IFRS 3, IFRS 6, IFRS 10 and IAS 16: Acquisition of an Entity Holding a Single Asset

Extract, IFRS Discussion Group Report on Meeting – December 9, 2014

IFRS 3 *Business Combinations* is clear that in a business combination, at the acquisition date, the acquirer shall recognize any non-controlling interest in the acquiree. However, IFRS 3 does not apply to the acquisition of an asset or a group of assets that does not constitute a business, and states that in such cases, the acquirer shall identify and recognize the individual identifiable assets acquired and liabilities assumed.

Fact Pattern:

Entity A acquires 80 per cent of the issued shares of Entity B. Consideration is in the form of cash. Entity B has just one asset, the rights to a mineral property in the exploration and evaluation stage. As a result of the transaction, Entity A obtains control of Entity B as defined by IFRS 10 *Consolidated Financial Statements*. The remaining 20 per cent of the issued shares of Entity B are retained by the entity from which Entity A acquired its shares (the seller). This fact pattern assumes Entity B would not be considered an investment entity as defined by IFRS 10.

Issue: How should Entity A account for the 20 per cent interest it did not acquire?

View A – The acquirer should recognize a non-controlling interest for the interest not acquired at fair value.

IFRS 10 requires that consolidation procedures consist of combining assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries. Entity B holds 100 per cent interest in the mineral property. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires that in the absence of an IFRS, management shall first refer to the requirements in IFRSs dealing with similar and related issues. A business combination could be viewed as a similar and related issue and, thus, IFRS 3 could be referred to for guidance.

IFRS 6 *Exploration for and Evaluation of Mineral Resources* requires that exploration and evaluation assets shall be measured at cost. While IFRS 6 does not provide specific guidance on the measurement of cost, IAS 16 *Property, Plant and Equipment* indicates that cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire the asset.

Under this view, the non-controlling interest recognized would be a reflection of the fair value of the interest in Entity B that is not acquired by Entity A. For example, if Entity A paid $80 for 80 per cent of Entity B, the non-controlling interest recognized would be $20, and the asset recorded would be at $100.

View B – The acquirer should recognize a non-controlling interest for the interest not acquired at its original cost.

This view is similar to View A, except that it may be argued since the transaction does not constitute a business combination, the assets and liabilities acquired should be recorded at cost rather than fair value. The cost of the non-controlling interest would be determined based on the carrying amount of the interest in the subsidiary retained by the seller.

View C – The acquirer should only recognize the cost of the interest acquired.

Under this view, it could be considered that the substance of the transaction is no different than if Entity A had acquired a direct 80 per cent interest in the mineral property asset. IFRS 3 is clear that when there is an acquisition of an asset or a group of assets that does not constitute a business, the acquirer shall recognize the individual assets acquired. It is considered that Entity A will only receive a future economic benefit from its interest and not the 20 per cent residual interest held by the seller.

IFRS 6 lists examples of expenditures that might be included in the initial measurement of exploration and evaluation assets, which include the cost of the acquisition of the rights to explore. In this fact pattern, the acquirer's rights are comprised of an 80 per cent interest in a mineral property, regardless of whether or not the rights are held directly or through a separate entity that holds the asset. Under this view, only the cost of the 80 per cent interest should be recorded.

View D – The IFRS guidance is unclear and there is an accounting policy choice.

It could be viewed that IFRSs do not specifically address whether or not a non-controlling interest should be recognized and, if recognized, how it should be measured, on the acquisition of an entity holding a single asset that does not constitute a business. As a result, IAS 8 would require an accounting policy be developed that best reflects the nature of the transaction based on the facts and circumstances.

The Group's Discussion

The majority of Group members supported the view that the acquirer should recognize the non-controlling interests of the subsidiary at fair value (View A). There is clear guidance in IFRS 10 that requires an acquirer to recognize the percentage of non-controlling interest when it consolidates the acquiree. Therefore, View D is not applicable. The Group discussed View B, which differs from View A in that the amount of non-controlling interest would be recorded at cost instead of at fair value. While it was acknowledged that this specific fact pattern would not be within the scope of IFRS 3 as the acquisition does not constitute a business, most Group members expressed the view that it would be difficult to support recognizing non-controlling interest at cost because there is a control premium that should be considered. It was further noted that if the acquiree's carrying amount was used as a measurement basis, a pro-rata approach to record the non-controlling interest at cost could result in the acquirer recording the subsidiary in excess of its fair value, which does not seem reasonable. Therefore, most Group members supported the view of recognizing the non-controlling interest at fair value as the preferred practice and cautioned the use of the approach under View B.

Source: www.frascanada.ca/ifrs-discussion-group

Group members noted that View C (i.e., the acquirer should only recognize the cost of the interest acquired), would be adopting a “look-through” approach that in general is not supported within the principles of IFRSs. One Group member also noted that the economic substance is different when a legal structure is setup to hold the asset compared to holding an asset directly. Therefore, View C would not be considered appropriate.

The Group’s discussion raises awareness about this item. No further action was recommended to the AcSB.