee decided not to propose an amendment to IFRSs with respect to this issue, and asked the staff to bring back proposed wording to the next meeting for a tentative agenda decision. However, after the May meeting, we received a comment, via the submitter, from a valuation expert who has specialist expertise in valuing biological assets in the submitter's jurisdiction. According to the valuer, there is no separate market for biological assets attached to land in its jurisdiction. The valuer therefore advocates that the use of the residual method would be the only way to value such biological assets. After we received this comment, we started to conduct further outreach on this matter. Our initial discussions suggest that other views exist on the ability to estimate fair value of biological assets attached to land other than by the residual method. In response to the differing views expressed in the comments received, and taking into account the potential significance for the basis of the Committee's tentative decision at the May 2012 meeting, we have decided to conduct further outreach to valuation specialists, including with members of the IASB's Valuation Expert Group. We will use the additional information we receive from this outreach to inform and advise the Committee. We will therefore bring this issue back to the Committee in September 2012, either with a recommendation for the wording of the tentative agenda decision or with a recommendation for an alternative response to the submission.

New Issues			
Ref.	**Topic**	**Brief description**	**Progress**
IAS 19-19	*Employee Benefits:* Measurement of the net DBO for post-employment benefit plans with employee contributions	Request for clarification of paragraph 93 of IAS 19 (2011). The submitter thinks that paragraph 93 was intended to address measurement of the net Defined Benefit Obligation (DBO) for plans where the risk of plan deficits and/or surplus is shared with employees through their contributions to the plan. However, the submitter is concerned that the guidance would affect any plan with employee contributions, resulting in a change in measurement of the net DBO for virtually all of those plans. The submitter thinks that this is an unintended consequence of the language in paragraph 93.	The staff will bring this issue to the September 2012 Committee meeting. The submission is included in **Appendix A** to this paper.
IFRS 3-14	*Business Combinations:* Special Purpose Acquisition Company (SPAC) merger transactions	Request to provide clear guidelines for SPAC-related merger transactions because IFRSs do not explicitly provide guidance for this particular type of legal mergers and there is diversity in practice. A SPAC is a shell entity established to obtain public listing, and then be used to provide an existing, non-listed, operating entity with that listing by legally merging the SPAC with the operating entity in such a way that: (i) the merged entity retains the SPAC's listing; and (ii) the former shareholders of the operating entity become the majority shareholders of the Merged entity. Consequently the operating entity obtains a market listing without needing to undergo its own IPO and all the reporting requirements that an IPO typically entails.	The staff will bring this issue to the September 2012 Committee meeting. The submission is included in **Appendix B** to this paper.

New Issues			
Ref.	**Topic**	**Brief description**	**Progress**
IAS 27 and IFRIC 17	*Consolidated and Separate financial statements and Distribution of Non-cash Assets to Owners:* Purchase of NCI when the consideration includes non-cash items	Request for clarification on the accounting for the purchase of non-controlling interest when the consideration includes non-cash items. The issue is whether the difference between the fair value and the book value of the non-cash items transferred should be recognised in equity (in accordance with IAS 27) or in profit or loss by analogy to IFRIC 17 *Distribution of Non-cash Assets to Owners*.	The staff will bring this issue to the September 2012 Committee meeting. The submission is included in **Appendix C** to this paper.

Issues on hold			
Ref.	**Topic**	**Brief description**	**Progress**
IAS 16-5	*Property, Plant and Equipment:* Contingent payments for the separate purchase of PPE and intangible assets	Request for clarification on how to account for contingent payments for the separate purchase of a single item of property, plant and equipment (PPE) or an intangible asset. The issue includes: (i) when to record the liability for such contingent prices; and (ii) whether subsequent changes to the contingent price, when recognised, should be recognised in profit or loss or as an adjustment to the cost of the asset purchased.	In the May 2012 meeting, the majority of the Committee members agreed that the principles that the IASB is developing in the Leases project should be used as the basis for the accounting for contingent payments for the separate purchase of PPE and intangible assets. The Committee directed the staff to prepare a paper to be presented in the September meeting which will consider: (i) whether the characteristics of contingent payments for the separate purchase of PPE and intangible assets are similar to the characteristics of variable payments in leases; (ii) what amendments would need to be made to IFRSs to enable the accounting for contingent payments for the separate acquisition of PPE and intangible assets to be consistent with the principles in the Leases project; and (iii) whether the accounting for contingent payments in IFRS 3 *Business Combinations* is an alternative to the Leases project.

Issues on hold			
Ref.	**Topic**	**Brief description**	**Progress**
IAS 2-1	*Inventories:* Long-term prepayments in inventory supply contracts	Request for clarification on the accounting for long-term supply contracts of raw materials when the purchaser of the raw materials agrees to make prepayments to the supplier. The question is whether the purchaser/supplier should accrete interest on long-term prepayments by recognising interest income/expense, resulting in an increase of the cost of inventories/revenue.	At the January 2012 Interpretations Committee meeting, the Committee noted that the exposure draft *Revenue from Contracts with Customers* published in November 2011 contains requirements regarding the time value of money. Provided that the requirements on the time value of money are not changed in the final standard on revenue, this would apply in the seller's financial statements when prepayments are received. The Committee observed that the principles regarding accounting for the time value of money in the seller's financial statements are similar to those in the purchaser's financial statements. The Committee decided to ask the IASB whether it agrees with the Committee's observation, and, if so, whether there should be amendments made in the IFRS literature in order to align the purchaser's accounting with the seller's accounting. At the February IASB meeting, the IASB agreed that a financing component contained in a purchase transaction should be identified and recognised separately. As a result, interest would be accreted on long-term prepayments made in a financing transaction. However, the IASB noted that payments made when entering into a long-term supply contract might include premiums paid for securing supply or for fixing prices. The IASB noted that in such cases, it is not appropriate to accrete interest on these payments. Consequently, the IASB tentatively decided that it should be made clear that the clarifications proposed should only apply to financing transactions, ie transactions in which prepayments are made for assets to be received in the future. The IASB asked the Committee to consider addressing the diversity in accounting, not by amending the current literature as part of a separate IASB project, but by clarifying the purchaser's accounting through an interpretation. We will prepare a paper to be presented at the November 2012 IFRS IC meeting, after the IASB has redeliberated on the ED on revenue.

4. This paper does not include requests on issues that are still at a preliminary research stage, including where further information is being sought from the submitter, or other parties, to define more clearly the issue.
5. We are reproducing in **Appendices A –C** the new requests that we have received. All information has been copied without modification. We deleted (except for Appendix B) details that would identify the submitter of the request.

Question
Does the Committee have any questions or comments on the Committee Outstanding Issues List?

Appendix A – IAS 19 *Employee benefits (2011):* Measurement of the net DBO for post-employment benefit plans with employee contributions

Interpretations Committee potential agenda item request

The issue:

Paragraph 93 of IAS 19 (2011) states:

Contributions from employees or third parties set out in the formal terms of the plan either reduce service cost (if they are linked to service), or reduce remeasurements of the net defined benefit liability (asset) (eg if the contributions are required to reduce a deficit arising from losses on plan assets or actuarial losses). *Contributions from employees or third parties in respect of service are attributed to periods of service as a negative benefit in accordance with paragraph 70* (ie the net benefit is attributed in accordance with that paragraph). [Emphasis added.]

It is our understanding that paragraph 93 was intended to address measurement of the net DBO for plans where the risk of plan deficits and/or surplus is shared with employees through their contributions to the plan. As written, however, the guidance would affect any plan with employee contributions, resulting in a change in measurement of the net DBO for virtually all of those plans. We believe this is an unintended consequence of the language in paragraph 93.

Attribution of employee contributions and expected benefits are based on a set of assumptions, including the discount rate. In periods in which the discount rate increases, employee contributions made in earlier periods have higher value, which may cause the net DBO to be back-loaded and increase the DBO. For example, even very simple contributory plans with a benefit based on a level percent of pay and employee contributions also based on a level percent of pay may be considered back-loaded if, as is common, the assumed salary growth rate is lower than the assumed discount rate. This is because, after allowing for the effect of interest on employee contributions, the pattern of employee contributions will be front-loaded, causing the net benefit to be back-loaded. The resulting DBO is higher DBO than under IAS 19 (2008), which seems contrary to the IASB's intent based on paragraph BC150(a) of IAS 19 (2011). Further complexity and cost is added when the attribution changes due to assumptions changes, most notably shifts in the relationship between the discount rate and the salary growth rate. For example, a shift from discount rate > assumed salary growth rate to assumed salary growth rate > discount rate can cause the employee contributions to change from being considered front-loaded (as described above) to back-loaded, and vice versa, with an offsetting change in the attribution of the net benefit.

An additional concern is the determination of the effect of employee contributions for periods prior to the date IAS 19 (2011) is adopted. In most cases, data on employees' past contributions no longer exists to determine the effect on the net DBO of those contributions. And even if the data does exist, without re-running valuations for prior years, the effect of pay growth different than assumed in those earlier years and the effect of plan changes would have to be arbitrarily split between amounts that would have affected P&L and amounts that would have affected OCI. Further, it is not clear

whether amounts contributed in prior years by employees should be assumed to grow at the discount rate or the actual rate or return on the plan assets.

Current practice:

Under IAS 19 (2008), employee contributions reduce the gross service cost in the period in which they are received. Thus, an employer's current service cost is the total cost of benefits attributed to service in the current period, less the portion of that cost borne by employee contributions for the period.

It is our understanding that application of paragraphs 93 and 70 of IAS 19 (2011) will be mixed, as some advisors have already indicated they intend to ignore paragraph 93 because they believe IAS 19 (2011) was not intended to change the method used to calculate the DBO. Their views are based on statements by the IASB that measurement issues will be addressed in a later phase of the project.

Reasons for the Interpretations Committee to address the issue:

As noted above, paragraph 93 of IAS 19 (2011) would affect any plan with employee contributions, resulting in a change in measurement of the DBO for virtually all of those plans. We believe that is an unintended consequence of the new standard. IAS 19 (2011) was a limited scope project that we understood was not intended to change measurement of the DBO, except in certain areas where clarification was needed (e.g., contributory plans with true risk-sharing of plan surpluses and deficits).

We also note that the cost recognition for a typical contributory plan would, if paragraph 93 is taken at face value, differ from the effect of the situation where employees are paid less, but are participants in an employer-provided noncontributory pension plan. In the noncontributory plan, the employer is effectively making the contributions on behalf of the employees by paying them less and bearing the cost that would have been contributed by those employees if they were paid more but had to contribute to the pension plan. Similar disparities arise in the UK for salary sacrifice arrangements.

Based on the above concerns we ask that IASB and/or the Interpretations Committee provide guidance on how paragraph 93 should be interpreted and applied to avoid those issues.

Appendix B – IFRSs relating to SPAC transactions

29 May 2012
Wayne Upton
Chair
IFRS Interpretations Committee
30 Cannon Street
London, EC4M 6XH

Re : Korean Accounting Standards Board's (KASB) technical inquiry about IFRSs relating to SPAC transactions

Dear Chair Wayne Upton:

On behalf of the KASB, I am writing this letter to ask for clarified guidelines on IFRSs relating to special purpose acquisition company (SPAC) merger transactions.

I greatly appreciate the efforts of the IFRS Interpretations Committee to reach out to diverse constituents around the globe and reflect their opinions in the IFRS standards. In this letter, I would like to draw your attention to issues relating to SPAC and propose that the IFRS IC consider the issues in its discussion.

A SPAC is a useful mechanism to raise capital and go public, and SPAC merger transactions are, and will continue to be, common in the business world. However, the lack of clarity in IFRSs relating to such SPAC mergers resulted in diversity in practice.

Therefore, I would like to ask the IFRS IC to provide clear guidelines for SPAC related merger transactions to achieve successful convergence between the IASB and FASB and to resolve diversity in practice, thereby improving comparability among entities.

I appreciate your consideration in advance, and it would be my pleasure to further discuss any aspects of this letter.

Please do not hesitate to contact me if you have any questions or comments about my inquiry. You may direct your inquiries either to me (suklim@kasb.or.kr) or to Woung-hee Lee (leewh@kasb.or.kr), Technical Manager of KASB.

Yours sincerely,
Suk-Sig (Steve) Lim
Chair, Korea Accounting Standards Board

Cc: Sungsoo Kwon, Research Fellow of Research Department

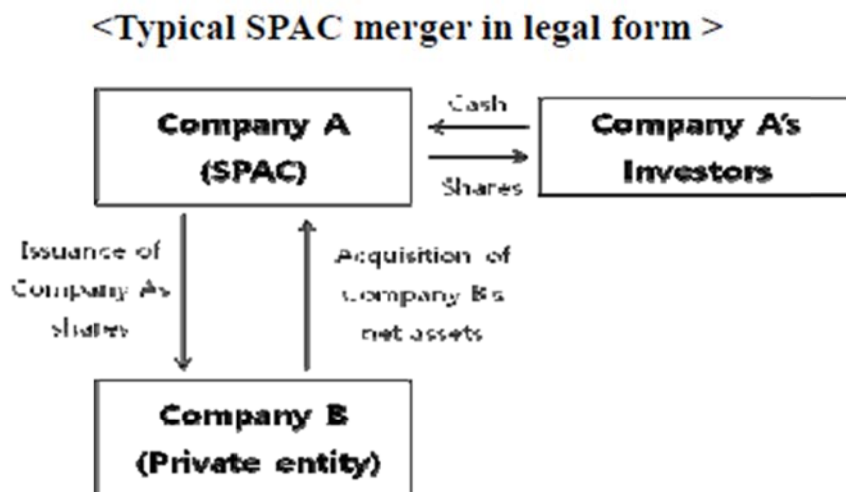
We are pleased to provide the IFRS Interpretations Committee with this technical inquiry about IFRSs regarding SPAC mergers. We finalized the technical inquiry through the due process established in the KASB.

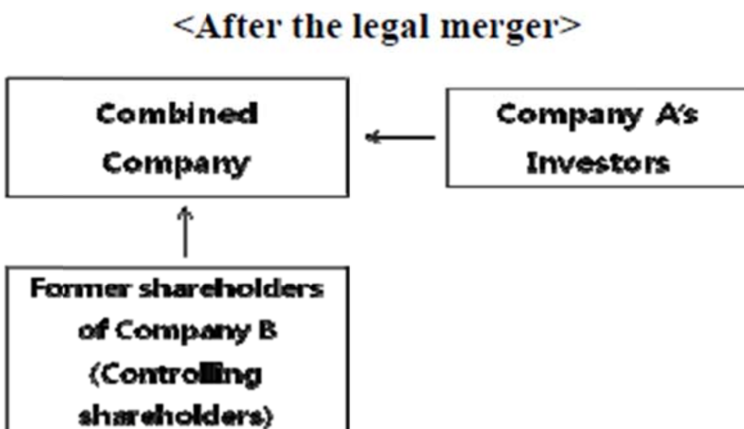
Background

1. SPAC stands for Special Purpose Acquisition Company which is a public shell company whose purpose of establishment is to go public through an IPO and legally merge with a private entity.

2. The structure of a SPAC merger in legal form is as shown in Diagram 1 below.

Diagram 1





3. With regard to the accounting treatment of a legal SPAC merger, the following issues are identified.

Issues

4. Company A is a SPAC and thus a public shell company, and Company B is a private entity.

> 4.1 Company A merges with Company B by issuing its shares to the shareholders of Company B. Any and all management of Company A (a SPAC is usually a one-person company) retires upon the merger and Company A fulfils its sole purpose of business stated in its articles of association upon the transaction.
>
> 4.2 After the legal merger, the shareholders of Company B own 90% of the combined company and the shareholders of Company A own 10%.

5. IFRSs do not explicitly provide the accounting treatment of this particular type of legal mergers.

> 5.1 In this case, the SPAC merger transaction is in substance a reverse acquisition due to the facts described in paragraphs 4.1 and 4.2. Consequently, Company B becomes the accounting acquirer. However, since Company A, the accounting acquiree, does not meet the definition of a business as defined in paragraph 3 of IFRS 3 'Business Combinations', IFRS 3 may not be applied to this transaction according to paragraph 2 of the same standard.
>
> 5.2 Although applying IFRS 2 'Share-based Payment' to the transaction may be considered since Company A issues shares in the legal form, IFRS 3 should be applied, not IFRS 2, because Company A acquires Company B (which meets the definition of a business) in return for the shares Company A issues. In such a case, however, one would have to go back to face the problem already described in paragraph 5.1 above (i.e., the transaction being a reverse acquisition and Company A, the accounting acquiree, not meeting the definition of a business).

6. This problem described in paragraph 5 above created a loop of going back and forth between the standards, and consequently resulted in diversity in practice regarding SPAC mergers.

Diversity in practice

7. After the legal merger, Company B is to account for the transaction. Consider an example where the shares of the combined company owned by the shareholders of Company A are worth $20mil at fair value and Company A's net assets are worth $15mil at fair value. There exist three different views relating to the accounting treatment of such a case.

<View 1: It is a share-based payment transaction - charge $5mil to expense (IFRS 2 – PWC, E&Y Manual)>

8. According to paragraph 2 of IFRS 3, IFRS 3 "does not apply to the acquisition of an asset or a group of assets that does not constitute a business." Company A, the accounting acquiree, is a public shell company (SPAC) whose sole purpose of

establishment is to acquire another company. Such SPAC's business will be terminated after the merger. Thus, Company A does not meet the definition of a business specified in paragraph 3 of IFRS 3.

9. Therefore, since IFRS 3 does not apply to the above transaction and there are no other IFRSs with clear requirements for such transactions, management shall develop and apply an accounting policy themselves in accordance with paragraphs 10 to 12 of IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'.

10. In this case of the transaction given above, it may be viewed that Company B (private entity) receives cash and services such as 'share listing' from Company A (SPAC) and in return issues its shares to the shareholders of the SPAC, i.e., Company A. This transaction could be interpreted as a share-based payment transaction and thus $5mil representing unidentified goods or services received may be recognized as expense in accordance with paragraph 8 and 13A of IFRS 2.

11. That is, View 1 perceives the economic substance of the transaction as a private entity receiving services and acquiring net assets from a SPAC to become listed and in return issuing shares as a consideration.

12. This view is based on the premise that IFRS 3 is not applied to this transaction because Company A does not meet the definition of a business as defined in IFRS 3. Even though reverse acquisition is a concept exclusively specified in IFRS 3, in this view where Company B (private entity) is perceived as the issuer of shares according to IFRS 2, only the reverse acquisition concept is selected from IFRS 3 by analogy and applied together with IFRS 2. This, however, lacks proper logic. (refer to paragraph 5.1 above)

13. Furthermore, according to the defined terms and paragraph 11 of IFRS 2, Company B shall measure the fair value of the shares at grant date. The date could be interpreted as approval date by meeting of shareholders when the merger arrangement is subject to an approval process by shareholders. In this case, the period of time between the date of merger arrangement and the date of approval would typically be four to five months in Korea. This could result in greater volatility in stock prices and a considerable amount of expenses recognized.

<View 2: It is an IPO for raising capital – reduction of $5mil to equity (US-GAAP, SEC Staff New Release 2001-FAQ)>

14. Although there is no clarified accounting standard for this type of SPAC transactions in the U.S., SEC Staff New Release 2001-FAQ interpreted that any excess of the fair value of the shares issued by the private entity over the fair value of the net assets of the public shell corporation shall be recognized as a reduction to equity.

15. SEC Staff New Release 2001-FAQ may be applied according to paragraph 12 of IAS 8, and thus $5mil, the difference between the fair value of Company B's shares ($20mil) and fair value of Company A's net assets ($15mil), may be charged to equity.

16. That is, View 2 perceives the economic substance of this transaction as Company B raising capital from investors (the shareholders of Company A)

using the merger transaction with a public shell company (SPAC). This is to view the transaction as one similar to a regular IPO performed by Company B to raise capital from investors.

<View 3: A SPAC meets the definition of a business - recognize $5mil as goodwill (IFRS 3)>

17. In the above transaction, Company A is a business listed for the purpose of acquiring another company, and thus it may be viewed as a public entity operating in accordance with its articles of association. Therefore, the SPAC merger transaction may be viewed as a reverse acquisition, fulfilling the requirements specified in paragraph B6(4) of IFRS 3. Thus, IFRS 3 may be applied to this transaction and $5mil, the difference between the fair value of Company B's shares ($20mil) and fair value of Company A's net assets ($15mil), may be recognized as goodwill.

Question

18. As described herein, there is no IFRS that can be clearly and specifically applied to a SPAC related legal merger transaction and there is diversity in practice regarding this issue such as the above three views.

Against the background, which of the three views provided herein do you see as the most appropriate accounting treatment for a SPAC related merger?

Suggestion for improvement

19. A SPAC is a useful mechanism to raise capital and go public, and SPAC merger transactions are, and will continue to be, common in the business world. However, the conflicting interpretations supported by Big 4 accounting firms and US-GAAP with respect to SPAC related mergers, i.e., charging any excess of the fair value of the shares issued by the private entity over the fair value of the net assets of the public shell company to 'expense' (Big 4 accounting firms) or to 'equity' (US-GAAP), are causing more confusion in practice.

20. Therefore, the IFRS Interpretations Committee should provide clear guidelines for SPAC related merger transactions to achieve successful convergence between the IASB and FASB and to resolve diversity in practice, thereby improving comparability among entities.

Supplement

21. In an effort to collect evidence of diversity in practice, the KASB requested members of the International Forum of Accounting Standard Setters (IFASS) to provide information on how they treat this particular type of SPAC merger transactions discussed in this paper in their own jurisdictions. The information provided by the members is as follows:

Country	Accounting treatment for SPAC mergers	Based on	Remarks
A	Accounting Policy Choice	IFRS	Recognizes diversity in practice.
B	Charge to expense (View 1)	IFRS	SPAC transactions are extremely rare due to legal and taxation related restrictions.
C	Charge to expense (View 1) or Recognize goodwill (View 3)	IFRS	View 3 (recognizing goodwill) could be possible but View 2 (charging to equity) is least likely to be supported.
D	Charge to expense (View 1) or Recognize goodwill (View 3)	IFRS	Auditors usually support View 1 but there were few cases where View 3 is applied.
E	Recognize goodwill (View 3)	IFRS	Premised on the assumption that the SPAC is an accounting acquirer.
F	Charge to expense (View 1)	Local GAAP	Local GAAP is almost identical to IFRS.
G	Recognize goodwill (View 3)	Local GAAP	Local GAAP is substantially different from IFRS.

Appendix

22. The KASB has submitted a suggestion for improvement regarding this issue of SPAC merger accounting to the IASB and is attached hereto as Appendix A for your reference. Furthermore, the related accounting standards discussed in this paper are attached as Appendix B for your reference.

Appendix A to the KASB's submission

29 May 2012

Hans Hoogervorst
Chair
International Accounting Standards Board
30 Cannon Street
London, EC4M 6XH

Re : KASB's suggestion for improvement of IFRSs relating to SPAC transactions

Dear Chair Hans Hoogervorst:

On behalf of the KASB, I am writing this letter to ask for clarification of IFRSs relating to special purpose acquisition company (SPAC) merger transactions.

I greatly appreciate the efforts of the IASB to reach out to diverse constituents around the globe and reflect their opinions in the IFRS standards. In this letter, I would like to draw your attention to issues relating to SPAC and propose that the IASB consider the issues in its discussion.

A SPAC is a useful mechanism to raise capital and go public, and SPAC merger transactions are, and will continue to be, common in the business world. However, the lack of clarity in IFRSs relating to such SPAC mergers resulted in diversity in practice.

Therefore, I would like to ask the IASB to provide clear standards for SPAC related merger transactions to achieve successful convergence between the IASB and FASB and to resolve diversity in practice, thereby improving comparability among entities.

I appreciate your consideration in advance, and it would be my pleasure to further discuss any aspects of this letter.

Please do not hesitate to contact me if you have any inquiries regarding my suggestion. You may direct your inquiries either to me (suklim@kasb.or.kr) or to Woung-hee Lee (leewh@kasb.or.kr), Technical Manager of KASB.

Yours sincerely,
Suk-Sig (Steve) Lim
Chair, Korea Accounting Standards Board

Cc: Sungsoo Kwon, Research Fellow of Research Department

We are pleased to provide the IASB with this suggestion for improvement of IFRSs regarding SPAC mergers. We finalized the suggestion through the due process established in the KASB.

Issue

1. SPAC stands for Special Purpose Acquisition Company (represented as “Company A” hereinafter) which is a public shell company whose purpose of establishment is to go public through an IPO and legally merge with a private entity (represented as “Company B” hereinafter).

2. Company A (SPAC) merges with Company B (private entity) by issuing its shares to the shareholders of Company B. Company A’s sole business operation of finding and merging with a private entity is terminated after the merger.

3. However, there is no IFRS that can be clearly and specifically applied to a SPAC related merger transaction such as the above example.

Diversity in practice

4. The lack of clarity in IFRS relating to such SPAC mergers resulted in diversity in practice. The following are three different views about the accounting treatment of SPAC mergers.

<View 1: Share-based payment (IFRS 2 – PWC, E&Y Manual)>

5. According to paragraph 2 of IFRS 3 ‘Business Combinations’, IFRS 3 “does not apply to the acquisition of an asset or a group of assets that does not constitute a business.” Company A, the accounting acquiree, is a public shell company (SPAC) whose sole purpose of establishment is to acquire another company, the accounting acquirer. Such SPAC’s business will be terminated after the merger. Thus, Company A does not meet the definition of a business specified in paragraph 3 of IFRS 3.

6. Therefore, since IFRS 3 does not apply to the above transaction and there are no other IFRSs with clear requirements for such transactions, management shall develop and apply an accounting policy themselves in accordance with paragraphs 10 to 12 of IAS 8 ‘Accounting Policies, Changes in Accounting Estimates and Errors’.

7. In this case of the transaction given above, it may be viewed that Company B (private entity) receives cash and services such as ‘share listing’ from Company A (SPAC) and in return issues its shares to the shareholders of the SPAC, i.e., Company A. This transaction could be interpreted as a share-based payment transaction and thus IFRS 2 ‘Share-based Payment’ is applied.

8. That is, View 1 perceives the economic substance of the transaction as a private entity receiving services and acquiring net assets from a SPAC to become listed and in return issuing shares as a consideration.

9. This view is based on the premise that IFRS 3 is not applied to this transaction because Company A does not meet the definition of a business as defined in IFRS 3. Even though reverse acquisition is a concept exclusively specified in

IFRS 3, in this view where Company B (private entity) is perceived as the issuer of shares according to IFRS 2, only the reverse acquisition concept is selected from IFRS 3 by analogy and applied together with IFRS 2. This, however, lacks proper logic.

10. Furthermore, according to the defined terms and paragraph 11 of IFRS 2, Company B shall measure the fair value of the shares at grant date. The date could be interpreted as approval date by meeting of shareholders when the merger arrangement is subject to an approval process by shareholders. In this case, the period of time between the date of merger arrangement and the date of approval would typically be four to five months in Korea. This could result in greater volatility in stock prices and a considerable amount of expenses recognized.

<View 2: Raising capital through an IPO (US-GAAP, SEC Staff New Release 2001-FAQ)>

11. Although there is no clarified accounting standard for this type of SPAC transactions in the U.S., SEC Staff New Release 2001-FAQ interpreted that any excess of the fair value of the shares issued by the private entity over the fair value of the net assets of the public shell corporation shall be recognized as a reduction to equity.

12. SEC Staff New Release 2001-FAQ may be applied according to paragraph 12 of IAS 8, and thus the difference between the fair value of Company B's shares and fair value of Company A's net assets may be charged to equity.

13. That is, View 2 perceives the economic substance of this transaction as Company B raising capital from investors (the shareholders of Company A) using the merger transaction with a public shell company (SPAC). This is to view the transaction as one similar to a regular IPO performed by Company B to raise capital from investors.

<View 3: Business combination (IFRS 3)>

14. In the above transaction, Company A is a business listed for the purpose of acquiring another company, and thus it may be viewed as a public entity operating in accordance with its articles of association. Therefore, the SPAC merger transaction may be viewed as a reverse acquisition, fulfilling the requirements specified in paragraph B6(4) of IFRS 3. Thus, IFRS 3 may be applied to this transaction and the difference between the fair value of Company B's shares and fair value of Company A's net assets may be recognized as goodwill.

Suggestion for improvement

15. A SPAC is a useful mechanism to raise capital and go public, and SPAC merger transactions are, and will continue to be, common in the business world. However, the conflicting interpretations supported by Big 4 accounting firms and US-GAAP with respect to SPAC related mergers, i.e., charging any excess of the fair value of the shares issued by the private entity over the fair value of the net assets of the public shell company to 'expense' (Big 4 accounting firms) or to 'equity' (US-GAAP), are causing more confusion in practice.

16. Therefore, the IASB should provide standards for SPAC related merger transactions to achieve successful convergence between the IASB and FASB and to resolve diversity in practice, thereby improving comparability among entities.

Supplement

17. In an effort to collect evidence of diversity in practice, the KASB requested members of the International Forum of Accounting Standard Setters (IFASS) to provide information on how they treat this particular type of SPAC merger transactions discussed in this paper in their own jurisdictions. The information provided by the members is as follows:

Country	Accounting treatment for SPAC mergers	Based on	Remarks
A	Accounting Policy Choice	IFRS	Recognizes diversity in practice.
B	Charge to expense (View 1)	IFRS	SPAC transactions are extremely rare due to legal and taxation related restrictions.
C	Charge to expense (View 1) or Recognize goodwill (View 3)	IFRS	View 3 (recognizing goodwill) could be possible but View 2 (charging to equity) is least likely to be supported.
D	Charge to expense (View 1) or Recognize goodwill (View 3)	IFRS	Auditors usually support View 1 but there were few cases where View 3 is applied.
E	Recognize goodwill (View 3)	IFRS	Premised on the assumption that the SPAC is an accounting acquirer.
F	Charge to expense (View 1)	Local GAAP	Local GAAP is almost identical to IFRS.
G	Recognize goodwill (View 3)	Local GAAP	Local GAAP is substantially different from IFRS.

Appendix

18. The KASB has also submitted a technical inquiry about this issue of SPAC merger accounting to the IFRS Interpretations Committee. The inquiry submitted to the IC contains backgrounds and description of the issue in more detail and is attached hereto as Appendix A for your reference. Furthermore, the related accounting standards discussed in this paper are attached as Appendix B for your reference.

Appendix B to the KASB's submission: Related accounting standards

[IFRS 2]

8 When the goods or services received or acquired in a share-based payment transaction do not qualify for recognition as assets, they shall be recognised as expenses.

13A In particular, if the identifiable consideration received (if any) by the entity appears to be less than the fair value of the equity instruments granted or liability incurred, typically this situation indicates that other consideration (ie unidentifiable goods or services) has been (or will be) received by the entity. The entity shall measure the identifiable goods or services received in accordance with this IFRS. The entity shall measure the unidentifiable goods or services received (or to be received) as the difference between the fair value of the share-based payment and the fair value of any identifiable goods or services received (or to be received). The entity shall measure the unidentifiable goods or services received at the grant date. However, for cash-settled transactions, the liability shall be remeasured at the end of each reporting period until it is settled in accordance with paragraphs 30–33.

[IFRS 3]

SCOPE

2 This IFRS applies to a transaction or other event that meets the definition of a business combination. This IFRS does not apply to:
(a) the formation of a joint venture.
(b) the acquisition of an asset or a group of assets that does not constitute a business. In such cases the acquirer shall identify and recognise the individual identifiable assets acquired (including those assets that meet the definition of, and recognition criteria for, intangible assets in IAS 38 Intangible Assets) and liabilities assumed. The cost of the group shall be allocated to the individual identifiable assets and liabilities on the basis of their relative fair values at the date of purchase. Such a transaction or event does not give rise to goodwill.
(c) a combination of entities or businesses under common

Identifying a business combination

3 An entity shall determine whether a transaction or other event is a business combination by applying the definition in this IFRS, which requires that the assets acquired and liabilities assumed constitute a business. If the assets acquired are not a business, the reporting entity shall account for the transaction or other event as an asset acquisition. Paragraphs B5–B12 provide guidance on identifying a business combination and the definition of a business.

The acquisition method

4 An entity shall account for each business combination by applying the acquisition method.

Identifying the acquirer

6 For each business combination, one of the combining entities shall be identified as the acquirer.

7 The guidance in IAS 27 Consolidated and Separate Financial Statements shall be used to identify the acquirer—.the entity that obtains control of the acquiree. If a business combination has occurred but applying the guidance in IAS 27 does not clearly indicate which of the combining entities is the acquirer, the factors in paragraphs B14–.B18 shall be considered in making that determination.
Identifying a business combination (application of paragraph 3)

B5 This IFRS defines a business combination as a transaction or other event in which an acquirer obtains control of one or more businesses. An acquirer might obtain control of an acquiree in a variety of ways, for example:
(a) by transferring cash, cash equivalents or other assets (including net assets that constitute a business);
(b) by incurring liabilities;
(c) by issuing equity interests;
(d) by providing more than one type of consideration; or
(e) without transferring consideration, including by contract alone (see paragraph 43).

B6 A business combination may be structured in a variety of ways for legal, taxation or other reasons, which include but are not limited to:
(a) one or more businesses become subsidiaries of an acquirer or the net assets of one or more businesses are legally merged into the acquirer;
(b) one combining entity transfers its net assets, or its owners transfer their equity interests, to another combining entity or its owners;
(c) all of the combining entities transfer their net assets, or the owners of those entities transfer their equity interests, to a newly formed entity (sometimes referred to as a roll-up or put-together transaction); or
(d) a group of former owners of one of the combining entities obtains control of the combined entity.

Definition of a business (application of paragraph 3)

B7 A business consists of inputs and processes applied to those inputs that have the ability to create outputs. Although businesses usually have outputs, outputs are not required for an integrated set to qualify as a business. The three elements of a business are defined as follows:
(a) Input: Any economic resource that creates, or has the ability to create, outputs when one or more processes are applied to it. Examples include non-current assets (including intangible assets or rights to use non-current assets), intellectual property, the ability to obtain access to necessary materials or rights and employees.
(b) Process: Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates or has the ability to create outputs. Examples include strategic management processes, operational processes and resource management processes. These processes typically are documented, but an organised workforce having the necessary skills and experience following rules and conventions may provide the necessary processes that are capable of being applied to inputs to create outputs. (Accounting, billing, payroll and other administrative systems typically are not processes used to create outputs.)
(c) Output: The result of inputs and processes applied to those inputs that provide or have the ability to provide a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.

B8 To be capable of being conducted and managed for the purposes defined, an

integrated set of activities and assets requires two essential elements—.inputs and processes applied to those inputs, which together are or will be used to create outputs. However, a business need not include all of the inputs or processes that the seller used in operating that business if market participants are capable of acquiring the business and continuing to produce outputs, for example, by integrating the business with their own inputs and processes.

B11 Determining whether a particular set of assets and activities is a business should be based on whether the integrated set is capable of being conducted and managed as a business by a market participant. Thus, in evaluating whether a particular set is a business, it is not relevant whether a seller operated the set as a business or whether the acquirer intends to operate the set as a business.

Identifying the acquirer (application of paragraphs 6 and 7)

B13 The guidance in IAS 27 Consolidated and Separate Financial Statements shall be used to identify the acquirer—he entity that obtains control of the acquiree. If a business combination has occurred but applying the guidance in IAS 27 does not clearly indicate which of the combining entities is the acquirer, the factors in paragraphs B14–18 shall be considered in making that determination.

B14 In a business combination effected primarily by transferring cash or other assets or by incurring liabilities, the acquirer is usually the entity that transfers the cash or other assets or incurs the liabilities.

B15 In a business combination effected primarily by exchanging equity interests, the acquirer is usually the entity that issues its equity interests. However, in some business combinations, commonly called ‘reverse acquisitions’, the issuing entity is the acquiree. Paragraphs B19–27 provide guidance on accounting for reverse acquisitions. Other pertinent facts and circumstances shall also be considered in identifying the acquirer in a business combination effected by exchanging equity interests, including:

(a) the relative voting rights in the combined entity after the business combination—The acquirer is usually the combining entity whose owners as a group retain or IFRS 3 receive the largest portion of the voting rights in the combined entity. In determining which group of owners retains or receives the largest portion of the voting rights, an entity shall consider the existence of any unusual or special voting arrangements and options, warrants or convertible securities.
(b) the existence of a large minority voting interest in the combined entity if no other owner or organised group of owners has a significant voting interest—he acquirer is usually the combining entity whose single owner or organised group of owners holds the largest minority voting interest in the combined entity.
(c) the composition of the governing body of the combined entity—he acquirer is usually the combining entity whose owners have the ability to elect or appoint or to remove a majority of the members of the governing body of the combined entity.
(d) the composition of the senior management of the combined entity—he acquirer is usually the combining entity whose (former) management dominates the management of the combined entity.
(e) the terms of the exchange of equity interests—he acquirer is usually the combining entity that pays a premium over the pre-combination fair value of the equity interests of the other combining entity or entities.

B16 The acquirer is usually the combining entity whose relative size (measured in,

for example, assets, revenues or profit) is significantly greater than that of the other combining entity or entities.

B17 In a business combination involving more than two entities, determining the acquirer shall include a consideration of, among other things, which of the combining entities initiated the combination, as well as the relative size of the combining entities.

B18 A new entity formed to effect a business combination is not necessarily the acquirer. If a new entity is formed to issue equity interests to effect a business combination, one of the combining entities that existed before the business combination shall be identified as the acquirer by applying the guidance in paragraphs B13–17. In contrast, a new entity that transfers cash or other assets or incurs liabilities as consideration may be the acquirer.

Reverse acquisitions

B19 A reverse acquisition occurs when the entity that issues securities (the legal acquirer) is identified as the acquiree for accounting purposes on the basis of the guidance in paragraphs B13–18. The entity whose equity interests are acquired (the legal acquiree) must be the acquirer for accounting purposes for the transaction to be considered a reverse acquisition. For example, reverse acquisitions sometimes occur when a private operating entity wants to become a public entity but does not want to register its equity shares. To accomplish that, the private entity will arrange for a public entity to acquire its equity interests in exchange for the equity interests of the public entity. In this example, the public entity is the legal acquirer because it issued its equity interests, and the private IFRS 3 entity is the legal acquiree because its equity interests were acquired. However, application of the guidance in paragraphs B13–18 results in identifying:

(a) the public entity as the acquiree for accounting purposes (the accounting acquiree); and
(b) the private entity as the acquirer for accounting purposes (the accounting acquirer).

The accounting acquiree must meet the definition of a business for the transaction to be accounted for as a reverse acquisition, and all of the recognition and measurement principles in this IFRS, including the requirement to recognise goodwill, apply.

Measuring the consideration transferred

B20 In a reverse acquisition, the accounting acquirer usually issues no consideration for the acquiree. Instead, the accounting acquiree usually issues its equity shares to the owners of the accounting acquirer. Accordingly, the acquisition-date fair value of the consideration transferred by the accounting acquirer for its interest in the accounting acquiree is based on the number of equity interests the legal subsidiary would have had to issue to give the owners of the legal parent the same percentage equity interest in the combined entity that results from the reverse acquisition. The fair value of the number of equity interests calculated in that way can be used as the fair value of consideration transferred in exchange for the acquiree.

[PwC A Global Guide to Accounting for Business Combinations and Non Controlling Interests]

2.10.1 Reverse Merger Involving a Nonoperating Public Shell and a Private Operating Entity

The merger of a private operating entity into a nonoperating public shell corporation with nominal net assets typically results in (i) the owners of the private entity gaining control over the combined entity after the transaction, and (ii) the shareholders of the former public shell corporation continuing only as passive investors. This transaction is usually not considered a business combination, because the accounting acquiree, the nonoperating public shell corporation, does not meet the definition of a business under the Standards. Instead, these types of transactions are considered to be capital transactions of the legal acquiree and are the equivalent to the issuance of shares by the private entity for the net monetary assets of the public shell corporation, accompanied by a recapitalisation.

Under U.S. GAAP, any excess of the fair value of the shares issued by the private entity over the value of the net monetary assets of the public shell corporation is recognised as a reduction to equity.

Under IFRS, such transactions fall within the scope of IFRS 2 and any excess of the fair value of the shares issued by the private entity over the value of the net monetary assets of the public shell corporation is recognised in profit or loss [IFRIC 8; IFRS 2].

[PwC Manual of Accounting IFRS 2011]

12.30 IFRS 3 states that if the accounting acquiree is not a business then it is not in the scope of IFRS 3. In some circumstances, for example for a reverse acquisition, it is not always clear whether a business has been acquired and, therefore, the substance of the arrangement should be considered. This is illustrated in the following example.

Example – Reverse acquisition into a shell company

Entity V, a listed entity that does not constitute a business at the time of the transaction, issues shares in exchange for shares in entity W. Although entity V becomes entity W's legal parent, the transaction is not a business combination under IFRS 3, because entity V is not a business and has not gained control over entity W in substance.

IFRS 2 scopes out transactions in which an entity acquires goods as part of the net assets acquired in a business combination as defined in IFRS 3.

We believe that the transaction is within IFRS 2's scope because the substance is that shareholders of private entity W have given shareholders of public entity V an interest in entity W in exchange for any assets sitting within entity V and entity V's listing. Accordingly, entity W should fair value the consideration that entity V's shareholders receive (the shares given out by entity W's shareholders) and the identifiable assets of entity V that entity W's shareholders acquired. Any resulting difference would be unidentifiable goods or services which should be expensed (unless it meets the definition of an asset under other standards). Appropriate disclosure to explain the accounting policy is necessary. See further chapter 25 for a more detailed example.

[EY International GAAP 2011]

3.2.5 Application of the definition of a business
In determining whether acquired assets and activities are a business, we believe the acquirer should first identify the elements acquired; that is, the inputs, processes and outputs. If outputs are not included in the acquired set, an assessment must be made as to whether the acquired activities and assets include inputs and processes that are capable of producing some form of return to its investors, owners, members or participants (the 'owners'). If some inputs and processes are omitted from the acquired activities and assets such that the acquired set is not capable of providing some form of return to its owners, the acquirer must assess whether the missing inputs and processes would preclude a market participant from operating the acquired activities to earn a return. If a market participant that, in many cases, would be a competitor of the acquirer, were to have the missing inputs or processes, or could easily replace or replicate the missing inputs and processes (i.e. the missing elements are minor), the acquired set is likely a business. However, if the acquired set has no processes (e.g. only assets, and no activities, were acquired), the acquired set in most cases would not constitute a business. All of the specific facts and circumstances must be considered in applying this highly subjective judgment.

The application of the above guidance to certain transactions in the extractive industries is illustrated in the following examples.

Example 9.3: Extractive industries – definition of a business (1)

E&P Co A (an oil and gas exploration and production company) acquires a mineral interest from E&P Co B, on which it intends to perform exploration activities to determine if reserves exist. The mineral interest is an unproven property and there have been no exploration activities performed on the property.

Inputs – mineral interest
Processes – none
Output – none
Conclusion

In this scenario, we do not believe E&P Co. A acquired a business. While E&P Co A acquired an input (mineral interest), it did not acquire any processes. Whether or not a market participant has the necessary processes in place to operate the input as a business is not relevant to the determination of whether the acquired set is a business because no processes were acquired from E&P Co B.

[SEC Staff New Release 2001 – FAQ]

F. Reverse Acquisitions -- Accounting Issues

APB No. 16, paragraph 70 states that "presumptive evidence of the acquiring corporation in combinations effected by an exchange of stock is obtained by identifying the former common stockholder interests of a combining company which either retain or receive the larger portion of the voting rights in the combined corporation. That corporation should be treated as the acquirer unless other evidence clearly indicates that another corporation is the acquirer..." SAB Topic 2A affirms the above principle and discusses some of the factors which may rebut the normal presumption.

In December 1989, the Emerging Issues Committee of the Canadian Institute of Chartered Accountants reached a consensus concerning Reverse Takeover Accounting, which is compatible with the guidance included in Topic 2A. The EIC consensus indicates that the post reverse-acquisition comparative historical financial statements furnished for the "legal acquirer" should be those of the "legal acquiree" (i.e., the "accounting acquirer"), with appropriate footnote disclosure concerning the change in the capital structure effected at the acquisition date. Ordinarily, the guidance of APB 16 is applied in the allocation of the purchase price to all of the assets and liabilities of the accounting acquiree. (The staff believes the "partial stepup" methodology of EITF 90-13 applies only in the particular facts and circumstances specified in that consensus.)

The merger of a private operating company into a non-operating public shell corporation with nominal net assets typically results in the owners and management of the private company having actual or effective operating control of the combined company after the transaction, with shareholders of the former public shell continuing only as passive investors. These transactions are considered by the staff to be capital transactions in substance, rather than business combinations. That is, the transaction is equivalent to the issuance of stock by the private company for the net monetary assets of the shell corporation, accompanied by a recapitalization. The accounting is identical to that resulting from a reverse acquisition, except that no goodwill or other intangible should be recorded.

Transaction costs (e.g., legal and investment banking fees, stock issuance fees, etc.) may be incurred in a reverse acquisition. In the merger of two operating companies, those costs will be, depending on their nature, either part of the purchase consideration that is allocated to the net assets of the acquired business, charged directly to equity as a reduction from the fair value assigned to shares issued, or expenses of the period. In contrast, an operating company's reverse acquisition with a nonoperating company having some cash has been viewed by the staff as the issuance of equity by the accounting acquirer for the cash of the shell company.

Accordingly, we believe transaction costs may be charged directly to equity only to the extent of the cash received, while all costs in excess of cash received should be charged to expense.

Appendix C – Consolidated and Separate financial statements and Distribution of Non-cash Assets to Owners: Purchase of Transactions with NCI when the consideration includes non-cash items

IFRIC POTENTIAL AGENDA ITEM REQUEST

The issue:

How should an entity account for the purchase of non-controlling interest when the consideration includes non-cash items?

Background

Two shareholders established an entity some years ago. Shareholder X has 51 percent and control whilst shareholder Y has 49 percent.

This year X will buy all the shares from Y. The book value of the non-controlling interest is CU 25 million.

In consideration for the 49% X is required to pay 30 million cash and to transfer some property, plant and equipment items to Y.

The book value of the property, plant and equipment is CU 10 million. The fair value of the property, plant and equipment is CU 20 million.

Literature and technical support

It is clear that the transaction should be recorded in equity as a transaction between shareholders (IAS 27.30). Any difference between the fair value of the consideration given and the book value of the non-controlling interest is attributed to the parent equity (IAS 27.31).

Considering the guidance in IAS 27, the total fair value of the consideration is CU 50 million. The book value of the non-controlling interest is CU 25 million with a resulting impact in equity of CU 25 million.

However, the book value of the assets transferred is CU 40 million (property, plant and equipment CU 10 million and cash CU 30 million). Does that mean that there should be an income statement impact?

Views

There are two potential scenarios for the accounting entries:

Scenario A– no income statement impact

Debits
Non controlling interest CU 25 million
Shareholders’ equity CU 25 million

Credits
Cash CU 30 million

Property, plant and equipment CU 10 million
Shareholders' equity CU 10 million (to balance and avoid income statement impact)

Scenario B - with income statement impact

Debits
Non controlling interest CU 25 million
Shareholders' equity CU 25 million

Credits
Cash CU 30 million
Property, plant and equipment CU 10 million
Income statement gain CU 10 million

We consider that scenario A is supported by IAS 27 although it effectively presents a net position.
Scenario B could be supported by analogy to IFRIC 17 and represents a gross position.
We believe that the guidance on exchange of assets in IAS 16 cannot be applied as own shares cannot be an asset.

Current practice:

We currently see both positions presented and so there is diversity in practice.

Reasons for the IFRIC to address the issue:

(a) Is the issue widespread and practical?

We have seen this issue arise in several transactions in Central America and in Asia.

(b) Does the issue involve significantly divergent interpretations (either emerging or already existing in practice)?

Yes, we see both transactions showing an income statement impact and transactions which do not.

c) Would financial reporting be improved through elimination of the diversity?

In our opinion, financial reporting would be improved by eliminating diversity in practice.

(d) Is the issue sufficiently narrow in scope to be capable of interpretation within the confines of IFRSs and the *Framework for the Preparation and Presentation of Financial Statements*, but not so narrow that it is inefficient to apply the interpretation process?

We believe that the issue is sufficiently narrow in scope for an interpretation as it addresses an apparent conflict in the literature. When non-cash assets are distributed to shareholders in a transaction which is within the scope of IFRIC 17 the accounting treatment is clear and an income statement impact will often occur. However if a transaction amongst shareholders occurs under IAS 27, then an income statement impact is prohibited.

(e) 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?
We are not aware that this issue relates to either a current or a planned IASB project.