Ladies and Gentlemen,

Please find below my comments on the above mentioned exposure draft. The first part contains answers to the specific questions to ED IAS 27, the second part contain comments on other issues of ED IAS 27 and the last part are comments on specific issues of ED IFRS 3.

Regards,

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Comments on ED to IAS 27 as proposed in June 2005:

Question 1 – No gain or loss is recognised on changes in the parent’s interest after control is obtained.

I agree. If the group is considered as one entity, transactions between parent and non controlling interest are equity transactions.

However, this concept is only consistent with the Full-Goodwill-Method as proposed in ED to IFRS 3. If a parent acquires additional shares from the non-controlling interest holders of a subsidiary, where IFRS 3 (2004) or IAS 22 have been applied to the original acquisition, the question arises if there should be any additional goodwill recorded for the additional acquired interest.

This matter is not addressed in the exposure draft. If the Board believes that the new rules (no recognition of gain or loss) should be applied irrespective of how the original acquisition has been accounted for, this should be stated in the standard or at least in the basis for conclusions.

Question 2 – Fair Value Measurement after loss on control

In praxis, there might be problems in cases the fair value cannot be derived from a transaction price. Assume that the parent owns 40% of the voting rights and has control due to potential voting rights from stock options. If the parent loses control because the stock options expire, there is no transaction at all, but the business (now accounted for under IAS 28) will be remeasured at fair value.

However, the proposed changes in ED to IFRS 3 imply that the fair value of a complete business can be measured reliably without an underlying transaction.

Question 3 – Multiple Arrangements that result in loss of control

The rules in Paragraph 30.F are rather complicated and might lead to different interpretations in practice. As noted in the BC, companies might try to structure transactions to achieve a particular accounting treatment.

In my opinion, an easier and better solution would be a recycling of all transactions between parent and non-controlling interest, which have been previously recorded in equity, after the loss of control.

The gain or loss which would be recorded upon loss of control would then reflect all payments from and to the parent during the period of time when the parent had control. This treatment seems to be appropriate: as long as the business is treated as subsidiary, any payment from the non-controlling interest holders to the company is like an payment of equity holders. But when the subsidiary is disposed off, the non controlling interest holders are not part of the group any more, the gain or loss of the disposal for the parent should also reflect payments from or to the non-controlling interest holders in the past.
With such a treatment, the gain or loss of the disposal cannot be influenced by splitting the disposal into several transactions.

Furthermore, readers of financial statements are already used to the concept of recycling in case of loss of control, because it is used for the FX-differences recognised in equity too.

Therefore I suggest to amend Par 30E of the ED with "(d) changes in the parent's ownership interest recognised directly in equity in accordance with Par 30A." and on the other hand delete Par 30F.

**Question 4 - Allocation of losses to Non controlling Interest Holders**

I do not agree. Non controlling Interest holders provide equity and bear a part of the business risk. However, if

- the group plans to continue the business of the subsidiary in a situation with negative equity (for example, because there is additional value for the other parts of the group)
- future gains are not expected and
- non-controlling interest holders have no obligation to cover the losses

an allocation of losses to the non-controlling interest would not show who finally bears the losses, i.e. the parent interest holders.

Therefore, I believe that in case of a negative equity in a subsidiary, judgement is needed if the losses will be covered by future gains or not. If no future gains are expected and the non-controlling have no obligation to cover the losses, these losses should be allocated to the parent's interest.

The advantage of the allocation of the total loss to the parent's interest is evident if the parent has already covered the loss by a loan to the subsidiary. Assume an 80% subsidiary has suffered a loss and shows a negative equity of 100. The parent has granted a loan of 100 to the subsidiary. In case that a repayment of the loan is not probable, the total loss will be borne by the parent and should therefore be allocated to the parent's interest.

On the other hand, if the non-controlling interest holders had an obligation to cover 100% losses and the parent has no obligation, 100% of the losses should be allocated to the non-controlling interest.
Other Subjects of ED to IFRS 27

Par 30B – non-controlling interest in the subsidiary’s net assets

Par 27.30B states that the non-controlling interest in the subsidiary’s net assets compromises (a) the proportionate interest in the subsidiary’s net identifiable assets based on the non-controlling ownership interest in the subsidiary and (b)...

In some companies, the holders of the non-controlling interest are entitled a smaller or larger portion of the net assets than their proportionate interest, for example because of minimum share in profit of the non-controlling interest holders or minimum share in profit of the parent.

Therefore, Par 30B (a) should be amended to clarify that such contractual arrangements should be considered in the amount of the non-controlling interest.

Par 30B – intercompany profits

Par 27.30B states that the non-controlling interest in the subsidiary’s net assets compromises (a) the proportionate interest in the subsidiary’s net identifiable assets based on the non-controlling ownership interest in the subsidiary and (b)...

IAS 27.25 states that profits and losses resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full.

The ED does not explain whether the non-controlling interest in the subsidiary’s net assets should be computed based on the assets as recognised in the subsidiary or based on the assets after elimination of intragroup-profits.

According to IAS 27.34, profit or loss is attributed to the parent shareholders and minority interests. In the same way, the rule does not state if profit or loss of a subsidiary should be allocated before or after elimination of intragroup-profit.

Assume a 60% subsidiary A sells stock with cost of 100 for 120 to a 80% subsidiary B; there are no other transactions in the group and no other assets besides of the stock. Should the non-controlling interest in the balance sheet be shown at 20 or 24? Should the profit of subsidiary A allocated to the non-controlling interest be nil or 8 (40% x 20)? Should the result allocated to the non-controlling interest of subsidiary B be nil or a loss of 4?

As the group should be treated as a single entity, it would make sense to show the non-controlling interest in the balance sheet as well as in the income statement based on values after intragroup eliminations, i.e. 20 in the balance sheet for B, nil in the income statement for A and nil in the income statement for B. The problem of this method is that the amounts attributed to the non-controlling interest in the balance sheet and the income statement would not reconcile.

In my opinion, the Standard should address these issues.
Par 30B - transition

Par 27.30B states that the non-controlling interest in the subsidiary’s net assets compromises (a) the proportionate interest in the subsidiary’s net identifiable assets based on the non-controlling ownership interest in the subsidiary and (b)...

This rule is not consistent with the benchmark treatment in Par 32 of IAS 22 (1999).

Assume the parent acquired 80% of a subsidiary owning a piece of land with a book value of 100 and a fair value of 1,000. Under IAS 22.32 the piece of land was recognised with the value of 820 in the consolidated statements of the parent. (80% x 1,000 + 20% x 100). Accordingly, the minority interest was recognised with the value of 20.

If the piece of land is still owned by the subsidiary when the proposed IAS 27 becomes effective, there are three solutions to apply the proposed Par 30B:

1) Revalue the book value of the land to the former fair value of 1,000 and accordingly show a non-controlling interest of 200.

2) Let the book value of the land unchanged at 820 and recalculate the non-controlling interest as described in Par 30B: 820 x 20% = 164, with retrospective change of the non-controlling interest.


The wording of the ED suggests solution 2), but this is not completely clear. In my opinion, solution 3 should be preferred; the transitional provisions should address this issue.

Par 30B - reassignment of goodwill based on the relative carrying amounts

The rule to reassign goodwill based on the relative carrying amounts of goodwill allocated to each group of equity holders on the date control was obtained is not clear.

In Example 4 of the illustrative examples, the amount originally attributed to the non-controlling interest is taken as basis for the reassignment:

\[ 15 \text{ (original attributed goodwill)} \times 15\% / 10\% = 22.5 \]

This calculation results in a shift of 7.5 to the non-controlling interest.

The rule in Par 30B could be understood as well in a way that the amount originally attributed to the parent is taken as basis for the reassignment:

\[ 285 \text{ (original attributed goodwill)} \times 85\% / 90\% = 269.17 \]

This calculation results in a shift of 15.83 to the non-controlling interest.

Another (much simpler) interpretation would be to multiply the total amount of goodwill with percentage of interest that is shifted between the equity holders. The reassignment of goodwill in Example 4 would be simply 300 (total goodwill) x 5% (shift of interest) = 15.
If the rule of Par 30B is interpreted as in the Example 4 of the ED, there would be unsatisfactory results: assume that a parent acquires 100% of a subsidiary, so 100% of goodwill would be attributed to the parent. If a part of the subsidiary, eg 40% is sold later so that a non-controlling interest arises, no goodwill at all would be attributed to the non-controlling interest because nil multiplied with 40% is still nil.

In case the parent had acquired only 60% of the subsidiary in the original acquisition, a part of the goodwill would have been attributed to the non-controlling interest. In my opinion, there is no justification for a different accounting treatment in these two situations.

Therefore, the reassignment rule of Par 30B should be reconsidered or at least expressed more clearly.

The same problem as described above arises in case the original acquisition was treated under IAS 27 (1999) or IFRS 3 (2004): in these cases the total goodwill was attributed to the parent, because recognition of goodwill for the minority interest was not allowed. If Par 30B is interpreted as in Example 4 of the ED, the goodwill attributed to the non-controlling interest will always remain nil. Maybe transitional provisions are needed for the reassignment rule to find different solutions for these cases.

**Illustrative Example 1**

The fact pattern of the illustrative example 1 to the ED is not complete, because there is no information about any goodwill and its allocation to the parent’s share and the non-controlling interest. If there were a goodwill, Par 30B of the ED had to be taken into account.

Therefore, an explanation should be added that no goodwill was recognised at the original acquisition.

**Appendix A2 – Statement of changes in Equity**

The ED proposes to change the illustrative statement of changes in equity in IAS 1. In the new version the components of equity (share capital, reserves, retained earnings) are added up to a total figure, which is then attributed to the parent and the non-controlling interest.

In my opinion, this presentation is not useful because the reserves and retained earnings in the balance sheet (which do not include any share of non-controlling interest) would not match to the reserves and retained earnings in the statement of changes in equity (which would include a share of non-controlling interest).

Therefore, the illustrative examples in IAS 1 should remain unchanged besides of that the term “minority interest” should be replaced by the term “non-controlling interest”.
Comments on ED to IFRS 3 as proposed in June 2005:

Par 19 – Measuring the fair value of the acquiree, as a whole, as of the acquisition date

This rule leads to the recognition of self-generated goodwill in certain circumstances. In the case a company floats a new business together with partners and holds an interest of 30% it will use the equity-method to account for this 30% interest. Assume that in addition to the 30% interest, the company has an option to acquire another 30% for a fixed price in 10 years. When the option becomes exercisable after 10 years, there is an acquisition due to the change of control (even if the option is not exercised).

As a consequence, the goodwill generated in the first 10 years of the entity is recognised, although it cannot be derived from a transaction of unrelated willing parties, but by valuation techniques only. After the option expires, the 30% interest, the equity method will be used again, but the internally generated goodwill will be part of the equity-value. If there is no balance sheet date or interim reporting date during the period the option can be exercised, the only effect shown in the financial statements will be an increase of the interest in the associate and a gain.

Similar examples can be made for fully consolidated subsidiaries; options to buy or sell shares which are exercisable for a short period of time could be used to recognise internally generated goodwill.

Therefore, I do not believe that the fair value at the acquisition date is a good measured value for accounting, if it cannot be derived from an exchange price of a transaction between knowledgeable, unrelated willing parties.

Par 61 - Example 6 in A67

Par 61 of the ED states that if the fair value of the acquirer’s interest in the acquiree exceeds the fair value of the consideration for that interest, the acquirer shall account for that excess by reducing the amount of goodwill that otherwise would be recognised in accordance with Par 49.

This rule will lead to unsatisfactory results, because it might happen that a goodwill and a gain on a bargain purchase are recorded on the same transaction.

In Example 6 the fair value of the acquirer’s interest exceeds the fair value of the consideration by 28, therefore total goodwill is reduced from 25 to 0.

In addition, the footnote in A67 explains that in a business combination in which the consideration transferred for a less than 100% equity interest in the acquiree is less than the fair value of that interest, goodwill measured in accordance with Par 49 is allocable to the acquirer and non-controlling interest based on their relative equity interests.

1) Assume that the consideration paid by AC in example 6 is 157.
In this case, the fair value of the acquirer’s interest exceeds the fair value of the consideration by 23, therefore total goodwill is reduced from 25 to 2. According to the footnote, the goodwill is allocated based on the equity interest, which means that 1.6 of goodwill are allocated to AC and 0.4 of goodwill are allocated to non-controlling interest.

The book entry would be as follows:

\[
\begin{align*}
\text{Assets acquired} & \quad 250 \\
\text{Goodwill} & \quad 2 \\
\text{Liabilities assumed} & \quad 50 \\
\text{Equity (for issue of shares)} & \quad 157 \\
\text{Gain on bargain purchase} & \quad 4.6 \\
\text{Non-controlling interest} & \quad 40.4
\end{align*}
\]

The share of AC in TC’s net assets is 160 (80% of 200). In my opinion it is not appropriate to recognise a goodwill for the acquirer’s share, if the acquirer’s consideration is less than the acquirer’s share in the net assets. Similarly, it is not appropriate to recognise goodwill and a gain on bargain purchase at the same transaction.

2) Assume that the consideration paid by AC in example 6 is 170.

In this case, the fair value of the acquirer’s interest exceeds the fair value of the consideration by 10, therefore total goodwill is reduced from 25 to 15. According to the footnote, the goodwill is allocated based on the equity interest, which means that 12 of goodwill are allocated to AC and 3 of goodwill are allocated to non-controlling interest.

The book entry would be as follows:

\[
\begin{align*}
\text{Assets acquired} & \quad 250 \\
\text{Goodwill} & \quad 15 \\
\text{Liabilities assumed} & \quad 50 \\
\text{Equity (for issue of shares)} & \quad 170 \\
\text{Gain on bargain purchase} & \quad 2 \\
\text{Non-controlling interest} & \quad 43
\end{align*}
\]

Again, goodwill and a gain on bargain purchase would be recognised at the same transaction, which is not appropriate.

Therefore, I suggest to change Paragraph 61 as follows:

If, … the fair value of the acquirer’s interest in the acquiree still exceeds the fair value of the consideration for that interest, the acquirer shall account for that excess by reducing the amount of goodwill that otherwise would be recognised in accordance with Par 49 and allocated to the acquirer in accordance with Par 58 (c). In addition, the goodwill that otherwise would be allocated to the non-controlling interest in accordance with Par 58 (c) shall be reduced by the proportionate amount.

In case of a consideration of 157, the goodwill allocated to the acquirer would be reduced from 20 to zero and in addition the goodwill allocated to the non-controlling interest would be reduced from 5 to zero (20 / 80% x 20%)
The book entry would be as follows:

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<th>250</th>
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<tbody>
<tr>
<td><strong>Assets acquired</strong></td>
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<tr>
<td>Liabilities assumed</td>
<td>50</td>
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<tr>
<td>Equity (for issue of shares)</td>
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<td>170</td>
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<td>Gain on bargain purchase</td>
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<td>Non-controlling interest</td>
<td>40</td>
<td>42.5</td>
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<tr>
<td><strong>Equity (for issue of shares)</strong></td>
<td>157</td>
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<td><strong>Gain on bargain purchase</strong></td>
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The gain on the bargain purchase is the difference between the acquirer's share in the net assets and the acquirer's consideration.

In case of a consideration of 170, the goodwill allocated to the acquirer would be reduced from 20 to 10 and in addition the goodwill allocated to the non-controlling interest would be reduced from 5 to 2.5 (10 \( / 80\% \times 20\% \)).

The book entry would be as follows:

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<thead>
<tr>
<th></th>
<th>250</th>
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</thead>
<tbody>
<tr>
<td><strong>Assets acquired</strong></td>
<td></td>
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<tr>
<td>Liabilities assumed</td>
<td>50</td>
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<tr>
<td>Equity (for issue of shares)</td>
<td>157</td>
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<td>Gain on bargain purchase</td>
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</tr>
<tr>
<td>Non-controlling interest</td>
<td>40</td>
<td>42.5</td>
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</table>

As the consideration (170) is less than the fair value of the acquirer's interest (180), but higher than the acquirer's share in the net assets (160), no gain is recorded.

The solution for the original fact pattern of example 6 would remain unchanged, because both the goodwill allocated to the acquirer's share and the goodwill allocated to the non-controlling interest would be reduced to zero.

A62 – A63 Goodwill allocated to the acquirer exceeds total goodwill

In Example 4 the fair value of TC is assumed at 195, AC acquires 80% for 160 and total net assets of TC are 150. Total goodwill of 45 is allocated 40:5 between AC and non-controlling interest.

The price paid for the 80% interest by AC could as well be 170, which still might be an exchange of equal values due to a control premium. Total goodwill would still be 45 (195 – 150), but the goodwill paid by AC would be 50 (170 – (150 \( \times 80\% \)).

The ED gives no guidance, how goodwill should be allocated between AC and non-controlling interest. In my opinion it makes no sense to allocate a negative goodwill of 5 to the non-controlling interest, therefore, additional guidance for these cases should be given.

Appendix C to IFRS 3 – Accounting for asset acquisitions

Appendix C to IFRS 3 provides guidance how to account for acquisitions of entities that do not contain a business as defined in IFRS 3.

There might be an additional issue if less than 100% of the entity are acquired.
As the asset acquisition is not in the scope of IAS 27, I believe that IAS 31.18-31.23 (jointly controlled assets) are applicable. Therefore, if 80% of an entity owning a piece of land are acquired, 80% of the piece of land and no non-controlling interest should be shown in the financial statements. In my opinion, Appendix C should address this issue.

Appendix C to IAS 36

The headlines of the proposed Appendix C to IAS 36 are mistaken. The differentiation should not be “before IFRS 3 (as revised 200X) is applied, the following guidance is relevant...” and “after IFRS 3 (as revised 200X) is applied”, but “the following guidance is relevant for impairment-test for goodwill which was created in an acquisition where IFRS 3 (2004) or IAS 27 have been applied” and “...where IFRS (as revised 200X) has been applied.”