Accounting Standards Board
Conseil des normes comptables

Subsidiaries and Investments

Background Information and Basis for Conclusions

Sections 1591 and 3051

CPA Canada Handbook – Accounting, Part II

Foreword

In December 2016, the Accounting Standards Board (AcSB) amended SUBSIDIARIES, Section 1591, and INVESTMENTS, Section 3051 in Part II of the CPA Canada Handbook – Accounting. The AcSB has approved for publication the contents of this document setting out its rationale for the amendments.

Background Information and Basis for Conclusions documents are sources of generally accepted accounting principles, as described in GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, Section 1100 in Part II of the Handbook. These documents are intended to help readers understand how the AcSB reached its conclusions, but they do not include explanations of requirements or guidance on the application of the relevant Section or Accounting Guideline.

December 2016

Table of Contents

INTRODUCTION

1 This document summarizes considerations that were deemed significant by members of the Accounting Standards Board (AcSB) in reaching their conclusions to amend SUBSIDIARIES, Section 1591, and INVESTMENTS, Section 3051 in Part II of the CPA Canada Handbook – Accounting. This document sets out the reasons the AcSB undertook the project to develop the amendments, the process of research and deliberation, the key decisions made and the principal reasons for adopting the positions taken and rejecting others. Individual AcSB members gave greater weight to some factors than to others.

2 Nothing in this document is to be taken as overriding the requirements of the Handbook. However, the discussion may help readers understand how the AcSB reached its conclusions in developing the amendments and the AcSB's intent with respect to its interpretation and application.

BACKGROUND AND EFFECTS ANALYSIS

3 Cost has been, and continues to be, an acceptable method of accounting for subsidiaries and for investments subject to significant influence since being introduced as a differential reporting option in 2002 in the pre-changeover standards in Part V of the Handbook. However, Part II of the Handbook did not include guidance on how the cost method should be applied to interests in subsidiaries and investments subject to significant influence. As a result, there was diversity in practice in the application of the cost method.

4 Section 1591 required an enterprise that chose to account for its subsidiaries using the cost method to apply that method in accordance with Section 3051. The AcSB was informed that this requirement led some stakeholders to think that the initial accounting for a subsidiary accounted for using the cost method should be the same as the accounting for an investment in accordance with Section 3051. However, other stakeholders thought that BUSINESS COMBINATIONS, Section 1582, applied to transactions that meet the definition of a business combination and are subsequently accounted for using the cost method.

5 Section 3051 permits an enterprise to choose to account for its investments subject to significant influence using the cost method. Similar to the observation above, there is diversity in practice on how the cost method is applied.

6 In developing these amendments, the AcSB considered the consequences of adopting them relative to the objective of financial statements and the benefit versus cost constraint. As described in FINANCIAL STATEMENT CONCEPTS, paragraph 1000.12, the “objective of financial statements is to communicate information that is useful to investors, creditors and other users (“users”) in

making their resource allocation decisions and/or assessing management stewardship.”

7 A primary effect of the amendments is an expected increase in consistency in the application of the cost method in accounting for subsidiaries and investments subject to significant influence. Consistency benefits users of private enterprise financial statements because it makes the financial statements of different private enterprises more comparable. The amendments provide similar guidance in Section 3051 for the application of the cost method for investments subject to significant influence as for subsidiaries accounted for using the cost method. This approach results in consistent accounting for an interest that changes from an investment subject to significant influence to control and vice versa.

8 Having considered the effects of the changes to Sections 1591 and 3051 discussed above, the AcSB thinks that the positive effects of the amendments outweigh any negative effects and that the amendments will result in significant improvements to financial reporting for subsidiaries and investments subject to significant influence accounted for using the cost method.

DEVELOPMENT OF THE AMENDMENTS

9 Throughout the development of the amendments, the AcSB followed its due process. This process included:

(a) ongoing input from its Private Enterprise Advisory Committee;

(b) issuance in September 2015 of the Exposure Draft, "Subsidiaries and Investments";

(c) analysis and consideration of feedback received through written responses to the Exposure Draft (12 comment letters);

(d) follow-up discussions with respondents to obtain additional feedback; and

(e) consultations with 41 stakeholders, including associates of the Advisory Committee (a diverse group of preparers and practitioners that work in the private enterprise sector).

10 The AcSB received written responses to the Exposure Draft from two preparers, a joint working group and public accounting firms. The AcSB reminds stakeholders that as part of its due process related to Part II of the Handbook, it makes available a public file of materials relating to completed projects, which includes response letters received, unless confidentiality is requested.

11 Respondents, including participants at meetings, supported the underlying principles in the Exposure Draft. However, some respondents provided additional comments suggesting changes to some of the proposals.

12 The specific issues addressed in this project, including the substantive comments received on the Exposure Draft and any changes made in response to those comments, are as follows.

MEASUREMENT OF A SUBSIDIARY

Initial measurement

13 The AcSB decided that the initial measurement of an interest in a subsidiary should be determined on a basis that is similar to other business combinations in order to promote consistency and inter-company comparability, regardless of whether the subsidiary is subsequently accounted for using the cost method or consolidated. This underlying principle is consistent with the AcSB's decision discussed in paragraph 13 of the "Background Information and Basis for Conclusions for the 2012 Improvements to Accounting Standards for Private Enterprises" relating to a prior amendment to Section 1591 on the accounting for acquisition-related costs and contingent consideration. The AcSB decided to include this principle in Section 1591 to provide stakeholders with the overall rationale for the requirements. Consistent with this underlying principle, the AcSB decided that the guidance in BUSINESS COMBINATIONS, Section 1582, on acquisition-related costs, contingent consideration, pre-existing relationships and subsequent accounting for contingent consideration should be applied. Hence, the AcSB decided to include guidance in Section 1591 or cross-references to Section 1582, when appropriate. To provide further clarity, the AcSB decided to include a description of cost in the standard.

14 Most respondents agreed that the initial measurement of an interest in a subsidiary should be determined on a basis that is similar to other business combinations. However, some respondents were concerned that the statement "initial measurement shall be determined on a basis that is similar to other business combinations" in paragraph 1591.26A was confusing and too open ended. The AcSB included this statement because it provides the AcSB's overall rationale for developing the amendments. Further, the AcSB noted that most respondents agreed with this underlying principle. As a result, the AcSB decided to retain this statement and add a reference to BUSINESS COMBINATIONS, Section 1582, as recommended by one respondent.

15 Some respondents raised a number of issues relating to whether Section 1591 should stand on its own and not require an enterprise to look to BUSINESS COMBINATIONS, Section 1582, and Section 3051 for guidance.

16 The Advisory Committee informed the AcSB that if Section 1591 provides the references to specific paragraphs in BUSINESS COMBINATIONS, Section 1582, stakeholders will be able to refer to that specific guidance. As a result, the AcSB decided to include a cross-reference to the relevant guidance in Sections 1582

and 3051 when that reference would provide better clarity and beneficial guidance. The AcSB thought that this approach:

(a) ensured consistency with Section 1582;

(b) limited the duplication of guidance;

(c) limited the amount of extensive guidance in Section 1591, especially for issues that do not frequently occur; and

(d) underscored the underlying principle that initial measurement of a subsidiary subsequently accounted for using the cost method should be determined on a basis similar to other business combinations.

A subsidiary that does not constitute a business

17 Some respondents expressed concern that not all subsidiaries acquired by an enterprise will meet the definition of a business as defined in BUSINESS COMBINATIONS, Section 1582. Respondents noted that paragraph 1591.26A would require a subsidiary that does not constitute a business to be accounted for on a basis that is similar to other business combinations when the cost method is used. As a result, there would be an inconsistency in the accounting treatment for a subsidiary that does not constitute a business if the subsidiary was consolidated instead of being accounted for using the cost method. This inconsistency arises because the acquisition of a subsidiary that is not a business is accounted for as follows:

(a) When the subsidiary is consolidated, paragraph 1582.02(c) requires the acquirer to identify and recognize the individual identifiable assets acquired and liabilities assumed. The cost of the group is 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.

(b) When the subsidiary is accounted for using the cost method, the requirements of Section 1591 are applied. As such, one difference is that acquisition costs are expensed.

18 The respondents provided a number of different suggestions on how to address this inconsistency. In addition, some respondents indicated that these types of acquisitions are common in the real estate industry; other respondents confirmed that the frequency of subsidiaries acquired that are not a business are not common but are more frequent than rare.

19 The AcSB noted that Section 1591 provides guidance relating to the accounting for a subsidiary, while BUSINESS COMBINATIONS, Section 1582, applies to the acquisition of a business. The AcSB also noted that existing paragraph 1591.27

requires acquisition-related costs to be expensed when the cost or equity method is used, irrespective of whether the subsidiary is a business.

20 After consulting with its Advisory Committee, the AcSB decided not to change the scope of the amendments because:

(a) adding guidance for these types of transactions would add complexity to Section 1591;

(b) acquisition-related costs on those types of transactions are generally not material; and

(c) the accounting for these types of subsidiaries is not a critical issue for private enterprises.

Common control transactions

21 The Exposure Draft scoped out common control transactions by indicating that a business transferred between enterprises under common control shall be accounted for in accordance with RELATED PARTY TRANSACTIONS, Section 3840. Some respondents noted that not all subsidiaries acquired by an enterprise will meet the definition of a business. Some respondents also noted that it was unclear how an acquisition of a subsidiary from a related party should be accounted for when the subsidiary is subsequently accounted for at cost. One respondent observed that when the transaction is measured at the exchange amount, Section 3840 requires the acquirer to account for the acquisition in accordance with BUSINESS COMBINATIONS, Section 1582, even when the acquirer intends to account for the subsidiary subsequently at cost. As a result, there was no simplification for enterprises that apply the cost method.

22 The AcSB agreed to clarify how a subsidiary, transferred between enterprises under common control, should be accounted for when the acquiring enterprise chooses to account for it using the cost method. The AcSB decided that this guidance should apply to a subsidiary transferred between enterprises under common control regardless of whether the subsidiary meets the definition of a business. In addition, the AcSB acknowledged that RELATED PARTY TRANSACTIONS, paragraph 3840.44, is not as clear as it could be and decided to provide clarity in Section 1591 instead of referring stakeholders to Section 3840. The AcSB decided to specify that when the criteria in paragraph 3840.29 are met, the guidance on the cost method would apply. The AcSB included the criteria in Section 1591 to be clear about when stakeholders should apply the guidance. The AcSB further decided to specify that when these criteria are not met, the interest in the subsidiary should be initially measured at the carrying amount, as defined in paragraph 3840.03(a). Including this guidance in Section 1591 resulted in a consequential amendment to Section 3840. The AcSB will consider whether a project to improve

Section 3840 should be undertaken after consulting with stakeholders about its relative priorities for future projects.

Determining the consideration transferred

23 One respondent noted that it is sometimes easier to determine the fair value of what is being purchased rather than the fair value of the consideration paid (for example, when an enterprise acquires a subsidiary by exchanging shares). The respondent questioned whether the acquisition could be measured based on the assets acquired and the liabilities assumed. The Advisory Committee disagreed with measuring the assets acquired and liabilities assumed because doing so is inconsistent with the cost method. However, the Advisory Committee noted that the guidance on an exchange of equity interests in BUSINESS COMBINATIONS, paragraph 1582.35, would be helpful in these circumstances, and suggested that the AcSB incorporate this guidance in paragraph 1591.26A(b). The AcSB agreed with the Advisory Committee's suggestion. Including this guidance in Section 1591 resulted in a consequential amendment to NON-MONETARY TRANSACTIONS, Section 3831.

Acquisition-related costs

24 The AcSB noted that Section 1591 requires an enterprise to expense acquisition-related costs when the cost method is used to account for a subsidiary and decided to keep this requirement. Therefore, the AcSB considered how acquisition-related costs that were previously capitalized in accordance with FINANCIAL INSTRUMENTS, Section 3856, should be accounted for when an investment accounted for in accordance with Section 3856 becomes a subsidiary.

25 The Advisory Committee informed the AcSB that based on their experience, acquisition-related costs for an investment accounted for in accordance with FINANCIAL INSTRUMENTS, Section 3856, are generally not material. However, identifying those costs might be difficult for transactions that occurred several years ago. Consequently, for cost/benefit reasons, the AcSB proposed that acquisition-related costs on the previously held investment capitalized in accordance with Section 3856 continue to be included in the carrying amount of the interest in the subsidiary rather than be expensed. All respondents agreed with this proposal and, as a result, the AcSB decided that no changes were necessary.

Pre-existing relationships

26 The Advisory Committee suggested that pre-existing relationships should be required to be identified under the cost method and the accounting for pre-existing relationships should be consistent with the guidance in BUSINESS

COMBINATIONS, Section 1582. As a result, the AcSB proposed that the cost of an interest in a subsidiary should not include the settlement of:

(a) a pre-existing relationship or other arrangement that existed before negotiations for the acquisition of the subsidiary began; or

(b) an arrangement that is entered into during the negotiations that is separate from the acquisition of the subsidiary.

27 All respondents agreed with this proposal and the majority of respondents indicated that these pre-existing relationships are not common. Therefore, the AcSB decided that no changes were necessary.

Bargain purchase gain

28 A bargain purchase occurs when the fair value of the consideration paid is less than the fair value of the subsidiary’s net assets acquired. Specifically, a bargain purchase gain arises when the amounts of the identifiable assets acquired and the liabilities assumed exceeds the aggregate of the consideration transferred and the amount of any non-controlling interest in the acquiree. The AcSB noted that the accounting policy choice to account for a subsidiary using the cost method was included in Section 1591 based on cost/benefit considerations. An enterprise applying the cost method to the acquisition of a subsidiary does not recognize and measure the identifiable assets acquired, liabilities assumed or any non-controlling interest in the subsidiary as would be required to calculate a bargain purchase gain. Users on the Advisory Committee informed the AcSB that a bargain purchase gain would often not provide useful information when the cost method is used. Consequently, the Exposure Draft proposed that a bargain purchase gain should not be recognized.

29 Most respondents agreed that a bargain purchase gain should not be recognized when a subsidiary is accounted for using the cost method. However, one respondent was concerned that referring to a bargain purchase gain mixes accounting concepts for a subsidiary that is consolidated and a subsidiary that is not consolidated. The respondent recommended deleting paragraph 1591.26A(e). The respondent suggested that if retained, this paragraph should define a bargain purchase gain in the context of the cost method and incorporate some additional explanation. The AcSB decided that adding additional detail could be confusing because the amendments do not permit recognizing bargain purchase gains. Instead, the AcSB decided that further detail should be added to the Basis for Conclusions, which was done in paragraph 28.

30 Two respondents suggested that an accounting policy choice should be considered to allow enterprises to choose whether to recognize a bargain purchase gain to eliminate the resulting inconsistencies between an enterprise's consolidated and non-consolidated financial statements. In contrast, other respondents thought that providing an accounting policy choice would make the cost method more complex, provide little benefit and increase diversity. The AcSB decided that an accounting policy choice should not be provided for the reasons noted by these respondents.

Acquisition of a subsidiary achieved in stages

31 An enterprise sometimes obtains control over another enterprise in which it held an interest immediately before acquiring control (i.e., a step acquisition). The AcSB noted that BUSINESS COMBINATIONS, Section 1582, requires an enterprise to remeasure the previously held interest in the acquiree at its acquisition-date fair value and to recognize the resulting gain or loss, if any, in net income. During the research phase of the project, stakeholders informed the AcSB that step acquisitions are not common for private enterprises. The Advisory Committee advised the AcSB that additional valuation work would usually be needed to determine the fair value of the prior non-controlling interest.

32 Most of the users on the Advisory Committee noted that remeasuring the previously held interest in another enterprise would not provide useful information to them. These users noted that financial institutions perform their own analysis using the individual financial statements for each material subsidiary. If the subsidiaries were considered to be significant, the financial institution would normally request consolidated financial statements. The Advisory Committee also noted that remeasurement of the previously held interest would validate the potential market value of the subsidiary – but only at that point in time (i.e., at the date on which control is acquired) because the subsidiary is not revalued in subsequent years. The users also noted that the income statement effect of the remeasurement of the previously held interest would not be included in their analysis.

33 Therefore, the AcSB decided that requiring remeasurement of the previously held interest in another enterprise would add complexity and cost without providing any significant additional benefits to users. The Exposure Draft proposed that the cost of an interest in a subsidiary should be the carrying amount of the interest in the other enterprise immediately before acquiring control plus the cost of the additional interest acquired.

34 The majority of respondents agreed with this proposal and confirmed that acquisitions achieved in stages are not common for private enterprises. One respondent noted that some of their members disagreed with the proposal

because of the resulting inconsistencies between an enterprise's consolidated and non-consolidated financial statements. In addition, two respondents were concerned that the proposals were too rigid and questioned whether an accounting policy choice should be considered to solve the concern about the resulting inconsistencies.

35 In contrast, some respondents thought that providing an accounting policy choice would make the cost method more complex, provide little benefit and increase diversity. Some respondents thought that the concerns could better be addressed by disclosing and explaining the circumstances in the financial statements. The AcSB decided that an accounting policy choice should not be provided for the reasons noted by these respondents.

Initial accounting for a subsidiary is incomplete

36 In many instances, complete information about the consideration payable for the acquisition is not known at the date on which control was acquired or for some time after. For example, acquisition agreements may have working capital adjustment clauses that can only be quantified after the acquisition closes. These clauses are usually inserted into a purchase agreement in order to adjust the consideration payable to reflect any difference between working capital at an agreed date (for example, the date of the last balance sheet before signing) and the closing.

37 The AcSB decided that if the initial accounting for a subsidiary accounted for using the cost method is incomplete, the carrying amount of the interest in the subsidiary at the end of the reporting period in which the acquisition occurs should be based on provisional amounts, consistent with the measurement period provisions in BUSINESS COMBINATIONS, paragraph 1582.47. The AcSB decided that the adjustment to the cost of the subsidiary should be recognized in the period the amount is finalized, which should not exceed one year from the acquisition date. However, for cost/benefit reasons, the provisional amounts recognized in the financial statements for the year of the acquisition should not be retrospectively adjusted. Any revisions to the accounting for an interest in a subsidiary, after one year from the acquisition date, should only be to correct an error in accordance with ACCOUNTING CHANGES, Section 1506.

38 All respondents agreed that the carrying amount of the interest in the subsidiary should be based on provisional amounts when the initial accounting is incomplete. In addition, most respondents agreed that the adjustment to the carrying amount of the interest in the subsidiary should be recognized in the period the amount is finalized. However, several respondents raised concerns about:

(a) what is meant by other reasons;

(b) the clarity of the guidance because an enterprise would need to have an understanding of BUSINESS COMBINATIONS, Section 1582; and

(c) limiting the period to one year from the acquisition date.

39 In light of these concerns and after consulting with its Advisory Committee, the AcSB decided to remove the reference to other reasons by highlighting instead that a working capital clause is just one reason the initial accounting may be incomplete. The AcSB noted that other examples do exist but decided not to specify these examples in Section 1591 because they are not common.

40 The AcSB decided it was not necessary to add further guidance to Section 1591 on the measurement period because it would add unnecessary complexity that is not entirely relevant when the cost method is used. The AcSB decided not to change the limit on the period to one year from the acquisition date because the guidance is consistent with BUSINESS COMBINATIONS, Section 1582, and most participants at meetings did not favour including an option to permit adjustments beyond one year, even in rare circumstances.

Acquisition of an additional interest in a subsidiary

41 An enterprise may also acquire an additional interest in a subsidiary. The Exposure Draft proposed that the acquisition of an additional interest should be measured at cost and the original interest is not remeasured. The AcSB noted that this accounting would be consistent with the accounting for a change in ownership interest in a consolidated subsidiary as described in NON-CONTROLLING INTERESTS, paragraph 1602.06. As the majority of respondents agreed, the AcSB decided that the cost of the subsidiary should be the carrying amount of the interest in the subsidiary immediately before the acquisition plus the cost of the additional interest acquired.

Decreases in ownership interests

42 The AcSB proposed that when the ownership interest in a subsidiary accounted for using the cost method decreases as a result of the sale of a portion of the interest in the subsidiary, the measurement of the retained interest in the subsidiary should be determined in the same manner as a consolidated subsidiary. This measurement of the retained interest would promote consistency in accounting treatment. Therefore, when an enterprise sells a portion of its interest in a subsidiary, the retained interest should be a proportionate share of the carrying amount of the subsidiary immediately prior to the reduction in interest.

43 The AcSB noted that Section 3051 requires a gain or loss resulting from a dilution of an enterprise’s investment to be recognized when the equity method is used but not when the cost method is used. Consistent with this approach, the AcSB proposed that an enterprise accounting for a subsidiary using the cost

method should not be required to recognize a gain or loss resulting from dilution. However, a dilution may indicate that the fair value of the subsidiary is less than the carrying amount. Therefore, the AcSB proposed that when a dilution occurs, the enterprise should assess whether the dilution indicates that the carrying amount of the interest in the subsidiary may be impaired.

44 Most respondents agreed with these proposals and the AcSB decided that no changes were necessary.

Impairment

45 The AcSB noted that Section 1591 did not include guidance on impairment; rather, former paragraph 1591.24(b)(i) referred an enterprise to Section 3051 when accounting for its subsidiaries using the cost method. After consulting with its Advisory Committee, the AcSB proposed including a cross-reference in Section 1591 to the impairment provisions in Section 3051 since all types of investments that are accounted for using the cost method should follow a consistent approach to impairment. The AcSB decided that a short paragraph with a cross-reference to the relevant paragraphs in Section 3051 would be sufficient and it was not necessary to duplicate the detailed guidance included in Section 3051. All respondents agreed with these proposals and the AcSB decided that no changes were necessary.

Reference to any other aspects

46 A number of respondents raised a concern that the requirement proposed in the Exposure Draft to apply BUSINESS COMBINATIONS, Section 1582, for any other aspects of the initial measurement of an interest in a subsidiary is confusing because references to specific paragraphs in Section 1582 were not provided. Some respondents were unsure what other aspects refers to and were concerned that enterprises would need to review Section 1582 in its entirety to ensure that there are no other aspects to consider. In light of these concerns, and after consulting with its Advisory Committee, the AcSB noted that the overall principle provided sufficient guidance in the event that another aspect arose in practice. Therefore, the AcSB decided to remove this additional requirement.

SECTION 1591 DISCLOSURES

47 The AcSB decided that when a subsidiary is acquired during the reporting period and non-consolidated financial statements are prepared, certain disclosures in BUSINESS COMBINATIONS, Section 1582, should apply to that acquisition. The AcSB was concerned that a private enterprise using the cost method may not refer to Section 1582 in making disclosures about its acquisitions of subsidiaries. As a result, the AcSB decided to include those disclosure requirements in Section 1591. In addition, to ensure that the

disclosure requirements in Section 1591 are complete, the AcSB included in Section 1591 the disclosure requirement from Section 3051 relating to an enterprise and a subsidiary that have fiscal periods that are not coterminous when the equity method is used to account for the subsidiary.

48 All respondents agreed with the proposed disclosures, with the exception of requiring disclosure of BUSINESS COMBINATIONS, paragraph 1582.62A. In addition, a number of respondents recommended adding disclosure requirements relating to when the initial accounting for a subsidiary is incomplete to provide clarification on when and why preliminary amounts are being used and what is subject to change. For the reporting period following the period of acquisition, this disclosure would describe the change from preliminary to final numbers.

49 The AcSB noted that the disclosure is not required under BUSINESS COMBINATIONS, Section 1582, when an enterprise undertakes a business combination and applies the consolidation method; however, the enterprise would be required to recognize any adjustments made to the preliminary accounting on a retrospective basis.

50 The AcSB agreed with respondents that this disclosure would provide useful information to users of financial statements and the cost to preparers of providing this information should not be onerous. As a result, the AcSB added disclosure requirements in respect of the initial and subsequent measurement of provisional amounts. In addition, the AcSB agreed that BUSINESS COMBINATIONS, paragraph 1582.62A is not relevant when the cost method is used and removed this reference.

MEASUREMENT OF AN INVESTMENT SUBJECT TO SIGNIFICANT INFLUENCE

Initial measurement

51 The AcSB decided, and all respondents agreed, that including a description of what comprises cost would add value and benefit to stakeholders. Doing so would clarify what cost is considered to be when an investment is accounted for using the cost method in accordance with Section 3051. This inclusion would also result in a consistent approach being applied to investments and interests in subsidiaries that are accounted for using the cost method.

Acquisition-related costs

52 The AcSB noted that Section 3051 did not specify whether to include acquisition-related costs as part of the cost of the investment when the cost method is used to account for the investment. The AcSB thinks that acquisition-related costs are not part of the cost of this type of investment. Therefore, the AcSB decided that acquisition-related costs incurred on the acquisition of an

investment subject to significant influence and accounted for using the cost method in accordance with Section 3051 should be expensed. Expensing these costs would result in a consistent approach being applied to an investment subject to significant influence and subsidiaries that are accounted for using the cost method.

53 Most respondents agreed that acquisition-related costs incurred on the acquisition of an investment subject to significant influence and accounted for using the cost method should be recognized as an expense. However, some respondents expressed concern that the proposals would result in a different treatment for acquisition costs for an investment subject to significant influence that is accounted for using the equity method. The Advisory Committee suggested adding a requirement to expense acquisition-related costs for investments subject to significant influence when the equity method is applied to Section 3051 consistent with the decision to expense acquisition-related costs when the cost method is used.

54 The AcSB acknowledged the concerns about the inconsistent application of the equity method depending on the nature of the investment. Specifically, that there will be inconsistent accounting for acquisition-related costs for:

(a) an investment subject to significant influence accounted for using the equity and cost methods; and

(b) an interest in a subsidiary and an investment subject to significant influence accounted for using the equity method.

55 The AcSB also considered its Advisory Committee’s concerns that:

(a) an enterprise’s accounting policy note disclosures will not make sense if there is an inconsistent approach; and

(b) enterprises might be more inclined to account for investments subject to significant influence using the equity method rather than the cost method in order to be able to capitalize acquisition-related costs.

56 However, the AcSB decided not to add a requirement to Section 3051 to expense acquisition-related costs for investments subject to significant influence when the equity method is applied because this change was beyond the scope of this project. The AcSB decided not to develop guidance on the use of the equity method at this time (see paragraphs 74-75). The AcSB plans to consider whether to propose this change at a later date.

Additional acquisitions

57 An investor sometimes obtains the ability to exercise significant influence over an investment in which it previously held an interest. An investor may also acquire an additional interest in an investment subject to significant influence that does not result in acquiring control over the investee. The AcSB decided that the cost of the resulting investment should be the carrying amount of the interest immediately before the acquisition plus the cost of the additional interest acquired. The AcSB noted that this accounting treatment is consistent with the cost method applied to interests in subsidiaries.

58 The AcSB considered how transaction costs that were previously capitalized in accordance with FINANCIAL INSTRUMENTS, Section 3856, should be accounted for when an investment accounted for in accordance with Section 3856 becomes an investment subject to significant influence. For cost/benefit reasons, the AcSB proposed that acquisition-related costs on the previously held interest capitalized in accordance with Section 3856, continue to be included in the carrying amount of the investment rather than be expensed. The majority of respondents agreed with this proposal and the AcSB decided that no changes were necessary.

Impairment

59 The AcSB noted that a change in the ownership interest held in an investment may indicate that the fair value of the investment is less than the carrying amount. Therefore, the AcSB decided, and all respondents agreed, that an enterprise should assess whether an acquisition of an additional interest, the proceeds from sale of a portion of an interest, or the dilution of an investor's interest indicates that the previously held equity interest in the investment may be impaired.

EFFECTIVE DATE

60 The Exposure Draft noted that the AcSB planned to issue the amendments in the fourth quarter of 2016, if no significant changes were required to the proposals after deliberating the comments received. In that case, the Exposure Draft noted that the effective date of the amendments would be for fiscal years beginning on or after January 1, 2018. This timing is consistent with the AcSB's prior decision to allow two years between each set of major improvements. Respondents did not raise any concerns on the timing of the effective date and the changes made to the final amendments were not considered significant. The final amendments were issued in December 2016 and are applicable for annual financial statements relating to fiscal years beginning on or after January 1, 2018 with earlier application permitted.

TRANSITION

61 The AcSB recognized that transition issues facing individual enterprises would differ, depending on how the enterprises previously accounted for their subsidiaries and investments subject to significant influence and the nature of their business. The AcSB noted that some private enterprises may have accounted for the cost of a subsidiary or an investment subject to significant influence on the basis proposed in the guidance. However, as Part II of the Handbook did not provide specific guidance on how to determine the cost of an interest in a subsidiary or an investment subject to significant influence when the cost method is used, this interpretation of cost may not have been applied consistently in practice. For example, step acquisitions may either have been accounted for by adding the cost of the additional acquisition to the carrying amount of the interest or by remeasuring the pre-existing interest on the acquisition of an additional interest.

62 The AcSB also recognized that many private enterprises may not have adjusted the consideration paid for a subsidiary to take into account any pre-existing relationships. The AcSB thinks that to determine whether there was a pre-existing relationship when the subsidiary was acquired and to measure it could be both difficult and subjective. Private enterprises may only have to consider acquisitions since their transition to Part II of the Handbook in 2011 because FIRST-TIME ADOPTION, Section 1500, provided an option for prospective treatment. However, the AcSB noted that the proposed guidance is effective in 2018 and, therefore, it may be onerous to require retrospective application.

63 The AcSB noted that the proposed requirement to expense acquisition-related costs for investments subject to significant influence could involve extensive effort if retrospective application was required. The Advisory Committee informed the AcSB that private enterprises that apply Section 3051 generally capitalize these costs in practice.

64 Consequently, the AcSB noted that applying the amendments retrospectively could be time consuming and costly for some enterprises and would not provide useful information to users of financial statements. Therefore, the AcSB decided that the amendments to Sections 1591 and 3051 relating to the application of the cost method should be applied prospectively to new acquisitions of subsidiaries and investments subject to significant influence from the date the amendments become effective.

65 All respondents agreed with the proposal to permit prospective treatment. However, one respondent was concerned about the clarity of the transitional provisions when the initial accounting for the subsidiary is incomplete as at the date that the amendments to Section 1591 become effective in respect of prior acquisitions. In light of this feedback, and after consulting with its Advisory

Committee, the AcSB decided to clarify the transitional provisions for this specific situation.

66 Since prior to the amendments, Section 1591 was silent on the accounting treatment when the initial accounting is incomplete, the AcSB decided not to specify the accounting relating to an acquisition that occurred prior to the date the amendments apply. Instead, the AcSB decided to indicate that the amendments do not apply to accounting for the acquisition of an interest in a subsidiary that is incomplete when the acquisition occurred prior to the date the amendments are applied. In these situations, preparers should apply the same accounting treatment that was applied prior to the amendments. The AcSB's intention is that the guidance in paragraph 1591.26B(d) would not be applied to acquisitions occurring prior to the earlier of January 1, 2018 and the date the amendments are applied. However, all other subsequent measurement requirements would apply.

CONSEQUENTIAL AMENDMENTS

67 The Exposure Draft included significant consequential amendments to other Sections in Part II of the Handbook. The rationale for the significant amendments is described below. Most respondents did not raise concerns with the consequential amendments. During deliberations, the AcSB made changes to the transitional provisions relating to the consequential amendments as described below. Additional consequential amendments to NON-MONETARY TRANSACTIONS, Section 3831, and RELATED PARTY TRANSACTIONS, Section 3840, were also made as a result of changes made during the deliberations of comments received (see paragraphs 22 and 23).

First-time adoption

68 An enterprise that applies Part II of the Handbook for the first time may not have previously accounted for its subsidiaries or investments subject to significant influence in a manner consistent with the proposed amendments to Sections 1591 and 3051. Requiring retrospective application of Sections 1591 and 3051 would entail the same difficulties that led the AcSB to include the existing transition relief in those Sections. Consequently, the AcSB decided to include a consequential amendment to FIRST-TIME ADOPTION, Section 1500, to permit first-time adopters of Part II of the Handbook to apply the transitional provisions from Sections 1591 and 3051.

69 One respondent was concerned that the transitional provisions to FIRST-TIME ADOPTION, Section 1500, required the amendments to be applied from the first day of the current financial statement period, rather than the transition date. The respondent also noted that applying the changes retrospectively for the comparative period only would not be onerous or impracticable. The AcSB

agreed with this respondent and decided to clarify the transitional provisions so that it is clear that the amendments apply from the date of transition.

Accounting changes

70 The AcSB proposed that the consequential amendments to ACCOUNTING CHANGES, Section 1506, would apply prospectively. During deliberations of the comments received, the AcSB observed that it is not necessary for the amendments to Section 1506 to be applied prospectively because this Section requires retrospective treatment unless otherwise specified. Therefore, the AcSB decided not to permit prospective application of these consequential amendments.

Business combinations

71 The AcSB noted that some of the disclosures in BUSINESS COMBINATIONS, Section 1582, would not be relevant when an interest in a subsidiary is accounted for using the cost method. The amendments to Section 1591 require that a previously held interest in the subsidiary should not be remeasured in a step acquisition and bargain purchase gains are not recognized. Section 1582 requires an acquirer to disclose, for each material business combination, the amount of any gain recognized in a bargain purchase. The Section also requires the acquisition-date fair value of a pre-existing equity interest in the acquiree and the amount of any gain or loss recognized as a result of remeasuring the pre-existing equity interest to fair value. As these disclosures are not relevant when the cost method is used, the AcSB decided to only require these disclosures when consolidated financial statements are prepared. Respondents did not raise any concerns with these consequential amendments.

72 In the Exposure Draft, the AcSB proposed that the consequential amendments to BUSINESS COMBINATIONS, Section 1582, would apply prospectively. During deliberations of the comments received, the AcSB observed that it is not necessary for the amendments to Section 1582 to be applied prospectively because the changes reorder disclosure requirements and do not add any new disclosures. Therefore, the AcSB decided not to permit prospective application of these consequential amendments.

OTHER ISSUES

Issues beyond the scope of the this project

73 Some respondents noted other issues that the AcSB considered to be beyond the scope of this project. The AcSB agreed to consider whether to address these issues as explained below.

74 A number of respondents encouraged the AcSB to move forward with a future project that would address the equity method. One respondent requested that the AcSB ensure that when a project on the equity method is undertaken, the proposals should be consistent with the amendments arising from this project (for example, bargain purchase gains should not be recognized and the accounting for pre-existing relationships should be consistent). Another respondent recommended that the relief on bargain purchase gains should also be applied to the equity method because the requirements are neither clear nor consistently applied. In addition, some respondents thought that the description of cost should be applied to all investments subject to significant influence including those accounted for using the equity method. One respondent proposed that the description of cost should be included in the definitions in Sections 1591 and 3051 as opposed to including a description directly within the requirements. The AcSB included the description of cost in paragraphs 1591.26A and 3051.07A rather than in the definitions because doing so would affect the application of the equity method.

75 The AcSB decided not to develop guidance on the use of the equity method as part of this project. As a full review of the equity method would be a major project, the AcSB decided to consider whether to undertake a project after consulting with stakeholders about the Board’s relative priorities for future projects. During deliberations of comments received, the AcSB reconsidered whether to develop guidance on the equity method and reconfirmed its previous decision.

76 Some respondents raised concerns regarding the interaction between RELATED PARTY TRANSACTIONS, Section 3840, and other Sections in Part II of the Handbook and suggested that the AcSB undertake a separate project. The AcSB decided to consider whether to undertake such a project after consulting with stakeholders about its relative priorities for future projects.

77 One respondent found it unclear how to account for the voting interest, if any, that an investor holds in a subsidiary controlled through a combination of voting rights and contractual arrangements. Through various outreach activities, this issue was also raised by other stakeholders. As a result, the AcSB decided to propose a separate narrow-scope amendment to clarify the guidance.

78 Two respondents raised concerns regarding the requirement to initially measure contingent consideration at fair value. The AcSB noted that the Exposure Draft did not change the initial measurement for contingent consideration in Section 1591. Further, this requirement is consistent with the requirement in BUSINESS COMBINATIONS, Section 1582. The AcSB noted that contingent consideration is measured on the same basis irrespective of the accounting method followed. The AcSB decided to consider whether to address this concern after consulting with stakeholders about its relative priorities for future

projects, which would include considering if and when to undertake a post-implementation review of Section 1582.

79 One respondent suggested that the AcSB amend BUSINESS COMBINATIONS, Section 1582, to allow an acquirer, during the measurement period, to prospectively adjust the provisional amounts recognized at the acquisition date. This amendment would provide consistency between Sections 1591 and 1582 and simplify the accounting for measurement period adjustments. The AcSB decided to consider whether to address this suggestion after consulting with stakeholders about its relative priorities for future projects, which would include considering if and when to undertake a post-implementation review of Section 1582.

80 One respondent raised concern that paragraph 3051.21 requires the cost method to be used for other investments when there is no further guidance on how cost for these other investments is measured, particularly in regards to acquisition costs. The AcSB decided to consider whether to address this concern after consulting with stakeholders about its relative priorities for future projects.

Dividends in excess of share of earnings

81 A number of respondents noted diversity in accounting for dividends that are in excess of the investor's share of earnings. These respondents recommended that the AcSB clarify Sections 1591 and 3051 for whether an investor must assess if a dividend is a return of investment and, if so, how to account for such dividends under the cost method. However, the AcSB was concerned that it is difficult to track post-acquisition earnings when the cost method is applied. In addition, the AcSB noted that International Financial Reporting Standards (IFRSs) do not include such a requirement and accounting standards for private enterprises should not be more onerous than IFRSs. Consequently, the AcSB decided not to add this requirement.

EXPOSURE FOR COMMENT

82 After resolving the issues arising from the exposure draft process, the AcSB considered, as part of its due process, whether the revisions to the proposals should be exposed for comment.

83 The revisions included providing additional guidance to clarify the proposed requirements, adding a disclosure requirement and modifying the transitional provisions. The AcSB did not consider these revisions to be significant and noted that most were based on feedback received from respondents. Other than these revisions, only minor drafting changes were made. Therefore, the AcSB decided that there was no need for re-exposure.